Contract writing and risk management

Contract writing and depended risks management, is a very large topic related with the contract law which includes volumes of documents, legal briefs, and court decisions. So, we try to explain the main subjects in contract writing and we hope that this presentation will give you general idea about main principles of it and how to hedge the risks can be occurred before and after signing the contracts…

We will follow these steps given below :

I. Introduction
II. Protective contract language & risk management
III. Developing risk standards (Standard provisions)
IV. Other contract provisions
V. Methods for resolving conflicts
VI. Special contract provisions for governments.

I. Introduction

Valid contracts typically require the mutual assent of two or more persons who are substantially equal in awareness and barganing power, someone who makes an offer and someone accept the offer, and purpose that is socially approved.

To write a clear, concise business contract draft, we have to be sure to include some certain key elements. These key elements are given as :

Key concepts in contract writing

i. The parties to the aggrement

Identify who's involved in the agreement. Usually, this will be apperent from the terms of the agreement, but if there is any doubt, you must go ahead and identify each individual by residence or other descriptive terms in addition to names.

ii. Mutual agreement

Means, there is a "meeting of the minds " as to what the parties of contract want to out of the contract. While legally enforceable contracts can be based on unspecified intentions, or handshake agreements. Generally, these types of contracts have no place in state or local government outsourcing (and need to be carefully avoided). But in private sector business contracts, sometimes, handshake or oral agreements can be more enforceable than the writing ones.

iii. Consideration of Agreement

Describes what benefit or gain each party will receive. Consideration involves the exchange of something of value btwn. the contracting parties. It can come in a number of forms, including performance or doing something you are not legally obligated to do, forbear or to perform. Additionally, many contracts (e.g. involving property, large gifts, or an exchange of resources above certain values, etc.) also require appropriate formalities if the contract is to be considered enforceable. For example, some contractual arrengements require the receipt of something of value as consideration for the promise that has been made.

iv. Terms

Detailing the nuts and bolts of the agreement. This is the critical part of the any business contract draft. Before starting to write an agreement, it is usually best to prepare a list of who is doing what and when. Basically, it must be written down each party's obligation under the agreement. And also, the agreement must be written in an understandable manner for accomplishing the function of providing a permanent record of exactly what the deal is.
Contracts in general and the terms specifcally, are most readily understood when written with relatively short sentences using familiar, short words.

v. Execution

Getting the the necessary signatures. All parties must sign the agreement Execution of an agreement shows there has been a meeting of the minds and agreement has been entered into. If each party individual , the signature is usually sufficient for execution. In some instances, it's desirable to have the signature witnessed, if there is doubt an individual's identity.

vi. Legality of a contract

Legality of a contract refers to whether a contract involves the performance of an illegal act or is contrary to public policy or statue. Such contracts are illegal and therefore unenforceable. Contract legality is the area where most state and local government contracts fail. This is the case because agency officials may unwittingly make verbal commiments or draw up letters of agreement or requests for proposal or invitations to bid without fully considering the limits of their authority.

vii. Contract Form

Refers to the mode (written, spoken, typewritten, handwritten, etc.) in which the contract is executed. Contracts don't to be in writing to be enforceable. However, written contracts are generally given by the preference over oral ones, and state and local governments are often required to use a written contract form.

- ✓ Verbal Agreement
- ✓ Purchase Orders
- ✓ Letters of Intent
- ✓ Letters of Agreement or Letter Contracts
- ✓ Letters of Acceptance
- ✓ Formal contracts

viii. Competency

Refers to the "legal capacity" of a party to contractor the ability of a person to have full power to bind himself/herself contractually.
Minors below the age of 18 and also the persons who are mentally in competent are generally incapable of contracting because they lack such capacity. So, a contract with a person lacking legal capacity can not be enforced even if the contract is otherwise valid.

ix. Delivery

Ensure valid delivery of contract. A contract (signed by all involved) must be delivered to each of the parties identified in the agreement. By signing and delivering contract , you indicate you have read, understand, and agree to the contract's terms. ***Delivery of the agreement is the final essential element to an enforceable contract.***

II. Protective contract language & risk management

While boilerplate contracts can be used successfully in the majority of outsourcing situations, use of contract language can also be taken too far. This is particularly case when the attorney in charge of creating required contract template or language is more concerned with predicting and adressing every possible contingency for every possible outsourcing situation than with the efficiency and effectiveness of the outsourcing process.

