Risk and Contract Management

Presented by

John Davies
“First thing we do, let’s kill all the Lawyers”

- William Shakespeare, Henry VI, Part 2
Learning Objectives

• Recognise the legal underpinnings of contracts and the relevant principles of the Law of Contract.
• Recognise the key terms and conditions of contracts and how they allocate risks between the parties
• Craft a project execution strategy that links customer requirements to a suite of commercial documents and processes necessary for delivery
• Recognise how to link risks to the most appropriate contract type and project execution strategy
• Identify the new risks that are introduced during contract negotiations and once contracts are afoot
• Identify the legal and commercial risks associated with breaches of probity and breaches of contracts
• Recognise how to establish contracts which enable realistic sharing of risks between customers and contractors
Australia’s Legal Framework

• A common law system (precedence and process)
  – Advantages and disadvantages of precedent/case law (certainty versus adaptability)

• Constitution (power to pass laws)

• Statute will invariably *trump* common law

• Differences between Civil Law and Criminal law (standard of proof)
Public and Private Sector Governance

The Basics
LEGISLATIVE FRAMEWORK
Legislative and Policy Requirements

• *The Australian Constitution (super-statute).*
• *Public Governance, Performance and Accountability Act 2013 (Cth)*
• *PGPA Rules 2014*
• *Finance Circulars*
• *Accountable Authority Instructions (AAIs)*
• *Commonwealth Procurement Rules (CPRs)*
• *Defence Procurement Policy Manual (DPPM)*
• *Defence Procurement Policy Instructions (DPPI)*
Class Discussion

• What other legislative instruments would influence your procurement activities?
  – Consider – transparency, confidentiality, anti-competitive behaviour, international covenants (treaties).
PGPA Act

Specific obligations on “Accountable Authorities” to manage affairs of their agency in a way that promotes:

• “Proper” use of Commonwealth resources
• Achievement of their purpose
• Financial sustainability
• Cooperation with other authorities
PGPA Act

“Officials” have duties

• To apply reasonable care and diligence
• To act in good faith
• Not to misuse position or information
• Disclose material personal interests

Compare this to Director’s Duties under the Corporations Act.
Commonwealth Procurement Rules

- Mandatory rules called out in the PGPA
- Obligations for seeking value for money, managing risk, tendering
- Some exemptions are allowed
Value for Money

• Rule 4.4: Core rule governing Commonwealth procurement
• Requires a comparative analysis of all relevant costs and benefits of each proposal, including risks
• Not necessarily the lowest price
• Evaluated on a whole-of-life basis (take account of both the acquisition and through life support costs)
CPRs

• Value for money is enhanced by:
  – encouraging competition
  – efficient, effective, economic and ethical use of resources, not inconsistent with policy
  – accountability and transparency
  – risk management
  – using a process commensurate with the scale and scope of the procurement
CPRs

• Encourage competition
  – non-discrimination in procurement. Cannot discriminate on basis of origin of supplies (with some Defence exceptions)
  – competitive procurement process

• Accountability and transparency
  – *accountability* - responsibility for actions and decisions taken
  – *transparency* - taking steps to support appropriate scrutiny
  – reporting obligations (e.g. RFT issued on AusTender, Annual Procurement Plans published on websites)
CPRs

• Efficient, effective, economic and ethical use of resources
  – *Efficient*: achieve maximum outcome for the resources used
  – *Effective*: how well outcomes meet objectives
  – *Economical*: minimum resources are used
  – *Ethical*: passes the Front Page test
CPRs

• Division 1 applies to all procurements
• Division 2 applies to procurements above the relevant threshold
Model Litigant Principles

(1) dealing with claims promptly and not causing unnecessary delays in the handling of claims and litigation;

(2) paying legitimate claims without litigation, including making partial settlements of claims or interim payments in appropriate circumstances, where it is clear that liability is at least as much as the amount to be paid;

(3) acting consistently in the handling of claims and litigation;

(4) where it is not possible to avoid the commencement of legal proceedings, keeping the costs of litigation to a minimum...

(5) not taking unfair advantage of a claimant who lacks the resources to litigate a legitimate claim;

(6) not relying on a technical defence which will delay or circumvent the resolution of the issues involved in litigation, unless the Territory’s or the agency’s interests would be prejudiced by the failure to rely on that defence;

(7) not undertaking and pursuing appeals unless the Territory or the agency believes that it has reasonable prospects for success or the appeal is otherwise justified in the public interest; and

(8) apologising where the Territory or the agency is aware that it or its lawyers have acted wrongfully or improperly.
Ethical dealings

• Encompasses concepts of honesty, integrity, probity, diligence, fairness and consistency
• Recognising and dealing with conflicts of interest
• Dealing with suppliers even-handedly
• No compromise of Commonwealth’s position by accepting inappropriate gifts or hospitality (actual, potential and perceived conflicts of interest)
Ethical Dealings – what not to do

• USAF Tanker Bid Process
• Boeing Satellite Launch vehicles
• QLD Health Payroll System
• City of Sydney Council and Goldspar
• Hughes Aircraft (ministerial interference)
Public versus Private Sector Governance

• Why do we care?
  – Customers need to understand the constraints applicable to their industry/supplier base
  – Project Execution Strategies must be crafted to satisfy both public and private sector needs (especially since industry is now a FIC)
  – Suppliers need to understand the procurement framework of their customers
Private Sector Director’s Duties

s180 (2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

(a) make the judgment in good faith for a proper purpose; and

(b) do not have a material personal interest in the subject matter of the judgment; and

(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and

(d) rationally believe that the judgment is in the best interests of the corporation.
Class Exercise

• Discuss the differences and similarities between public and private sector governance
  – Consider industry development, social objectives, defining ‘value’.
  – Consider corporate versus non-corporate government entities.
CONTRACT LAW BASICS
Procurement Options

• Contracts represent the most common method for procurement but others include:
  – Memorandum of Understanding
  – Memorandum of Agreement
  – Partnerships
  – Make or Buy Decisions

Discussion When would you use each of these alternative forms?
Elements of a Contract

• Offer and acceptance
• Consideration passing between the parties
• Intention to create legal relationship
• Certainty of terms
  – Other elements (capacity, legality)

When does a contract have to be written?
What if there is nothing in it for one party?
Deeds

• Deeds are special type of contract, sometime referred to as a ‘formal contract’ and represent a most solemn promise.
• Deeds do not require the element of ‘consideration’
• Deeds must be in writing and of the form ‘signed, sealed and delivered’ as a deed depending on jurisdiction
Deeds

• Statutory limitation period for deeds are much longer than for contracts

  – Australian Capital Territory, New South Wales, Northern Territory Queensland, or Tasmania - 12 years
  – South Australia or Victoria - 15 years
  – Western Australia - 20 years.

Discussion – where would we use a Deed?
Offer and Acceptance

• When is the offer made?
• When is it accepted?
• How can an offer be withdrawn?

