

Project Contracts

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PMG323

Lecture 4



Chapter

01

Drafting



Clarity

If an overarching theme has been detected yet, hopefully it is that contracts should clarify the rights and obligations of both parties, not confuse them. In cleaning up any draft agreement, always assume that others will eventually have to read it for any number of reasons:

- Comply with performance or payment obligations.
- Prepare amendments and supplements to the agreement.
- Understand the agreement's term and termination provisions.

Clarity

If an overarching theme has been detected yet, hopefully it is that contracts should clarify the rights and obligations of both parties, not confuse them. In cleaning up any draft agreement, always assume that others will eventually have to read it for any number of reasons:

- Exercise or pursue appropriate breach or default remedies.
- Future readers of an agreement will greatly appreciate being able to understand it.

Clarity

Whether reviewing your own work or a document from the other side, follow these rules:

- Fix unclear or confusing language.
- Remove unnecessary, inapplicable provisions.
- Correct internal inconsistencies.

Drafting red flags

It is important to not be intimidated when reviewing drafts originated by the other side, even if they bluster that it is their “standard template” and that they usually do not change it.

As a general rule, if you cannot understand a sentence or paragraph after reading it once or twice, flag it. If someone can explain it, require edits consistent with the explanation. If it cannot be explained, strike it.

Drafting red flags

Another red flag is any document that seems suspiciously longer than similar types of agreements.

In addition to burdening and possibly confusing future readers, unnecessarily long documents can increase the likelihood of internal inconsistencies and other errors. While some commercial relationships are unavoidably complex, some contracts are too long simply because of bad drafting. “Over lawyered” templates drafted to cover multiple types of products or services or multiple irrelevant options are common offenders.

Drafting red flags

While non-lawyers need to be cautious when editing legal “boilerplate,” removing wholly irrelevant terms from a bloated template always makes for a more readable document.

In general, it is reasonable to take a run at aggressively carving back overly expansive, one-sided legalese written purely for the other party’s benefit.

Completeness

In addition to being clear and concise, contracts need to be complete. While certainly not standardized across all industries and types of agreements, similar legal elements are found across most types of contracts and most contracts are organized using somewhat similar looking headings and sub-headings.

Completeness

Understanding typical contract structure helps one quickly assess how well a document likely addresses key issues:

Is it clear what the parties intend to accomplish?

Are their mutual obligations spelled out sufficiently?

Does the agreement say what should happen if either party fails to perform?

Completeness

Understanding typical contract structure helps one quickly assess how well a document likely addresses key issues:

How and when can it be terminated?

What happens when it is terminated?

Which parts of the agreement survive termination?

How are intellectual property rights addressed?

How are disputes resolved?

Completeness

Disputes and disappointments are less likely with contracts that clearly and completely address these issues. Tight agreements discourage meritless disputes by helping keep everyone more honest. Even if completeness requires accepting provisions that cut both ways, it is generally better to choose the devil you know over the devil you do not.

Sometimes a party to a negotiation will balk at detailing performance obligations, timelines, remedies, termination rights, or other terms discussed. This is sometimes a clue that they have orally over-promised. Do not be deterred, insist on clear commitments and remedies.

Technical details

Technical details are often best addressed in one or more “schedules” or “exhibits” attached at the end of the document. These schedules and exhibits are often captioned “Specifications,” “Technical Specifications,” “Schematics,” “Deliverables,” or “Work Order.”

Placing schedules and exhibits at the end of the document enhances readability, but doing so is no excuse for less rigorous analysis and drafting, or for signing an agreement before its schedules and exhibits are complete.

Technical details

In fact, schedules and exhibits are often at the heart of one or both parties' obligations and, as such, critical for ensuring proper performance or resolving disputes over performance. Persons with "subject matter expertise" should review, understand, and take responsibility for complex or technical exhibits, and confirm that each exhibit stands on its own, such that persons with similar expertise will know exactly what it describes and requires.

