CHAPTER 10 : CONTRACT MANAGEMENT GUIDE

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Section 1

Introduction To Contract Management

1.1 Objective/Scope/Purpose/Definitions

The objective of this *Contract Management Guide* (*Guide*) is to provide State contract managers with relevant information and practical guidance in managing contracts executed by the State of Colorado (State). It was prepared by knowledgeable individuals that are involved in the State contracting process on a daily basis and contains their guidance on beginning contract administration, day-to-day contract administration, modifications to State contracts, subcontracts, dispute resolution, performance remedies and terminations, and contract close-out. This *Guide* was developed as a "stand alone" document, but since contract management affects all aspects of the State contracting process, it was incorporated into the *State of Colorado Contract Procedures and Management Manual* (*Manual*) as Chapter 10, the final chapter of the *Manual*.

The scope of this *Guide* is limited to contracting as it refers to the engagement of a party, either a firm or an individual, not on the State's payroll, to perform services or functions that would otherwise be performed by an agency or institution. The key differences between a service that is contracted for and one that is not are: whose employees are actually performing the work, and the existence of a contractual agreement that specifies the promises each party has made to the other. In a "self-provided" or "in-house" service, the State's employees do the work, supervise the performance of that work, and are paid on the State's payroll. In a contracted service, the State negotiates a contract in which it purchases certain services from the contractor. The precise method by which the service is to be performed is, within the constraints imposed by the statements of work or specifications in the contract, left to the discretion of the contractor.

The purpose of a contract is to document the way in which business will be conducted between the agency or institution and the contractor. A contract should represent the requirements of the agency or institution in clearly worded, understandable, legally enforceable terms. A contract might also specify remedies available to either one of the parties in the event that the other breaches any portion of the contract. A good contract can facilitate performance, minimize problems of coordination, and minimize risks associated with contingencies which may arise during contract performance.

The definitions for the terms contract and contract management are noted below. These two definitions are used consistently throughout this *Guide*.

A contract is an enforceable agreement between two or more competent and authorized parties in which one of the parties, the offeror, promises something of value to the other in return for that party's acceptance of the offer and promise to perform or refrain from performing certain activities. The

definition of contracting, as it is used in this *Guide*, includes purchase orders (POs) for goods and services, but it does not include employment contracts with State employees.

Contract management is the process of administering an agreement and includes:

- Defining the need.
- Developing the means and methods to meet the need.
- Complying with all legal requirements.
- Assessing risks and allocating resources.
- Monitoring the agreement.
- Comparing measured performance to established standards.
- Communicating concerns and taking corrective action, as necessary, to ensure the successful completion of the agreement.
- The receipt by the State of the intended benefit from the transaction, and documenting and evaluating the results.

1.2 Responsibilities

The primary responsibilities of a contract manager are:

- Participating, as necessary, in developing the solicitation and writing the contract.
- Monitoring the contractor's progress and performance to insure that goods and services provided conform to the contract requirements.
- Managing any State property used in contract performance.
- Making payments consistent with the contract requirements.
- Exercising State remedies, as appropriate, where a contractor's performance is deficient.
- Resolving disputes in a timely manner.
- Maintaining appropriate records.

The number of participants in the State contracting process will vary in number from one to many depending on the size and complexity of the project. Identify staff, early in the procurement process, who will participate in the project. Identify a single Project Manager (PM) and various subordinates, if necessary, who will be responsible to the PM. Each participant's responsibilities should be clearly defined to ensure a successful contract. Identify any teams with shared responsibilities. Assign individual and team goals, tasks, outcomes, quality levels, acceptable performance standards, and completion deadlines. Responsibilities of the State that are normally assigned to individuals or teams include: participating in structuring the entire project from procurement through completion and warranties, attending meetings, completing assignments, and other tasks in support of the contract.

Section 2

Beginning Contract Administration

2.1 Pre-Contract

Defining the Need

The contractor is obligated to perform in accordance with the contract, whether it is in the form of a standard State contract, a purchase order or another document authorized by the State Controller. Where a contractor is selected from a competitive selection process, the scope of work in the contract must be substantially the same as the scope of work as described in the solicitation. Accordingly, it is critical to properly structure the description of the State's needs, in the solicitation, keeping in mind the goal of having a contract that is readily understood, provides the goods and services that meet the State's needs, is easy to manage, and has the capability of measuring the contractor's performance.

Where no solicitation document is used, the agency must negotiate, and reduce to writing, a "Statement of Work" (SoW) that meets these same standards. A thorough, well-defined SoW with clear, precise specifications is critical to the success of the entire contract.

The legal obligations of both the contractor and the agency or institution are contained in the contract. The contract's SoW should be an accurate, thorough, detailed, precise, measurable description of the essential and technical requirements for the goods and services to be provided, including the desired results and the standards to be used to determine whether the requirements have been met. The SoW should:

- Be written. Use plain simple English written in the same logical order as the activities.
- Focus on results. Results or performance should be the focus, not procedure or process. The more detail that is provided to the bidders, the more likely it is that the State will satisfy its needs once the contract has been executed.
- Be accurate. The contractor should not have to guess at what is to be expected in terms of performance. All aspects of performance should be included.
- Be thorough. Cover all issues and express all expectations. If it is not in writing the contractor does not have to provide it.
- Be detailed. Include necessary detail to accurately describe a desired outcome, include all of the necessary detail.
- Be precise. Specify that the outcome is in the detail that is needed.
- Be measurable. Write the performance requirements in such a way that it can easily be determined if and when the contractor has successfully completed performance.

When preparing a SoW be systematic and thorough. Define the desired outcome in detail. List the steps necessary to achieve the desired outcome. Do an analysis to identify the various task components. Determine performance measures. For each task be able to answer questions such

as: "What is the input?" "What work will be done?" "What output is expected?" "What are the measurable standards?' "When is the performance to be completed?"

Establish reporting and monitoring requirements. For example, a regular conference should be scheduled to review standards, evaluate progress, identify problem areas, and determine actions to be taken by parties to resolve problems.

Developing the Means and Methods to Meet the Need

The contract manager should review the contract documents and be thoroughly familiar with all aspects of the contract and the required performance. The contract manager should understand what is expected of both the contractor and the agency or institution. The contract manager should also know what, when, where, how and to what standards the contractor is to perform.

The contract manager must organize and, as appropriate, work with any teams assigned to participate in monitoring the contract. To achieve these outcomes, the contract manager should complete the following:

- Identify any teams with shared responsibilities.
- For each individual and team, identify clearly and thoroughly the assigned mission, goals, objectives, tasks, and sub-tasks.
- Designate the individual or team responsible for accomplishing each of the tasks.
- Determine the sequence of activities, dependencies, required or desired outcomes, and acceptable performance levels.
- Develop a timetable and start and end date for each performance component. Include milestones with accompanying time frames, and monitoring and reporting requirements.
- Monitor contractor activity on a specified frequency to identify problem areas.
- Meet with the contractor on a regular basis to review progress, discuss problems, and consider necessary changes.
- Provide access to State facilities, equipment, data, staff, materials, information.
- Contact other staff to assure access and provide equipment and data.
- Establish scope of authority, clear lines of communication and reporting, and identify specific individuals who will interact directly with the contractor.
- Establish control of correspondence, data and reports.
- Identify potential problems and solutions.
- Define terms or conditions of default.
- Establish a procedure, identify a responsible person and establish a time frame for handling non-compliance.
- Establish the procedure, identify a responsible person, and establish a timeline for making necessary contract decisions or modifications.

Since the SoW is essentially a work plan of the contractor's and State's performance, it may be appropriate to include activities that are not part of the direct delivery of goods or services but are

critical to the vendor's ability to provide the services. The following listing contains some of the items that may be included:

- Participation in the structuring of the entire project from procurement through need definition, vendor selection, completion of performance and warranty periods, attending meetings, making site visits, reviewing vendor reports, testing equipment, software, forms, procedures.
- Requiring and attending periodic meetings to review schedules, establish standards, evaluate progress, identify problem areas, and identify actions to be taken by parties to resolve problems.

Remember that the SoW should be as complete and thorough as possible. It must be able to answer the who, what, when, where, why and how of any aspect of the contract or contractor performance.

Procurement

State agencies and institutions must select contractors in accordance with the Colorado Procurement Code and Rules and related standards, including the State Personnel Rules and State Fiscal Rules. A well defined SoW with detailed, measurable specifications is critical to the success of the entire contract. The steps in the procurement process are identified in the procurement Section of the *Manual*.

2.2 Understanding the Contract

All contract managers should start with an understanding of the basic components of a contract. All documents relating to the contract should be obtained, thoroughly reviewed, and maintained in a contract file. These documents include the contract, exhibits, requests for proposal, and any other related correspondence from the State, the agency or institution, or the contractor. The contract manager should become familiar with the procurement process associated with this specific contract type. Questions should be asked to find out what kind of relationship exists between the contracting parties. Were there any controversies regarding the contracting process? Determine if the contract negotiations went smoothly or if there were significant issues raised or problems encountered. Review all memorandums concerning the key elements of the negotiation.

Does the contract contain:

- Where and how the work is to be performed: The answer to this question may have an impact on whether or not the contractor will be considered an independent contractor or an employee.
- Expected outcome measures: This should include the staging of deliverables, if appropriate. Any significant deliverable should be tied to the payment schedule.
- Complete addresses: The addresses where correspondence is to be sent, where payments are to be made, and other addresses, as appropriate.

- Complete costs: The total cost, including any indirect cost allocation, of the goods and services that are to be provided.
- Complete contract performance: Where, when, and how the goods and services are to be delivered.
- Complete acceptance/rejection standards and conditions: The State's right to inspect and accept or reject the goods and services and the conditions of acceptance or rejection.
- Complete contract dates: The contract's effective date, completion date, and any additional dates necessary to monitor contract performance.

Is there a concern regarding the contractor's ability to perform? Are the parties relying on any verbal promises made outside of the scope of the contract? Verbal promise problems can be most effectively dealt with during the contract drafting stage by including an "entire agreement" clause. This clause emphasizes written agreements and requires the parties to look to the contract itself for terms and conditions. It prevents either party from substituting terms not agreed upon and forces the parties to formalize all future contract amendments in writing.

Another important clause to look for in the contract is a proprietary information clause that is designed to put both contracting parties on notice to maintain confidentiality requirements (if claimed by contractor), and Colorado Open Records Act requirements. It is critical that the contractor be made subject to all confidentiality requirements that the State may be obligated to observe, given the specific subject matter of the contract. Verify that the contract makes the contractor individually liable for disclosing any confidential information.

Independent contractors usually own the copyright and patent rights to works and inventions, including data and software created under the contract, unless the contract states otherwise. This is typically an issue in software development, computer programming, and other related types of service contracts. It is important to note whether or not the contract specifies the "ownership" of these rights. If the State is paying for the development of documents or software, the contract should at least provide for the State to use, modify, and copy the documents, and use the software or other inventions. If the contractor is being allowed to retain copyrights and patent rights without reserving adequate rights for the State, the contract manager may want to discuss this rationale with the contract negotiators. Finally, the contract should not only define the "rights", the contract should also clearly specify what data, documents, or software is deliverable, and the format for delivery.

The contractor's progress reports should be readily available to the State, if discussed in the contract. The contract manager should become familiar with how to acquire these reports and when they are posted. The contract should also define what information is to be included in the reports. If the initial reports provided contain incomplete information or the information provided is in an unacceptable format, discuss the issue with the contractor as soon as the problem is noted and decide on a report format that is mutually acceptable to the parties. These reports may include such items as:

- The specific accomplishment(s) achieved during the reporting period.

- The specific task(s) completed pursuant to the provisions of the contract and the completion dates of the tasks.
- The specific completion date(s) for all task(s) remaining to be completed pursuant to the provisions of the contract.

It is important that the contract manager set up a tickler file for acquiring reports. Do not let the contractor fall behind in delivering reports. This may be the only indication that the contract is on schedule and that the deliverables will be completed on time. By reviewing these reports, the contract manager may be able to identify a potential problem in its early stages and discuss the issue with the contractor, and prevent a problem from occurring. It is important to have a post-award contract requirements review with the contractor to answer questions and discuss outstanding issues. Holding periodic meetings during the course of the contract to discuss current issues and the status of deliverables is important in achieving contract performance.

2.3 Contract Type Considerations

Supply vs. Service Contracts

In general, what the State is buying, known as the State's "requirements", can be characterized as either goods, where a specific item or system is delivered on a delivery date or services, where the predominant value to the State is labor. Of course, contracts can also be combinations of both goods and services, as is the case in construction and "studies contracts", where services are often a substantial component of the performance, with the delivery of a study, a report, or other deliverable due at a certain time, usually at the end of the contract. Consider these differences in the administration of these two types of contracts.

Supply Contracts

- How the "Contract" is Defined. Inspection, acceptance, rejection, interpretation, and remedies for default are governed by the Uniform Commercial Code (UCC), Title 4, Articles 1 and 2, Colorado Revised contracting parties have not agreed how to handle specific issues. This is why purchase orders (which contain little, if any, language about "remedies") are more commonly used in supply purchasing.

- Payment. Payment usually is due after delivery, inspection, and acceptance of the supply or deliverable.

- Delivery Date/Performance Period. Normally the time for performance is expressed as a delivery date.

- Inspection and Acceptance. Inspection is usually performed by examining the product and comparing it against testing standards, or by visually examining and comparing the item to

contract specifications or "industry standards." Acceptance is usually “final”, except for a limited right under the UCC to “revoke acceptance” after discovery of substantial latent defects.

- Acceptable Performance. Under the UCC, there is a "perfect tender" rule (with limited exceptions). In general, the contractor must deliver the promised supply by the time specified, or the buyer has the right to reject and not pay, unless the contract specifies different rights.

- Warranties. The UCC grants implied warranties of merchantability and fitness for a particular purpose. Section 7 discusses warranties.

Service Contracts

- How the "Contract" is Defined. The Uniform Commercial Code does not apply to service contracts, so contract language is generally relied upon to define rights and obligations, except the few issues that are resolved by "common law" rules that were developed by the courts. The trouble is that common law rules typically are not clear and generally do not protect the State’s interests. Legal counsel should be consulted to better understand these remedies if they are not defined in the contract.

- Payment. Payment usually occurs as services are performed. Payments are normally made monthly and are based on invoices submitted that detail the nature of the services performed and any additional costs or expenses incurred.

- Performance Period/Delivery Date. Service contracts usually use the term "period of performance" to define the time within which services must be performed.

- Inspection and Acceptance. Often a "service" is difficult to inspect and examine. Inspection and testing is usually performed by selecting representative samples of the service and examining them to determine if they are acceptable. There is more reliance on examining invoices and relying on the contractor's affirmation of the time spent in performing the services. This is especially true where payment is based on the number of labor hours.

- Acceptable Performance. In services, usually "substantial performance” (not perfect performance) obligates the State to pay, even though the State has a right to sue for damages caused by deficient performance. This is the reason it is important to define the State's rights (e.g. payment withholding) for deficient contractor performance in service contracts.