Discussion – sunset clauses, implied acceptance, offer at large, invitation to treat.
Offer

An offer is something that is capable of acceptance. An offer can be to an individual, a class of personnel or the world at large. In summary an offer must

a. Clearly state the terms of the potential contract
b. Be communicated to another party
c. Indicate that the offer (if accepted) will bind the offeree.
Invitation to Treat

In *Pharmaceutical Society v Boots Cash Chemists (1953)* it was held that the display of goods on a shelf of a shop did not constitute an offer. It is only when a customer takes the goods to the cashier that an offer is made.
Offer versus Puffery

‘Puffery’ is a term used to describe wildly exaggerated or vague claims about a product or service that no one could possibly treat seriously. For example, a restaurant claims they have the ‘best steaks on earth’. These types of statements are not considered misleading. – ACCC

See also:
Carlill v Carbolic Smoke Ball Company [1892] EWCA Civ 1
https://www.youtube.com/watch?v=U_n5SNrMaL8
Sunset Clauses

The inclusion of a timeframe for cessation of the offer itself is often referred to as a sunset clause. Such clauses are very important if the offeror is concerned about

a. Price escalation
b. Changing economic conditions
c. Diversion of critical resources to other endeavours

In the absence of a sunset clause or option, the courts will look to *reasonableness* as to when an offer expires.
Acceptance

Acceptance must be ‘unqualified’. Acceptance must be communicated to the offeror. Acceptance may occur:

• In writing
• Verbally
• By behaviour
Acceptance and Technology

The postal rule states that acceptance occurs when a compliant letter is placed in the hands of the post office.

For electronic transmission, such as email, the Electronic Transactions Act 1999 (Cth) applies by which acceptance will occur when a valid electronic transmission enters a system ‘outside of the control of the originator’.
Assumed Acceptance

• Case Study – *Empirnall Holdings v McMahon Paull Partners* (1988) 14 NSWLR 524

  – A party does not sign the contract but performs the work (acceptance by conduct).
  – Where a reasonable opportunity exists to reject the offer but the party accepts the benefit.
Cautionary Note

• Beware of counter-offers – *Butler Machine Tool v Ex-Cell-O [1977] EWCA Civ 9*

How is this risk managed in Defence Procurement (Consider supplies acceptance certificates SG-1)?
Negotiations issues

• What about in negotiations where we have statements of the type “subject to contract”?  
  – *Masters and Cameron*
    • The parties have reached finality in the terms and intend to be immediately bound, but they also propose to have the terms restated in a formal form (but not different);
    • the parties have completely agreed upon all terms, but certain conditions must be satisfied first (e.g. subject to finance);
    • the parties do not have a concluded bargain unless and until they execute a formal contract; and
    • The parties are bound by an agreement that will be replaced by another agreement in the future (two stage approach).
Consideration

• Any valuable consideration is valid
  – What is the value of a baseball card?
  – Forbearance

• “Peppercorn rental”, “chocolate bar wrappers”

Discussion – why do you think the courts do not want to get involved in determining the adequacy of consideration?
From the perspective of consideration, the following key issues must be recognised:

a. past consideration is unsuitable for the formation of a contract;
b. consideration does not need to be fair, it only needs to be sufficient – *Chappell v Nestle (1960)* AC 87.
Intention to Create Relations

• How binding is a bet between mates?
• Can family members contract between themselves? (e.g. wife and husband)
Intent

The contract must involve a ‘meeting of the minds’ and intent to create a legally binding arrangement. Domestic arrangements and informal agreements may not be enforceable. The courts will not rewrite a poorly crafted contract.
Capacity

• Who can enter into contracts
  – Minors?
  – Company agents?

What if a government agent enters into a contract without appropriate financial delegations?

- Australian Broadcasting Corporation v Redmore Pty Ltd [1989] HCA 15
Capacity

- The contracting parties must have the capacity to enter into the contract.
- Corporations are treated as separate legal entities. An agent of a company has the capacity to enter into contracts and assumptions related to authority are included in the Corporations Act 2001 (Cth) s129.
- Contracts may be rescinded (voided by the courts) for other matters such as special disadvantage and drunkenness in some circumstances. *Blomley v Ryan* (1956) 99 CLR 362
Legality

• Provisions of a contract that are ‘illegal’ may be struck out or the contract rescinded
• Statutory illegality is the key concern for public sector procurement.

- What ‘legality’ risks exist in Defence procurement?
Certainty

• The courts will not rewrite a poorly written contract

• A contract will be rescinded for lack of certainty (rescission *ab initio*)

• The courts will correct minor errors but
  – Unilateral mistakes will not be corrected. A contract will only be rescinded if there is a bilateral mistake (refer ‘Peerless’ *Raffles v Wichelhaus* [1864] EWHC Exch J19)
Contract Termination

• Completion (termination by performance)
• By agreement
• Rescission
• Frustration
• Repudiation
Frustration

- Frustration will only occur in extreme circumstances where events make it impossible to perform the contract *Taylor v Caldwell* (1863)

- Frustration is not the same as force majeure (industrial disputes and bad weather will not be grounds for frustration).
Rescission

• the contract is set aside (unwinding of the transaction). The aim of rescission is to bring the parties to the position they were in before the contract was entered into (status quo ante). The major causes of rescission are misrepresentation, bilateral mistake, lack of certainty, duress/undue influence, unconscionable conduct, incapacity, and illegality.
Termination for Convenience

• Must be pursued in good faith (not for an extraneous purpose – refer *KBR and Australian Aerospace*)
Termination for Performance (or lack of)

• Great care must be taken when termination for performance is sought.

• *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64 – wrongful termination resulted in a massive loss for the Commonwealth.
Types of Terms

• Condition
  – Goes to the essence of the contract, justifies termination

• Warranty
  – “non-core promise”, does not justify termination. Normally where damages are an adequate remedy

• Innominate term
  – Might be either, depending on outcome (*Hong Kong Fir Shipping*)
Types of Terms

• Express
  – Those expressed in the contract itself

• Implied by statute
  – Statutory warranties (see e.g. Australian Consumer Law, Insurance Contracts Act)

• Implied by law
  – Needed to clarify ambiguity or silence (implied by Law and/or implied by fact)
Implied Terms

• Terms implied by fact must:
  – be reasonable and equitable;
  – be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;
  – be so obvious that "it goes without saying";
  – be capable of clear expression; and
  – not contradict any express term of the contract

  *BP Refinery v Hastings Shire Council* (1977) 180 CLR 266
Implied Terms

• Terms implied by law occur when the courts decide that those terms should be included for a contract of a certain type
  – Doctor/patient confidentiality
  – Reasonableness for performance (if not specified)
  – Duty to seek legislative approvals
Common Implied terms

• Duty to cooperate
• Duty of good faith (in some classes of contract)
• Duty of Confidentiality (employment law)
• Not to act for an extraneous purpose

Discussion – what does *good faith* mean? (refer *KBR and Australian Aerospace* [2007] VSC 200)
Contract Interpretation

The Parole Evidence Rule

- “The true rule is that evidence of surrounding circumstances is admissible to assist in the interpretation of the contract if the language is ambiguous ... it is not admissible to contradict the language of the contract when it has a plain meaning.”
Interpretation

“If the words are unambiguous, the court must give effect to them ... The court has no power to amend a contract for the purpose of avoiding a result which is considered inconvenient or unjust”

Australian Broadcasting Commission v Australasian Performing Right Association Ltd (1973) 129 CLR 99
Incorporation of Terms

• *Toll (FGCT) v Alphapharm* [2004] HCA 52
  – If you sign it, you are taken to have read it

• *Oceanic Sun Line v Fay* (1988) 165 CLR 197
  – If parties have to travel to Greece to read the policy, it is not binding

• *La Rosa v Nudrill* [2013] WASCA 18
  – A term may be incorporated by a course of dealing even if it has not been included previously (quote versus invoice) but only if it brought to a party’s attention
Entire Agreement Clauses

• Clauses of the type:
  “the document as executed by the parties constitutes their "entire agreement".”

