

Contracting for Services

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Date: September 23, 2010

Time: 12:00 – 1:30 EST



Business Success Through Contract Management Excellence



Contracting Premise

- Contracts identify and allocate the business risks between the parties
- Appropriate allocation requires a “meeting of the minds” of the parties
 - necessitates understanding critical elements of the contract
 - results from discussions/negotiations

Agenda

- Services versus Commodities Contracts
 - What are the substantive differences?
 - How are “hybrid” contracts for both classified?
- Legal Issues
 - What laws apply?
 - Appropriate terms and conditions?
 - Performance on another’s premises?
 - Commercial law applicability to F.A.R. contracts?
 - Part 12 Contracts?
 - Subcontracts?
- Practical issues in Services Contracts
 - Critical success factors?
 - SOW/service description

Services Contracting – Legal Distinctions

- UCC (state commercial codes) does NOT apply
 - therefore, no clear, consistent law
 - “buyer favored” clauses not available
 - Warranty
 - Damages
 - Uncertainty in the Battle of the Forms
 - Electronic contracting may require a “writing”?
- Performance often on Purchaser’s premises
 - creates significant legal issues regarding liability for damages and/or injury
- Different & more complex contracts needed
 - Standard commodity contract generally inadequate

Services Contracting – What Laws Apply?

- State common law and/or statutes on contract law
 - Substantively different than UCC
 - Requires comprehensive assessment and contractual allocation of risk(s)
- Intellectual Property Protection (IP)
 - IP provides competitive edge to an organization
 - critical component for protection in most services contracts
 - especially challenging in foreign environments
- Privacy Protection
 - employee health records (HIPPA)
 - company financial information (SEC & State regs)
 - other sensitive information requiring protection?

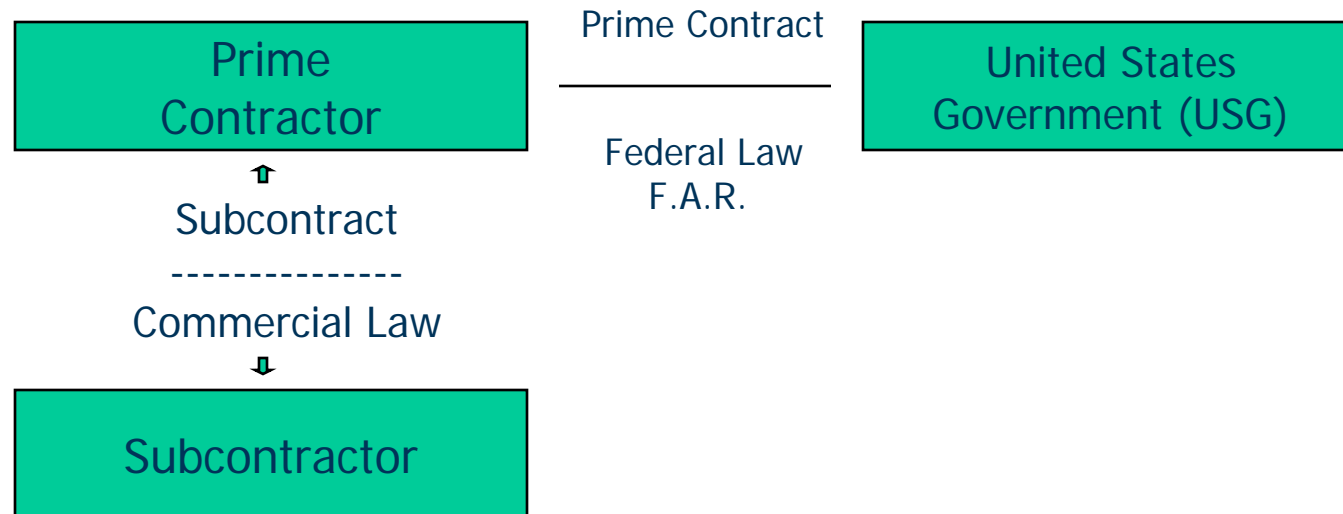
Contracting for Services – Hybrid Contracts

- What if contract covers BOTH goods and services
 - How will it be classified?
 - What laws apply?
- “Predominant purpose” of contract generally determines the classification
 - If classified as “goods”, UCC applies
 - If classified as “services”, common law or other state law applies
 - Could BOTH be applied?
 - e.g.: telecommunications WITH equipment
 - courts split on how to treat; therefore, agree in contract

Terms and Conditions – U.S. Government

Government Contracts and/or Subcontracts

- Acquisition of services subject to F.A.R. requirements & provisions
- Critical issue is flowdown of appropriate clauses from the prime contract or higher-tier subcontract
 - failure to flow down a requirement could subject the procuring organization to liability
 - e.g.: termination for convenience, changes, etc.
- **Subcontract requirements governed by commercial law?**
- F.A.R. Part 12 acquisitions governed by 52-212-5 requirements
 - **what if the Prime fails to flow down?**



Contract/Subcontract Relationship – What Laws Apply?