- Warranties. There are no implied warranties. All warranties must be specified in the contract.

2.4 Contract Payments

There are four common types of payments required by State contracts: Firm, fixed price, or "lump sum" payments; Cost reimbursement payments; Time and material or "labor hours" payments; and Indefinite delivery payments. It is also important to note that cost and price ceilings apply to all State contracts.

Firm, Fixed Price Payments

- The contractor is entitled to payment of the agreed price upon successful delivery and acceptance of the goods or service, regardless of how much the performance costs the contractor.

- This is the easiest contract type to administer. There is no need to conduct an audit or require the contractor to account for direct and indirect costs.

- Firm, fixed price contracts are of low risk to the State, because the amount to be paid is stated in the contract.

- The contract manager must know the price, conditions for payment (e.g. delivery and acceptance), and the standard of acceptability for the goods or service provided.

Cost Reimbursement Payments

- The cost reimbursement contract is the most complex to manage and highest cost risk to the State. Cost reimbursement contracts require the State to pay the contractor "reasonable, allowable" costs.

    - Allowable costs are those that are "allocable" to goods or services provided under the contract and are not prohibited by the standards governing allowable cost, (e.g. the cost of fines and penalties cannot be reimbursed, even if directly related to performance of the work).

    - "Allocable" means that the cost being claimed was for the purpose of contract performance. It is sometimes difficult to determine allocable costs when dealing with "indirect costs" (for example overhead) that benefit not only contract performance, but also other "cost objectives".

- Grant contracts are typically cost reimbursement payments, and the cost accounting rules are contained in the Federal Office of Management and Budget (OMB) circulars.

- Chapter 5 of the *Manual* contains a more complete discussion of these cost accounting rules. The OMB circulars govern cost accounting on grant contracts.

- The State rarely uses cost reimbursement payments in any contract other than grant contracts. State statutes, Article 24-103-501, CRS, require a written determination that the use of a cost reimbursement contract is likely to be less costly to the State. If this type of payment is used, the standards for cost accounting must be defined. State of Colorado Procurement Rule R-24-107-1-1-01 contains guidance on cost principles.

- Contract management is difficult when cost reimbursement payments are used because an audit is the primary tool used to monitor contract costs.

- Typically when cost reimbursement payments are made, contract performance is so difficult to project that the customary contract approaches for breach/termination for default do not work. The State's remedy is to require reperformance by the contractor and pay for this reperformance, when satisfactorily accomplished.

- Payment for costs can be denied where unallowable or where costs are unreasonably high for performance of the work. This is often a difficult burden of proof for the State. See State of Colorado Procurement Rule R-24-107-101-05(f) for additional information on this subject.

- Contracts should set a "not-to-exceed" ceiling for materials and supplies, and define the scope of reimbursable supplies and materials.

Time and Material/Labor Hour Payments

- Time and material/labor contracts are used where service level is the primary component of the work, or it is difficult to otherwise price the "deliverable."

- These contracts should include agreed upon per hour labor rates, that include direct and indirect costs and profit. The contract should also include a ceiling amount that the contractor cannot exceed. Ceilings should be monitored, and the contract should contain a provision making the contractor responsible for reporting when the contract costs have exceeded a percentage of the contract ceiling.

- These contracts should also set a "not-to-exceed" ceiling for goods and services, and define the scope of reimbursable supplies and materials.

- Administration of these contracts requires examination of invoices specifying labor hours and materials, some validation that goods were purchased or services were performed, and inspection of services performed to insure compliance with contract requirements.

Indefinite Delivery Payments

- The quantity of goods and services to be provided cannot be so the parties must agree on a rate of payment for the units of goods or services as they are delivered.

- These are "Open-ended" contracts often priced on a "per unit" basis where the specific quantity, (e.g. hours of computer programming services) is not known.

- "Estimated Quantities Contracts" set a minimum quantity order that the State is obligated to purchase. These contracts usually also set maximum quantities and limits on each individual order issued to the contractor.

- "Requirements Contracts" require the State to satisfy all its requirements for the goods or services under the contract.

  - If the State satisfies the obligation with another contractor, the State may be in breach.

  - The advantage to this type of contract is that it gives the State more favorable prices. The disadvantage is that it requires the State to satisfy its requirements through a single vendor.

  - An example of this type of contract is a mandatory state-wide price agreement with a single vendor.

- Administration responsibilities of “indefinite delivery” contracts require the contract manager to:

  - Know and order the minimum quantity specified in the contract;

  - Limit the quality ordered to the maximum quantity allowed or other ordering limitations;

  - Ensure that the provision of "requirements contracts" are upheld that the requirements are not satisfied outside of the contract, such as by buying from another vendor; and

  - Inspect goods and services as usual and validate receipt of the goods or services listed as delivered on the invoice.

- The State Controller's policy on "Contract Modifications, Changes, Amendments, and Approval Routing", in the Policy Letters Annex of the *Manual*, contains a detailed discussion of these contracts and sample clauses.

Cost and Price Ceilings

Cost and price ceilings apply to all State Contracts.

- The State Fiscal Rules require that all State contracts have a price "ceiling" or "not to exceed" amount.

- Firm, fixed price contracts obligate the contractor to complete performance for the specified price.

- Usually, a cost reimbursement contract is a "best efforts" contractual obligation with no promise by the contractor that it can complete the work within the estimated cost, or the "not to exceed" cost.

- In between these two extremes are labor hours contracts having "not to exceed" amounts. Contract managers must know whether the "not to exceed" is merely an encumbrance or accounting control mechanism, or a promise by the contractor to complete the work within the amount specified in the contract as the ceiling.

- This distinction is important when rejecting performance or giving the contractor other technical direction in order to know whether the contractor may have a claim for additional costs if the contract reaches the ceiling amount.

2.5 Establishing a Contract Administration File

Keeping a complete contract administration file is critical. This file will provide a basis for settling claims and disputes should they arise in administrative or court actions. Through the life of the contract, the contract administration file may contain such things as:

- A copy of the current contract and all modifications thereto;
- A copy of prior contracts with this specific vendor if they offer valuable historical data;
- A copy of all specifications, drawings, or manuals incorporated into the contract by reference;
- The request for proposal (RFP), the contractor's RFP response, the contract award document and supplemental agreements;
- A list of contractor submittal requirements;
- A list of government furnished property or services;
- A list of all information or documents furnished to the contractor;
- A copy of the pre-award survey, if conducted;
- Any applicable labor clearances such as Minority Business Enterprises/Women Business Enterprises certifications;
- A schedule of compliance reviews; internal correspondence if appropriate;
- A copy of all general correspondence related to the contract;

- The originals of all contractor data or report submittals;
- A copy of all routine reports required by the contract such as sales reports, pricing schedules, approval requests, and inspection reports;
- A copy of all notices to proceed, to stop work, to correct deficiencies, or change orders;
- A copy of all letters of approval pertaining to such matters as materials, the contractor's quality control program, prospective employees, and work schedules;
- The records/minutes of all meetings, both internal and external;
- A copy of all contractor invoices; information relative to discount provisions for prompt payment; letters pertaining to contract deductions or fee adjustments;
- A copy of all backup documentation for contractor payment or progress payment; and copies of audits if conducted.

Keep confidential or proprietary material clearly marked and separate from other contract documentation. In the event an "Open Records Act" request is received, all such material will be together so it is not accidentally released.

It is always helpful, and sometimes necessary in cases of large contract volumes, to maintain a manual or computerized tracking system. A tracking system is a handwritten or automated system that provides detailed information to contract managers about each contract, such as contract deliverables, deadlines, amounts, risks, and any other useful information.

The contract administration file, the procurement file, and the payments file for any particular contract may be the same file, depending on the size of the agency or institution and the amount of the contract. If this is the case, the file is normally managed by one person, the contract manager. In large agencies or institutions, contract administration is often a separate function. In this case, the contract manager may be located in a separate section of the agency or institution from the procurement and payroll sections, and would, therefore, require a separate contract administration file. However, even in the case of a large agency or institution, it is likely that the separate contract administration file would include portions of the material and information contained in the procurement and payment files.

The contract administration file should be retained throughout the contract term and all subsequent extensions/renewals, as well as during the final payment period and warranty period. Prior to archiving the contract file, the contract manager should ensure that there are no outstanding issues that could result in a lawsuit, an administrative hearing, or other action as a result of the contract. Retain the contract administration file in the agency's or institution's archived file for at least 6 years after contract completion. The agency or institution should refer to Section 24-80-101, CRS, the State's archiving statute, prior to destroying any contract file.

2.6 Planning for Administration

Assessing the Risk

The resources devoted to managing a contract should bear some relationship to the degree of risk associated with that contract. The size, complexity, and sensitivity of a contract should dictate the amount of resources devoted to its successful completion.

- The size of the contract is measured in terms of its dollar value.
- The complexity of the contract is measured in terms of its scope.
- The sensitivity of the contract is measured in terms of its exposure.

Common sense would indicate that more resources should be devoted to contracts that are large, complex, and sensitive. Although this statement appears true, it is not always the case and it may not always be wise to devote a majority of resources to contracts simply because they are large, complex, and sensitive. Some of the largest contracts, some of the most complex contracts, and some of the most sensitive contracts are the easiest to manage; while some of the smallest contracts, some of the least complex contracts, and some of the least sensitive contracts are the most difficult to manage.

Successful contract management involves continually assessing the risk associated with all ongoing contracts and devoting the necessary resources to successfully complete each of them. If available resources are in short supply, the most successful contract manager will be the person that can best apply the resources available to satisfactorily complete each of the contracts assigned.

Participating in "Partnering"

Partnering is a process designed to assist all parties of a contract to satisfactorily complete their contracted responsibilities. It involves establishing a bond of trust among the parties where problems are identified and solved at the lowest possible level in order to provide a "win-win" situation for all parties involved. Partnering establishes a relationship among the parties to the contract where disputes are resolved and litigation is avoided. If partnering is to be part of the contract, it should be adopted as early as possible in the process.

If partnering is required by the contract, it is usually found in the solicitation as a contract clause and includes a dispute resolution procedure, required meeting participation, and a partnering workshop. Since these partnering activities have the potential of increasing costs to the contractor, if they are required, the contractor prices these activities along with the other contract requirements. For example, if a contractor is expected to participate in a partnering workshop during the planning phase for contract performance, the contract should specify that participation is required.

The strategy for implementing the partnering process is developed by the contracting parties and usually involves designing a mechanism for solving the problems that arise during the performance of a contract. This process is especially suited to those contracts that involve the construction process but the concepts are transferable to other types of contracts. The basic premise is to design a process to which each stakeholder will adhere and allow problem solving at the lowest

possible level in each of the parties' organization. The goal is to save time, energy, and money by providing a structure for problem resolution, resulting in higher quality products and services.

A partnering workshop is normally held at the inception of the contractual relationship to assist all parties in identifying their respective goals and objectives. Subjects covered in the workshop usually include establishing lines of authority and responsibility, meeting financial goals, minimizing paperwork, and avoiding litigation. Other potential problem areas or areas of concern may be discussed. The workshop should stress the fact that the satisfactory accomplishment of the contract should be the major concern, and that all parties can have their individual contract goals and objectives met without detracting from those of another party. In addition, a workshop can be held in the middle of the performance period of most contracts if all stakeholders desire to repair relationships and avoid disputes that appear to be headed toward litigation.

A partnering workshop has no set length but is usually structured to last from a half-day to one or more days depending on the size of the contract involved. The number and complexity of issues raised initially are major determinants to the time required to successfully partner a project. The cost of conducting a partnering workshop is usually shared by all parties on an agreed upon basis of equality.

The partnering process has seven distinct areas of involvement for each party that must be addressed in the partnering workshop. They are commitment**,** equity, trust**,** development of mutual goals and objectives, implementation, continuous evaluation and timely responsiveness. Commitment to the process is required from top management and requires their participation. Typically the parties to the contract formalize their commitment to the partnering process by developing and signing a partnering charter. The charter becomes the symbol of commitment, but is never a contract and is not legally enforceable. Equity is established at the onset of a relationship to include all parties' interests in a specific contract relationship. Each party is assured its concerns are heard and a commitment is made toward satisfying each of its interests. Trust is developed by overcoming each party's critical and cynical outlook of others motives. Teamwork activities should be designed to develop personal relationships and communicate goals. Understanding the "partner(s)" is key to trusting, and trusting relationships lead to synergistic relationships that can accomplish far more, far faster than normal contract relationships.

After working through the above steps, the parties will establish a plan for periodic evaluation of the partnering process. This is done to ensure that the process is accomplishing the agreed upon mutual goals and objectives, each party's interests are being considered and each is carrying its share of the load, as agreed. This phase of partnering allows for corrections that may be needed to keep the process progressing and for avoiding any potential disputes.

The final phase of partnering involves timely responsiveness. Timely communication and decision making are recognized deterrents to wasting resources such as money, time, manpower, and materials. At this step, the contracting parties will develop mechanisms to encourage issue resolution, including an escalation process in which unresolved issues are presented to and resolved by the next highest level of management.

When properly instituted, partnering will result in a team environment where all parties have a heightened awareness of value and fair-dealing and contribute to higher work standards and ethics. Other benefits derived from partnering may include reduced exposure to litigation, a lower risk of cost overruns and delays, improved quality of a project or product delivery, expedited project or product delivery, improved communication between all stakeholders, lower administrative costs, increased opportunity for innovation which may result in substantial savings, and an increased opportunity for a financially successful contract for all stakeholders. These benefits are realized by addressing the human element of contractual relationships and providing a method of improving each relationship, allowing all participants to win.

The major benefit of partnering is the establishment of a non-adversarial relationship which results in lower costs and higher quality products and services.

Conducting a Post Award Conference

A mutual understanding between the parties of all contractual requirements is essential to successful contract performance and, therefore, after a contract is awarded, all key parties should meet to discuss contract terms in a "post award conference". The post award conference provides an opportunity to identify and resolve any existing or potential problems. It is an opportunity for the State contract manager to set the ground rules for contract administration and performance that should prevail throughout the term of the contract. Issues relating to the contract such as reporting, time-lines, and dispute resolution, as well as any problems or misunderstandings, should also be clarified at this time. Note, however, that it is not the intent of this conference to re-negotiate contract terms. Also note that the fact that a post award conference has been held does not eliminate the possibility of additional conferences. If the contract manager determines the need to redirect contract efforts, for example, this must be communicated to the contractor as soon as possible by way of an additional conference.

The contract manager first needs to determine whether a conference is necessary by noting such things as the contractor's qualifications and experience, urgency of delivery schedule, past performance of the contractor, complexity of financial arrangements, and other pertinent issues. If potential problems do not warrant a conference, or if the contract requirements are not particularly complex, the contract manager may choose to simply write a letter to the contractor. The letter may include any notices to the contractor, a brief discussion of any unique or significant contract requirements, and identify all State representatives responsible for administering the contract. The letter should clarify authority and request a central point of contact for all communications with the contractor. The contract manager should make a conscious determination of the extent and the method of post award orientation which would best serve the State's interests. If a full post award conference is to be held, all key agency or institution staff, including the contract manager, procurement officer, accounts payable representative, program manager, and program staff who are the customers or end users of the services and/or commodities provided by the contractor, should attend.