  – May be effective in excluding some implied terms
  – Will not provide relief for errors of omission
In *Bell Canada v. Rogers Communications Inc. et al.*, (2010) ONSC 2788, a termination clause was drafted as follows:

*Subject to the termination provisions of this Agreement, this Agreement shall be effective from the date it is made and shall continue in force for a period of five (5) years from the date it is made, and thereafter for successive five (5) year terms, unless and until terminated by one year prior notice in writing by either party.*

What is the effect of the second comma?
Privity of Contract

• General rule
  – only parties to a contract have rights/liabilities under the contract.
  • Two aspects –
    – Only a party to the contract can enforce the contract
    – Only a party to the contract is bound by contract

• A Third party is a ‘stranger to the contract’
  – How does this affect your IP rights from a sub-contractor?
Privity risks and issues

• Financial capacity of the contracting party vs the parent company
  – Who is the contracting party and what is their financial capacity?
  – Should you get a performance guarantee from the parent company?
  – What insurance do they have?

• IP owned by third party (including parent or related body corporates) and not the contracting party
Class Discussion

• How can we secure rights over subcontractors in procurement activities?
ASDEFCON templates

• Boiler plate contracts that deal with varying complexity and for different parts of the procurement lifecycle
Class Discussion

• What are the advantages and disadvantages of boilerplate contracts

• Where would Defence depart from templates e.g. significant changes to ASDEFCON (SM), HC-1 (2003) or MCC-1 (2003)?

• What flexibility is there for tailoring templates (see e.g. Contract Manual for HC-1 2003, MCC-1 2003, DSC-1 2003, MW-2 2004 and ASDEFCON handbooks)
Transition

• Transition between Acquisition and Support must be covered

• Ensure Support does not start before Acquisition has delivered (for example: Seasprite Project - $60 million sustainment funding expended)
The cost of complexity

• ASDEFCON Strategic Material Contract
• 30 CDRLs due Effective Date + 21 days
• What value do you get? Consider ASDEFCON plans as a pseudo-mobilisation payment

• Contra MCC-1 (Detailed Contract Activity Plan, Local Industry Plan)
Contract Remedies
Damages

• Usual remedy for breach
• Might not be an adequate remedy for the loss
  – Performance by a specific artist
  – Delivery of a specific work
  – Loss of capability
• Some losses (Indirect or Consequential Loss) might be included or excluded from the scope
  – Get legal advice (e.g. Hadley and Baxendale)
Damages (cont)

• When claiming damages there is a positive duty for the aggrieved party to mitigate

• A party can not ‘let the world collapse around them’ and then seek compensation

• The costs of mitigating damages are an ‘allowable’ cost
The nuclear option

• The innocent party generally has the right to terminate the contract, for the contractor's failure to perform
  – Must be a breach of an essential term, or spelled out
    – process must be carefully managed (refer *Amann Aviation*)

• Contractor may be liable for costs of completion by another, as well as loss of profit

• Tarnished reputation

• Good faith obligations (refer *Goldspar*)
Equitable Remedies

Specific Performance
• Can seek Specific Performance for breach
• May be difficult to enforce (only where damages are insufficient (*Smythe v Thomas*))
• Do you really want an unwilling Contractor?

Injunctions
• Prevent one party doing something (e.g. moving to a competing company)
• Example – KBR v AA
General rights for termination

• Must clearly identify breaches which give a right to terminate
• MCC-1 Clause 14: May terminate for
  – Insolvency or Breach [14.2]
  – Default [14.4]
  – Convenience [14.7]

ASDEFCON – Termination allowable if contractor exceeds limit of liability
Termination

• Obligations might survive:
  – confidentiality
  – indemnities/warranties
  – IP licences
TENDERING CONSIDERATIONS
Tendering Objectives

• Select the supplier who is best able to deliver Value for Money
• Conduct the process fairly
• Conduct the process quickly and cheaply (efficiency)
Tendering

• What is the purpose of the RFT?
• In what order do you prepare the
  – TEP
  – SOW and attachments
  – COC and attachments
  – Project Execution Strategy
• What Evaluation Criteria do you use?
If the RFT is not clear, accurate and complete ...

- Risk of confusion amongst tenderers and the likelihood of incorrect tenders
- Likelihood of non-compliant tenders
- Likely that the published RFT process will not be followed by the agency
- Difficult to obtain a sound result
- Difficult to defend against a challenge
Forms of Tender

• Open tender

• Restricted/limited Tender
  – Direct Sourcing

Other options – standing offers, panel deeds...
Tendering

• How will you
  – Deal with and make requests for clarification
  – Deal with requests for more information
  – Vary the tendering process
  – Vary the statement of requirement
  – Vary the evaluation criteria
Tendering

• Ensure that the Tender Evaluation Plan is consistent with the RFT
• Be careful of [DON’T] talking to tenderers unless probity advice is sought
  – Refer *Waverley Transit Pty Ltd v Metropolitan Transit Authority* [1991] 1 VR 181
  – Any information must go to all tenderers
Tendering

How can an aggrieved tenderer respond?

  • Injunction
– Ministerial review
– Breach of “Process Contract”
– Negligence
– Misrepresentation (statute and common law)
– Trial by media
Process Contracts

• “Contract” to conduct the RFT under the advertised conditions
• What is the Offer and Acceptance?
• What is the consideration?
• Is there an intent to create a legal relationship?
Process Contracts

• MCC-1 *Disclaimer and Confidentiality Agreement cl 2(b)* and ASDEFCON COT cl 1.2 is the “Hughes” clause – is this effective?

• What are the advantages of ‘mandating’ a tender process contract?
Misrepresentation

• Australian Competition & Consumer Act 2010
  – (Formerly Trade Practices Act 1974)
    s18 misleading or deceptive conduct
    s4 misleading or deceptive conduct
  with respect to future events

s18 attracts strict liability!
Commonwealth is normally exempt (not carrying on a business)

Examples – *Brewarrina Shire Council v Beckhaus Civil* [2005] ADJLR 08/04 [182].
Relevant Torts

- Misrepresentation (allows the contract or tender to be set aside)
- Negligent misstatement
Administrative Review

• Contract Decisions were not generally amenable to Administrative Review

• Government Procurement (Judicial Review) Act 2018 provides recourse if the CoA fails to follow CPRs
  – Only applies to covered procurement
  – Allows for injunctions and award of damages
Class Exercise

As a supplier, what strategies would you employ to avoid being caught by s4 and s18 (Schedule 2) of the *Competition and Consumer Act 2010* (Cth)? Consider:

- Compliance programs
- Qualifiers/disclaimers
- ‘Complete Agreement’ Clauses
RISK IN PROCUREMENT
Risk Basics: ISO 31000

• Evaluate the Environment (Context)
• Identify the Risks
• Analyse the Risks
• Evaluate the Risks
• Treat the Risks

— Prevention v Mitigation
Critical issue

There are many different types of Risk Hazard matrices. Some are for legal liability, some are for financial risks, some are for procurement categorisation, and some are for technical regulatory frameworks.