Understanding the deal

If your role is limited to drafting or editing a contract versus participating in the business discussions to be covered in the contract, get as much background information as possible. Ask who, what, when, where, why, how, how much and a lot of “what ifs” to establish a foundation for your review. Invite yourself to key meetings and conference calls when possible.

Understanding the deal

Other helpful questions or requests might include:

- ✓ Please explain the importance, cost and logic of the transaction.
- ✓ How are the negotiations going?
- ✓ Are there possible concerns about the partner or the transaction?
- ✓ What alternatives were considered?
- ✓ What are the technical or industry-specific considerations?
- ✓ What are the anticipated implementation processes?

Active Analysis

Carefully reading and analyzing a contract is challenging and requires energy, focus and discipline. Even bad contracts can read well and seem to make sense, especially if you fail to think hard about what might be missing.

The following are some helpful tips for ensuring active analysis:

- Use any background information you requested to identify unaddressed concerns.
- Use a general contract checklist based on customary contract headings and sub-headings to look for important missing provisions.

Active Analysis

Carefully reading and analyzing a contract is challenging and requires energy, focus and discipline. Even bad contracts can read well and seem to make sense, especially if you fail to think hard about what might be missing.

The following are some helpful tips for ensuring active analysis:

- Be alert for passages that overreach or that provide too much flexibility or ambiguity in favor of the other party.
- Imagine different ways in which the relationship could unfold over time and how those different scenarios could or should be addressed.

Active Analysis

Carefully reading and analyzing a contract is challenging and requires energy, focus and discipline. Even bad contracts can read well and seem to make sense, especially if you fail to think hard about what might be missing.

The following are some helpful tips for ensuring active analysis:

- Ask yourself whether and how each sentence is relevant, how each sentence relates to the paragraph, how each paragraph relates to the section, and how the section relates to the overall agreement.

Initial Draft Issues

In reviewing any third-party's proposed agreement, keep in mind that sloppy drafting and one-sided drafting are both common. In somewhat rare instances, documents proposed by third parties are so bad that they are simply not a valid starting point.

Several choices present themselves when faced with such a document. The path of least resistance is often to edit extensively until it resembles something you would sign.

If the proposed agreement is so far off that it seems unrealistic as a starting point, consider telling the other party as much, and politely ask that they work with outside counsel to produce a better document.

Starting from Scratch

Depending on timing and resource constraints, a third alternative, and possibly the most practical approach, is to offer to start from scratch with your own document.

The other party may simply lack the business and legal sophistication necessary to do better or to even see the problems. Starting from scratch, although burdensome, may be the best way to protect your own interests.

Handwritten Changes in Final Draft

Handwritten text inserted into, or deletions of text from, the final copy of any agreement must be initialed in each instance by both parties in a manner that clearly reflects acceptance of the changes by both parties.

Otherwise, it would be easy for the party who has not initialed a change to argue that it is not part of the agreement.

Chapter

01

Contract types



Fixed Price Contracts

In Fixed Price Contracts, a Fixed Amount of consideration is required to be paid by the Buyer to the Seller for the Specified Work. The Specified Work could be Deliverables, a Service or a Result or anything else as defined in the agreement document. It is also called Lump-sum Contract.

Fixed Price Contracts

Contract Attribute	Buyer's Responsibility	Seller's Responsibility
Scope of Work is well defined.	Buyer has a legal obligation to accept finished work as defined in the Scope.	Seller has a legal obligation to complete work as defined in the Scope.
Scope change (modification) is allowed as per the T&C of the contract.	Generally, Buyer has to pay extra (over & above the Fixed Price) for the agreed upon change.	Seller has to complete extra work as defined in the agreed upon change.
Price is Fixed.	Buyer has a legal obligation to pay Fixed Price to the Seller after the work has been completed.	Seller can legally claim full payment after completing the work as defined in Scope.
Cost Risk is in favor of the Buyer.	Buyer has minimal Cost Risk.	Seller has a Risk of losing money. Conversely the Seller can maximize her/his profits.
When is this used?	Buyer can document Scope of Work in detail.	Seller can estimate Cost based on the defined Scope of Work.