Prior to any post award conference, or the issuance of a post award orientation letter, the contract manager should conduct a preliminary meeting with all State personnel who assisted in the procurement, the preparation of the contract, and who have an interest in the contract

deliverables. During this preliminary meeting a detailed review of the contract and any associated statement of work should be conducted to identify all actions that must be taken by State personnel. The goal is for affected State personnel to gain a common understanding of all specific State and contractor contractual responsibilities, as well as understanding the capability of affected State personnel in performing their specific contract requirements or critical requirements leading up to contractor performance. It is critical that all affected State personnel agree on the contract goals and objectives, standards of performance, and required deliverables before the State meets with the contractor in any post award conference.

The contract manager should prepare and distribute the agenda in a timely manner which allows all meeting attendees adequate preparation time. The agenda should include all topics to be discussed and who will be responsible for leading or facilitating the discussion for each particular topic. Post award conference agenda topics may include:

- Introduction of all participants;
- Identification of all key personnel for the contractor and the State;
- Designation of the specific contact personnel for the State and the contractor regarding all correspondence and communications during the contract term;
- Specifications, work requirements, quality control/testing requirements;
- Special contract provisions;
- Reporting requirements and reporting format;
- Procedures for monitoring and measuring progress; and
- Billing and payment procedures.

As noted above, it should be made clear at the beginning of the post award conference that the purpose of the meeting is to explain or clarify contract requirements and not to make changes to the contract or to re-negotiate contract terms. If during the discussions it is determined by the contract manager that a change is necessary, it will be up to the contract manager to clearly define the justification for, as well as establish the extent of, the change. However, it should be made clear to all parties that until such time as the changes are approved by the required contract officer and a formal contract amendment is fully executed by all required parties, the original contract remains in effect. State personnel present at the meeting should be notified in advance that they are present only to provide information to the contractor and, with the exception of the contract manager, are not to provide direction to the contractor. This is necessary to help eliminate program staff from being held personally liable as a result of acting outside the scope of their authority and to help eliminate arguments regarding the apparent authority of State personnel.

Other items for discussion include any contract requirements regarding the furnishing of State property to the contractor. If State property is to be provided to the contractor, the procedures for obtaining, accounting, and periodic inspection and inventory for such property should be discussed. See Section 3.4 for additional information on the furnishing of State property. During the meeting it should also be made clear to the contractor and to all State employees that the contractor has sole responsibility to inform and manage its subcontractors. All instructions, interpretations, or other contractual dealings with the subcontractor(s) are the business of the prime contractor and not the State. Additionally, if the contractor is to perform contractual

services in a State facility, it will likely be necessary to discuss working hours, security passes, insurance requirements, and other factors related to such performance.

Finally, minutes from the conference should be typed and distributed to all conference participants and a copy should be included in the contract file. The contract manager should make sure that the minutes include, at least, all significant items discussed in the conference, any issues not resolved, any additional actions required, their completion dates, and persons responsible for completing those actions.

Section 3

Day-To-Day Contract Administration

3.1 Fundamental Duties of Contract Administration

A signed contract does not relieve the State of the ultimate responsibility for the quality and quantity of the goods and services provided. For this reason an individual, or individuals, should be designated as contract manager(s). There may be separate performance and fiscal/administrative managers.

In general the contract manager is responsible for:

- Monitoring the contractor's performance;
- Identifying the need for changes, arranging for their implementation in the contract;
- Monitoring and approving payments;
- Conducting financial reviews and audits during the course of the contract;
- Working with the contractor to resolve any problems that arise;
- Terminating the contract, if necessary, which includes determining performance or contractual provisions breached and documenting efforts to correct the breach and recommend termination to the office that has authority to cancel the contract;
- Managing close-out of the contract; and
- Evaluating the contract results. If the evaluation discloses a systematic problem, recommending corrective action be taken to eliminate the problem.

3.2 Work Planning and Scheduling

Careful planning and scheduling of work to be performed by the parties are absolutely necessary to the successful completion of any contract. A work plan is an agenda of the goods to be delivered or the services to be provided by the contractor and the agency or institution set in a time frame. The time frame may be daily, weekly, monthly, or any other agreed upon schedule. The more detailed the project, the more detailed the work plan. A carefully drawn work plan reflects all steps of the project and identifies responsible staff and due dates for deliverables. A detailed work plan facilitates monitoring, evaluating progress and identifying problems early, so proper attention can be directed toward problem resolution. In situations where the contractor provides goods or services on an as-needed basis, the work plan will be very simple.

For simple contracts with few deliverables, the work plan and schedule can be quite simple and may be prepared by hand, if desired. However, project management software is available that will help the contract manager effectively develop a work plan and schedule for even the most complex contracts, automatically preparing Gantt and PERT charts among other things.

The specific requirements set forth in the scope or statement of work or specifications provide the basis for work planning. When a work plan is prepared, the starting point is to list the major tasks in the statement of work or specification review checklists. The specific objectives are the tasks

included in the scope of work, the deliverables under the contract, or both. The objectives should be arranged in a logical manner, showing both the scheduled times for accomplishment and the interrelationships between the objectives. To fully plan the work, major objectives may need to be further broken down into a series of steps. The work plan should be arranged clearly to show events that are necessary in order to accomplish a requirement. It is also necessary to show the dependent relationship between the tasks when, for example, one task must be accomplished before another can be completed.

Once the specific tasks and requirements are developed, a time frame or schedule for the process should be added. Again, use the scope or statement of work or specification review checklists as the starting point. The time frames included in these items, as well as any in the contract itself, should serve as the basis for scheduling.

Typically at this point the work plan and schedule will provide enough information to allow for a determination of appropriate reporting points or milestones. Any event that is critical to the success or further performance of contract tasks is a milestone event. Normally, milestone events and the progress reports associated with them are the primary focus during contract monitoring. It is not feasible to continually monitor a contractor's performance and, therefore, by concentrating on critical or significant events (milestones), the contractor performance can be measured adequately to assure timely performance or to detect problems early in the process.

In order for the work plan and schedule to remain effective throughout the contract process, it is vital to keep the plan current by ensuring it reflects the best information and work/time estimates available at any given time. Plans require revisions to reflect slippage in contractor performance (contractor inability to timely perform a task) and to reflect excusable delays (delays caused by circumstances outside of the contractor's control).

3.3 Inspection, Monitoring, and Accepting Performance

The primary responsibility for performance of the contract rests with the contractor. However, it is imperative that the agency or institution monitor its contracts for adequate performance to ensure protection of the State's (and the contractor's) interests. Post-award administration should be a series of organized and coordinated actions, tailored to the type of contract and contractor involved. Careful monitoring will avoid misunderstandings and prevent small difficulties from becoming major problems. Typically, the more complex the contract, the more extensive the monitoring activity.

Objectives related to monitoring

- To ensure legal obligations are fulfilled, and
- To ensure acceptable levels of service are provided (performance standards, efficiency, and effectiveness).

Elements of a good monitoring program

- **Contractor relations**. The relationship between the contractor and the agency or institution begins immediately after the contract is signed, with an initial meeting before the contractor begins work. The purpose of the meeting is for the key contractor representatives to meet the key agency or institution representatives and to clarify specific contract provisions. Continuous interaction after the initial meeting is necessary, both formal and informal, to provide information between the parties and to provide feedback to the contractor regarding performance.

- **Contract provisions**. The contract must be written properly for an active monitoring process to occur. The most important provisions for monitoring are actual specific performance standards, and the measures of efficiency and effectiveness that are to be applied to evaluate the contractor's performance. Penalties for nonperformance must also be specifically outlined in the contract. See Chapter 6 of the *Manual* for guidance on writing a contract. See Chapter 6, Appendix A, for model contract clauses.

- **Contract Monitor**. This individual needs specific guidelines so that the monitoring process is consistent, effective, and equitable to the contractor. A contract monitor needs detailed information about the contract, the performance standards, the processing of contractor reports, and the handling of user/citizen complaints, in order to effectively monitor a contract.

- **User Relationships**. Users and sometimes citizens or others affected by the contract can be brought into the contracting process in basically two ways: 1) through a formal complaint system and 2) through user surveys. The user should know where to send complaints. The contractor should know the responsibilities with regard to complaints, and the contract monitor must see that complaints are processed in a timely manner and the user is notified of actions taken. Surveys can be an important tool to judge the effectiveness of a contractor's service.

When may monitoring take place?

- **Before the contract is awarded**. Often, specific requirements for contract monitoring and quality management are set forth in the solicitation document. The prospective contractor's ability to fulfill these requirements is then factored in the bid evaluation process.

- **During the course of delivery of services**. Monitoring may take many forms and the best form to use depends on the circumstances of the situation, such as complexity of work, prior experience with the contractor, length of contract, etc. Monitoring may consist of:

    - Contractor Reports. Reports such as progress to date, explanation of costs, problem description, certification that services meet specifications, forecasts, levels of service provided.

- Inspections and observations. Depending on the situation, these should occur based on complaints, upon completion of work, surprise inspections, and periodic samples. Inspections and observations should have a rating scale or form to note problems or quality of service.

- Complaints. Complaints are almost always a basic part of monitoring, although in many cases, they are used only as one source of information. These may be gathered on a formal or an informal basis.

Who performs the monitoring?

Identification of State personnel who should be responsible for monitoring any given contract will depend on the circumstances involved, such as the complexity of the contract, the size and diversity of the agency or institution, the nature of the service or project being contracted, the qualifications of the program officials, and the nature of the program official's relation to the contractor. Usually, the field or line manager should monitor contractor's performance, because this individual knows the service or project better than the contracting officials. Specific activities of the field manager should include, depending on the circumstances:

- Inspection of work;
- Ensuring required permits are obtained;
- Monitoring work performance to ensure conformance to budget and work schedule;
- Reviewing work performance to ensure conformance to safety rules;
- Reviewing contractor invoices for accuracy and completion;
- Deciding if the percentage of billing is equal to the percentage of work completed, if the contract is fixed price;
- Verifying any withholding of contractor funds;
- Comparing equipment charges for rentals, labor, and material with contract provisions and any change notices;
- Comparing invoiced labor rates with the contract;
- Verifying that services were delivered, material was delivered, laborers worked, and equipment used; and
- Initiating any necessary change orders if the scope of the contract needs to be modified.

Measuring Contract Performance

Often, contracts specify performance standards such as dates tasks are to be completed, contractor payments, and penalties to be levied. Specific standards about exactly what constitutes adequate performance are often missing. Measures of efficiency and effectiveness should be considered and incorporated in the contract to establish the evaluation criteria as to whether the contractor is performing the service at an adequate level.

Caution must be exercised in specifying input vs. output measures in defining performance standards. Often the input measures or resources consumed are specified (e.g. number and

qualifications of personnel assigned, hours committed), which do not specify how well the end product satisfies the user, thus making it often impossible to demand actual contractor performance. Measures of effectiveness and efficiency are important in evaluating the quality of the service. Measures of effectiveness involve actual outputs or the impacts of the service on the user or the public. An example of an effectiveness measure in a contract for custodial services is: "The restroom must be cleaned, at least, on a daily basis." Efficiency is the ratio between inputs and outputs. An example in the same custodial contract of an efficiency measure would be: "Is the restroom being maintained in a satisfactory condition?" Both of these may be comparative measures. The contractor's performance can be compared to similar scores when others were providing the service, or on a year-to-year basis. If the contractor is meeting performance standards but the measures of effectiveness and efficiency are lower than in the past or need to be improved, the standard may need to be revised.

Handling Unacceptable Performance

The key to handling unacceptable performance begins before the contract is in place. The contract manager must identify what constitutes unacceptable performance and include in the contract provisions the actions that are to be taken and the remedies available to the agency or institution if unacceptable performance occurs. This provides a clear understanding with the contractor at the time of signing as to the course of actions to be taken should it not perform. Contract management becomes very difficult if the provisions of the contract do not provide for specific remedies in the event of a party's failure to perform. Keep in mind also that the more explicit the performance standards, the easier it is to determine when unacceptable performance has occurred. See Chapter 6 in the *Manual* for guidance on drafting a contract and Section 7 of this *Guide* for remedies for unacceptable performance and default.

Acceptance

Acceptability for contract performance must be determined by review, test, evaluation, or inspection. Final acceptance concludes performance by the contractor, except for administrative details relating to contract close-out. Once final acceptance has been accomplished, the contractor is no longer responsible for unsatisfactory effort, unless otherwise specified in the contract. Therefore, the contract monitor must ensure the work performed under the contract is measured against the work statement in the contract. Accordingly, acceptability is a natural progression from contract monitoring. An effective contract monitoring process places the contract monitor in a good position to determine acceptance.

Acceptability can be best determined if milestones are established and set forth in the contract, be they the satisfactory achievement of certain standards, tasks, or other output. Progress payments may be tied to the achievement of these milestones, thus establishing their significance to the contractor. As with contract monitoring, determining the appropriate quality standards against which to measure acceptability depends on the situation involved.

3.4 Administration of State Property

When the State furnishes property to a contractor, or the contractor obtains equipment or supplies from the State for use during the term of the contract, and title remains with the State, the property, equipment, or supplies must be properly accounted for by the State.

Types of State Property

State Property means all property owned by the State and furnished to the contractor, or acquired by the State under the terms of the contract. State property is generally of two types: 1) "State furnished property" or 2)"State acquired property".

1. State furnished property is property that the State owned at the time of contract execution, such as equipment or computers, that were furnished to the contractor to use during contract performance. Usually, this property is made available for one of two reasons. First, there may be no other property available that can be used, (e.g. a hybrid, networked State computer system with installed software that is made available to a contractor to enable it to do a study or report). The second reason to provide property is to achieve a price/cost reduction from the contractor by allowing the contractor to use available State property.

2. State acquired property is property that is purchased by a contractor during the course of the contract and, by virtue of a title-vesting clause in a contract, becomes State property at the conclusion of the contract. For example, some grant contracts provide that the State acquires title to any equipment or supplies purchased during the performance of the contract where the value of the equipment or supplies exceeds $5,000.

Administration of State Property

State Fiscal Rules require each agency or institution to be responsible for ensuring that all equipment acquired is properly accounted for when acquired, inventoried and safeguarded throughout its useful life, and properly accounted for at the time of disposal. Generally, the same property management rules should be applied to other types of State property. The following are some general guidelines to follow concerning the administration of State property.

- Read the contract and determine what the contract says about the title to property purchased during the term of the contract, as well as the State's obligation to furnish equipment or supplies for use by the contractor during the term of the contract.

- Establish a "tickler" system to monitor dates when the State is obligated to deliver State-furnished equipment or supplies. Under clauses such as the State-furnished property clause, see Appendix A to Chapter 6 of the *Manual*, the contractor is entitled to an adjustment in time and price if the State does not meet its obligation to deliver State-furnished property.