“Following the first principles review, CASG is aiming to implement a group wide risk management framework that applies to the group, division/domain and specialist risk areas. This will ensure common models, processes, language and culture applies to risk Management.”
Categories of Risk (not exhaustive)

- Cost
- Schedule
- Performance
- Supportability
- Safety
- Reputation
- Compliance
- Security
- Environment

Refer Defence Risk Categorisation Framework (2012)
Risk Identification

• Brainstorming
• Examination of similar projects (domestic and overseas)
• Checklists
• Interviews and focus groups
• Scenario analysis
• Surveys and Questionnaires
• Work breakdown Structure analysis
Risk categorisation

• Identify likelihood
• Identify consequence (cost, schedule, performance, reputation etc.)
  - may be qualitative or quantitative
## DMO Standard Risk Matrix

<table>
<thead>
<tr>
<th>LIKELIHOOD</th>
<th>Almost Certain</th>
<th>Likely</th>
<th>Possible</th>
<th>Unlikely</th>
<th>Rare</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>8</td>
<td>12</td>
<td>18</td>
<td>23</td>
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<td>1</td>
<td>4</td>
<td>6</td>
<td>15</td>
<td>17</td>
</tr>
<tr>
<td>CONSEQUENCES</td>
<td>Insignificant</td>
<td>Minor</td>
<td>Moderate</td>
<td>Major</td>
<td>Severe</td>
</tr>
</tbody>
</table>

**Legend:**
- Low
- Medium
- High
- Extreme

**DMM(PROJ) 11-0-002**
<table>
<thead>
<tr>
<th>RISK LEVEL</th>
<th>RISK ACCEPTABILITY</th>
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<tbody>
<tr>
<td>EXTREME</td>
<td>The impact of this risk occurring would be so severe that the related activity would need to cease immediately. Extreme risks need immediate mitigation strategies to be implemented. <strong>Risk must be treated unless it is not cost effective to do so.</strong></td>
</tr>
<tr>
<td>HIGH</td>
<td>This type of risk cannot be accepted. Treatment strategies aimed at reducing the risk level should be developed and implemented as soon as possible. <strong>Risk must be treated unless it is not cost effective to do so.</strong></td>
</tr>
<tr>
<td>MEDIUM</td>
<td>This level of risk can be accepted if there are no treatment strategies that can be easily and economically implemented. The risk must be <strong>regularly</strong> monitored to ensure that any change in circumstances is detected and acted upon appropriately.</td>
</tr>
<tr>
<td>LOW</td>
<td>This level of risk can be accepted if there are no treatment strategies that can be easily and economically implemented. The risk must be <strong>periodically</strong> monitored however to ensure that any change in circumstances is detected and acted upon appropriately.</td>
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DMM(PROJ) 11-0-002
Risk Treatment

• Prior to treating risk we need to examine
  – Effectiveness of existing controls
  – Acceptability of risk and risk appetite
  – Cost of mitigation
  – Confidence of estimates
Risk Treatment Option

DMO Risk Management Manual:
• Avoid the Risk
• Reduce Likelihood
• Reduce Consequence
• Share the risk
• Retain the risk

Sharing incorporates full or partial transfer.
Discussion – what risks may not be capable of being transferred or shared?
Risk and Complexity

Risk Management in Complex projects is a challenge. Issues arise with structural, technical, directional, and temporal dimensions.
Remington and Pollack

<table>
<thead>
<tr>
<th>Type</th>
<th>Comment</th>
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<tbody>
<tr>
<td>Structural complexity</td>
<td>Numerous individual structural elements; often described as “complicated”</td>
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<tr>
<td>Technical complexity</td>
<td>Complexity in project-product, among others, from technical or design problems</td>
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<tr>
<td>Directional complexity</td>
<td>Unshared goals and goal paths, unclear meanings and hidden agendas</td>
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<tr>
<td>Temporal complexity</td>
<td>Results from unanticipated environmental impacts, such as legislative changes or civil unrest</td>
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Procurement categorisation

Procurement agencies regularly use ‘procurement categorisation tools, to assist in identifying procurement risks and likely procurement delivery models. For example:

- Kraljic Matrix
- Helmsman Complexity Assessment Tool
- ACAT
- Smart Buyer Framework
Helmsman Complexity
## Core Acquisition Risk Categories vs. Core Sustainment Risk Categories

<table>
<thead>
<tr>
<th>Core Acquisition Risk Categories</th>
<th>Core Sustainment Risk Categories</th>
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<tbody>
<tr>
<td>Requirements</td>
<td>In-Service Requirements</td>
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<tr>
<td>Technology</td>
<td>Obsolescence</td>
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<td>Schedule</td>
<td>Commercial</td>
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<tr>
<td>Commercial</td>
<td>Fundamental Inputs to Capability</td>
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<td>Project Integration</td>
<td>Financial</td>
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<td>Defence Integration</td>
<td>Strategic</td>
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<td>Operational</td>
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</tbody>
</table>
Procurement Categorisation issues

• One size does not fit all
• It may be necessary to split phases of procurement as each may have very different risk profiles
• Uncertainty can muddy the water
  – Epistemic and Ontological
Liability Risk Assessments

• Organisations need an appreciation of their aggregate liability (at project, portfolio and enterprise levels)

• A liability is defined as:
  – any liability or obligation (whether liquidated or unliquidated, certain or contingent, or accrued or accruing)
Liability Risk Assessments

The Liability risk assessment is conducted:

a. prior to procurement;

b. where a tender process is necessary for a procurement, as part of the evaluation of a tenderer's proposal;

c. during negotiation of the contract; and

d. at the time of any contract change proposal.
Contingency

• Risk assessments help inform estimates for contingency or management reserve.
• Contingency is broadly categorised as
  – **Allocated Contingency.** Covers the residual exposure remaining after the identified risks have been treated; and
  – **Unallocated Contingency.** Covers ‘unknown unknowns’ (e.g. yet-to-be identified risks)
Budgeting for Projects

![Diagram of Project Investment Budget and Components]

- Programmed Budget
  - Contingency Budget
    - Unallocated Contingency
    - Allocated Contingency

Project Investment Budget

Components
• We use Monte carlo analysis to develop estimates for contingency.
• For example, we may select the 90th percentile as the upper limit for cost escalation
Monte-carlo analysis for a project schedule
Discussion

For complex projects, cost overruns are common. Consider the following cost overruns. How would you deal with contingency for these projects?

<table>
<thead>
<tr>
<th>Sector</th>
<th>Average Cost Overrun</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rail</td>
<td>45 percent(^1)</td>
</tr>
<tr>
<td>Tunnels and bridges</td>
<td>34 percent(^2)</td>
</tr>
<tr>
<td>Roads</td>
<td>20 percent(^3)</td>
</tr>
<tr>
<td>Weapon Systems</td>
<td>46 percent(^4)</td>
</tr>
</tbody>
</table>


\(^2\) Ibid.

\(^3\) Ibid.