Fixed Price Contracts

Example projects where this is generally used:

For developing limited scope software projects
like developing mobile apps.

For testing strength of telecom signals in a
region.

Fixed Price Contracts

There are three sub-categories of this type of contract:

- Firm Fixed Price (FFP)
- Fixed Price Incentive Fee (FPIF)
- Fixed Price with Economic Price Adjustments (FP-EPA)

Fixed Price Contracts

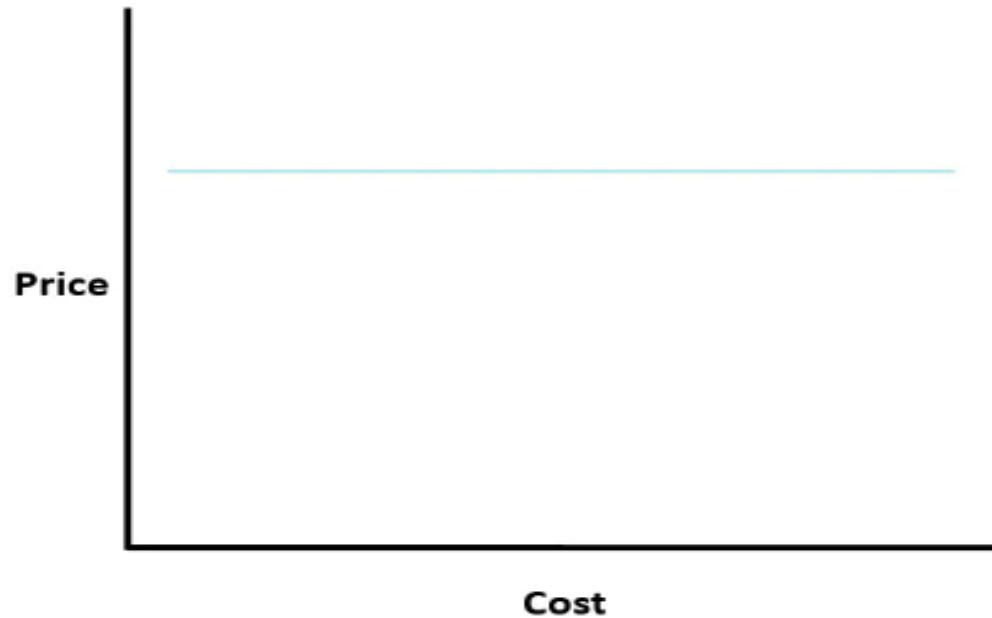
Firm Fixed Price (FFP)

Even though FFP Contract is one of the subtypes of FP Contract but it is just like FP Contract.

- The Buyer and the Seller agree upon a Price at the time of signing the Contract.
- The Scope of the Contract is well defined.
- The Price and Scope can be changed only through a formal change control procedure.
- The Sellers have more Cost Risk than the Buyers in this type of Contract.

Fixed Price Contracts

Firm Fixed Price (FFP)

