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August 4, 2004

Mr. FERNAN A. GIANAN
 Chairman, Bids and Awards Committee
 2nd Floor, New Municipal Building
 Municipality of Virac, Catanduanes

Re : **Warranty Security under Section 62 of Republic Act No. 9184 and its Implementing Rules and Regulations Part A**

Dear Mr. Gianan:

This refers to your letter dated June 18, 2004, which we received on June 28, 2004, requesting for opinion on issues under Republic Act No. 9184 ("R.A. 9184") and its Implementing Rules and Regulations Part A ("IRR-A"), to wit:

1. Whether or not warranty for goods covered by retention money or bank guarantee under Section 62.1 of the IRR-A of R.A. 9184 is required for highly-perishable goods, which are consumed before the expiration of the three-month warranty period;
2. Whether or not the bidder is allowed to include the cost attendant to retention money in making estimates for his unit bid prices;
3. Whether or not it is mandatory for the Bids and Awards Committee ("BAC") to require a warranty security with a validity period ranging from five (5) to fifteen (15) years for a completed infrastructure project; and
4. Whether or not the inclusion of a provision on contractor's liability in the conditions of the contract in lieu of a warranty security conforms with the provisions of R.A. 9184 and its IRR-A.

Retention Money or Special Bank Guarantee Required to Cover Warranty for the Procurement of Goods

To protect the proprietary interest of the Government, the crafters of R.A. 9184 and its IRR-A deem it necessary to insert an innovative provision that will provide for guarantee and immediate indemnity in case the goods or the construction works procured are found to be defective or of substandard quality. Thus, R.A. 9184 and its IRR-A contain special provisions on

warranty in the procurement of goods and infrastructure projects which provide for an upfront or forward assurance that the supplier, manufacturer, or distributor warrants the goods from hidden defects and the procuring entity against eviction therefrom, whereby the happening of any, works as a signal for the procuring entity to call on the retention money or bank guarantee. For the procurement of goods, Section 62. 1 of the IRR-A explicitly provides:

For the procurement of goods, in order to assure that manufacturing defects shall be corrected by the supplier, manufacturer or distributor, as the case may be, a warranty shall be required from the contract awardee for a minimum period of three (3) months, in the case of supplies, and one (1) year, in the case of equipment, after performance of the contract. The obligation for the warranty shall be covered by either retention money in an amount equivalent to at least ten percent (10%) of every progress payment, or a special bank guarantee equivalent to at least ten percent (10%) of the total contract price. The said amounts shall only be released after the lapse of the warranty period: *Provided, however, That the goods supplied are free from patent and latent defects and all the conditions imposed under the contract have been fully met.* (Underscoring and Emphasis supplied)

By virtue of this provision, procuring entities are now mandated to retain a part of the contract price, or require a bank guarantee from its suppliers, manufacturers or distributors in the procurement of goods. This provision is generic in application and provides for no exception such that even procurement of goods in small amounts and quantity including those highly-perishable goods, which are to be consumed immediately, are subject to this requirement.

However, as regards the warranty period which is fixed by law as three (3) months for supplies, we believe that this period may further be shortened for highly-perishable goods depending upon when such goods are consumed. It can be observed from the aforementioned provision that the release of the obligation for warranty, which is covered by a retention money or bank guarantee, though attached to a fixed period, is also dependent upon the condition that the goods supplied are free from patent and latent defects and that all of the conditions imposed under the contract have been fully met. Hence, it can be gainsaid the warranty obligation is not only with a term, but also with a resolatory condition.

Generally, the obligation on the warranty is extinguished upon the concurrence of the expiration of the term, which is three (3) months, and the resolatory condition that goods are without defects. However, in case of highly-perishable and fungible goods, their consumption would obviously bring about the extinguishment of the warranty obligation, since the use of the thing implies the fulfillment of the resolatory condition that the goods are without defects. Furthermore, since the goods, which are the object of the warranty obligation, no longer exists upon consumption, this will bring about the concomitant extinguishment of the obligation, and hence, the term of three (3) months on the warranty becomes irrelevant.