\(^4\) RAND Corporation 'Sources of Weapon System Cost growth' (2008)
Risk and procurement Options

• The Project Execution Strategy must match the project risk profile. This requires an understanding of not just what risks exist but also when those risks are likely to be retired.
Risk Attitude

• We also need to explore our risk attitude at the project, program, capability stream and enterprise/portfolio level. For example:
  – Expected value
  – Least Regret
  – Maximin (pessimist)
  – Maximax (optimist)
Figure 1 – Cost Probability Curves for Various Procurement Options
Which option would you choose?

Table 1 Outturn Costs for the Procurement Options at Figure 1

<table>
<thead>
<tr>
<th>Probability</th>
<th>Option 1 (incentive)</th>
<th>Option 2 (fixed price)</th>
<th>Option 3 (cost plus)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Probability</td>
<td>$P_{10}$</td>
<td>$P_{50}$</td>
<td>$P_{90}$</td>
</tr>
<tr>
<td>Option 1</td>
<td>118</td>
<td>128</td>
<td>144</td>
</tr>
<tr>
<td>Option 2</td>
<td>124</td>
<td>132</td>
<td>138</td>
</tr>
<tr>
<td>Option 3</td>
<td>106</td>
<td>156</td>
<td>170</td>
</tr>
</tbody>
</table>
Procurement Options

• Commercial Off the Shelf
• Traditional (construct or implement only)
• Design and Construct/Implement
• Design, Construct, Maintain
• Managing Contractor/EPCM
• Alliances
• Leasing
• PPP
Guidance Documentation

Construction & Engineering Model

Focus on a two stage process:

a. Design

b. Construction

e.g. AS 4300-1995 General Conditions of Contract for Design and Construct

This does not cater for other procurement options such as services contracts, R&D, spiral development, evolutionary acquisition, IT etc.
Traditional Contracts (Construct Only)

Benefits

– Minimal Resources needed from the Buyer
– Price competition demonstrates value for money (contra cost reimbursement)
– Quantitative emphasis on tender selections
– Retention of legal remedies
– Visibility of costs and schedule before contract signature
– Adoption of Abrahamson’s principles of risk allocation
– Mature insurance products
– Arms length contract
Traditional Contracts (continued)

Costs

– Buyer liable for errors/omissions in the design
– Greater likelihood of variations/contract change proposals
– Greater risk of no bids/inflated bids
– Little or no scope for innovation
– Greater likelihood of disputes
  - Buyer must retain some design expertise
Design and Construct Contracts

Benefits

– Same as traditional but buyer is no longer liable for design errors/omissions.
– Lower resources required from principal (no need to retain in house design expertise)
– Greater scope for innovation

Costs

– Same as traditional but buyer loses control over the design
  - May introduce IP issues when contractor adopts proprietary design solutions.
Project Management

Delegation of Project Management Responsibility (EPCM/PCM)

• e.g. AS4916-2002 and AS4915-2002

There is a clear distinction between administrative versus contractual obligations

Defence examples – Major Service Provider/Integrated Support Contracts (above the line)
Benefits
  – Same as D&C
  – Less management resources needed from buyer

Costs
  – buyer loses control over management
  – Insurance becomes more complex
Managing Contractor

A form of outsourcing where the customer appoint a Managing Contractor (MC). The MC contracts directly with suppliers.

The MC does not assume all risks associated with suppliers.

Figure 1 - Managing Contractor – Contractual Nexus
Benefits

– Less resources required from Customer
– MC incentivised to achieve superior outcomes

Costs

– May be a limited pool of suppliers
– Loss of Control
Early Contractor Involvement

First Stage
Cost reimbursement for the initial design and risk reduction activities.
Develop target cost and schedule for Stage 2.

Second Stage
Incorporates Construction/Implementation (typically guaranteed maximum price)
Stage 1

Contractor Appointed
Project Planning
- Preliminary Design
- Risk management

Stage 2 Offer accepted

Stage 2

Defects Liability Period

Reimbursable—Schedule of Rates
- Design development
- Choice of options
- Value Engineering
- Assistance during approval period
- Risk analysis/management
- Project Plans
- Quality, Safety, Environmental, Cultural

Typically 17 weeks

Stage 2 offer submitted at end of preliminary design & planning
- Preparation for/attendance at community consultation
- Resumptions confirmed
- Stage 2 Offer – RAP
  - Rates
  - Productivity data
  - Subcontract prices
  - open book
  - KPIs and incentives
- Agreement of Stage 2 Offer
- Terminate for convenience

RAP—Lump Sum or Open Book Target Price
- Detailed design
- Construction documentation
- Construction
- Incentives
- Rectifying defects

Construction Period + Defects Liability Period
Contract Finalisation

Commercial Negotiations

ECI Contract Award

Appoint ECI Contractors (2)

ECI

Collaborative Design and Cost Development and Risk Mitigation

Offers for D&C Contract Works

Offers Considered

D&C Contract Award

ECI Contractor Appointed for D&C Works

D&C

Detailed Design

Construction

Handover
Benefits
  – Allows for early identification of risks.
  – Best suited for equitable risk allocation and the delivery of value for money
  – Greater scope for innovation
  – Attractive to industry

Costs
  – Requires substantial buyer resources in the first stage
  – May be difficult to introduce price competition into tender selection.
  – Not suitable where substantial risks exist in the construction stage (stage 2)
Discussion

• How does the ECI process compare to Offer Definition and Improvement Activities?
  – Multi stage tender process
  – Early identification of potential suppliers
  – Less reliance on adversarial negotiations
Project Alliances

• Risk Sharing
• No disputes
• No Blame
• Open Book financial reporting
• Best for Project Principles
• Express Good Faith Provisions

Refer ‘National Alliance Contracting Policy and Guidelines’ (2015)
Alliance Variations

• Pure Alliance (no price competition)
• Multiple TOC alliance (price competition)
• Hybrid Alliance (carve out risk sharing/joint project teams)
Alliance Benefits

• Creation of a commercial framework which aligns the interests of all parties;
• Improved risk management especially with uncertain project requirements and environments;
• Earlier involvement in preliminary design activities providing greater visibility of project costs;
• Reductions in resources needed to administer contracts, especially contract change proposals;
• Improved project performance and innovation;
• Greater transparency in project prices; and
• Attractive to industry (higher likelihood of bidding).
Alliance Costs

- An absence of legal recourse should the project go awry,
- Acceptance of risks that may be broader than the risks normally associated with a particular participant,
- The absence of price competition in tender evaluations (for pure alliances),
- The need for greater involvement of management resources in the alliance,
- No cap on the project schedule or cost,
- An increased risk of opportunistic behaviour from other parties to the alliance,
- Prohibition on unilateral decision-making, and
- Relatively high tendering costs.
Spiral Development/Evolutionary Acquisition
(DPPM refers to incremental and spiral)
Deviate from the stovepipe/waterfall development lifecycle by incrementally delivering capability.
Avoids the big bang approach.
Used in IT/systems engineering acquisition where end-user requirements are difficult to define.
Spiral Development

Benefits

• Provides the principal with flexibility to change project requirements at each prototype stage
• Incorporates gateway reviews to allow termination or progression of the acquisition
• Provides suppliers with a means to increase or decrease project costs/fees as risks eventuate or get retired

Costs

• Principal is not provided with certainty (fixed cost or fixed schedule)
• Needs greater management resources to implement from both principal and supplier
• There is inherently rework built into this procurement method
Service Contracts and Performance Based Contracts

Used for:

• Maintenance
• Cleaning
• Catering
• Engineering Services
Service Contracts Example Clause (cl 27 of AS4920-2003)

The Contractor shall give the Principal reasonable advance notice of when the Contractor needs information, materials, documents or instructions from the Principal.

