Contract Types and Contract Management

Richard Foster
VGSO Seminar
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Contract Types and Contract Management

+ Contract Types, Relationships and Enhancing Value
+ Contract Types – A new view
  – What does this mean for contract managers?
+ Maintaining and Enhancing Value through Contract Management – Some Issues:
  – Enforcing the contract
  – Single points of contact
  – People/firms changing sides
  – Shopping lists
Contract Types – An Old-fashioned View

Hard (risks allocated)

Contract

Fixed Price

Payment

Adversarial

Relationship

Soft (risks shared)

Cost Based

Cooperative
“Hard” Contracts, “Soft” Contracts, PPPs

+ “Hard” contracts include:
  – Construct to design
  – Design and construct

+ “Soft” contracts include:
  – Cost plus
  – Project alliances

+ Which category do public private partnerships fit into?
PPP Contracts – “Hard” or “Soft”

+ PPPs are hard money (fixed price) contracts based on risk allocation
+ However:
  – A 25+ year adversarial relationship is unlikely to be satisfactory
  – Experience shows better outcomes can be driven through cooperation
  – Experience shows the nature of the relationship can change from one phase of the contract to another
Project Alliance Outcomes

- Value to Contractor (Profit)
- Value to Government (Performance against KPIs)

- Expected Profit
- Zero Profit
PPPs – Contracted Outcome

- Output Specification (KPIs)
- Public Sector Comparator
- Acceptable Deal

- Cost to Government
- Revenue to Contractor (e.g. Service Payments)
- Value to Government

Bid 1
Bid 2
PPPs – Payment Mechanism

Output Specification (KPIs)

Cost to Government
Revenue to Contractor (e.g. Service Payments)

Public Sector Comparator

Bid 1

Acceptable Deal

Value to Government (Performance against KPIs)
PPPs – Modifications / Variations

Output Specification (KPIs)

Cost to Government

Revenue to Contractor (e.g. Service Payments)

Public Sector Comparator

Bid 1

Potential value-adding modifications / variations ("win – wins")

Acceptable Deal

Value to Government
PPPs – Modifications / Variations

+ If the parties adopt an adversarial approach because this is a “hard money” contract:
  – How can they add value when they are at each other’s throats?
    • In most case they can’t, unless there’s a thaw in the relationship

+ If the parties instead adopt a cooperative approach:
  – How can they ensure they are not on the losing side of “win-lose” modifications and variations?
    • Through robust and effective contract management

+ This logic applies to all contracts, not just PPPs!
Contract Types – A New View

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<th>Cooperative</th>
<th>Adversarial</th>
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<tbody>
<tr>
<td><strong>Relationship</strong></td>
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<td><strong>Fixed price contracts with value fixed or compromised</strong></td>
<td><strong>Cost based contracts with potential for added value</strong></td>
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<td><strong>Disasters?</strong></td>
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**Hard (risks allocated)** | **Contract** | **Soft (risks shared)**

**Fixed Price** | **Payment** | **Cost Based**
Contract Types – A New View

+ Some “hard” fixed-price contracts are now being managed using “soft” techniques
  – Example: VicRoads using an Alliance relationship management structure on a design & construct contract

+ Gateway Procurement Guidelines released last week provide a current approach for selecting an appropriate contract type
  – See: www.dtf.vic.gov.au
    -> Gateway Reviews and Best Practice Guidelines
    -> Lifecycle Guidance Material
    -> Procurement Guidelines
Contract models are now being identified on a project by project basis:
- What will enable most efficient and effective management of the risks of the project?
- Contract managers can seek to enhance value, regardless of the model

“THE State Government is... [deciding] how to build its proposed $3.1 billion Wonthaggi [desalination] plant. Advice is being prepared for Cabinet that will weigh the relative merits of three options…”
- Herald-Sun, 16 July 2007
Contract Management – Some Issues

- Enforcing the contract
- Single points of contact
- People/firms changing sides
- Shopping lists
Maintaining value – Enforcing the contract

+ A well structured payment mechanism promotes the value outcome agreed in the contract
  – Provided it is enforced, where appropriate
  – KPI breaches can be waived, but ensure that an inappropriate precedent is not created
+ Where there are no payment reductions, the contractor will boast about this:
  – See the Case Studies at www.infrastructure.org.au
+ Where there are reductions, relationship management comes to the fore
Single points of contact – EAS Project

- CFA
- SES
- RAV
- ABN Amro (Debt)
- ABN Amro (Equity)
- State
- Stakeholders
- Customers
- Project Contract
- VEC
- Finance
- Sub-contracts
- DTF
- ESTA
- Optus
- LSE
Single points of contact

+ Major contracts may have many interested parties on either side of the contract, each with their own agendas
+ Different pairs of interested parties will have different relationships (e.g. DTF with ABN Amro)
+ Formal contract communications should be channelled through a single point of contact
+ Where necessary, define what interaction can occur through informal channels (as done by government stakeholders in for the Melbourne Convention Centre project)
People/Firms Changing Sides – Probity Issues

+ For complex and unusual contracts, some segments of the subcontractor or adviser markets may be limited
+ Advisers may also move between firms
+ Example:
  – Melbourne office of Firm X provides commercial advice to government during tender process
  – Sydney office of Firm X subsequently advises the contractor in relation to financing issues
People/Firms Changing Sides – Probity Issues

- Perceived conflicts can be managed in appropriate instances to enable parties to get the right advice or subcontractors, without compromising probity.

- See the Disclosure and Management of Conflicts of Interest Advisory Note at www.partnerships.vic.gov.au
Enhancing value – Shopping lists

+ Some modifications / variations may not be acceptable to the other party, or if implemented on their own, the costs of implementation may outweigh the benefits

+ By keeping a “shopping list” of these items, the contract manager can add value through seeking agreement for the implementation of the modification / variation upon:
  – It later becoming acceptable to the other party; or
  – Costs falling or benefits increasing.
Shopping list – Modification becomes acceptable

+ Wastewater treatment project had been operating successfully for several years, with occasional minor non-compliances in one area
+ Contractor unwilling to upgrade plant to prevent future non-compliances
+ Contractor’s parent company subsequently seeks to sell the contractor – agrees to upgrade plant first to secure consent from government party and agreement from purchaser
Shopping list – Costs decrease

+ Contractor provides equipment for emergency services vehicles
+ Government enquires about minor upgrade to the equipment (requires a contract variation)
  – Cost and inconvenience of accessing vehicles for this alone would outweigh benefit of upgrade
+ Contractor subsequently identifies a defect in the equipment and proposes to access all vehicles to repair this
  – Minor upgrade can be done at the same time
    • Cost may depend upon relationship quality
Summary

+ Whatever type of contract you are managing, the right relationship can create a value-adding environment

+ Areas to pay attention to include:
  – Enforcing the contract
  – Single points of contact
  – People/firms changing sides
  – Shopping lists
Questions?
Contact Details

+ Richard Foster  
  Acting Head, *Partnerships Victoria*  
+ Phone: 03 9651 2221  
+ E-mail: richard.foster@dtf.vic.gov.au  
+ Web: www.partnerships.vic.gov.au