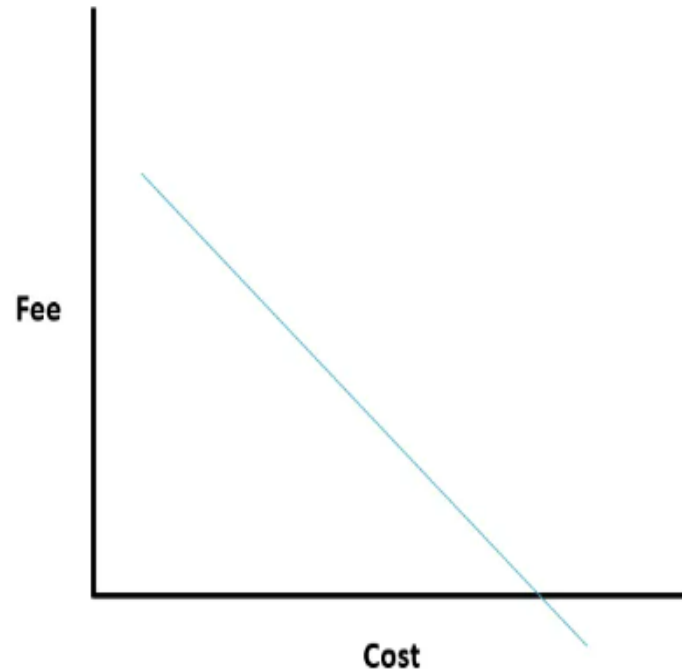


Buyer's Price remains fixed even as Cost increases

$$\text{Price} = \text{Cost} + \text{Fee}$$

Fixed Price Contracts

Firm Fixed Price (FFP)



Seller's Fee goes down as Cost increases

$$\text{Price} = \text{Cost} + \text{Fee}$$

Fixed Price Contracts

Fixed Price Incentive Fee (FPIF)

The basic nature of FPIF Contract is very much like a FP Contract but there is some price flexibility built into the contract. The price flexibility is achieved through financial incentive(s). The Buyer and Seller agree upon financial incentive(s) and establish some performance criteria as part of the contract. The Seller is entitled to the agreed upon incentive(s) after meeting or exceeding the established performance criteria.

Fixed Price Contracts

Fixed Price Incentive Fee (FPIF)

FPIF Contracts can have provision for negative incentives also. These are often called penalties. The penalties are levied in case the Seller does not meet established performance criteria.

In FPIF Contract, the final price is determined only after completion of the contracted work. The final price can vary based on the performance of the Seller.

Fixed Price Contracts

Performance Criteria of Fixed Price Incentive Fee (FPIF)

In FPIF Contract, the Buyer and the Seller can use any project parameter to establish the performance criteria. Project parameters can include Schedule, Cost, Quality, technical performance etc.

Following are some examples of performance criteria.

- Finishing the contractual work one month before the due date.
- Product downtime is less than 0.1%

Fixed Price Contracts

Performance Criteria of Fixed Price Incentive Fee (FPIF)

The defined performance criteria can be based on a single project parameter or on a combination of multiple project parameters. One of the more popular performance criteria is based on cost performance of the Seller. The cost performance is established by defining Cost Targets at the outset.

The same general formula that we discussed for FFP contract, is applicable for FPIF Contract also.

Fixed Price Contracts

Performance Criteria of Fixed Price Incentive Fee (FPIF)

$$\text{Price} = \text{Cost} + \text{Fee}$$

The Fee calculation can be done only after determining the Incentives as defined in the Contract.

Fixed Price Contracts

Fixed Price with Economic Price Adjustments (FP-EPA)

The basic nature of FP-EPA Contract is very much like an FP Contract. But in FP-EPA Contract, special provision is made to allow price adjustments. At the beginning of the contract, the Buyer and the Seller agree upon predefined criteria for such price adjustments. This is done due to uncertainties and vagaries that are inherently present in the markets. The market dynamics and economic conditions change with time. Usually, these contracts run for a very long period spanning multiple years.

Fixed Price Contracts

Fixed Price with Economic Price Adjustments (FP-EPA)

Some of the common characteristics of this type of Contract are:

- The Buyer and the Seller agree upon a Fixed Price at the time of the signing of the Contract.
- The Buyer and the Seller agree upon definite criteria for Adjusting the Final Price.
- The criteria are based on the market and economic conditions as they are beyond the Buyer's or Seller's control.

Fixed Price Contracts

Fixed Price with Economic Price Adjustments (FP-EPA)

Some of the common characteristics of this type of Contract are:

- Usually, the Scope of the Contract is well defined.
- Usually, these contracts run for multiple years.
- Usually, these contracts involve a lot of administrative difficulties, but money at risk outweighs the difficulties of administration.

Fixed Price Contracts

How is an FP-EPA Contract Framed?