The Principal shall not be obliged to give any information, materials, documents or instructions earlier than the Principal should reasonably have anticipated at the date of acceptance of tender.

The Principal may direct in what order and at what dates and times the various stages or portions of the Services shall be performed. If the Contractor can reasonably comply with the direction, the Contractor shall do so. If the Contractor cannot reasonably comply, the Contractor shall give the Principal written notice of the reasons.

A performance program is a written statement showing the times and frequency of each performance duration and performance period cycle during the total performance period. It shall be deemed a Contract document.

The Principal may direct the Contractor to give the Principal a performance program within the time and in the form directed.

Does this cater for emergence and complexity?
Leasing Options

Ownership may not be desirable for the following reasons

- High upfront costs
- Taxation
- Loss of flexibility
- Obsolescence
- Introduction of non-core activities

Options – traditional lease, wet lease, dry lease, hybrids (damp lease)
Leasing Risks and Opportunities

Ownership may not be desirable for the following reasons

• Loss of flexibility
• ‘Quiet possession’
• Potential higher through life costs
• Renewal issues

Private sector option – Sale In Lease Out (SILO) with accelerated depreciation.
Public Private Partnerships

‘PPPs may be loosely defined as agreements between the public and the private sector for the purposes of ‘designing, planning, financing, constructing, and/or operating projects, normally regarded as falling within the remit of the public sector.’

Public Private Partnerships

Transport Authority

SPV

Banks

Holding Company

D&C Contractor

O&M Contractor

Equity Investors
Public Private Partnerships - Benefits

- ‘Free’ infrastructure for the public
- More efficient delivery
- Better utilisation with commercial focus
- Eliminate non-core functions
Public Private Partnerships - Benefits

• High costs of borrowing
• Non-compete clauses
• Optimism bias (strategic misrepresentation)
• User pays?
Public Private Partnerships - Evolution

**Supported Debt Model** – the state provides some funding

**Credit Finance Guarantee** – The state underwrites some of the risk
Remuneration

• Within each procurement option, the remuneration options can be varied to change risk allocation
• Firm fixed price – supplier adopts the risk
• Cost reimbursement – customer adopts risk
• Target Cost – risk sharing
• Cost plus fixed fee - risk sharing
Multi stage Contracts

- Change the procurement option within each phase of procurement
  - Cost plus for design activities up to Detailed Design Review (DDR)
  - Fixed price from DDR onwards
Multiple parties

- Multiple parties may be involved
  - Multiple contracts (Commonwealth as prime?)
  - Multiparty contracts (joint liability?)
  - A combination of the two approaches (see for example SEA 4000 Air Warfare Destroyer)
Innovative Contracting options

• Rapid Prototypes
• Challenge based Acquisition
• Incentive Based Competitions
• FIRE

US Govt ‘Innovative Contracting Case Studies’ (2014)

RISK MANAGEMENT TOOLS
Prevention

- Pre-contract investigation
- Monitoring, reporting
- Commercial framework (incentivisation)
- Strong relationships
Risk Management in Contract

Transfer the risk to the party best able to manage the risk (Abrahamson’s principles). i.e. transfer risk where:

- The risk is within the party’s control
- The party can transfer the risk
- The preponderant economic benefit of controlling the risk lies with the party in question
- To place the risk upon the party in question is in the interests of efficiency, including planning, incentive and innovation
- If the risk eventuates, the loss falls on that party in the first instance.
Risk management options

• Escrow
• Insurance
• Warranty
• Indemnity
• Guarantee
• Performance bond
• Substitution
• Withholding payment
• Liquidated Damages
• Termination and litigation
Escrow

• An arrangement whereby an asset (money, plant or IP) is held by a third party to be released on conditions agreed between the supplier and customer
  – Paypal

• Gives the customer protection if the supplier is unable or unwilling to support the IP
  – Supplier insolvency might trigger release of source code held in escrow
Insurance

• How does it work?
  – Insurer promises to meet certain kinds of liability, subject to conditions
• Who pays for it?
  – Ultimately, the customer
• What if they have breached the obligation to have insurance?
• Does Comcover insure the event?
• What are self-insurers?
Insurance

• Contractor insurance:
  – Often needed to provide financial back up to any indemnities, and other liabilities of the contractor to the CoA

• Assessing insurance for contracts:
  – Type of insurance, amount of insurance (contracts of indemnity, contracts of contingency)
  – Deductibles
  – Period of insurance (claims made versus claims occurred)

• Need to obtain and review insurance policies
Insurance

• ASDEFCON (Strategic Materiel) example clauses:
  – Clause 8.6
    • Insurance for death or injury of employee (common law and statutory liability)
    • Contractor responsibility for subcontractor’s corresponding insurance
    • 8.6.3 – Contractor shall be insured in respect of ......
Insurace

HC-1 2003 Example:
The Contractor must:
(a) from the Award Date cause to be effected and maintained or otherwise have the benefit of the following insurance:

(i) Construction Risks Insurance;
(ii) Public Liability Insurance;
(iii) Workers Compensation Insurance;
(iv) if the Contract requires the Contractor to design any part of the Works, whichever of Professional Indemnity Insurance or Errors and Omissions Insurance has an amount specified in the Contract Particulars; and
Car Insurance

• How many years have you been driving?
• How many crashes that were your fault?
• Crashes per year?
• Cost per crash?

• Cost of insurance?

• Why should the Commonwealth be any different?
Insurance Issues

• Material change in Risk
• Utmost good faith (disclosure)
• Over insurance versus under insurance
• Principal Supplied insurance (umbrella policies)
• Doctrine of privity may not apply in some cases (s20 Insurance Contracts Act 1984 (Cth))
Warranty

• Variously
  – promise in a contract
  – Promise to achieve a particular result

• Warranty Period
  – The period for which the warranty is valid
  – When does it start?
Include appropriate Contractor Warranties to Remedy Defects

• *What does this clause do?* Usually obliges the contractor to remedy defects in the supplies during a "defect liability period". After the defect liability period, the contractor must usually remedy any latent defects in the supplies (these are defects which could not have been identified at the time of acceptance of the supplies by you).

• *How does it help you?* Gets the contractor to fix defects.

• Need to ensure that appropriate contract management is in place.
Warranty issues

• Does not negate the need for the customer to perform due diligence:

  “During the Collins submarine manufacture, quality audits revealed significant welding problems. These were soon corrected. If they were discovered too late, then the cost of correction would have been enormous.”

ANAQ Audit report no 34 1997-98
Indemnity

• A promise to pay (or reimburse) all the costs incurred - hold a party harmless or blameless
• When will the Commonwealth give an indemnity?
• What are the risks?
• What must be done?
Indemnity

• PGPA Act requirements for Commonwealth indemnities – s60
  “The Finance Minister may, on behalf of the Commonwealth, grant an indemnity, guarantee or warranty.”