The contract manager's use of risk management mechanisms can differ substansially from the results of an attorney's desire to create air-tight contracts. This is the case because many of the clauses that an attorney may desire to include in a contract involve both direct and hidden costs.

So, good contract management requires that the contract manager can take certain steps :

- ✓ **Determine if the risk involved in a particular contract is substantially above some risk standards.**

If the contract manager is expected to oversee numerous contracts it may make sense to systematize this process though use of checklist such as that presented in table below :

Breach of contract risk level	Sample Range of appropriate remedies
Risk is at or below acceptable risk standard	No special risk prevention terms should be included in the contract
Risk is slightly above acceptable risk standard	The cost of risk prevention risk terms should not be less than 1% or greater than 2% of total value of the contract.
Risk is moderately above acceptable risk standard	The cost of risk prevention risk terms should not be less than 2% or greater than 5% of total value of the contract.
Risk is substantially above acceptable risk standard	The cost of risk prevention risk terms should not be less than 5% or greater than 15% of total value of the contract.

- ✓ **Determine whether particular risk-management clauses are appropriate to particular contracts.**

Risks can be grouped into two categories : risks related inappropriate contract awards or award challenges and risks of the contractor failing perform as expected. The **table given below** outlines how certain risks might be handled by specific contract provisions.

Risk	Possible Contract Provisions
That some contractors will challenge the award because of their being unaware of a contract amendment.	Require bidders to acknowledge receipt of amendment notifications.
That ootentially winning the contractors may withdraw or change bids that the government wants to accept.	Set the period of time in which a bid response is bidding on the bidder; specify that a withdrawn bid cannot be resubmitted;specify that valid excuses for withdrawing a bid.(e.g.clerical errors,submittal by an unauthorised staff member) must be provided beyond a reasoneable doubt.
That a bidder will challenge the award or payment level because of an undisclosed fact or condition.	Include a clause in the RFB or IFB documents and in the contract that makes the bidder or contractor responsible for conducting investigations of the work specifications and contract conditions. Disclose all conditions that could effect the cost of the service to the contract.
That bidders may conspire to rig the bids.	Hav ethe bidders certify that their bid and/or proposal was developed independently and that they did not communicate the details of their bid/proposal to anyone else; have bidders certify that they have not been previously debarred from contract competitions because of their collusion on bids/proposals
That bidders will include their own bolierplate terms and conditions that change the balance of risk in their favor	State in the RFP and IFP that nonconforming terms and conditions will be considered as nonresponsive and will be rejected.
That excellent proposals or bids will have to be rejected because of minor defects that technically make the response nonconforming.	State in the RFP and IFP that the government has the right to waive informalities or irregularities that do not affect the service price, quality, qantity or delivery.
That the best proposal arrive late	State in the RFP and IFP that late proposals due to the forces beyond the control of the bidder can be accepted.
That an informal oral agreement will be considered as an amendment to the contract	State in the RFP, IFP and contract that only written amnedments will be accepted as contract changes.

✓ Contract Provisions for addressing risks that the contractor will not perform as desired.

In that part the following points given below have great importance. These are :

i. Warranties : They extend the time period in which a seller, supplier, or service provider agrees to assume responsibility for what has been provided as part of a contractual exchange.

ii. Indemnification clauses : They require the supplier or service provider to to protect the buyer (e.g. government) against losses or damages caused by the provider or contractor. These clauses typcially include language related to loss, claims, damages, actions and liabilities related to work conducted as a part of the contract.

iii. Bonds : Genarally, they involve a payment by the contractor to a third party who is able to quarantee certain behaviour or performance by the contractor.