- The subcontract is a “commercial” relationship/contract; USG is not a party
- Commercial code (state law) governs, unless parties agree otherwise in the subcontract, or federal statute specifically requires compliance by subcontractor
- F.A.R. will apply only to the extent incorporated into the subcontract, i.e.: can’t require subcontractor to comply with F.A.R. clauses if not incorporated

Commercial Law Relevance to FAR Part 12 Transactions

- Contracts for “commercial items” shall, to the maximum extent practicable, include only clauses:
 - “determined to be consistent with customary commercial practice; or
 - required to implement provisions of law or executive orders applicable to acquisition of commercial items”.
- Terms & conditions prescribed by Part 12 should “seek to balance interests of both buyer and seller”, and shall not be tailored “inconsistent with customary commercial practices”
- *Perspective* - UCC and/or state codes govern non-government transactions for the same commercial goods & services
 - there is NO Federal equivalent for purchase of commercial items or services

Commercial Contracting & FAR Part 12

- Formality and structure of FAR is significantly different from informality and flexibility of UCC
- FAR Part 12 makes FAR compatible with UCC – but not entirely consistent
- Personnel in Federal acquisition environment must be familiar with both federal and commercial contracting practices and contracting terms

Services Contracting – Practical Issues

- The contract defines *risk(s)* and allocates that *risk* among the parties
- Contract terms & conditions (T&C)
 - Standard P.O. appropriate?
 - specifically designed for services contracts?
 - Each service will likely require customization of T&C, *e.g.*: janitorial service, versus roof repair versus computer services?
 - Use a comprehensive checklist to ensure critical elements are considered and included in the contract
- Never defer definition of a necessary component
 - TBD or to be agreed upon?
 - **Deferred definitions will affect price and/or schedule!**

Unique Contractual Considerations

- ✓ Scope of work
 - ✓ More frequent performance issues necessitate more comprehensive coverage
 - ✓ How to describe the requirement? *e.g.: paint a room*
- ✓ Changes
 - ✓ What will constitute an increase or decrease in scope?
 - ✓ What will be the acceptable impact on price and/or delivery?
- ✓ Work disruption
 - ✓ What will happen if service provider is interrupted?
 - By Purchaser?
 - By others?
 - ✓ Contract should provide for this possibility!

Unique Contractual Considerations (cont'd)

- ✓ Environmental Issues
 - ✓ What is service provider's responsibility? e.g.: hazardous waste produced or environmental damage?
 - ✓ Liability protection (indemnity) is needed

- ✓ Liability to third parties
 - ✓ Who is responsible/liable in event of damage or injury?
 - Employees of purchaser?
 - Employees of contractor?
 - Third parties/Invitees/bystanders?
 - Subordinate subcontractors?
 - ✓ Require indemnification and/or insurance!
 - ✓ Critical when performance is on Purchaser premises

Unique Contractual Considerations (cont'd)

- ✓ Contractor employees
 - ✓ OSHA and other regulations will apply; therefore, who will assure compliance with rules & regulations?
 - ✓ Contractor employees committed to follow Purchaser safety rules when on Purchaser premises?

- ✓ Behavioral issues – *Contractor on Purchaser premises*
 - ✓ Drug possession or use
 - ✓ Sexual harassment (*definition?*)
 - ✓ Smoking or drinking on premises
 - ✓ Ensure clear, written organizational policy
 - ✓ Require that contractor and subcontractor employees agree to comply as condition to admission on our premises

Unique Contractual Considerations (cont'd)

- ✓ Warranty
 - ✓ No UCC implied warranties available
 - ✓ How to judge the quality of work? What criteria?
 - ✓ What will be the remedy if work is unsatisfactory?

- ✓ Subcontracts
 - ✓ Require approval of any subcontractors
 - ✓ Ensure they provide required expertise!