Guidelines for Issuing and Managing Indemnities, Guarantees, Warranties and Letters of Comfort, September 2003
Indemnities

• What indemnities might the CoA obtain to transfer risk to the supplier? Examples include:
  – Breach of contract and negligence by the contractor
  – personal injury caused by the contractor
  – claims by third parties against the CoA arising out of the breach of third party intellectual property rights

• Contractor may require exclusion for acts of the Commonwealth
Indemnities

• ASDEFCON examples of the use of contractual indemnities in allocating risk:
  – Clause 8.1
    • Indemnity for death or personal injury to employees
  – Clause 8.2
    • Indemnity for public liability and property damage
  – Clause 8.4
    • Indemnity for the infringement of third party IP and breach of confidentiality owed to third parties
Guarantee

- Collateral contract to answer for the default of another
- Remedy lies against the guarantor for breach of contract
- Generally interpreted against the protected party
  - May be voided if the primary contract is varied without knowledge of the guarantor
Include a Bank Guarantee from the supplier

- *What does this clause do?* Gives you the right to obtain money from a Bank on demand by you for loss caused by the contractor.

- *How does it help you?* Puts you in funds to compensate for your losses and provides an incentive on the contractor to perform (because of the threat of you exercising the bank guarantee).
Performance Bond

• Promise by a bank to pay a fixed amount on demand
• Generally unconditional and relies on bona fides of the beneficiary
• How are they funded?
Substitution

• Parent Company
• Commonwealth
• Another Contractor
“Step In” Rights

- Commonwealth may “step in” to the contractor's shoes and provide the services itself, or by another contractor
- Uses the contractor's assets and personnel
- Management overhead
  - WHS issues
  - This WILL get messy
Payment Schedules

• Structure contractor's payment to ensure adequate incentive to perform
  – No hardware, no money
• Linked to Milestones
• Mobilisation Payments must be justified
  – Why did LAND 106 gave Thales a mobilisation payment to keep an existing line running?
  – Frustration means forfeiture of mobilisation payments
Withholding Payment

• “Incentivisation” – refer SEA1390 Audit report
• Customer can withhold payment for inadequate delivery of the supplies, until such time as any defects are rectified
• Amount must be enough to give Contractor incentive without crippling them
• Ensure there is no ambiguity between obligation to pay and right to withhold
Performance-Based Payment

- Payment bonuses or deductions (fees at risk) to the contractor depending on whether it achieves or fails to achieve key performance indicators (KPI) or other performance requirements.
- Gives the contractor a financial incentive to meet the KPIs to either receive a bonus payment or avoid a payment deduction.
- Requires accurate performance measurement.
Performance and monitoring

• Service levels:
  – Some factors:
    • must be driven by operational/ mission critical outcomes
    • must be relevant to stakeholders
    • can drive the wrong behaviours (e.g. answering the phone on time, cutting grass ten times a year)
    • new emphasis on sharing risks and rewards
  – How is performance measured?
    • Milestones? (Option B clause 7.2.3)
    • Progress Certification (clause 6.4)
Performance

– Performance reporting
  • must be reliable, accurate, meaningful
  • audit function
  • disclosure by Contractor of anything which may materially affect Contractor’s ability to perform (HCC-1 cl 3.10(c) and clause ASDEFCON cl 10.2)
  • Regular contract performance meetings

– Progress/Design Certification (HCC-1 cl 6.15, ASDEFCON cl 6.6)

– Acceptance process (HCC-1 cl 12, ASDEFCON cl 6.7)

– Liquidated damages and Key Performance Indicators
Incentives and Disincentives

• Performance-Based
• Performance- and Productivity-Based
• What is the VFM to the Customer if the KPI is exceeded?
• What is the incentive to the Contractor to perform as intended?

• Penalties: only in the World Cup
Supplies Acceptance Criteria

- *What does this clause do?* Gives you the right to not "accept" supplies until they comply with the contract and are free of defects (it is also usually tied to an installment payment on acceptance and sometimes liquidated damages for late acceptance).

- *How does it help you?* It gives the contractor an incentive to ensure the supplies comply with the contract because otherwise they will not be "accepted" by you and the contractor will not be paid.
Liquidated Damages

• Contractor must pay an amount of money for each day that they are late in delivering the supplies
• Gives the contractor a financial incentive to deliver on time
• Must not operate as a penalty
• May operate in addition to general damages
Liquidated Damages

• “Genuine estimate of loss”
  – What are the damages if a local industry involvement obligation is not met?
  – What are the damages if an airframe is not available for an exercise?
  – What are the damages if a vehicle is not returned to the loan pool on time?

*Clydebank Engineering Co -v- Castaneda* (1904)
Swindler Aerospace is developing an Air Traffic Management system for the ADF. Total contract value is $300 million. Having just completed Detailed Design Review, Swindler are currently 36 months behind schedule. A liquidated damages clause is included in the head contract allowing for recovery of $50,000 per week for each week the system is delivered past the nominated IOC date (up to a maximum of $5m). As the Project Director you wish to set off liquidated damages against the DDR milestone payment. Is this a problem?
LIMITATION OF LIABILITY
Limitation of Liability

• Limits Contractor’s or Customer’s liability
  – May create a Contingent liability for the Customer

• Relationship to insurance
  – Limitation of liable should correlate to insurance limits
Limitations on Liability

- Often a supplier will seek to limit its potential liability to the CoA arising out of the performance of a contract (usually under an argument that its level of profit from the contract does not justify unlimited potential liability)

- The effect of a limit on liability is to shift financial risk of damages or loss incurred by the CoA caused by the supplier above the cap to the CoA

- There are restrictions on the CoA agreeing to give limitations on liability (see Finance Circular 2003/02 on Managing Indemnities, Guarantees, Warranties and Letters of Comfort)
Limitations on Liability

• Before agreeing to give a limitation on liability to a supplier a risk assessment must be undertaken (ASDEFCON (SM) CoC Cl 10.10)

• See clause 10.11 & 14.8 of HC-1 for an example limitation on liability clause for the benefit of the Commonwealth.
Contingent Liabilities

• Liability that might or might not arise
  – Limitation of Liability in a contract
  – Any FMS Case
  – Any Cth indemnity

• PGPA Act agencies have special delegation requirements

• LRA and accounting rules informs decision
Contract Administration

Other Contracting Issues
CHANGE MANAGEMENT
Contract Changes

• “It is a bad plan that admits to no modification”
  – Publilius Syrus (circa 40 BC)
• “Nothing in life is constant except change”
  – Heraclitus (circa 500 BC)
• “No Battle plan survives contact with the enemy”
  – Field Marshall Helmuth von Moltke (the elder)
Contract Changes

• What is a contract variation?

• Why is a contract variation clause necessary?