iv. Liquidated damages : Provisions require the supplier or service provider to pay the buyer a specific amount for the failure to provide a level or quality of service that is specified in the contract and that results in some level of damage to the buyer .

v. No damages for delay : Terms essentially excuse the buyer from responsibilities for delays that the buyer itself causes.

vi. Consequential damages : Control for substantial unforeseen and undesirable results of using a product or service.

vii. Assignment : They are used to control for the possibility of a contractor winning the contract award and then assigning the work to another service provider.

viii. Force majeure : It is legal doctrine that excuses contractors from performing their contracted duties because of conditions beyond the ontrol of the respective parties (e.g. bad weather, vehicle breakdown, civil disturbance, etc.)

ix. Independent contractor : These clauses are often included in contracts as a means of establishing that the contractor can not claim benefits (e.g. overtime, etc.) to which government employees are entitled.

x. Requirements contracts clauses : These specify that the government is only contracting for services as required, that the payments or contract value is only estimated, and the government does not quarantee the amount of work or requirements over the course of contract.

✓ Match types of risks to specific contract mechanisms

Risk related clauses are those that attempt to appropriate the risk levels to be borne by the parties to the contract. Not every contract involves every type of risk. Good contract management calls for a close fit between the type and level of risk involved in the contract terms that one intends to require. The table given below attempts to provide some basics guidance on making such a match between risk and risk-management measurements.

Type of Risk / Condition	Potential Contract Terms / Mechanisms
Risk that the supplier will be delayed in the delivery of time-sensitive goods or services	Liquidated damages/performance bonds/no damages for delay;exclusion of force majeure provisions
Risk that the contractor will have another service provider actually do the work or will have unqualified or unlicensed personnel perform contract tasks	Bidder qualifications;prohibition of assignment clauses; requirements that bidders submit copies of certificates and licenses of personnel who will be doing the work
Risk that the government/company will have to provide over time and other benefits to the contractor	Certification that the contractor is independent of the government
Risk that the government/company may not be able to live up to its all responsibilities in the contract	No damages for delay,indemnification; inclusion of force majeure clause that applies to the government; requirements contract
Risk that the contractors work will not be satisfactory	Performance bond
Risk that the failure of a product-service could result in substantial damages over and above replacement of the product/service	Consequential damages
Risk that the contractor will fail the complete the work because of bankruptcy, fraud for other financial weakness	Performance bond,payment bonds,liquidated damages; right to audit the contractor`s books.
Risk that the product/service will not be serviceable for as long as the government/company needs it to be	Warranties.
Risk that a noncontractual party will take some action against one of the parties to the contract and thereby delay/prevent performance on the contract	Indemnification; hold-harmless clauses related to the use of copyrighted or licensed materials or procedures.
Risk that one of the parties will not pay for the materials that have been purchased	Payment bonds.

- ✓ **Decide whether to include special risk-management clauses**

In contract negotiation it may be relatively easy to asses the potential risks which are higher than average. But it is often more difficult to decide how to manage these risks.
This is a very important case because each of the risk management clauses outlined has a cost and these costs are rarely explicit or itemized.
So, a good contract manager has to know which clauses are absolute necessary and which are not.
Theoretically speaking, what we have to understand, every risk management clause or behavior that we decide not to require force the contractor to lower the contract price.
For example if the government decides not to require a performance bond companies that bid on the contract should be able to lower their price by the cost of performance bond.

III. Developing Risk Standards (Standard provisions)

Ok. Under this headline I am going to try to illustrate you the need for the contract manager to understand both the cost structure of various levels and types of risk management and how this cost structure affects the entire outsourcing situation.

God protects them ☺ there are some veteran contract managers who have prepared for us, through long experience, a series of steps for managing risk in contractual situations.

And here we go to the first step of this systematic approach.

✓ identify an acceptable risk standard

The duty of contract manager is to manage contractual risk according to the level of acceptable risk. So, it means, the first task for us is to identify what is an acceptable risk for the parties.

How can a contract manager identify an acceptable risk?