- ✓ Payment
 - ✓ Progress payments needed?
 - ✓ Assure that subcontractors are paid in timely manner
 - ✓ Require indemnification against mechanics liens

Unique Contractual Considerations (cont'd)

- ✓ Taxes
 - ✓ What tax liability for services?
 - ✓ Determine classification of the contractor
 - ✓ employee versus independent contractor
 - ✓ Considerably different tax liability
- ✓ Termination
 - ✓ What conditions warrant default termination of contract?
 - ✓ How to replace contractor in event of termination?
 - ✓ Are there alternate service providers?
 - ✓ What is contractor liability if termination is required?
 - ✓ Liability if Purchaser organization defaults?

Unique Contractual Considerations (cont'd)

- ✓ Unexpected conditions
 - ✓ Adjustment mechanism in event of unexpected conditions?
 - ✓ Criteria for renegotiation?
- ✓ Completion
 - ✓ What event(s) constitute completion?
 - ✓ What rights/obligations if performance not complete?
 - ✓ Advisable to provide for “liquidated damages” in event of failure to perform in timely manner
 - ✓ Agreed upon cost of non-performance
- ✓ Dispute resolution
 - ✓ What is the process in event of disagreement?
 - ✓ Avoid litigation! (ADR clause for arbitration?)

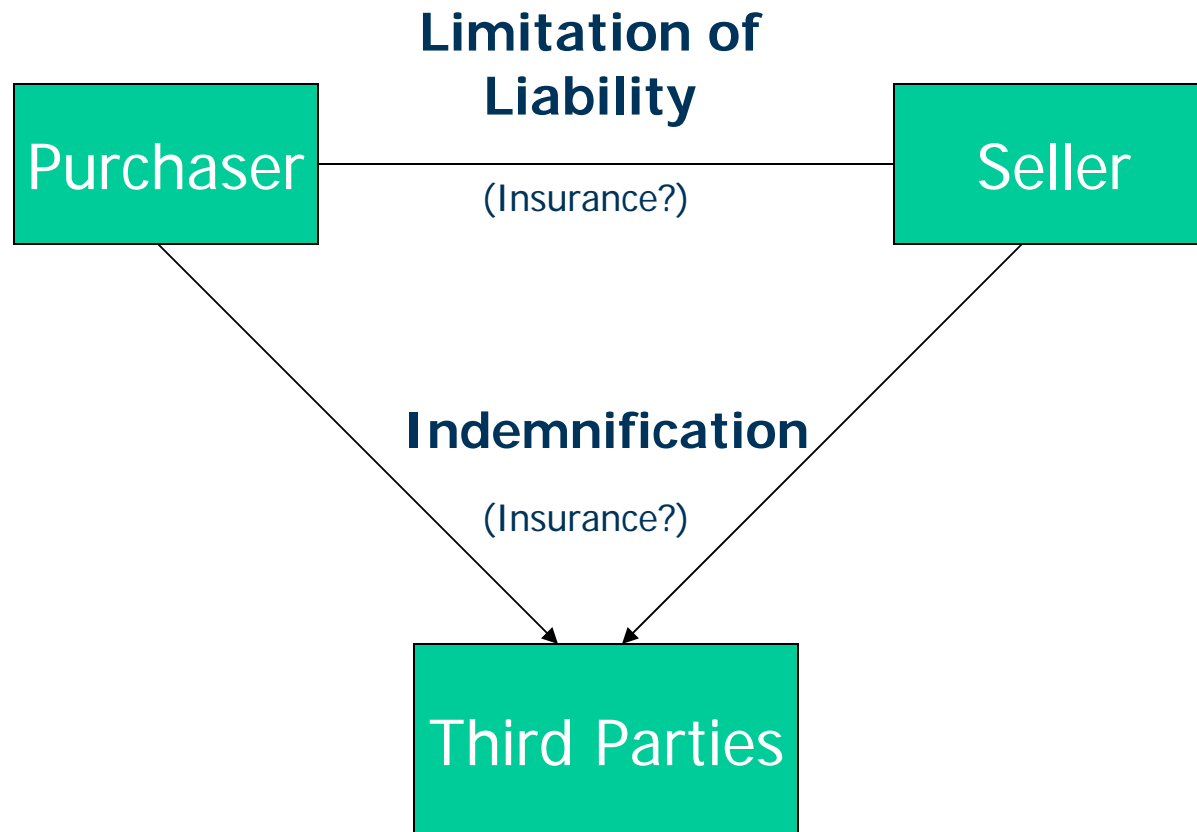
Terms Most Frequently Disputed/Negotiated

