

# Contracting for Services Distinctions & Critical Issues

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# Contracting for Services – Distinctions & Issues

- Services versus Commodities Contracts
  - What are the substantive differences?
  - How are hybrid contracts for both classified?
- Types of Services Contracts
  - Traditionally purchased by SCM
  - Non-traditional categories
  - Outsourcing

# Contracting for Services – Distinctions & Issues

- Legal Issues
  - What laws apply?
  - Appropriate terms and conditions?
  - Performance on Purchaser's premises?
  - Special issues with Outsourcing contracts
  - What law(s) for International contracts?
  - Can we form Contracts electronically?
- Practical issues in Services Contracts
  - Contract performance metrics
  - Critical success factors
  - SOW/service description
  - Services contract administration/management
    - What? When? How often?

# Contracting for Services – Types of Services

- Traditionally acquired through Supply Chain/Contracts, e.g.:
  - Janitorial
  - Facility repair
  - Freight/logistics
- Non-traditional, e.g.:
  - Energy
  - Travel
  - HR services
    - Health or life insurance?
- Outsourcing
  - Complete relinquishment of responsibility for a business process and/or function
  - Becoming more prevalent; contracts are more challenging

# Don't Forget Non-traditional Categories

Energy \*

Travel \*

Fleet vehicles \*

Security Services \*

Freight audit/payment \*

Courier services

Telecommunications

Subscriptions

H.R. Benefits Service

- Medical, dental, vision, prescription

Payroll processing \*

International Logistics

\* *Outsourced to service provider(s)*

## Services Contracting – Legal distinctions

- UCC (state commercial codes) does NOT apply
  - 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
  - Significant legal issues regarding liability for damages and/or injury
- Different & more complex coverage needed
  - Standard commodity contract generally inadequate

# Services Contracting – What Laws Apply?

- State common law or statutes on contract law
  - Substantively different than UCC
  - Requires more comprehensive contractual coverage to allocate the risks
- Intellectual Property Protection (IP)
  - critical component of any services contract
  - IP provides competitive edge to your organization
  - especially problematic in foreign environments
- Privacy Protection
  - employee health records (HIPPA)
  - company financial information
  - other sensitive information?

## 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 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

## Services Contracting – Electronic Contracts

- Can we form a services contract electronically?
- Governed by state common law or statute
  - UCC clearly requires “writing” and “signature”
  - some states have same requirement for services contracts; however, some states do not address the “electronic” formation issue
  - UETA and E-SIGN will enable e-contracts; however no *court interpretations* yet available
- How do we ensure electronic contract formation?

## Uniform Electronic Transactions Act (UETA)

- Provides for recognition of electronic contracts and signatures for “ transactions”
- Requires that parties consent to transact business electronically
  - may be inferred from the circumstances
- Some version adopted in 47 states; all others have an alternative which preceded UETA
- Very few *court interpretations* of the law

## Electronic Signatures in Global and National Commerce Act (E-SIGN)

- Federal law, which applies to electronic “transactions”, in or affecting interstate or foreign commerce
- Prohibits any state from denying legal effect of electronic contracts and/or electronic signatures
- Preempted where a state has adopted UETA into their commercial code
- Can apply to *both* goods and services contracts
- Limited *court interpretations* of E-SIGN

# e-Contracts for Services

- Solution:

- Utilize an *Electronic Commerce Agreement (ECA)* to clearly “agree” that electronic exchanges satisfy the requirements for a writing and for a signature
  - eliminates issue of which laws apply
  - eliminates doubt; provides certainty

# Contracting for Services – Outsourcing Contracts

- What is an outsourcing contract?
  - usually provides for complete relinquishment of a task or function
  - generally classified as a services contract
    - common law or other state statutes apply
    - same legal distinctions from commodities
- Special issues
  - Performance failure could have serious ramifications
    - requires more comprehensive contract terms and SOW
  - Purchaser has continuing responsibility for compliance with laws, e.g.: Sarbanes-Oxley
  - Service provider has access to proprietary and/or sensitive information
    - always utilize a non-disclosure agreement (NDA)

# Contracting for Services – Outsourcing Contracts

- Special issues
  - Intellectual Property (IP) sharing may jeopardize ownership rights
    - clearly identify and allocate ownership in the contract
  - Hiring/transferring Purchaser employees
    - any restrictions on who they can hire from Purchaser?
    - any Purchaser employees work for Service provider? (seconded)
    - notification to employees required by law?
  - How would contract termination be handled?
    - Generally has significant economic consequences to Purchaser
    - What rights continue post-termination? e.g.: continue service during transition back to Purchaser?
- Challenge is to balance legal issues with business issues!
- Assure that the process is functional before outsourcing the function!!

# Contracting for Services – International Contracts

- No International common law of contracts
  - Select appropriate forum/choice of law (neutral?)
- Will depend upon the country(ies) of contracting parties
  - Supplier will likely desire to apply the laws of their country
  - U.S. courts will try to apply U.S. Federal Law
    - Defer to state law?
- Extremely important for parties to agree on what law(s) will apply to their relationship
  - Utilize United Nations Convention for the International Sale of Goods (UNCISG) by agreement ?
  - Where will disputes be resolved? In what language?