Inclusion of the Cost Attendant to Warranty Obligation in Making Estimates for Unit Bid Prices

Considering that a new form of obligation on warranty is imposed by R.A. 9184 and its IRR-A for procurement of goods and infrastructure projects, some Government agencies have

expressed the view that requiring a warranty security from contractors, suppliers, distributors and manufacturers would cause the rise in their bid prices, as they would consider the cost attendant thereto in their financial proposals. As maximum profit is the aim of any person or entity participating in the biddings of Government agencies, there is a great possibility that such bidder may include the cost of warranty security in making his financial proposal. This is within the prerogative of the bidder, to which R.A. 9184 and its IRR-A do not impose any restrictions. In this situation, there is admittedly a possibility for the bidders to submit higher financial proposals as they would include the premium it has to pay for the warranty security, or the cost of the use of its money retained or earmarked to secure the warranty obligation as part of its overhead cost.

Be that as it may, the probability of getting higher financial bid proposals due to warranty cost on the part of the bidder is equalized by the principle of open competition promoted by competitive bidding. Hence, as competitive bidding is the general mode of procurement mandated by R.A. 9184, we believe that procuring entities would still get the best possible deal, considering that the contract shall be awarded to the bidder with the lowest calculated responsive bid. Besides, procuring entities are sheltered by the approved budget for the contract, which is the ceiling for all bid prices, meticulously and judiciously estimated consistent with the appropriations for the project.

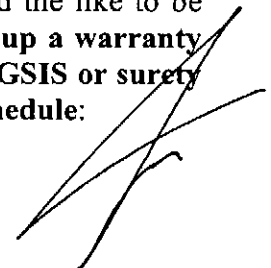
Warranty Security for Infrastructure Projects Mandatory

In the procurement of infrastructure projects, a warranty is required to ensure that the contractor will correct structural defects and failures. Hence, a one-year period after the completion of the project, called the defects liability period, is observed until final acceptance by the procuring entity. After final acceptance of the project, a warranty period, the length of which will depend on the nature of the project, will commence. Accordingly, the contractor is required to post a warranty security that will cover both the defects liability period and the warranty period.

It is noteworthy that during the defects liability period and after the contractor has posted a warranty security in any of the form and amount prescribed in Section 62.2 of the IRR-A, the procuring entity will return to said contractor its performance security.

Section 62.2 of the IRR-A prescribes the forms and amount of the warranty security which the contractor may post, as well as its effectivity, to wit:

For the procurement of infrastructure projects, the contractor shall assume full responsibility for the contract work from the time project construction commenced up to final acceptance by the government and shall be held responsible for any damage or destruction of the works except those occasioned by force majeure. The contractor shall be fully responsible for the safety, protection, security, and convenience of his personnel, third parties, and the public at large, as well as the works, equipment, installation and the like to be affected by his construction work and **shall be required to put up a warranty security in the form of cash, bank guarantee, letter of credit, GSIS or surety bond callable on demand, in accordance with the following schedule:**



Form of Warranty	Minimum Amount in % of Total Contract Price
1. Cash deposit, cash bond or letter of credit	Five percent (5%)
2. Bank guarantee	Ten percent (10%)
3. Surety bond	Thirty percent (30%)

The warranty security shall be stated in Philippine Pesos, **shall remain effective during the applicable warranty period provided in Section 62.2.2 hereof, and shall be returned after the lapse of the said warranty period.** (Emphasis supplied)

In correlation to this, Section 62.2.2(a) of the IRR-A provides that, a contractor shall be held responsible for structural defects and/or failure of the completed project up to a period of fifteen years from final acceptance, to wit:

After final acceptance of the project by the Government, the contractor shall be held responsible for structural defects and/or failure of the completed project within the following warranty periods from final acceptance, except those occasioned by *force majeure* and those caused by other parties:

a) Permanent Structures: Fifteen (15) years

Buildings of types 4 (steel, iron, concrete, or masonry construction with walls, ceilings, and permanent partitions of incombustible fire resistance) and 5 (steel, iron, concrete, or masonry construction), steel and concrete bridges, flyovers, concrete aircraft movement areas, ports, dams, diversion tunnels, causeways, wharves, piers, dikes, filtration and treatment plants, sewerage systems, power plants, transmission and communication towers, railway system, and other similar structures;

b) Semi -Permanent Structures: Five (5) years

Buildings of types 1 (wooden), 2 (wood with 1 hour fire resistance), and 3 (masonry and wood-construction), concrete roads, asphalt roads, river control, drainage, irrigation and drainage canals, municipal ports and river landing, deep wells, rock causeway, pedestrian overpass, and other similar structures;and

c) Other Structures: Two (2) years

Bailey and wooden bridges, shallow wells, spring developments, and other similar structures.

Based on the above-quoted provisions, it cannot be doubted that it is mandatory for a contractor to post a warranty security in any or a combination of the prescribed forms from the final acceptance by the procuring entity for the infrastructure it has constructed. The warranty security shall only be returned to the contractor after the lapse of the warranty period.

As regards the constraints of your municipality that no commercial insurance firm in the locality issues surety bonds with a validity period in excess of one year, and that the Government Service Insurance System in Legazpi City has yet to issue surety bonds with a validity period in excess of one year, subject to certain conditions; we are of the view that this should not proscribe your municipality from imposing warranty obligation on infrastructure projects.

A careful consideration of Section 62.2 of the IRR-A of R.A. 9184 reveals that there are a number of forms of warranty security for infrastructure projects that a contractor may choose from. Hence, if a contractor cannot find an insurance company within the locality that issues surety bonds that complies with the IRR-A of R.A. 9184, he may avail of the other forms of warranty such as: cash deposit, cash bond, letter of credit and bank guarantee. Besides, a contractor can always find a reputable insurance firm in other areas, such as nearby cities or provinces, that issues warranty securities in the forms acceptable to the procuring entity and compliant to the IRR-A of R.A. 9184.

We are also of the opinion that premiums for warranty security should not actually be included in cost estimates for infrastructure projects. Strictly these are not overhead expenses, considering that this is an obligation to be assumed by the contractor himself. Otherwise, if the cost for such security is included in cost estimates, the government agency concerned would be in effect guaranteeing to itself the structural soundness of the infrastructure project it wishes to procure. Further query on this aspect may be appropriately addressed to the Department of Public Works and Highways and Commission and Audit as to the proper interpretation of their guidelines.

Inclusion of a Provision on Contractor's Liability in the Conditions of the Contract Agreement

Based on the foregoing discussions, it can be deduced that the warranty obligation under Section 62 of the IRR-A of R.A. 9184, which shall be secured by specified forms of security stated therein is mandatory and exclusive. Hence, though the contractor's liability for warranty should be actually included in the general and special conditions of the contract, the requirement under the IRR-A of R.A. 9184 as to the terms of the warranty obligation and the forms of security should be maintained.

With the foregoing elucidations, we hope that our opinion has provided the Municipality of Virac the needed information pertinent to its queries on warranty.

We trust that this clarifies matters.

Very truly yours,



JOSE MARTIN C. SYQUIA
Executive Director

REPUBLIC OF THE PHILIPPINES
GOVERNMENT PROCUREMENT POLICY BOARD
Technical Support Office

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June 28, 2004

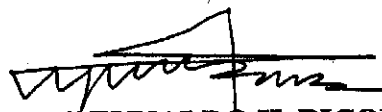
MR. FERNAN A. GIANAN
BAC Chairman
Municipality of Virac
Province of Catanduanes

Dear Mr. Gianan:

This refers to your letter dated June 18, 2004, which we received on June 28, 2004, addressed to the Government Procurement Policy Board (GPPB), requesting for clarification on several provisions of Republic Act 9184 and its Implementing Rules and Regulations Part A.

We wish to inform you that we shall respond to your concerns either through phone or in writing at the earliest possible opportunity, or raise the same to the GPPB for appropriate resolution should referral thereto becomes necessary.

Very truly yours,


ATTY. REYNALDO H. BICOL JR.
Procurement Management Officer V