

## **Contract Terms and Project Management: Best Practices and Common Problems** **Andy Mantler, JD**

As professional project managers, you know that project implementation is the latter half of the job. Before you have a project to implement, a contract with a detailed statement of work should precede.

Contract managers, finance managers, and project implementations managers each have an important role to play in formulating a sound commercial project implementation contract. While each have their own special concerns and “hot-button” issues they would like to have addressed in the contract, when they work together constructively, they will consistently product a superior document that anticipates and diffuses what are often the most contentious issues impacting a project implementation.

What is meant by “Contract?”

At this point, it is probably worthwhile to give a little background on some terminology I will use during this presentation.

When I use the word “Contract”, what I mean is a written embodiment of an agreement between two or more parties. For the purposes of this discussion, we will limit the scope to just two parties. The Contract can be divided into two major parts – the first being the general commercial terms, and second being the statement of work.

The general commercial terms are the terms that the finance and contract managers worry about the most. A well-drafted Contract’s commercial terms will address such important issues as governing law, limitations of liability, intellectual property rights, indemnification obligations, insurance requirements, payment instructions, and ordering processes (including change orders). In short, the commercial terms will provide the framework under which the work will be performed. Because of this, project managers should have at least a solid understanding of the commercial terms, particularly those that directly impact the project’s performance and accounting.

The statement of work sets out the how, when, and where the actual work will be performed. A well-drafted statement of work includes a detailed description of the work to be accomplished by each party, a schedule of the work, a breakdown of payment milestones and amounts, and a detailed description of testing and acceptance procedures.

What Do I Need to Know About the Commercial Terms?

Because the general commercial terms may contain terms and conditions that have a meaningful impact on the performance and delivery of a project, a professional project manager must be able to know and understand if and how a term would affect the project implementation. A good contract manager will involve the project manager early in the negotiation process so that the project manager can aid the contract manager in

identifying and addressing proposed provisions that would negatively impact the project manager's project implementation concept.

For instance, many proposed commercial terms will prohibit the use of subcontractors or foreign nationals as part of an implementation. These are standard terms in many contract templates. Unless the contract manager is aware that these terms may have a negative impact on the project implementation, these terms may be accepted without comment in an attempt to focus the negotiation on issues that really matter. These terms can often be overcome through negotiation if the need is there, however, addressing such issues either way prior to drafting and pricing the statement of work will benefit both the project manager and the implementing company.

A smattering of project-impacting commercial terms include:

- Liquidated Damages
- Governing Law
- Export Rules
- Residency Restrictions
- Travel Obligations
- Security and Safety Rules for On-Site Work
- Prohibition of the use of Subcontractors
- Prohibition of using off-shore employees
- Drug testing requirements
- Expense accounting procedures
- Removal/replacement of project team members
- Intellectual Property Rights
- Dispute Settlement

All three managers should sort through these types of terms and determine if and how each term would impact the ability of and/or costs to the company associated with each such term. If this review is performed early enough, negotiation with the customer can occur before hard and fast expectations are set and customer satisfaction is diminished before the project even starts.

### Best Practices in Statements of Work

As I stated before, it is up to the contract, finance, and project managers to negotiate a good Contract. It is without a doubt that a contract manager is primarily responsible for the creation of the general commercial terms. As a practical matter, the project manager should have a greater role in drafting the statement of work. Among the three managers, it is only the project manager that has incubated and crafted the project implementation plan.

From the contract and finance managers' point of view, the key components of the statement of work are:

Schedule

Delivery  
Acceptance and Acceptance Testing  
Payment Milestones  
Warranty Obligations  
Scope Management

Let's look at each in kind.

### Schedule

The schedule impacts accounting, revenue recognition, risk management, risk pool management, delivery schedule, billing schedule, warranties, project costs, travel schedules, other projects, and customer satisfaction. Being honest with a schedule is the key. Contract managers, finance managers, and sales people have to trust the experience of the project manager in setting the schedule, unless the project manager has a habit of sandbagging.

The schedule present in the statement of work can be presented either as a guarantee or a guideline. In either circumstance, this should be made plain.

It is key that customer obligations that are critical to meeting the schedule are plainly stated in the statement of work. Do not let customers shirk their responsibility to meet the schedule – they will not give you the same courtesy. If a customer insists on a liquidated damages provision, it is reasonable that they grant liquidated damage credits when they do not meet the scheduled themselves.

Too often, companies only conduct a critical business review when a bid is lost. Best practices include working a post-implementation audit into the project schedule for your wins, including customer meetings, so that your project team and management will conduct a “lessons learned” exercises for its successes as well. There are always areas of a project implementation that can and should be improved, and successful portions of the project implementation can be reinforced and carried over to other projects.

### Delivery

The concept of the delivery of a project's deliverables is one of the easiest to address, and one that is often overlooked. In nearly any fixed priced work effort, payments, acceptance testing, warranties, and avoidance of scheduling penalties are triggered by deliveries. Therefore, there should be a clear understanding between the parties as to what constitutes a delivery and what is required of each party after a delivery is made.