This is the case because there are no universal standards. Risk management is not an exact science and the probability of specific events' occurring is not always known .Our situation in this case is so genant "teufels kreise". Nevertheless there is one way to begin to conceive of an acceptable risk standard.

***Risk factor**= (estimated cost of a contract breach) x (the probability of the breach occurring)*

What are the mechanics of developing and using of a risk factor function?

If you have a look the x page of your hand-outs, you will see a table which shows, how we can estimate the probability of a contract breach. I hope this table gives you at least an idea about the identifying an acceptable risk standard.

- ✓ **assess the degree to which the contract poses risks above standard**

The second step after identifying risk standards to asses the degree to which the contract poses risks above standard. The result of this assessment is a single risk factor score. If this factor is lower than the acceptable score the contract manager need examine the proposed contract to insure that it does not contain costly risk management clauses which could be eliminated. if the factor score is higher than acceptable score than it is necessary to go to the next step.

- ✓ **identify potential risk-management mechanisms and contract clauses**

It is necessary to identify the method that will provide the greatest risk reduction for the least cost. There are at least 2 basic ways to do it.

a-) asking bidders to supply 2 bids, that is, a bid that includes the risk reduction provisions and a bid for the same work that does not include the risk reduction language in the contract

b-) require an independent estimate of the cost of a risk reduction measure

- ✓ **Analyze the base cost of each risk-management mechanism clause.(i.e., estimated cost to bring the contract within the range of acceptable risk)**
- ✓ **Analyze how the mechanism clause will play out within the outsourcing situation.**
- ✓ **Adjust the estimated cost based on the analysis.**
- ✓ **Decide whether to require a mechanism as part of an official bid**

Factor	Sample weight/scale
There is generally higher risk in a new contractual relationship than in an old one.	Base score of 0.10 for a new relationship; subtract 0.01 for each year of successful relationship.
There is generally higher risk when the company is new.	Score new companies as 0.05. Score companies five to ten years old as 0.03 and companies older than ten years as 0.01.
There is generally higher risk when a contractor is overextended.	Score 0.1 for companies that are very extended and 0.05 for companies that are moderately overextended.
There is generally higher risk when the deal seems "too good to be true"	Score 0.05 if the deal seems too good to be true.
There is generally higher risk with small companies than with large companies.	Score 0.03 if small companies are bidding on the contract.
There is generally higher risk if the technology is complex.	
Score 0.2 if the technology is untired or unproven, 0.1 if it is tried but is complex and not yet standardized, and 0.5 if standardized but still very complex.	There is generally higher risk if the work is dependet on a large number of subcontractors.
Score 0.01 for every subcontractor over 5 subcontractors.	There is generally higher risk with out-of-town firms or consultants than with in-town firms or consultants.
Score 0.05 if the contractor is located out of town.	There is generally higher risk with contracts in areas where the work itself is risky.
Score 0.04 for construction workand work involving heavy equipment, 0.03 for personal services work, 0.02 for work involving transportation and so on.	There is generally higher risk with companies that have failed to comply with contract obligations in the past.

IV. Other contract provisions

The risk management is perhaps the most complex aspect of constructing a good contract. There are some issues which we, as a contract manager , have to consider about them. So, here I am going to try to give you some of these provisions.

i. <u>Payment Terms or Provisions</u>

These clauses would outline the payment type, the schedule of payments , and max / min payment amounts.

ii. Contract Change Provisions

Under these clauses we understand the right dealings to make some needed changes during the contracting phase or after the contracting phase. Sometimes change clauses are as simple as a statement that the parties can change the contract by mutual agreement. At other times it may be more efficient to allow one party to unilaterally make changes or certain number of changes within a certain time frame.

iii. Contract Suspension Provisions

In a contracting phase with government there may be times when the government would want to have a right to suspend the work that has been contracted. For example if the government plans to pay for a project out of expected sales tax receipts and if they fails to collect the expected level of tax according to the schedule, a situation may occur when the government has not allocated any other resources to the project it may be necessary to suspend the contract until the necessary founds are collected. Contract suspension is usually not a cost-free activity unless this is clearly specified.