# Services Contracting – Critical Aspects

- The contract defines *risk(s)* and allocates that *risk* among the parties
- Never defer definition of a necessary component
  - TBD or to be agreed upon?
  - Deferred definitions will affect price and/or schedule!
- Contract terms & conditions (T&C)
  - Do not use standard P.O. – unless specifically designed for services contracts
  - Each service will likely require customization of T&C, e.g.: janitorial service, versus roof repair?
  - Use a comprehensive checklist to ensure critical elements are considered and included in the contract

# Services Contracting – Critical Aspects

- Determine appropriate performance metrics
  - 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) or service level agreement (SLA)
  - Which service levels will be measured?
  - What is the required result?
  - What penalty if result inadequate or unacceptable?
    - Establish liquidated damages?
    - Define contract termination criteria

# T & C for Complex Services Contracts

- What is appropriate or needed?
  - every category will require different coverage
    - IT consulting
    - payroll processing
    - health/medical insurance
    - energy management
  - every contract or situation may require unique T&C
- Utilize templates cautiously!
- Quality RFX = quality proposal = quality contract

# Service Contracts – Unique Contractual Considerations

## ✓ Changes

- ✓ What will constitute an increase or decrease in scope?
- ✓ How to establish the acceptable impact on price and/or delivery?

## ● Unexpected conditions

- Adjustment mechanism in event of unexpected conditions?
- Criteria for renegotiation? e.g.: tie to an index?

## ✓ Work disruption

- ✓ What will happen if service provider is interrupted?
  - ✓ By Purchaser?
  - ✓ By others?
- ✓ Must provide for this possibility!

# Service Contracts – Unique Contractual Considerations

- ✓ Environmental Issues
  - ✓ What is service provider's responsibility? e.g.: hazardous waste produced or environmental damage?
  - ✓ Liability coverage (indemnity) is needed?
- ✓ Liability to third parties
  - ✓ Who is responsible/liable in event of damage or injury?
    - ✓ Employees of purchaser?
    - ✓ Employees of contractor?
    - ✓ Invitees/bystanders?
    - ✓ Subordinate subcontractors?
  - ✓ Require indemnification and/or insurance!
    - ✓ Especially important where performance on your premises
    - ✓ Which one, or both?

# Service Contracts – Unique Contractual Considerations

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

# Service Contracts – Unique Contractual Considerations

- ✓ 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
  - ✓ Control approval of any subcontractors
  - ✓ Ensure subcontractors provide required expertise!
- ✓ Payment
  - ✓ Progress payments needed?
  - ✓ Assure that subcontractors are paid in timely manner
  - ✓ Require indemnification against mechanics liens

# Service Contracts – Unique Contractual Considerations

## ✓ Taxes

- ✓ What tax liability for services? (*state, federal, local*)
- ✓ 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 liability of contractor if termination is required?
- ✓ Liability if your organization defaults?

# Service Contracts – Unique Contractual Considerations

## ✓ 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?)

## ✓ Scope of work

- More frequent performance issues necessitate more comprehensive coverage

# Ensuring an Effective SOW

- Each 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 Spec/SOW

## Typical problem areas for Supply Chain Managers:

- Escape clauses
  - Use of “if, when, but, except, unless”, etc.
  - May allow unintended escape from obligation
- Speculative clauses
  - Use of “usually, generally, often, normally, typically”, etc.
  - What is really required if we are only speculating?
- Multiple requirements in one statement
  - Use of conjunctions, such as “and, or, also, with”
  - Separate requirements wherever feasible

# Ensuring an Effective Spec/SOW

Typical problem areas for SCM:

- Unverifiable terms
  - Use of “flexible, approximately, nearly, as possible”, etc
  - Need to clearly establish the requirement (not almost)
- Suggestion of possibilities
  - Use of “may, might, should, could, probably”, etc.
  - Is it a requirement or not? If not, why include it?
- Run-on sentences
  - Create confusion and result in omission or duplication
  - Write in short, concise sentences – forget eloquence!

# Ensuring an Effective Spec/SOW

Typical problem areas for SCM:

- Unrealistic expectations (wishful thinking?)
  - “100% reliable, totally safe, never fails, fully compatible”
  - If it is realistic, use clear terminology, such as “all calls will be answered by the 3<sup>rd</sup> telephone ring, or returned within 4 minutes ”
- Ambiguity
  - Use of terms which may have more than one reasonable meaning, e.g: supplier will provide documentation in the “future”
  - May enable the supplier to perform to their interpretation, rather than to our expectation or need

# Ensuring an Effective Spec/SOW

Problematic words & phrases:

- “*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 \_\_\_”
- “*large*”, or other such vague adjectives, i.e.: what may be large under one circumstance, will not be under another circumstance

***Use word processor to seek out and eliminate such words***

## Services Contracts: Administration/Management

- Well written contract with clearly defined SOW and appropriate metrics is the KEY to effective administration
- Careful selection of service provider imperative
  - More complex & critical than for most commodities?
- Regularly scheduled performance reviews invaluable!
  - Review performance against SOW/SLA
- Clear documentation of performance against each contractual metric will assure desired results
- Contract management/administration must be active
  - Performance problems identified and addressed early!

# Services Contracts: Administration/Management

- Carefully control any changes during contract period
  - The best contract may become worthless if changes are not adequately documented
  - Who has authority to make changes?
  - Require all changes be written!
- SOW must remain current, correct, and controlled
  - carefully document any change
    - What?
    - Why?
    - Cost impact?
    - Schedule impact?

## Services Contracting - Summary

- Considerable differences from commodities
- Legal issues are often more complex
- Terms & Conditions can be complex & are critical
- The SOW can be the source of major performance issues
- Services contracting requires exceptional professional competencies
- The SCM should assure the appropriate allocation of risk among the parties
  - Our *professionalism* is critical to the success of our organization!

# Questions?

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