Top 20 TERMS	2010	2009	2008	2007
Limitation of Liability	1	1	1	1
Indemnification	2	2	2	2
Price/Charge/Price Changes	3	3	4	6
Intellectual Property	4	4	3	3
Confidential Information/Data Protection	5	10	7	8
Service Levels and Warranties	6	7	11	10
Delivery / Acceptance	7	9	8	9
Payment	8	8	9	4
Liquidated Damages	9	11	10	12
Applicable law / Jurisdiction	10	6	6	5
Warranty	11	13	14	14
Service Withdrawal or Termination	12	5	5	7
Responsibilities of the Parties	13	-	-	-
Scope and Goals	14	-	-	-
Insurance	15	12	12	15
Dispute Resolution	16	16	17	-
Change Management	17	-	-	-
Audits / Benchmarking	18	17	18	17
Invoices / Late Payment	19	14	19	-
Assignment / Transfer	20	19	16	16

Critical Clauses in Services Contracts

- Indemnification *versus* Limitation of Liability
 - Consider the circumstances
 - Law Department guidance advisable
- *Indemnification* = One Party agrees to stand in for other Party in event of incident and/or litigation with third parties; subject to expressed limitations
- *Limitation of liability* = agreement of Parties on the limits of their respective liability to each other, under stated circumstances
- Financial stability of other party should be considered

Indemnification versus Limitation of Liability



Critical Clauses in Services Contracts

- Indemnification *versus* insurance – which one or both?
 - Depends upon the circumstances
 - Obtain Law Department guidance
- *Indemnification* = One Party agrees to stand in for other Party in event of incident and/or litigation; subject to expressed limitations
- *Insurance* = insurer is engaged to provide financial protection in event of incident and/or litigation; subject to expressed coverage & limits
- Financial stability of other party and/or insurer should be a factor in determining which is appropriate (*both?*)

Services Contracting – Critical Perspective

- Appropriate performance metrics are imperative
 - What variables would indicate supplier is performing well or poorly?
 - What metrics will adequately measure appropriate variables?
 - How frequently can/should measurements be taken?
 - How and to whom will reports be made?
- Establish clear, comprehensive statement of work (SOW) and/or service level agreement (SLA)
 - What is the required result?
 - What remedy if result inadequate or unacceptable?
 - Establish liquidated damages?

Ensuring an Effective SOW

- Statement of Work (SOW) is a critical part of the services contract!
- Consider the impact of each aspect of the SOW on other aspects of the SOW or contract
 - scope
 - cost
 - quality
 - time/schedule

Effective SOW



Ensuring an Effective SOW (cont'd)

- SOW provides performance criteria for services contract
 - most performance issues have their genesis here!!
- Each SOW requirement should be:
 - Correct: technically accurate
 - Complete: express a whole idea or statement
 - Clear: unambiguous; not subject to interpretation
 - Consistent: not in conflict with other requirements
 - Feasible: technically & legally possible
 - Verifiable: can be proven to meet specific requirement(s)
 - Also, whenever possible:
 - modular: one element can be changed without excess impact on other elements;
 - measurable: clearly identified, with appropriate metrics included for measurement

Ensuring an Effective SOW (cont'd)

Problematic words & phrases:

- "**large**", or other such vague adjectives, i.e.: what may be large under one circumstance, will not be under another circumstance
- "**and/or**" – which is it?
- "**not limited to**" – unless otherwise specified, the stated parameter will be a limit
- "**because**" – why explain the rationale? spec/sow should specify, not explain.
- "**etc**" – if something else is needed, define and specify; otherwise, it will not be required.
- "**up to**" – avoid confusion, and clearly state the parameters, e.g.:
"**from ___ to ___**"

Use word processor to seek out and eliminate such words

Services Contracting - Summary

- Considerable differences from commodities
- Legal issues are often more complex
- Terms & Conditions are critical & may be unique
- The SOW can be the source of major performance issues
- The Contracting Managers should assure the appropriate allocation of risk among the parties
- Services contracts require exceptional professional contracting and contract management
 - Our *professionalism* is critical to the success of our organization!

Contact Information

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Questions?