- Establish an inventory control system before delivering State-provided property to the contractor. Make sure the property is assigned an inventory control number and accounted for in accordance with State Fiscal Rules and agency or institution procedures.

  - Enforce the contract provisions regarding identification of equipment or supplies which are purchased and which become State property.

  - If there are no contract provisions, negotiate a procedure with the contractor that requires State furnished equipment, supplies, or property to be identified in a timely manner, and marked or tagged consistent with State Fiscal Rules and agency or institution procedures. This should be a "no cost" procedure and may be included as an amendment to the contract. Ideally, these procedures should already be contained in the contract.

- Include the property's description in the annual report to Risk Management and specify its contents' value and location.

- Include inspection of State-furnished property when the agency or institution does its own property inventory.

- Establish a "tickler" system to monitor the inspection and return of State property.

Contractor Bankruptcy and State Property

When a contractor files for bankruptcy, issues often arise concerning ownership and return of property. Secured creditors, for example, may see State-furnished property as additional security for their own debts. This is a reason to make sure all State-furnished and acquired property is clearly marked with an inventory control number. Since bankruptcy can cause serious problems, legal advice should be sought as soon as a contractor solvency is in question.

3.5 Funding and Financial Administration

Funding

Prior to the State Controller approving a contract, the contract is reviewed to assure completeness and to ensure that funds are available to cover the contract liability. It is important to note that at times there are restrictions placed on funding sources and that some funds are only available for a certain period of time. The contract manager should investigate the source of the funding for the contract early in the process to determine if any restrictions exist and take whatever actions may be necessary in order to comply with the funding restrictions. If additional funding becomes necessary due to expanding the scope of the project, change orders, or other unforeseen problems encountered during the contract term, the contract manager must know if additional funds are available and how to secure these funds. This also is important when a contract has more than one funding source. For example, if the project is funded equally in cash, federal, and general funds, the contract manager must know

beforehand that additional funds are available from each of the sources prior to committing to additional work by the contractor.

Financial Administration

Once the contract has been fully executed it becomes the responsibility of the contracting agency or institution for the day-to-day financial administration of the contract. The day-to-day financial administration includes making sure that the contract payments are made in accordance with the terms and conditions of the contract and that the contract expenses are paid from the proper funding source(s). It is also the contract manager's responsibility to maintain an adequate contract file where an accurate contract balance is readily available. This contract file is subject to pre-audit prior to contract close-out and post audit after contract completion. A contract should not be closed out until the contract manager has reviewed the contract and determined that all requirements of the contract have been satisfactorily performed and there are no outstanding items to be completed.

Section 4

Modifications To Contracts

4.1 Introduction

While it would be ideal for the original contract to accurately anticipate and provide provisions for all situations that might occur as a contract is being performed, additional needs, changing conditions, unanticipated situations, and innumerable other factors may arise that give cause to modify the contract. Careful consideration as to the nature of the modification and the terms and conditions of the original contract will determine the appropriate action to be taken to successfully execute a change to a contract.

It is critical for the contract manager to understand that the State cannot modify a contract without the contractor's consent, unless provided for under the contract. While this may seem elementary, it is very easy to overlook some basic terms and conditions in the original contract that allow for certain types of modifications once performance has commenced.

4.2 Basis of Modifications

There are basically two ways to modify a contract. One is by a bilateral amendment, in which all parties to the contract agree that a modification is necessary because the scope of work, the term of the contract, or some other provision of the contract needs to be altered. The second is the right to unilaterally modify the contract. In this case, terms and conditions in the original contract set forth the situations under which the State may exercise a right to modify the contract without the contractor's consent.

4.3 Modification Examples

Chapter 6, Appendix A, of the *Manual* provides three provisions generally used in contracts related to modifying the contract. They are: Changes, Price Adjustments, and Modification and Amendment.

Changes Clause

The Changes clause provides the State with the right to modify the contract without the contractor's consent. In this situation, the work required of the contractor must be within the scope of the original contract. For example, suppose that a contract's scope of work requires remodeling and furnishing of a conference room. If the State decides that it now desires the conference table to be oblong in shape rather than rectangular, it may initiate a change in the contract under the Changes clause. If, however, the State desires to add a window to the room, and this changes the scope of the contract, the contractor may not be ordered to make the change.

Price Adjustments Clause

This clause sets forth the ways that the contract price may be modified if contract clauses that provide for price adjustments are exercised in the contract.

Modification and Amendments

This clause states that the contract may be modified or amended as agreed upon between the State and the parties to the contract, but the modification or amendment must be approved by the State Controller.

4.4 Procurement Rules and Approvals Related to Modifications

Procurement Rules

In the case of bilateral amendments to a contract, procurement issues arise when there is an increase in the scope of work required of the contractor. Because the solicitation related to the project did not contain the additional work, the contract manager must consider whether to conduct a solicitation for the additional work or to provide justification as to why the contractor is to provide the services. Such justification must include documentation as to what gave rise to the change in the scope of work. The contract manager should obtain approval from the State Purchasing Director or the agency's purchasing director, as appropriate, before proceeding with the amendment. Section 8.3 has a discussion of contract "scope" as it relates to extensions.

For unilateral changes to a contract, procurement rules are not an issue as the changes do not materially affect the scope of work. The changes are often already specifically priced and provided for in the original contract, and the State is merely exercising its right to require the contractor to provide the goods or services.

Approvals

In general, all modifications to contracts require review and approval by the same parties that approved the original contract, (e.g. the Department of Personnel, State Purchasing Director or a delegate, the Attorney General and the State Controller or a delegate). The State Controller's Office issued a memorandum, dated January 8, 1997, setting forth the approval requirements on various contract modifications. A copy of this memorandum is included in the Policy Annex of the *Manual*. The memo clarifies which modifications do not require the approval of the Attorney General. Basically, if the changes called for are already identified and priced in the original contract, and the State is exercising its option to require performance of those changes, then Attorney General approval is not required. The memorandum also provides examples of language to be used in specific contract modification situations where no Attorney General approval is required. These include examples for extending the term of the contract, purchasing additional goods or services, purchasing indefinite quantities, purchasing tasks, and change orders in grants/subgrant contracts.

4.5 Other Modifications

Besides the "Changes" clause, there are other clauses in some contracts which give the State the right to direct performance in exchange for adjustment in price, or time for performance, or both. Similarly, there are clauses that grant entitlement to additional time or money (or both) based on the occurrence of specified, unanticipated conditions. Examples of these clauses are in Appendix A to Chapter 6 of the *Manual*. The contract manager should become familiar with the specific "remedy granting" clauses in the contract that give the State rights to stop work or otherwise affect contractor performance. The contract manager must know the limits on the rights under those clauses, the responsibilities of the contractor, and what the contractor is entitled to receive under those clauses.

State-Furnished Property Clause

The administration of "State-furnished" or "contractor-acquired" property is discussed in Section 3.4. The model clause for "State-furnished Property" is included in Chapter 6, Appendix A, of the *Manual* and defines the rights and obligations with respect to property the State must deliver. If the property is delivered late or in an unsuitable condition, the contractor is entitled to an equitable contract adjustment, in price, time, or both.

Force Majeure

This clause defines "excusable delay." For reasons specified in the clause that cause delay, such as fires, explosions, unusually severe weather, etc., the contractor is entitled to an extension in time for performance, not additional money.

Stop Work Orders

Like the Suspension of Work clause, usually found in the construction contract general conditions, this clause permits the State to order the Contractor to stop work. Upon termination of the order, the contractor is entitled to "an appropriate adjustment in the delivery schedule or contract price, or both, and the contract should be modified accordingly". The model "Stop Work Orders" clause is included in Chapter 6, Appendix A, of the *Manual*. It is important that the contract manager read the clauses carefully. In some cases, the clause limits the nature of costs that the contractor can claim as damages, or the circumstances under which the contractor can claim any damages or costs for the delay.

Bilateral Change Orders/Letters

Unlike unilateral change orders, described in Section 4.3, bilateral change orders are changes to the scope of work, and adjustments in price/cost and schedule, that are agreed to by the parties. Normally, these "change orders" are processed by a contract amendment, and routed through the contract approval system. Exceptions include capital construction change orders and "supplements" (architect-engineer "change orders") that meet the approved State Buildings Program policies for change orders not requiring review by the Attorney General. Also, the State Controller has defined conditions under which bilateral change orders can be included in other contracts, and used without review as amendments by the Attorney General. Model provisions and a description are included in Chapter 6, Appendix A, of the *Manual*.

Options

Options are also "modifications" in the sense that they usually modify a contract to require more supplies or more performance time in exchange for more money due the contractor. Options are commonly used in State contracts, and the terms to exercise the modifications are contained in the initial contract. It is important to follow the option exercise conditions, (e.g. the lead time for exercising the option). If the conditions are not followed, the right to modify the contract may be lost. A model option provision is included in Chapter 6 of the *Manual*.

Task Orders

Some contracts permit the flexibility to define and price individual tasks during contract performance, because the precise work is not known at the time the contract is signed. Contracts for emergency hazardous waste clean-up are examples. The State Controller's policy has conditions for using task orders, and model provisions are included in Chapter 6, Appendix A, of the *Manual*.

Any task orders, change orders, and other modifications that do not meet the conditions established by the State Controller must be processed and approved as contract amendments.

4.6 Pricing Changes and Modifications

Changes and most other modifications have to be priced like any other contract. For task orders and bilateral change orders meeting the State Controller's conditions for inclusion in the original contract, (e.g. those having pre-priced rates and unit prices that will be applicable to the change), there may not be any need for a price/cost analysis. Usually, where unit rates are pre-priced, evaluation shifts to a technical evaluation of the number of labor hours or other units being proposed to do the work.

Most modifications, though, are not pre-priced and require a cost or price analysis under the procurement rules. The ultimate objective is to achieve a fair and reasonable price for the change or modification. See "Contract Pricing", Chapter 5 of the *Manual,* for a more detailed discussion of contract pricing principles.

4.7 Contractor Name Changes and Novation Agreements

Novations and "Name Change" agreements are two types of modifications that warrant special mention. Neither usually involves an adjustment in time for performance or price/cost of the contract.

Name Changes

Entities such as corporations sometimes change their name, even though the entity itself is still in existence. Changes in name may seem like "technicalities," but they affect such obvious, but important, things as the name on the payment warrant. A "change-of-name agreement" is a legal

instrument executed by the contractor and the State that recognizes the legal change of name of the contractor without disturbing the original contractual rights and obligations of the parties.

When a contractor requests to change the name by which it holds a contract with a agency or institution, the contract manager responsible for the contract must, upon receipt of a document indicating such change of name, enter into an agreement with the requesting contractor to effect the change of name. An amendment to the articles of incorporation, corporate bylaws, or documents filed with the Secretary of State showing the change of name, should be obtained from the contractor. (See Procurement Rule R-24-106-101-09).

The best way to memorialize the name change agreement is as part of another necessary amendment, or in its own amendment, with clauses substantially as follows:

> The [new contractor name] (Contractor), a corporation duly organized and existing under the laws of Colorado, and the [Department or Institution] (State), enter into this agreement to recognize the Contractor's change-of-name as of [date].
>
> The Contractor, by [an amendment to its articles of incorporation], dated [date], and attached as Exhibit A, has changed its corporate name from [old name] to [new name].
>
> Documentary evidence of this change of name has been filed with the Secretary of State.
>
> In consideration of these facts, the parties agree that the name [new name] shall be substituted for the name [old name] wherever it appears in the contract.
>
> Except with respect to the change of the contractor's name, or other modifications identified in this amendment, no other terms or conditions of the original contract are changed, and the rights and obligations of the State and Contractor are unaffected by this change.

If a contractor has multiple contracts with the State through different agencies or institutions, it is possible to have a "lead agency or institution" execute one name change agreement that will recite all of the affected contracts and be recognized by all agencies and institutions having a contract with the contractor. The contract manager should identify each affected contract by its contract number and routing number. Contact the agency or institution contract administrator for assistance.

Novation Agreements

Unlike a name change, where the basic contractual relationship is not changed, a novation agreement essentially substitutes one contractor for another. Sometimes contracts are acquired by other companies, known as "successors in interest", requiring the execution of a novation agreement.

Since the ability to execute a novation agreement may be limited by the Procurement Code, State Purchasing or the State agency's or institution's purchasing director should be contacted prior to

executing a novation agreement. Generally in a procurement covered by the Procurement Code, one company cannot step in and take a contract being performed by another.

The Procurement Code (R-24-106-101-09(b)) permits recognition of a successor in interest novation, when in the best interests of the State, as long as the transferor and transferee agree that:

- The transferee assumes all of the transferor's obligations;
- The transferor waives all rights under the contract against the agency or institution; and
- Unless the transferor guarantees performance of the contract by the transferee, the transferor shall, if required under the contract, furnish a satisfactory performance bond.

A novation agreement is usually executed and approved as a contract amendment, signed by the State, transferor (original contractor), and transferee (new contractor), with WHEREAS recitals and clauses substantially as follows:

NOVATION AGREEMENT

This NOVATION AGREEMENT, is made this 1st day of July, 1997, among _____("Contractor" and "Transferor"), _____ ("Transferee"), and the State of Colorado Department of _____, Division of _____ ("State").

Recitals

A.The Contractor (Transferor) and State have entered into a Contract dated March 2, 1994 ([routing no. or other ID]) and amended by _____ dated September 1, 1995 for the [description of contract]. Copies of these Contracts are attached as Exhibit I hereto.

B.Transferor wishes to assign to Transferee, and Transferee wishes to accept and assume, all of Transferor's right, title and interest in and to, and duties and obligations under, the Contract(s). Transferee's written acceptance of these obligations is acknowledged by letter dated May 1, 1996 and incorporated herein as Exhibit II.

Agreements

NOW THEREFORE, in consideration of the foregoing premises and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1. Assignment of Contract. Transferor grants, transfers and conveys unto Transferee, and Transferee accepts and assumes, effective as of the Effective Date as set forth in this Amendment, all of Transferor's right and interest in, and duties and obligations under, the original contract.

2. Waiver of Rights Against State. Transferor hereby waives any and all rights it may have against the State, effective as of the Effective Date set forth in this agreement.

3. The State recognizes the Transferee as the Transferor's successor in interest in and to the contracts. The Transferee by this Agreement becomes entitled to all rights (including payment), titles, and interests, and assumes all duties, obligations, and liabilities, of the Transferor in and to the contracts as if the Transferee were the original party to the contract(s). Following the effective date of this Agreement, the term "Contractor" as used in the contract, shall refer to the Transferee.

4. Except as expressly provided in this agreement, nothing in it shall be construed as a waiver of any rights of the State against the Transferor. All payments and reimbursements previously made by the State to the Transferor, and all other previous actions taken by the State under the contract, shall be considered to have discharged those State's obligations under the contract. All payments and reimbursements made by the State after the date of this Agreement in the name of or to the Transferor shall have the same force and effect as if made to the Transferee, and shall constitute a complete discharge of the State's obligations under the contract, to the extent of the amount paid or reimbursed.