The uncertainties can arise due to any of the following factors:

- Changes in labor, material or other resource costs
- General inflation
- Price fluctuations in commodities
- Changes in bank interest rates
- Fluctuations in currency markets

Fixed Price Contracts

How is an FP-EPA Contract Framed?

This is not a complete list. There could be many more factors that can lead to market uncertainty. The Buyer and the Seller frame a FP-EPA Contract if they believe that such factors can influence the cost of completing the contracted work. They can either develop a simple or a complex criteria based on these factor(s).

Fixed Price Contracts

How is an FP-EPA Contract Framed?

Examples

- A multi-year software development project outsourced to a different country: interest rates & currency exchange rates fluctuate with time.
- A multi-year oil and gas exploration work: Labor & commodity rates change with time.

Time & Material Contracts

In Time & Material Contracts, a Fixed Rate is required to be paid by the Buyer to the Seller for the Specified Unit. The Specified Unit could be Labor Duration Unit or a Material Unit as mutually decided between the Buyer and the Seller. The Quantity of Labor or Material is not specified at the beginning. The Quantity is take as per the actual consumption.

It is also called Rate Contract or Unit Price Contract.

Time & Material Contracts

General Attribute	Buyer's Responsibility	Seller's Responsibility
Scope of Work is broadly defined. Quantity is undefined.	Buyer provides acceptance only after work is satisfactorily completed.	Seller has a legal obligation to complete the work as defined by the Buyer.
Scope change (modification) is allowed as per the T&C of the contract.	Buyer has a legal obligation to pay for the extra units that were used due to changes.	Seller can legally claim payment for the extra units that were used due to changes.
Rate is fixed.	Buyer has a legal obligation to make payment for each unit delivered by the Seller at the predefined rate.	Seller can legally claim payments at predefined rate after delivering the units.
Buyer and Seller share the Cost Risk.	Buyer has to pay predefined rate for each delivered unit even if the work is not completed.	Seller can claim only predefined rate for each delivered unit even if the costs escalate.
When is this used?	Buyer is unable to estimate the quantity due to uncertainty of requirements or for some other	Seller cannot estimate the total cost due to the absence of well defined Scope of

Time & Material Contracts

Examples of Time & Material Contracts

- For providing services of skilled/unskilled labor at a predefined rate e.g. services of lab technicians.
- For delivering standard off-the-shelf consumable products at a predefined rate like machine parts.

Cost Reimbursable Contracts

In Cost Reimbursable Contracts, the Buyer is required to reimburse Actual Cost of Work and an Agreed Upon Fee to the Seller for the Specified Work. The Specified Work is usually loosely defined in the agreement document. It is also called Cost Plus Contract.

Cost Reimbursable Contracts

Contract Attribute	Buyer's Responsibility	Seller's Responsibility
Scope of Work is either undefined or loosely defined.	Buyer provides acceptance only after work is satisfactorily completed.	Seller has a legal obligation to complete the work as defined by the Buyer.
Scope change (modification) is allowed as per the T&C of the contract.	Buyer has a legal obligation to reimburse extra cost and additional fee that arises because of changes.	Seller can legally claim extra cost and additional fee that arises because of changes.
Price is not fixed.	Buyer has a legal obligation to reimburse the Actual Cost and agreed upon fee to the Seller.	Seller can legally claim reimbursement of the Actual Cost and agreed upon fee after delivering the best effort.
Contract Fee is well defined.	Buyer has a legal obligation to pay the agreed upon Fee to the Seller.	Seller can legally claim Fee after delivering the best effort.
Cost Risk is in favor of the Seller.	Buyer has maximum Cost Risk.	Seller has almost no Risk of losing money.
When is this used?	Buyer is unable to define Scope of Work due to lack of information or for some other reason.	Seller cannot estimate Cost due to absence of well defined Scope of Work and changing economic conditions.

Time & Material Contracts

Examples of Cost Reimbursable Contracts

- Large infrastructure projects where cost of goods changes from time to time e.g. cost of cement bags.
- Projects involving lot of travel by project personnel.



Thank You