At a minimum, there must be some way to prove a physical delivery has been made. In its most simplistic form, a delivery may be made by a reputable delivery service that will provide a record of the delivery having been made. You may wish to ask customers to execute a delivery receipt when you hand materials or goods over to the customer.

It is becoming more and more commonplace for customers to request that deliveries be made electronically, either via email or FTP. In these circumstances, it is reasonable to accommodate the customer, but insist they provide you with a receipt upon delivery and an escalation provision in the event such documentation is not forthcoming.

### Acceptance

No statement of work should neglect a treatment of the concept of acceptance of deliverables. In every instance, acceptance must be defined, and once defined, must be worked into the schedule.

The definition of acceptance can be something as simple as delivery and as complex as a demonstration of the affirmative adherence to each and every specification associated with a deliverable. No matter how the acceptance process is framed in the statement of work, it should be constrained by objective criteria that end the process and move the project from a testing phase to a warranty or maintenance phase.

While it is customary in complex projects to not have a complete set of specifications against which deliverables will be created and tested at the time of contracting, it is possible to legitimately constrain the time the parties expect to conduct acceptance testing. For instance, it may be agreed that an acceptance test plan will be agreed to between the parties, and that the plan should be designed that the test plan can be executed in X number of days and that the tests should be ordered by importance so that at the end of X days, testing stops and whatever remains untested shall be accepted and dealt with as a warranty or maintenance issue. At a minimum, the parties should agree that if the test plan cannot be fully conducted within a certain period of time, certain payment premiums or additional fees would apply during the excess testing period.

There are dozens of variations to the theme, however, the project manager should ensure that the project does not fall into an endless cycle of test, rework, and retest.

### Payment Milestones

The issue of setting payment milestones the issue where the interests of project managers and financial managers most closely intersect. In the post-Enron world, real corporate power has shifted from the legal department to the auditors. Project cost accounting, cash flow, and revenue recognition rules all conspire to push the project manager to generate more invoiceable events earlier. Therefore, setting appropriate payment milestones – and by extraction, creating more reasonable deliverable events more frequently – will take more and more attention from project managers.

Project managers must be creative in working billable deliverables into the plan without offending the customer's sensibilities. Extremely reasonable customers or customers without significant negotiation leverage may agree to percentage completion payments on regular intervals. More often, besides agreeing to some payment at the time of contract execution, customers will only authorize payments upon the receipt of certain

deliverables or the conclusion of certain events. Consider the completion of workshops, training, information gathering, or joint project team meetings (or the delivery of associated documentation) as billable milestones in addition to the usual options.

### Warranty Obligations

It is standard practice to provide a warranty for project deliverables. It is the job of the project manager to ascertain and define the warranty for the contract and finance managers. Issues to set out plainly in the statement of work (if not in the commercial terms) include crafting the warranties in an appropriate manner for the deliverables delivered, the remedies for breach of the warranties, the exceptions to warranty claims, and the duration of the warranties. Additionally, accounting for time to perform warranty work during the warranty period should be part of the project schedule.

### Scope Management

Unrecognized, unbilled, and unpaid work associated with scope creep is the greatest economic drain on technology services companies today. Protecting against scope creep is a three-part process. First, clearly define the scope of the work to be performed, including a clear recitation of work that will not be performed where there may be a reasonable question about the scope. Second, make sure the commercial terms or statement of work have a robust change management process that protects the company from performing questionable work. Third, the project manager must identify and stop the performance of out of scope work during the project implementation. However, without performing the first two steps during the contracting process, the project manager may be left without the tools to enforce step three.

Defining the scope of work is squarely on the shoulders of the project manager. The contract manager is often relegated to reading the work description to see if it makes logical sense and avoids internal conflicts. However, don't rely on a contract manager to remind you to work in the factory acceptance test.

Similarly, while the contract manager is often asked to go back and interpret what was meant in portions of the statement of work when scope questions arise, the learned contract manager will know that questions about whether certain work is within or outside the scope of work will nearly always be determined in favor of the customer because in most instances, the company drafted the language in question.

A robust change management process has at least the following elements: a process by which the parties can document and define the work that is questionable in scope, identification of personnel from each party who must be formally notified in the event out of scope work is requested, a statement that the company is not required to perform the questionable work until the parties can come to a resolution on the matter, and a process through which the questionable work can be vetted and determined to be either in scope or out of scope.

## Conclusion

All managers have the shared obligation to attempt to reduce risk and cost associated with each project, while protecting the company's revenue stream and customer satisfaction. This cooperative process begins when prospecting for business begins, but in terms of working as a team of managers, peaks at the time of contract negotiation. Truly rational decisions can only be made when each manager takes an active part in putting the contract together.

While this presentation was itself limited in scope, hopefully it will help you take a more informed and proactive part in this process.