[5. The Transferor guarantees payment of all liabilities and the performance of all obligations that the Transferee assumes under this agreement or may undertake in the future should these contracts be modified under their terms and conditions. The Transferor waives notice of, and consents to, any such future modifications.]

6. The effective date of this agreement is _____.

7. Except for the "Special Provisions," in the event of any conflict, inconsistency, variance, or contradiction between the provisions of this agreement and any of the provisions of the Original Contract, the provisions of this Agreement shall in all respects supersede, govern and control. The

"Special Provisions" shall always be controlling over other provisions in the contract or this agreement. The representations in the Special Provisions concerning the absence of bribery or corrupt influences and personal interest of State employees are presently reaffirmed by the transferee.

8. FINANCIAL OBLIGATIONS OF THE STATE PAYABLE AFTER THE CURRENT FISCAL YEAR ARE CONTINGENT UPON FUNDS FOR THAT PURPOSE BEING APPROPRIATED, BUDGETED, AND OTHERWISE MADE AVAILABLE.

9. THIS AGREEMENT SHALL NOT BE DEEMED VALID UNTIL IT SHALL HAVE BEEN APPROVED BY THE CONTROLLER OF THE STATE OF COLORADO OR SUCH ASSISTANT AS HE MAY DESIGNATE.

IN WITNESS WHEREOF, the parties hereto have executed this Amendment of the day first above written.

Transferor:	Transferee:	State of Colorado ROY ROMER, GOVERNOR
_____ (Full Legal Name)	_____ (Full Legal Name)	
_____ (Signature of Individual)	_____ (Signature of Individual)	By: _____ Executive Director
_____ (Name of Individual)	_____ (Name of Individual)	
_____ Position (Title)	_____ Position (Title)	DEPARTMENT OF _____
_____ Social Security Number or Federal Employer Identification Number	_____ Social Security Number or Federal Employer Identification Number	
Attestation	Attestation	
By: _____ Corporate Secretary, or Equivalent, Town/City/County Clerk	By: _____ Corporate Secretary, or Equivalent, Town/City/County Clerk	
(Seal)	**(Seal)**	

APPROVALS

ATTORNEY GENERAL	STATE CONTROLLER
By:_____	By:_____

Section 5

Subcontracts and Assignments

The State enters into contracts with prime contractors, who may or may not subcontract out portions of the work. This Section outlines considerations in managing contracts where work is performed by subcontractors.

5.1 "Privity of Contract" -- The Implications

There is no contractual relationship between subcontractors of the contractor and the State. The contractual relationship exists only between the prime contractor (or lessor, consultant, etc.) and the State, between whom there is "privity of contract." That means that the obligations, rights, duties, and remedies exist between the State and prime contractor only. It is in the best interests of the State to be able to hold a single entity responsible for completing the contract.

Prime contractors will usually make a discretionary decision of whether to "outsource" or "make or buy", terms commonly used to describe the prime contractor's decision on whether to do the work itself in-house, or subcontract the work. In some instances the prime contractor knows that it does not have the capability to perform a particular aspect of the work, and plans at the beginning of the contract to subcontract the work.

The subcontracting process can create problems with the "responsibility" determination done by the State during procurement, when the State determines that the contractor has sufficient resources and integrity to perform. For example, if the State evaluates IBM Corporation and determines IBM is "responsible", and then IBM subcontracts the whole effort to another company, theoretically the State's interest in assuring successful, on-time performance by a "responsible" entity may be prejudiced.

5.2 State Approval of Subcontractors

The common technique for retaining some amount of State control over the subcontracting process is the use of a solicitation process that requires identification of subcontractors, so the State can evaluate them, and a subcontractor approval clause in the contract that permits the State to approve the proposed use of subcontractors. Consent to subcontracts may be particularly important where the work is complex, dollar value is substantial, the State has a unique interest in having performance personally performed by the prime contractor, or the State's interest is not adequately protected through normal subcontracting practices of prime contractors. An example of such a clause is shown in Chapter 6, Appendix A of the *Manual*.

If disapproval of a subcontractor is done in good faith, and based on legitimate State concerns, (e.g. with subcontractor responsibility in terms of resources and capability), contract approval requirements are enforceable.

Note that the clause does not permit the State to direct the use of any particular subcontractor. It merely permits the State to withhold its assent to the use of subcontractors. Unreasonable withholding of State assent in order to steer subcontracting opportunities to "State favorites" could be characterized as a breach. It may also be a violation of criminal statutes prohibiting State employees from directing selection of subcontractors. See Section 18-8-307, CRS.

5.3 State Relationship with Subcontractors

Legally, there is no direct relationship between the State and the subcontractor. In fact, the clauses in the contract between the prime contractor and the State are not required to be included in any subcontract, unless the prime contract says otherwise. For example, Special Provision paragraph 5, "Discrimination and Affirmative Action," has specific "flow-down" provisions requiring the prime contractor to include certain provisions in its subcontracts.

As a practical matter, the State should exercise caution when specifying "flow-down" clauses to a subcontractor. The State can enforce contract obligations against the prime contractor who has subcontracted out a portion of the work. For example, if the State has specified a delivery schedule, and the prime contractor forgets to flow down the schedule to a subcontractor, the prime contractor is responsible when the State insists on enforcing the delivery schedule. The contractor's failure to include the schedule in its subcontract is no defense. By contrast, audit rights are not very meaningful if not flowed-down to subcontractors. In general, though, there is probably a cost premium when the State interjects itself into the relationship between a prime contractor and its subcontractors and specifies flow-down of contract clauses.

In matters involving patents, copyrights, and other intellectual property rights, caution is also necessary. Subcontractors creating copyrightable works (e.g. software), patentable inventions, and other work protected by intellectual property laws “own” those works and ideas. It is important that the contract language with the prime contractor guarantees the “right to sell” those intellectual property rights and gives the State the right to use them. In some cases involving high technology goods and services, intellectual property indemnification clauses are used to protect the State against claims by third persons and companies that the State has no right to use software or supplies.

With respect to State observations of subcontractor work, as a general rule, a State representative cannot remain silent when aware of deficient performance. The proper course of action is to notify the prime contractor immediately.

As a general rule, avoid directing or instructing subcontractors, unless the prime has agreed to the specific arrangement, and the parties make it clear that technical direction or inspection of the subcontractor by the State does not minimize or limit the prime contractor's obligations under the contract. The scope of these direct communications with the subcontractor should be defined in the contract documents. The State should always "copy" the prime contractor in any communications with the subcontractor.

The risk from technically directing subcontractors is that the prime contractor may be able to escape liability for the subcontractor's deficient performance where the State has entered into an implied

contractual relationship with the subcontractor by directly dealing with the subcontractor and issuing direction or instructions during performance. Further, the subcontractor may have a right to sue the State directly for alleged breaches by the State under the contract. It is wise to limit the State's obligations (and potential liability) to those owing to the single entity--the prime contractor.

5.4 Assignments Distinguished

When the term subcontracting is used, it usually applies to an element of performance due to the State. For example, a subcontractor in a construction contract may be doing foundation work. In a computer systems contract, there may be subcontractors actually writing the software or supplying some of the hardware. The customary "assignment", on the other hand, involves the contractor's giving away the right to receive something--most often payment. Assignments of the right to payment for the benefit of creditors are common. An example is an assignment to a bank. There is usually little interest in the State's interfering with such an assignment. Section 4-9-318, CRS, permits contractors to assign the right to payment, notwithstanding the existence of a provision in the contract requiring consent to assignment of the contract. Legally, the State is obligated to honor such an assignment once it receives notice. If a notice of assignment of payment is received, do not pay the original contractor; contact your agency or institution controller immediately. Other assignments, on the other hand, such as assignment of performance duties or obligations, can be controlled by requiring consent of the State. Appendix A to Chapter 6 has an example of such a clause.

Checklist of Contract Management Considerations

- Read the contract to identify specific subcontract limitations, approval requirements, reporting obligations, etc.

- Do not interfere in subcontracting decisions made by the prime contractor without the contractual right to do so.

- Never direct the use of any specific subcontractor.

- Do not process claims for payment by subcontractors. Refer the subcontractor back to the prime contractor.

- Retain neutrality in disputes involving the prime contractor and any of its suppliers or subcontractors, except that contract rights or statutory obligations to withhold payments (e.g. in construction contracts) may be exercised, BUT ONLY TO THE EXTENT DEFINED IN THE CONTRACT OR OTHER APPLICABLE LAW. Obtain the assistance of legal counsel in cases involving disputes over payment where subcontractors are trying to get the State involved.

- Do not direct or instruct subcontractors or subcontractor employees in performance of work. Work through the prime contractor, unless the contract has specified the scope of technical direction and keep the prime contractor responsible for the work Reduce to writing and provide a copy to the prime contractor of any instructions given directly to the subcontractor.

- Take assignments of payments seriously. Validate the authenticity of an assignment of payment and comply with its terms. Do not pay the prime contractor after notice of a valid assignment. Consult with legal counsel if questions concerning payment arise.

- Ensure, through appropriate prime contract language, that any patented, copyrighted or other proprietary ownership rights of subcontractors are properly licensed or sold to the State through the prime contractor.

Section 6

Dispute Resolution

6.1 Introduction

For purposes of this *Manual*, a "dispute" is defined as a controversy during contract performance that may require litigation to resolve. A dispute usually means that the two contracting parties are at irreconcilable positions. Usually, the contractor wants more money or time for performance, and the State disagrees and believes that better or faster performance is required.

Sometimes the contract sets out remedies available to one or both of the parties where there is a breach of contract or circumstances change. An "inspection and acceptance" clause may give the State the right to deduct payments. A "suspension of work" or "delay of work" clause may give the State the right to suspend the work. The "termination for default" and "termination for convenience" clauses may enable the State to terminate the contract under certain conditions. "Force majeure" or other clauses may grant entitlement to a contract extension for certain delays, (e.g. natural disasters or unusually severe weather).

Where these kinds of clauses are in the contract, the routine exercise of the remedies consistent with the clauses is not usually considered a dispute, unless a dispute has been defined that way in a dispute resolution clause in the contract. The contractor may sue over wrongful termination for default, or deductions for nonpayment, which quickly give rise to disputes that are settled in court. In some instances a contract contains a clause requiring elevation of disputes to senior officials of the contracting parties before legal action is taken. In this case, defining what constitutes a dispute has legal significance, because it may limit the State's ability access the court system to enforce a contract or sue for damages.

There is always a potential for disputes. Disputes can arise in the contract formation and source selection stages. Disputes commonly arise after contract award and during the performance period of the contract. State agencies or institutions normally have all remedies available against a contractor that exist under State law. When a contract contains a clause requiring a specific remedy for disputes, such as mediation or elevation of the dispute to the next higher management level, the provision can be enforced. Contractual remedies and dispute resolution techniques should be considered, whenever feasible, as a means of expediting and simplifying the resolution of contract disputes. The primary dispute resolution techniques and remedies to consider are:

- Negotiation and Settlement. -- The parties to the contract discuss and resolve their dispute. This is the best available option with minimal disruption to the contract process.

- Mediation. -- The parties to the contract agree to use a neutral third party in an attempt to resolve the dispute. Successful mediation usually results in agreement even though it is not binding on either party.

- Arbitration. -- The parties to the contract choose an independent person or persons to assist in the resolution of the dispute by making a determination as to how the dispute should be resolved. Arbitration can be non-binding or binding on the contracting parties. Normally, the State will not agree to binding arbitration.

- Litigation. -- Both parties to the contract have the right to be present and represented by legal counsel in a court.

It is important to remember that dispute resolution usually requires contract interpretation, considerations of litigation, risk, and knowledge of available judicial remedies. Early involvement of the agency's or institution's contracting and purchasing specialists should be the first step when contract disputes are encountered. The brief summary on dispute resolution contained in this Section cannot substitute for sound legal advice.

6.2 Responsibilities in Dispute Resolution

Introduction to business or contract law classes teach that an enforceable contract has to be supported by "sufficient" consideration. In State contracts, the "consideration" requirement goes beyond merely having sufficient consideration. The State is required to receive "reasonable value" for its payments, including those made in settlement of disputes.

Settlements, or relinquishments of rights by the State, must be in the best interests of the State. The contract manager's responsibility is to ensure the State receives value for its payments and does not relinquish its rights.

The primary purpose of competitive bidding is to ensure the State receives value for its payments. The competitive bidding process is ineffective if the low, responsible bidders are permitted to obtain relief from unreasonably low bids by requesting additional money, time for performance, or relaxation of contract specifications. Not only does the State suffer from not receiving value, the rights of the other bidders are also compromised.

If disputes are to be resolved by granting more money, additional time, or relaxed specifications, the contract manager is responsible for assessing whether the contractor is entitled to more money or time and whether the compensation or other consideration is fair, based on changes in conditions or events giving rise to the dispute. This is an acknowledgment that contractors also have interests. They expect to be compensated for changes in requirements which are not known at the time of the contract award. They also expect relief from some delays or other unforeseen conditions that both parties agree to be outside of the risk normally assumed by the contractor. Every adjustment in price, extension of time, or relaxation of requirements should be the result of a contract provision or other legal principle permitting the adjustment to contract terms. Resolution of disputes requires investigation of the facts, an understanding of the contractor's position, consultation with experts, if necessary, and a process, such as negotiation, that is designed to achieve a settlement that fairly approximates the risks and costs associated with contract performance.

6.3 Negoiation

The first time that the contractor asks for more money or more time, requests relief from specifications, or otherwise notifies the State of a problem concerning the contract, a dispute has started. And, the first time the contractor contacts the State to discuss the dispute, negotiations have started.

Roger Fisher and William Ury, *Getting to Yes--Negotiating Agreement Without Giving In, 2nd Ed.* (Penguin 1991), is an excellent resource tool regarding negotiations. The ideas contained in this summary regarding contract dispute negotiations are adapted from that book. The negotiation process described here is useful for other contract management functions as well as for negotiating contracts, pricing change orders and modifications, and for use in other areas where disagreements may exist. Similarly, these tools, techniques, and planning considerations are useful for other alternative dispute resolution techniques, as well as litigation. Litigation, arbitration, and mediation are all forms of negotiations where a third party is involved, whether an arbitrator, judge, or mediator. The planning requirements for any type of negotiation are much the same, regardless of the method used.

Planning

The key to effective negotiation is planning. The planning elements described here are intended to establish a structure for approaching the negotiation, so that all arguments, risks, and options can be considered. The State contract manager needs to be knowledgeable about all facts the contract file, and the substance of the contract. The contract manager must be prepared and have well developed arguments, and counter points. The contract manager should develop a personal style for writing all of this in a format that can be quickly and effectively used on the phone or at a negotiation table.

- Interests of the Parties. A successful settlement satisfies in some respects the interests of both parties. To succeed in negotiation, the contract manager should identify not only the State's interests, but those of the contractor as well. Examples of interests include:

  - Funding constraints of the State.
  - Maintaining the public trust.
  - Avoiding litigation and excessive costs associated with resolving disputes.
  - Fair and reasonable compensation for work performed.
  - Fostering a good continuing relationship.