• How can you vary a contract?
  – correspondence
  – verbal exchanges
  – invoices that act as variations
  – by conduct of the parties (waiver and estoppel)

• Scope creep
Contract Changes

– change management
  • should be tightly controlled through the variation provisions of the contract
  • manage scope creep
  • keep it simple
  • difficult in evolving contracts
– performance management
– transition in / transition out
Contract Changes

• HC-1 2003

  Variations - clause 11
  – the Contract Administrator may instruct the Contractor to carry out a Variation by a written document titled "Variation Order"
  – See also ASDEFCON (SM) CoC Cl 11

Need to be very careful to not inadvertently waive a right, or vary the contract (election, waiver, estopple).
Waiver

• Giving up a right once
  – Do you lose the right for all time?
• Expressly denied by clause (no waiver clause)
• When does a Waiver become a Variation?
Estoppel

• ‘You can’t break a promise’
• Provides equitable relief to a party who has relied on an assumption, assurance or representation (by words or deeds (inaction)) encouraged or made by the other party such that it would be unconscionable to allow that other party to resile from their position
Class Exercise

• How should we manage the risk of inadvertent variations in procurement?
INTELLECTUAL PROPERTY
Intellectual Property (IP)

• What is IP?
• What is an IP Right?
• What is Technical Data (TD)?
Intellectual Property Overview

IP:
• gives creators and inventors certain exclusive rights to deal with creative or inventive endeavours
• a form of property that can be owned, sold, assigned and licensed.

Types of IP include:
• designs, patents, trade marks, circuit layouts, plant breeders rights, confidential information and copyright
Intellectual Property overview

• Most of these forms of IP are protected by specific legislation

• Some require registration to gain and protect IP e.g. designs, trade marks, patents
  – registration not required for copyright, circuit layouts

• Non-economic rights of creators of IP:
  – codified with respect to copyright - Moral rights

• Related actions: breach of confidence and passing off
IP Risks

– Need to ensure that the buyer obtains all necessary rights to use, modify, adapt, enhance, etc... all IP which it needs under the contract (e.g. in respect of software, engineering design documents, CDRLs, etc.). This may be through ownership of IP or licensing of it to the Buyer.

– If the Buyer does not obtain sufficient rights then it may be restricted in its use of the IP or in breach of a third parties IP rights.

– Role of Foreground and Background IP.
Discussion

ASDFECON (Strategic Material) CoC Cl5 states that (as of 18 Jun 2018):

“the Commonwealth will own any new IP created under the Contract or a Subcontract in relation to GFM (including new IP in updates or amendments to GFM), unless otherwise specified in Attachment E”

What are the disadvantages of this approach?
The Contractor grants to the Commonwealth a perpetual, royalty-free, irrevocable, non-exclusive, worldwide licence to exercise all rights of the owner of the Intellectual Property Rights in the Project Documents, including to use, re-use, reproduce, communicate to the public, modify and adapt any of the Project Documents.

(see also ASDEFCON Complex vol 2 cl 5.3.1)
IP Issues

• Configuration Management of IP Plan

• Licensed Source Code is often required to be placed into a third party escrow

• Use of IP registers to monitor and record IP ownership and licensing status
Moral Rights

• Integrity of Authorship
• not do something with a work (including modification) that would have a negative impact on the creator’s reputation

_Gilliam v American Broadcasting_ (2d Cir) 1976  
_Snow v Eaton Centre_ (1982), 70 CPR (2d) 105

Moral Rights Consent:  
Confidentiality

• Regardless of contractual provisions certain exemptions should usually be carved out for government accountability purposes:
  – FOI Act;
  – Parliament and its committees; and
  – the Minister;
  take precedence, requiring disclosure under certain circumstances.

• Need to ensure that confidentiality obligations on the Commonwealth do not restrict the Commonwealth’s ability to disclose material to third parties where the Commonwealth needs to do so (e.g. other supplies)
Copyright

• Copyright owners have a number of exclusive economic rights which vary depending on the nature of the work or other subject matter

• Exclusive rights include:
  – to reproduce work in material form (which includes making a sound recording or film of the work or including a substantial proportion of the work in a database)
  – publish work (make copies available to public for first time)
  – perform work in public
Copyright (Cont)

• Exemptions from Copyright Act relate to ‘Fair Dealing’
  – Research or study
  – Criticism or review
  – Reproduction for security testing/interoperability

Defences exist for ‘independent creation’.

Commonwealth has special rights under s183 of the Copyright Act as well.
Intellectual Property

• If a Licence is required – on what terms?
  – Exclusivity
  – Royalty free
  – Territory
  – Purpose of licence (commercialise?)
  – Licence period or perpetual
  – Sub-licence

• IP Deeds from subcontractors
IP Needs Analysis (IPNA)

- What IP do you NEED over the life of the capability?
- What IP do you WANT?
- What is it worth to you?
- How can you obtain that IP?
- What TD is required to support the IP?
Whilst Defence mandated back to back IP provisions, the prime contractor failed to adequately implement this. Third party IP is delivered but Defence has no rights to even use this IP. What options exist for Defence?

What problems arise with open source software?
Parallel Negotiations

- Permitted and give leverage
- Probity issues
- Workforce requirement
- Not to be used to put pressure on one tenderer
- Must be flagged in the RFT (Refer *Fabcot v Port Macquarie-Hastings Council*)
- Both tenderers must receive any additional information
OTHER LEGAL ASPECTS
Damage Control

• litigation can take many years to progress (especially considering appeals)
• litigation can be hideously expensive
• litigation results in exposure of sensitive information to the public (reputational risks)
• litigation is adversarial by nature and can destroy business relationships
• litigation introduces substantial uncertainty to organisations (contingent liabilities)
Alternate dispute resolution

Attempt to resolve disputes and issues at the lowest possible level

• Mediation
• Expert Determination
• Arbitration
Mediation

• Mediation is a confidential process where an independent and neutral third party assists the disputants to negotiate and reach a decision about their dispute

• Quick and cheap – more likely to preserve relationships
Expert Determination

• For technical disputes, an expert can be employed in a resolution role.

• Expert normally selects between the ambit of the dispute.

• Variations – Swingman Clauses/Final offer/Baseball arbitration
Arbitration

Formal dispute resolution process governed under state legislation – e.g. *Commercial Arbitration Act 1990 (QLD)*

Decisions of arbitrator are binding unless:

- Error of Law
- Misconduct of arbitrator

Can be expensive and take a long time to resolve issues. Less likely to preserve relationships.
Best Practice

• Include a dispute escalation clause in your contract; for example, the following process may be mandatory before litigation is sought:
  – Disputes and issues must be resolved within seven days from when raised to the respective project managers.
  – If dispute or issue cannot be resolved in seven days then the matter must be escalated to the Director General/CEO for resolution
Relationship Management


• Reasonableness
• Self Regulation
• Contracting Strategies the drive the right behaviours
Relational Contract features

Joint Decision Making
Implementing Partnering Charters
Implementing target cost or gainshare/painshare remuneration
Pursuing no blame/no-liability frameworks
Jointly managing program risk
Transparency and open book financial reporting
Fair and timely dispute resolution processes
Encourage shared financial, configuration management and decision support systems
Promote Agility and flexibility in the relationship
Encourage senior executive participation.
Discussion

What risks are likely to emerge from relational contracts?
Conclusion

• Whilst we need to recognise the importance of positive relationship management we should not ignore the basics of prudent commerce/contractl management

• Good faith and reasonableness will prevent a lot of problems

• Contracting strategies must be integrated into the broader Project Execution Strategy to achieve enterprise objectives