iv. Contract Renewal Provisions

These provisions allow the government the option of renewing the contract at the current price without having to bear the cost of re-bidding the contract but here we have to keep in mind a very important factor, inflation. Because of inflation a contractor will not be interested in the renewal offer at the same price. If this is likely to be the case and the government wants to keep the renewal option alive, the contract manager will need to include a price adjustment or escalator that will allow the contract value to be maintained in the face of price or wage inflation.

v. Contract Termination Provisions

These termination provisions act to allow one or both parties to breach the contract without substantial penalty. These termination clauses are usually written so as to allow the buyer to get out of the contract on certain terms.

vi. Conflict Resolution Provisions

These provisions can be divided into two basis types:

a) *Prevention provisions*: can take many forms depending on the kind of conflict a common prevention provision is one that specifies which documents will take precedence over others.

b) *Resolution process*: there are basically three methods to resolve conflicts

V. Methods for resolving conflicts

Negotiation: in this method parties try to find mutually satisfactory resolution on conflict during to discuss the conflict with each other. As a conflict resolution strategy negotiation is the most effective when all the parties in conflict have good communication skills, good intentions and also general willingness to compromise.

Mediation: in mediation, as a different from the negotiation, there is added the expertise of a skilled mediator. The responsibility of the mediator is to help the parties to identify their interests, to generate multiple solutions and to discover the solution that provides best chance of mutual satisfaction. Another important task of a mediator is to avoid further conflict which may occur during the mediation. To prevent this kind of undesirable conflicts the mediator has to provide that parties' rights are respected and that the agreement is fair and tight in all respects. The mediation is a bit more expensive than the negotiation, if all else is equal. Because the services of a mediator must be purchased.

Arbitration: this method essentially involves the parties presenting their case to a neutral third party and having this party. The arbitrator judges the merits of each side's case. In binding arbitration the parties agree to submit to the judgment and remedies which are specified by the arbitrator.
Here I want to show you some options which can be considered in developing the rules to guide arbitration.

- ✓ ***Either or judgment*** : require the arbitrator to choose either the solution suggested by party A or the solution suggested by party B. it does not allow the arbitrator to fashion a compromise solution.
- ✓ ***Unrestricted / restricted rules of evidence***
- ✓ ***Formal / informal method of argumentation.***
- ✓ ***Restrictions on levels of judgment and types of remedies:***

VI. Special contract provisions for governments

Here I will give you some contracting situations where public sector agencies are constrained in ways that private sector firms are not

•*Procurement regulations*: That force the government to prefer some contractors over others

•*Special codes of ethics*: Many of these provisions have developed and codified to set a limit the relationship between government employees and government contractors. 'So be careful and don't accept any gift!!'

•*Employment of government's workers*: According to these clauses governments can make a condition in contract that the contractor first offer displaced government workers employment before seeking new employees in the general labor market.

•*Special powers and responsibilities*: Governments have certain sovereign powers. Also they assume a greater level of responsibility for facilitating the contracted work or removing barriers to this work. For example if the contract was with a government body that had the authority to issue the permit but failed to do it. The government may be responsible for a claim of added costs due to delay.

Some terms in Contract Writing & Risk Management

Agreement :The understanding btwn. Two or more parties.
Bona fide :In good faith; with integrity and honesty in dealing.(Latin)
Boiler plate :Contarct provisions that are used repeatedly and may be considered a standard for use in an agreement.
Consideration:Something of value in the eyes of the law that justifies a binding commitment part of the party receiving the consideration.
Contract :A covenant or agreement btwn. two or more parties to do or not to do certain things.
Corporation :A legal entity formed by one or more persons.
Counterpart :A copy of an agreement that is executed by one or more of the parties to the agreement.
Force Majeure :An irresistible or overpowering force (e.g. floods,riots,strikes) (French)
Intellectual Property :Primarily refers to the to rights in products of mental activities.
Jurisdiction :The power of a court to enforce certain laws by enforcement or the award of remedies.
Party :One who undertakes an obligation under a contract and thus becomes a “party” to the party.