- Best Alternative to Negotiated Agreement (BATNA). The concept of the BATNA is a way of getting away from the traditional positional bargaining of "take it or leave it, it's my bottom line", to principled negotiations where both parties focus on all interests and try to reach an agreement accommodating the interests of both parties. The BATNA becomes the litmus test against which all options, offers, and positions implicitly are tested.

  - The BATNA is simply this, "What is the best alternative for the State if an agreement cannot be reached in this negotiation?" Is it to "take your business elsewhere," to re-solicit, to "see you in court" and risk litigation? The BATNA serves to highlight

interests and considerations that become a yardstick for evaluating alternatives and options. The BATNA helps to identify the primary points of negotiations and the commitments that can be made if the opportunity arises.

- Try to assess the contractor's BATNA as well. Questions such as, "What alternatives exist to resolve this issue?" are appropriate questions during negotiations.

- A realistic assessment of litigation risk is necessary if the BATNA is, "See you in court." Three basic questions should be asked. What is the chance that the contractor will be entitled to recover more money? If there is entitlement, how much will the expected recovery be? How much is litigation going to cost?

- Legitimacy Arguments. **INVESTIGATE . . INVESTIGATE .. . INVESTIGATE . . AND PREPARE**. Successful negotiators are the ones who know the facts and can articulate clear, rational arguments.

  - Most contract disputes involve matters of contract interpretation, (e.g. trying to determine the objective intent of the parties at the time the contract was executed). Attachment B contains some of the more common principles of contract interpretation to assist in the process of interpreting the contract and trying to arrive at the objective intent of the parties when the contract was written.

  - Plan arguments to support the position on each of the substantive issues in dispute. Anticipate the contractor's issues and plan counters to the arguments presented. Determine what should be the "standard for agreement," (e.g. "whether the contractor is 'entitled' to more money" or "what the parties objectively intended at the time of contract signing"), and develop reasons why. Sometimes, when communications break down, talking about the "standard for agreement" can be a constructive way to open lines of communications.

  - In the format devised for planning negotiations, write the skeletal arguments/responses for easy reference. Decide what documents to present that best support the State's position.

- Plan Communications.

  - Consider "scripting" the opening argument. This is going to require determining the tone to set, the amount of "support" for the negotiation process (e.g. "I think we all agree that resolving this dispute is in everyone's interest"), and whether an opening offer is to be made. The most difficult part of the negotiation process may be in the beginning. Scripting the beginning communication can set the tone for the rest of the negotiations.

  - Define and record all of the issues that need to be addressed. In many disputes, the issues are, "Is the contractor entitled to more time or money?", and "If so, how

much?" Under each issue that is identified, have two columns. Write down the questions that need to be asked of the contractor, (e.g. "Who authorized the change in reporting format?" "Was the State notified that this was 'out of scope'?" or "Can the invoices and receipts be provided that show how much was paid?"). Anticipate what difficult questions are expected from the contractor, and how to answer them. For example, what is the best response when the contractor asks, "Why did we need to provide written notice, the State's representative knew our position?" or "Does the State at least agree that we are entitled to recover something?" or "Is it possible to make some compromises in this dispute?"

- Think about communications to facilitate the "process," such as, "Help me understand the rationale behind this position a little better" or "How about agreeing to disagree on this point for a while and moving on to the next issue?"

- Plan the Commitments the State is Ready to Make. Fisher and Ury advise to move toward commitment slowly. Identify the points of resistance and the points to change from being readily agreeable to being more cautious. Related to this idea of "commitment" is the opening position. The opening position, and whether to even make an opening offer, represent commitments that should be planned. Finally, decide whether to handle each issue individually, or await agreement globally after a discussion of all of the issues.

- Options. Armed with known interests, the BATNA, a good investigation and development of arguments, brainstorming may be used to identify options. All legitimate options identified should be put in priority; (e.g., "Can we trade a little performance time if the contractor drops the claims for money?" "How about getting some increased maintenance obligations if we give some money for the claim?") Evaluate each option at least provisionally. At the negotiation table, use questions such as, "What if . . ." or "Is there a possibility . . ." to explore options. Remember, raising possible options is, in a sense, a commitment in itself.

Process and "Tactical" Considerations

- The relative advantages/disadvantages of tactical considerations, such as time, location, and who attends the negotiation should be considered. The checklist in Attachment A of this Section notes a few such considerations.

- Take adequate time to reflect on the entire negotiation process and how to facilitate communications:

  - Focus on the issues. Especially when communication starts to break down, focus on the issues and try to depersonalize them. Consider offering to do an initial "draft" so it can jointly be used as a guide to explore ideas.

- If unprincipled negotiation techniques like "good guy/bad guy" or others are being used, confront them head on, try to eliminate them and then proceed with the negotiations.

- Use the negotiation "process" as a way to build consensus, such as, "How can these disagreements best be handled, Can we agree to disagree and move on?"

- Always consider the "continuing relationship" as a goal. It may be difficult for negotiating parties to admit, but continuing their relationship is essential to the negotiations.

- When recapping or asking questions, focus on the State's "misunderstanding" to limit the confrontational atmosphere sometimes associated with direct questions; (e.g. "It is difficult to understand why the notice requirement in the changes clause was not followed.").

- Remember, a little humor never hurts.

Memorialize the Agreement

Write negotiation memoranda to summarize important aspects of the negotiation. Most important, make sure the agreement is written, usually in a contract amendment. See Section 6.5 for more discussion of how to memorialize the agreement.

6.4 Other Dispute Resolution Techniques

Sometimes negotiation is effective and sometimes it is not. Occasionally the dispute will reach a point where the negotiation process breaks down and no longer works. If the contract has a dispute resolution process, it must be followed. If not, an alternate dispute resolution (ADR) process may be used in an attempt to settle the dispute. All ADR processes cost money, however, and one of the first issues is payment for the expenses involved in the ADR process, (e.g. mediator fees). Typically, the parties agree to split the costs.

General considerations for choosing ADR are listed in the dispute resolution checklist at Attachment A of this section. Although there are numerous variations of ADR, this discussion will summarize only three: mediation, mini-trials, and arbitration.

Mediation

Mediation is widely used in the private sector. It tends to be informal and flexible, and still retain the confidentiality that the parties want. Mediation is the term used to describe any process where a third party, not involved in the controversy (often a technical professional or someone trained in mediation), assists the parties in reaching settlement.

The mediator will listen in confidence to the parties, help clarify interests, assist each party in developing or considering options, and facilitate exchange between the parties. Typically a mediation

agreement is signed that defines the role of the mediator and expectations concerning confidentiality during the mediation process. The mediator meets privately with each of the parties, usually several times, and acts as a catalyst in fostering improved communications. The mediator may propose solutions, options for settlement, assess litigation risk, identify unreasonable expectations, etc. The mediator may also help facilitate joint discussions between the parties if they desire.

In short, the parties themselves define this process, the involvement of the mediator, and they control the outcome. No one "decides" anything that is binding on the parties. It is an especially useful process where the communications have broken down, but both parties are still committed to settlement, or when emotions or personalities have interfered with the negotiation process.

Most mediators will have a proposed mediation agreement that can be modified to define the mediation process to be used. At the same time the mediator retention agreement can be processed to address compensation. The negotiation agreement will define the "discovery" or information/document exchange in terms of quantity and scope, the confidentiality of information exchanged by the parties and disclosed to the mediator, the numbers and roles of participants, the allocation of expenses, and the like.

Informal Mini-Trials

An informal mini-trial is a more structured settlement process. Parties engage in informal discovery or exchange of information, even limited depositions, in advance of the mini-trial; the parties agree on the number or scope of requests for information or depositions. Then they agree to a proceeding, usually limited to a day or two in length, in which each party listens to the other's "case". Usually there is a neutral third party present to "preside" at the mini-trial. Each party's attorney gives an abbreviated version of its case, with some "introduction of evidence" as agreed by the parties. Many commentators stress the importance of having key management/executive officers present to hear the case presentations. Sometimes the neutral third party is also asked to issue an advisory, non-binding opinion, concerning the merits of the dispute after the mini-trial. Often the mini-trial is followed by mediation, with the presiding neutral third party serving as the mediator.

Other Forms of Third Party Neutral Involvement

There are other forms of ADR, (e.g. "early neutral evaluation" or "conciliation"), that are modifications of the mediation model. They differ in the role of the third-party, whether the third-party is a specialist in the subject area, whether an opinion is issued after the process, etc. The agreement between the parties is what defines the character of and differences between these other types of ADR techniques.

Arbitration

Apart from mediation, the other major category of ADR is arbitration. Arbitration is the most structured kind of ADR, and most closely resembles a court proceeding. Arbitration can be either "binding" (meaning there is very limited judicial review) or "non-binding" (meaning parties are free to pursue judicial remedies).

The American Arbitration Association (AAA) is a well-known organization providing arbitrators and rules governing the process. When parties agree to submit to arbitration in accordance with the rules

of the AAA, they are implicitly agreeing to a procedure that closely controls the process of dispute resolution. There is a procedure, for example, for selecting an arbitrator from a list furnished by the AAA. Although the rules of evidence are relaxed, there are procedural rules governing these proceedings. Commonly, attorneys are used in arbitration just as they are in litigation. In general, decisions on the disputes may be issued more quickly than they would be in court, and there is more limited discovery, (e.g. document production requests, requests for interrogatories, and depositions).

Paragraph 7 of the Special Provisions makes arbitration provisions in State contracts unenforceable. Binding arbitration provisions may conflict with other State law governing contract disputes and the State Controller's responsibility to approve contracts obligating State funds. The arbitration prohibition could be waived, (e.g. non-binding arbitration provisions), if a vendor insists that an arbitration provision be included in a State contract. If this is the case, legal counsel should be contacted so a provision could be developed that might be acceptable to the State Controller.

6.5 Implementing the Settlement of Disputes

After agreement or resolution of the dispute, appropriate amendments must be made to the contract to permit payment to the contractor and/or to establish a new delivery date. Also a negotiation memorandum should be prepared to summarize the history of the negotiation and discussions that occurred concerning key issues of the dispute.

Settlement Amendments

The standard amendment format can be used for making the contract adjustments necessary to settle the dispute, with factual recitals to explain the basis for the amendment, similar to the sample in Attachment C. Note that there are two kinds of amendments in the sample. In one, the contractor is entitled to an extension of time and adjustment in price based on clauses in the contract giving the contractor more time and money for certain unanticipated events, (e.g. differing site conditions, interference by the State, constructive change of requirements, etc.). In the second factual recital, the contractor has missed the delivery date, but the State decides to waive the late delivery and reestablish a reasonable delivery date. For more information on the distinction, see the discussion in Section 7.1.

Both types of amendments have a release, which cuts off additional claims arising out of the same circumstances. Releases are important because the State does not want to have to address a series of similar claims throughout contract performance. If time must be taken to address a claim, once is enough. Sometimes the contractor may want to negotiate the scope of the release, (e.g. excluding things like "impact", where the scope of the contract adjustment and release are negotiated up-front). The contractor may also reserve the right to submit claims for certain other things. Caution should be taken against limiting the scope of the release by using terms such as "excluding claims from impact," because other claims and negotiations may follow. At least be clear on what the contract price and time adjustment were intended to cover in the release, so that the contractor is not compensated again for the same costs.

"Impact" claims usually follow payments to the contractor for direct costs and time attributable to the changed work. For example, if the State changes door materials and colors in a construction contract,

there may be an impact on the schedule in installing the different doors, and the price may also be more. A contractor may, at the end of the job, try to claim that the door substitution also adversely impacted scheduling other work at the site, such as interior finish, and that the change had a "ripple effect" that caused even more delay and expense. Reserving "impact claims" in a release could result in more similar claims later, and may require additional negotiation when the matter was thought to be resolved.

Negotiation Memoranda

Prepare and sign a memorandum of understanding that explains the history and key aspects of the settlement, especially terms that may seem ambiguous without a full understanding of the history. Any discussion concerning the scope of releases is particularly important. Include all previous versions of the amendment that were exchanged between the parties as attachments, and explain the reasons for the changes to the amendment language. Retain this memorandum in the contract file.

ATTACHMENT A

Considerations During Dispute Resolution

Investigations

- Remember that any representations made to the contractor may be "admissions" held against the State in any subsequent litigation.

- Be aware that written memoranda relating to disputes are not privileged and are "discoverable" by the contractor in litigation or in "open records" requests.

    - Do not speculate when writing factual recitals in memoranda. Be objective and avoid emotional characterizations of the events.

    - When soliciting descriptions or memos from other individuals, make sure they understand the need to be accurate.

- Ask for clarification, preferably written, of the contractor's claim, the circumstances giving rise to the claim, and identification of any people that have first hand knowledge.

    - Obtain as much documentary evidence relating to the contractor's claim as is possible.

- Collect State records, including the contract, memos, other correspondence, and site progress reports. Collect other records that were developed by the contractor, the architect/engineer, or other State representatives, that relate to the dispute.

- READ THE CONTRACT, ALL OF THE CONTRACT

- If there is a dispute resolution clause, comply with the clause.

    - If there is a question concerning whether a contract dispute resolution provision governs the dispute, consult legal counsel.

Planning for Negotiation - Interests and Constraints on Settlement

When planning for negotiations, answer the following questions:

- What are the contractor's interests, (e.g. interest in the relationship)? What are the State interests?

- What is the funding situation? Are there additional funds available? What is the likelihood there will be other claims or adjustments to the contract?

- How can the State summarize its desired "standard of agreement," and convey it to the contractor? Said another way, how is the State going to know a "good agreement"? What is the State going to advocate to the contractor as the "standard of agreement?"

Best Alternative to Negotiated Settlement (BATNA)

- The State's BATNA, (e.g. deny the claim or "see you in court")
  - How good is the case (entitlement)?
  - How much can the contractor recover if entitled to recover?
  - What are the expected costs of litigation?
  - How do the interests, (e.g. the on-going relationship), affect the BATNA?
- What is the contractor's expected BATNA?
  - How do expected interests affect the contractor's BATNA?

Legitimacy Arguments

- What are the arguments for and against the desired resolution of each issue?
  - Should the contractor be entitled to more money, time, or relief from specifications?
  - What is the amount of damage or delay, assuming entitlement?
  - What is the standard for agreement on the negotiation, e.g. fair and reasonable compensation?
  - What is the agreed negotiation process? "Help me understand the factual basis for the claim.", or, "I know there are some hard feelings, but put them aside and focus on the problem."
- What are the critical documents, contractor admissions, and other information relevant to the arguments?
- Is the file organized adequately so it is easy to find critical documents?

Communications During Negotiation

Use the following to develop communications:

- Script opening arguments and include some "negotiation process".

- Be sure that the opening offer is a commitment that the State is willing to make.

- Know what to say if pressed for or confronted with a specific offer. Know the State's "bottom line" prior to negotiations.

- List and organize the issues that need to be discussed.

- Be prepared for difficult questions or arguments.

- Prepare a list in advance of questions to ask the contractor.

- Plan answers to difficult questions the contractor is most likely to ask.

Plan, Discuss and Agree Upon Commitments

Answer the following questions:

- Is a specific opening offer a commitment that is acceptable to the State?

- What are the "resistance points" in terms of price, delivery schedule, and relaxation of specifications? If presented with the opportunity, what commitments can be comfortably made at the table, in terms of price, schedule, relaxation of specifications?

- Are there any commitments the State is willing to make? "Does the State agree that some additional compensation might be appropriate?"

- How is the State going to handle a request for commitment from the other side? "Let's recap what has been agreed upon to this point."

- What "process" commitments can be made to "build the relationship"? "Why not agree to disagree and come back to that issue at a later time?" or "Apparently there are some misunderstandings. Let's take some time now and try to resolve them?"

Options

- Ask, "What if . . ." or "Is there a possibility . . ."

- Prioritize some specific options in terms of delivery schedule, price, relaxation of specifications, waiver of liquidated damages, etc.

- Resort to other forms of ADR, alternate dispute resolution, (e.g. mediation or mini-trial).

Some "Tactical" and Process Considerations

- Focus on "misunderstandings" of the facts or the reasons behind a position, instead of putting the contractor on defensive.

- A little humor/lighthearted communication never hurts.
- Is there an advantage to having the meeting at a particular location?
- Is it an advantage to have all the people capable of making decisions at the negotiation?
- Is it necessary to have all first-hand "witnesses" to events and documents at the negotiation?
- Is it useful to have accessibility to word processing or other resources to immediately document an agreement?
- In "team negotiations," decide who will handle which parts of the negotiation, (e.g. fact-finding, difficult questions, getting the process back on track, etc.).

When Alternative Dispute Resolution (ADR) Does And Does Not Made Sense

- DO consider mediation when the parties want or need to maintain a good relationship.
- DO consider mediation when communication has broken down but both parties seem committed to settlement.
- DO consider ADR when time or limiting costs of settlement are major factors.
- DO consider ADR when emotions or personalities are getting in the way.
- DO consider mediation when an unbiased appraisal of complex or multiple issues might encourage an objective assessment by the parties.
- DO consider mediation if maintaining confidentiality of facts or positions is important.
- DO consider a mini-trial when party positions are reasonably developed, facts or laws are complex, amount in controversy is significant, and involvement of high level decision makers is key to settlement.
- DO try to keep it simple, and reduce the process to writing.
- DO NOT include arbitration provisions in State contracts without advice from the Attorney General and a waiver of Fiscal Rules by the State Controller.
- DO NOT use ADR when a definitive and authoritative decision is needed on an issue that is likely to be precedent setting.

- DO NOT use ADR when established policy must be maintained to avoid variations in implementation and enforcement.

ATTACHMENT B

Principles of Contract Interpretation

- The basic objective of contract interpretation is to determine the intent of the parties.

  - Focus on what a reasonable person familiar with all of the facts and circumstances at the time of the bargain would have understood the meaning to be, not what one party may have subjectively intended the contract to mean.

- Unless a different intent is clear:

  - Where language has a generally prevailing meaning, the contract is interpreted in accordance with that meaning (e.g. dictionary meanings may be relevant).

  - Technical terms and words of art are given their technical meaning when used in a transaction within their technical field (e.g. "expert" testimony may be necessary).

- Read the contract as a whole.

  - All writings that are part of the contract are interpreted together.

  - An interpretation usually will be rejected if it leaves portions of the contract language difficult to understand or otherwise meaningless.

  - An interpretation is favored if it avoids conflict between and harmonizes all of the contract provisions.

  - Contracts are interpreted to fulfill the principal purpose of the parties.

  - Unless written otherwise in an "order of precedence" clause, the more specific language controls in cases of conflict with more general language.

- Where contract language is clear and unambiguous, no extrinsic evidence (evidence outside the contract language) will be considered in the contract interpretation.

  - Custom and trade practice may be used to explain contract terms dependent on the custom and trade practices prevalent in the industry.

  - Custom and trade practice can not contradict plain contract terms, because the parties are free to vary from custom and trade practice during performance.

  - The party asserting trade practice has the burden of proving it.

- Extrinsic evidence (e.g. oral discussions, requests for clarification and responses, bidder's conference presentations, pre-dispute interpretations and actions) can be considered to determine whether there is "ambiguity" within the contract.

- Where an "ambiguity" exists, extrinsic evidence can be considered during interpretation.

  - Oral discussions of the issue conducted before the dispute arose may be considered.

  - Prior interpretation before the dispute arose, or performance before the dispute arose consistent with one party's interpretation, can be considered.

  - Prior course of dealing between the parties on other transactions is probably next in importance. For example, were there similar transactions before that showed how the parties interpreted the issue?

- If, after applying these rules, there are still two reasonable interpretations, the ambiguity is usually construed against the drafter of the contract.

- If the non-drafting party knew or should have known of ambiguity ("patent ambiguity"), that party has a duty to clarify, and if it does not, the contract will be construed against it.

ATTACHMENT C

Sample Settlement Amendment

AGENCY OR INSTITUTION CODE

_____

CONTRACT ROUTING NUMBER

_____

CONTRACT AMENDMENT NUMBER

_____

THIS AMENDMENT, made this ____ day of _____ 1997, by and between the State of Colorado, hereinafter referred to as the State, for the use and benefit of the Department of _____, [Address], and _____, [Address], hereinafter referred to as the Contractor,

FACTUAL RECITALS

Authority exists in the Law and Funds have been budgeted, appropriated, and otherwise made available and a sufficient unencumbered balance thereof remains available for payment in Fund Number _____, Appropriation Code _____, Contract Encumbrance Number _____; and

Required approval, clearance, and coordination has been accomplished from and with appropriate agencies; and

The parties entered into a contract dated October 1, 1996, Contract CE Number C 840095, Contract Routing Number LAW 96-0018, which is hereby incorporated by reference; and attached, and

The contractor has submitted a claim for adjustment to contract price and extension of time of performance, and the parties desire to settle the claim through appropriate adjustments to the contract price and time for performance;

OR

The contractor has exceeded the time for performance in the contract, and the parties desire to reestablish a reasonable time for delivery or performance of the contract;

NOW THEREFORE, it is hereby agreed that:

1. Consideration for this Amendment consists of the adjustment in contract price and/or extension of time for performance, as well as the contractor's release of claims, which shall be made pursuant to this Amendment.

2. It is agreed the Original Contract is and shall be modified, altered, and changed in the following respects only:

a. Page 2 paragraph 9, "Contract Price": The figure $50,000.00 shall be deleted and the figure $60,000.00 shall be substituted in its place.

b. Page 3 paragraph 10, Time for Performance": The date June 30, 1997 in the first sentence shall be deleted and the following substituted in its place, "September 3, 1997," permitting an additional 65 calendar days of contract performance.

3. The effective date of this Amendment is the later of _____, 1997, or the date of approval by the State Controller.

4. Release of Claims. [Two examples of releases here, the first for equitable adjustments in time and price where contractor is entitled to more time and/or money. The second is a waiver of delivery date and re-establishment of a reasonable time for performance.]

(Time and Money Adjustment). In consideration of the [cost][price] adjustments, extensions of time, or other adjustment, promises and relinquishment of rights herein described, all claims for additional compensation or time, based on events recited in the contractor's [letter][claim] dated _____, whether known or unknown, including claims for delays and impacts from any changes or modifications, are hereby released and forever waived.

OR

(Waiver of Delivery Schedule/New Delivery Date) The parties agree that the new time for performance specified in paragraph 2 is a reasonable time for performance and completion of this contract. In consideration of the re-establishment of a new delivery date, the contractor hereby waives any right to claim time extensions, pursuant to provisions of this contract or otherwise, arising out of facts or events, known or unknown, occurring prior to the date of this Amendment.

5. Except for the "Special Provisions," in the event of any conflict, inconsistency, variance, or contradiction between the provisions of this Amendment and any of the provisions of the Original Contract, the provisions of this Amendment shall in all respects supersede, govern and control. The "Special Provisions" shall always be controlling over other provisions in the contract or amendments. The representations in the Special Provisions concerning the absence of bribery or corrupt influences and personal interest of State employees are presently reaffirmed.

6. FINANCIAL OBLIGATIONS OF THE STATE PAYABLE AFTER THE CURRENT FISCAL YEAR ARE CONTINGENT UPON FUNDS FOR THAT PURPOSE BEING APPROPRIATED, BUDGETED, AND OTHERWISE MADE AVAILABLE.

7 THIS AMENDMENT SHALL NOT BE DEEMED VALID UNTIL IT SHALL HAVE BEEN APPROVED BY THE CONTROLLER OF THE STATE OF COLORADO OR SUCH ASSISTANT AS HE MAY DESIGNATE.

IN WITNESS WHEREOF, the parties hereto have executed this Amendment on the day first above written.

Contractor:

_____
(Full Legal Name)

_____
(Signature of Individual)

_____
(Name of Individual)

_____
Position (Title)

_____
Social Security Number
or Federal Employer Identification Number

Attestation

By: _____
Corporate Secretary,
or Equivalent,
Town/City/County Clerk

(Seal)

State of Colorado
ROY ROMER, GOVERNOR

By: _____
Executive Director

DEPARTMENT OF _____

APPROVALS

ATTORNEY GENERAL

By:_____

STATE CONTROLLER

By:_____

Section 7

Performance Remedies and Termination

7.1 Performance Remedies

A valid contract requires both parties to complete the expected performance, usually contractor performance of services or delivery of goods in return for payment by the State. Unless the contract grants it to a party, there is no "unilateral right to rescind" a contract. For example, home solicitation sales contracts give a right to rescind if exercised a few days after signature. This Section discusses termination options and remedies available when faced with a breach (failure to perform) by the contractor. Generally, the State can only withhold payment or otherwise suspend its own performance in limited circumstances, unless the contract gives the right to do so.

A contract breach is failure of the performance to measure up to specific contract requirements, in terms of quantity, quality, or timeliness. A warranty (either "express" or "implied") that makes affirmative representations about quality, can also give rise to a breach if not satisfied. Contract interpretation rules used to determine whether there has been a "breach" of the contract by either party are discussed in other sections.

Remedies Where the Contract Is Silent

The contract should address issues such as inspection and acceptance, termination for default, termination for convenience, liquidated damages, and other pertinent topics. If the contract is silent on these issues, the "law" will define duties and determine rights. Where this is the case, legal counsel should be consulted to assist in developing the best strategy for the State. This summary is intended only to introduce some of the issues that may arise when a contractor’s performance is not what was specified in the contract.

Remedies for contract breach, where the parties have not otherwise defined remedies in the contract, differ depending on whether the contract is for goods or services. For services contracts that involve the furnishing of goods, the first issue is often whether the contract is predominately one for goods (as in hardware installation) or services (as in pure hardware maintenance involving installation of spare parts). This distinction is important because the Uniform Commercial Code has a detailed remedy procedure for "transactions in goods."

Contracts for Goods

Colorado has adopted the Uniform Commercial Code (UCC), with some modifications. The Code applies to transactions in goods. Title 4, Articles 1, 2, and 2.5, CRS, provides general statutory guidance for contracts governing transactions in goods and leases of personal property.

The statutes cover such issues as when contracts have to be in writing to be enforced, how agreements are to be interpreted, how missing terms in contracts are "filled in", how the "battle of the forms" issues are resolved when there are conflicting terms, what warranties apply and how

they are excluded, the buyer's and seller's obligations during performance, and remedies for breach of contract.

The basic rights of the State (the buyer) in a contract for goods under the Uniform Commercial Code are:

- The State has a right to inspect the goods prior to acceptance at any reasonable place and time, and in any reasonable manner. See section 4-2-513, CRS.

- Unless otherwise agreed in the contract, the buyer may "reject" the goods if they fail to conform in any respect to the contract, including delivery on time, subject to a limited seller's right to cure a defect. This is known as the "perfect tender" rule. See sections 4-2-601 and 4-2-508, CRS.

- To reject goods, the buyer must "seasonably" (defined as the time agreed by the parties in the contract, or if none is specified, a "reasonable" time) notify the seller and hold them with reasonable care at the seller's place of business to permit the seller to remove them. See Section 4-2-602, CRS. If the buyer fails to notify the seller of the reasons for the rejection, the buyer cannot later rely on the defects to justify rejection or establish breach. See Section 4-2-605, CRS.

- After the acceptance of goods, or acts inconsistent with seller's ownership (known as constructive or implied acceptance (e.g. use of the goods after delivery), the buyer is limited to the remedy of "revocation of acceptance." Revocation of acceptance is only permitted if:

  - It is done within a reasonable period of time after discovery of the defect.
  - The value of the goods is "substantially impaired" by the defect, and
  - The seller has assured that the defects would be cured, or
  - The defect was "difficult to discover."

- The UCC also grants the buyer cancellation rights where no delivery is made or the seller repudiates the contract, and gives the buyer the right to "cover", recover excess costs and other damages, and in some cases obtain specific performance of the contract. See Section 4-2-711, CRS.

As noted above, there is a fairly comprehensive statutory structure governing contracts for goods. One important thing to remember about contracting for goods is that these remedies can be complicated, and legal advice should be obtained before using them.

Contracts for Services

By contrast, there are no detailed statutes governing service contracts, and as a general rule, a bilateral contract, one signed by both parties, should be used when contracting for services. The use of a bilateral contract allows the parties to contractually define rights and remedies similar to those that the statutes provide in contracts involving transactions in goods. In a service contract,

there are no laws that grant inspection rights, rejection rights, termination rights, etc. If these rights are not included in the contract and a disagreement arises, something called the "common law", a set of rules inferred from court decisions, will be used to settle the dispute.

The contractor should be notified immediately when performance is observed to be below standard and does not meet contract requirements. Otherwise, the State risks waiving a contract requirement. The following are some guidelines for contract remedies where the contract is otherwise silent.

- The State's performance, usually payment for the service, is excused by a material failure to perform by the contractor. Notice, this is not the "perfect tender" rule that exists by statute in supply contracts. The courts dislike cases involving "forfeitures," and the burden of proving a substantial breach of contract can be difficult. If this remedy is exercised, the State would still be required to pay the contractor for acceptable services received, that is, the value of the benefit conferred on the State by the contractor.

- If the contract provides for periodic payments, generally these payments cannot be withheld to "encourage" better performance from the contractor, unless the contract permits it. As long as the contractor is "substantially" performing, the State has an obligation to pay. There is, however, a limited right to withhold final payment to the contractor where the amount withheld represents the amount of damages to the State caused by the contractor's failure to perform.

- Unlike supply contracts, time is usually not considered "of the essence" unless the parties clearly specify otherwise in the contract. Missing service contract milestones may not be enough to establish "substantial breach" where the contract does not clearly say which milestones are of the essence. Further, standard contract boilerplate may not be enough to make every time milestone an "of the essence" obligation of the contractor.

- Apart from these limited remedies, the State has the option to sue the contractor for breach of contract.

As can be seen, common law contract remedies for service contracts are not very comprehensive. Contractual remedies should be included in all service contracts. Legal advice should be obtained before attempting to exercise any of the common law remedies noted above.

Inspection Remedies, (e.g. Rejection and Payment Withholding)

As noted above, the UCC grants an inspection right in supply contracts. See Section 4-2-513, CRS. However, the only right is rejection, not reduction in payment, unless the seller will agree to a payment offset in exchange for acceptance of goods that do not comply with contract requirements.

By contrast, no inspection rights exist in a service contract, unless agreed to by the parties. Of course, it may be possible to actually inspect the services as they are being delivered. But, absent a specific provision in the contract, the contractor cannot be required to permit inspection of the services it is performing, and there may not be an effective remedy if the performance is defective, other than notifying the contractor of the deficiencies. For an example of an inspection clause for use in service contracts that provides specific remedies, see the model clause in "Inspection and Acceptance", Chapter 6, Appendix A. Notice that the clause gives the State the right to inspect at reasonable times and places, to direct reperformance, and to make an "equitable" reduction in price if services are incapable of reperformance.

Warranties

A "warranty" is an affirmation of fact about the quality or durability of goods or services.

An "express warranty" in a contract usually has an affirmation of fact or representation about quality or durability, with rights if the supply does not measure up. For example, contract language that states, "the contractor warrants that the computers will remain failure-free for 90 days after acceptance by the State," allows the State to escape the normal rule that says that acceptance is "final." Read the contract carefully to determine what warranties exist, and what remedies are available if the goods or services do not comply with the terms of the warranty.

In the case of supplies, there may also be "implied warranties", warranties that apply to goods sold by merchants even if the contract does not say anything about a warranty. The warranty of merchantability contained in Section 4-2-414, CRS states that in order for goods to be merchantable, they must at least:

- Pass without objection in the trade under the contract description; and
- Be of average quality within the description f fungible goods (e.g. bulk grain);
- Be fit for the ordinary purpose for which such goods are used; and
- Be within the variations permitted by the agreement, of even kind, quality, and quantity within each unit and among all units involved; and
- Be adequately contained, packaged, and labeled as the agreement may require; and
- Conform to the promises or affirmations of fact made on the container or label if any.

Notice that this implied warranty does not mention anything about a guarantee for the future. In fact, implied warranties are not "failure free" warranties in the sense that one usually thinks of them. These warranties really only imply a standard of quality. Also, they are most useful in transactions in fungible goods. In reality, implied warranties offer little, if any, protection.

Another kind of warranty is "fitness for particular purpose". Section 4-2-315, CRS states that "Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is, unless excluded or modified, an implied warranty that the goods will be fit for such purpose.". This warranty may, for example, be some protection if a computer company suggests specific models for a computer system, and the system does not work when

integrated. Because the State was relying on the computer company to make a workable system, there might be a remedy against the contractor.

But beware if these commonly implied warranties are excluded using language such as:

> **THE SELLER SELLS THE SUPPLIES "AS IS" AND DISCLAIMS ALL EXPRESS AND IMPLIED WARRANTIES, INCLUDING BUT NOT LIMITED TO THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE.**

If a disclaimer like this is in a contract, it may prevent reliance on either one of these implied warranties. The State will then have to rely on any express warranties written in the contract.

Note there has been no discussion about service contracts. That is because the Uniform Commercial Code warranty rules do not apply to service contracts, only to transactions in goods. Warranties would have to be written in a service contract to be effective. There are no implied warranties.

Warranties require close reading to determine just what is being warranted. For example, a statement that the seller warrants that a product is free from defects for one year may only mean that the buyer has a year in which to find defects that existed at the time of delivery. A statement that the seller warrants that a product will remain free from defects for a period of one year is probably a "failure free" warranty. Read the warranty clauses carefully.

Liquidated Damages

A liquidated damages provision is a contract clause that gives one party the right to withhold payment at an agreed rate per calendar day if the specified performance is late. This right does not exist unless it is stated in the contract. These clauses are common in construction contracts. They are not commonly used in supply and most service contracts.

Damages for breach (e.g. late performance) by either party can be liquidated in the contract, but only at an amount which is reasonable in light of the anticipated or actual harm caused by the breach, the difficulty in proving the loss, and the inconvenience or unfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void because it is interpreted to be a penalty. See Section 4-2-718, CRS.

Procurement Rule R-24-106-101-07 (reproduced in Chapter 6, Appendix A of the *Manual*), is an example of a liquidated damages provision. Whether liquidated damages will be enforced by the courts depends on whether they are characterized as "penalties." The contract file should contain a memorandum explaining the rationale for the liquidated damages amount. Examples include the rental costs of substitute facilities or equipment, the labor costs of continued oversight or inspection when services contracts are delayed, the lost opportunity for improved efficiencies because of late or unsatisfactory performance, or other specific elements of costs that might have been avoided had performance been completed on-time.

Assuming the clause is enforceable, listed below are some considerations in assessing liquidated damages:

- If the contractor is excused from delay because of an "excusable delay" granted by a "force majeure" clause (see the model “force majeure” clause in Chapter 6, Attachment A) or another contract provision, such as “Termination for Default,” the contractor cannot be assessed liquidated damages for that portion of the delay.

- In services or construction contracts, the right to assess liquidated damages generally ends on the date that there has been "substantial completion," or "beneficial occupancy" in construction contracts, unless some other standard has clearly been defined. "Substantial completion" has been defined as the moment when the deliverable is capable of being used for its intended purpose.

- If a contract is terminated for default, the contractor can be assessed liquidated damages until a substitute contractor is reasonably procured and achieves "substantial completion."

- As a general rule, actual damages for the delay covered by liquidated damages cannot be recovered in addition to liquidated damages.

Waiver of Delivery Dates and Other Requirements

If a State representative observes defective contract performance and remains silent, the contractor may be able to argue that the requirement was waived, particularly if the contractor could have changed its performance and avoided additional costs had the discrepancy been disclosed at the time.

Waiver of performance/delivery dates is a more common problem. The State can wait a reasonable period after a delivery date has expired to determine whether to terminate the contract or exercise other remedies. However, if the State induces the contractor to continue performing, or waits an unreasonable time to decide on a remedy, the State may have "waived" the delivery date. The following steps are recommended to avoid potential problems:

- Comply with any contract clause requirements for notice, (e.g. the termination for default clause, discussed in Section 7.2).

- Do not issue change orders or use other directives after the delivery date has passed, until a decision on remedies has been made.

- Correspondence with the contractor seeking facts is acceptable, but do not "induce" or encourage performance. To do so may waive the delivery date.

- Make decisions to terminate contracts promptly after receipt of the contractor's response to "cure notices".

If a delivery date is waived, make sure to re-establish a reasonable date for delivery or performance, preferably by written agreement with the contractor.

7.2 Termination for Default

The discussion in Section 7.1 emphasized remedies that exist when the contract is silent about them. One of the most significant rights often granted by contract is the right to "terminate" a contract when the contractor has defaulted in performance. In supply contracts, the UCC grants a similar right called "cancellation" that can be exercised under the circumstances and using the procedures in Section 4-2-711, CRS. Otherwise, the right to terminate, and the procedures to execute it, are defined in a clause in the contract. The Procurement Rules have a model clause, that is reproduced at Chapter 6, Appendix A, of the *Manual*. This clause is patterned after the federal procurement termination for default clause that has been in use in government contracts for many years.

There is no Colorado case law on use of the clause, although there are many federal cases discussing the right to terminate, whether the procedure has been properly followed, etc. The clauses are enough alike that some of the same principles apply. When considering terminating a contract for default, legal counsel should always be consulted. Termination for default is disfavored by the courts, because the effect of a termination for default is to stop payment to a contractor even though it has incurred a substantial amount of expense during performance. The "presumptions" are usually against the State in default termination. Justifying the remedy involves a fairly heavy burden of proof by the State agency or institution.

The following are commonly used terms in performance remedies and termination:

Notice

The primary reason to terminate a contract is for failure to perform on time or failure to perform with due diligence. A second reason, usually more difficult to establish, is that progress is such that it appears the contractor cannot successfully complete the work on-time. In both cases, the model clause at Chapter 6, Appendix A, of the *Manual*, requires written notice to the contractor and an opportunity to promptly correct or "cure" the deficiency. Although the clause does not specify a time limit to correct the deficiency, it is recommended that at least 10 days be allowed, which is the same as the federal "notice" period.

Basis for Termination

It is not clear what level of nonperformance will be considered adequate to invoke the termination clause. Because the concept of "forfeiture" will be applied in a court's evaluation of the termination, the safest standard to use is "substantial breach", the standard in services. The UCC "perfect tender" rule will likely govern in the case of goods, although there are exceptions to that

rule also. Consult with legal counsel to determine whether there is an adequate basis for termination.

Compensation

The contractor is entitled to payment up to the date of termination, but only for "completed supplies delivered and accepted by the State." This means that the contractor is not paid for all of its costs of performance, or any at all, if it has not delivered and the State accepted supplies or deliverables.

Excusable Delay

Paragraph (d) of the model clause at Chapter 6, Appendix A, of the *Manual*, gives reasons for delay that will not be held against the contractor. If the contractor asserts these reasons for delay in response to a "cure" letter, the reasons will have to be evaluated to determine if the performance due date needs to be reestablished. This should be completed with the concurrence of the contractor, if possible.

Contractor Liability for Excess Costs

Paragraph (a) of the model clause at Chapter 6, Appendix A, of the *Manual*, states the contractor "shall be liable for excess costs in procuring similar goods or services elsewhere." So long as the reprocurement is conducted reasonably, that is, with competition that is practicable under the circumstances, the contractor will be liable for those excess costs. Competition does not require that the formal bidding process be used again. The federal rule, and State practice, permits agencies or institutions to negotiate with alternative sources to procure similar services or supplies in a reasonable period of time without formal competition. Often, the other competitors in the original procurement will be a source for the reprocurement after a default.

Erroneous Termination for Default

The last paragraph in the model clause at Chapter 6, Appendix A, of the *Manual* parallels the federal clause on termination for default. This clause has been applied to mean that, if the termination for default is not considered a breach of the contract by the State, the termination will not be invalidated but instead be treated as a termination for convenience. As is discussed in Section 7.3, a contractor is entitled to the costs of performance plus a reasonable profit after a termination for convenience. This remedy is significantly different from a contract breach remedy. In normal actions for breach, the contractor is entitled to actual damages and "lost opportunity" or the "loss of the benefit of the bargain." This normally means that a contractor is entitled to recover anticipated profits. The effect of this clause is to limit the damages to those granted in the termination for convenience clause, which do not include anticipated profits.

7.3 Termination for Convenience

In a commercial contract, a buyer cannot normally cancel a contract simply because the buyer's needs change. Government contracts commonly include a clause that grants that right, called a "termination for convenience" clause. The clause in Chapter 6, Appendix A of the *Manual* is the

Termination for Convenience clause prescribed by the Colorado Procurement Rules. This clause is modeled after the federal termination clause that has been in use since the Civil War. The clause permits the State to terminate the contract in whole or in part when "the interests of the purchasing agency or institution so require."

This clause differs from the termination for default clause in that it is not based on defaults by the contractor. A contractor can be performing successfully, and still the State may want to terminate the contract. For example, a software development contract for an agency or institution would no longer be necessary if the agency or institution were abolished, so the State would want to terminate the contract. Similarly, if technological developments made the particular software obsolete, the State would also want to terminate the contract.

Methods of Termination

The clause requires termination by written notice by the State to the contractor. Termination can also occur "by operation of law" if a termination by the State for default is held to be unjustified. See the discussion in Section 7.2.

Compensation of the Contractor

The difference from the contractor's perspective is the compensation. In a termination for default, the contractor is compensated only for supplies and services accepted by the State. In a termination for convenience, by contrast, the contractor gets the contract price for accepted supplies and services plus costs incurred during performance, costs incurred in settling subcontract termination claims, a reasonable profit (not anticipated profits), and reasonable settlement costs. Payments cannot exceed the contract price. "Allowability" and "allocability" of costs are governed by cost principles in the Procurement Code.

Termination in "Good Faith"

In Colorado, no cases have construed the termination for convenience clause. By contrast, there is a considerable amount of litigation in federal courts over the clause.

The litigation usually revolves around the concept of "consideration." There is no legally binding contract where, for example, one party agrees to perform a service and the other party agrees to pay only if it wants the service. We say that the contract fails for "want of consideration." The promise by one side to perform a service is a promise to do something the contractor would not otherwise have to do. But the other side has no such promise. Absolute control over whether performance will be required does not support a binding contract.

Sometimes a contractor will portray a "termination for convenience" right as such a contract, with one party absolutely able to control the bargain. The courts that have considered the issue, however, do not find lack of "mutuality of consideration." But they do impose an implied obligation to exercise the termination right in "good faith." A government may not "dishonor with impunity its contractual obligations." Torncello v. United States, 681 F.2d 756 (Ct. Cl. 1982). Courts talk in terms of restricting the termination for convenience right to situations where the circumstances of the bargain or the expectations of the parties have changed.

"Bad Faith"

"Bad faith" may be present if the termination right is exercised by the agency or institution with the specific intent to injure the contractor; or the State knows there is a cheaper price at the time of contract execution, signs the contract anyway, and then terminates the contract during performance to take advantage of a better price of a competitor.

It is unclear how the courts in the State of Colorado will construe these clauses. A termination for reasons related purely to the need for the requirement should be upheld. On the other hand, a termination motivated purely by economic considerations, such as availability of the supply or service at a cheaper price from a competitor, may be challenged on "mutuality of consideration" and "bad faith" grounds. The risk is that the contract would be enforced without the termination clause, making the State liable for normal breach damages, such as "anticipated profits."

Legal advice should always be sought in cases where the termination is motivated by economic considerations such as availability of the supply or service at a cheaper price from a competitor.

7.4 Avoiding Contract Interruptions

Sometimes there is no way to avoid delays and protect against interruptions. Usually, delay is caused by reasons beyond the State's control. However, diligent contract monitoring, inspection, and administration will uncover problems quickly, so the issues can be worked out. Often, contract interruptions become aggravated because no one knew about the problem until it was too late to avoid adverse effects and delays. Use the following checklist to assist in avoiding contract interruptions.

- Plan for contingencies. Have a general approach to the most frequent causes of delay and interruption to projects.
- Become familiar with the information provided in this *Guide* on contract monitoring, inspection, and performance remedies.
- Use "tickler" systems to prompt monitoring or inspections on due dates for delivery of documents, progress reports, supplies, and services.
- Inform other State agencies and institutions personnel who need to know about milestones in the contract and performance standards.
- Identify at the beginning of the contract who in the State has the authority to accept work and reject work, and issue directions.
- Immediately notify contractors using informal notices, if appropriate, about problems with performance.
- Promptly follow up an informal notice with more formal written notification, where appropriate.

- Plan a general approach to these common situations:

  - The contractor misses a required progress report date.

  - Based on past experience, the contractor is not making sufficient progress to complete the contract on time.

  - Problems are observed or complaints are received about the contractor's work.

  - A supply delivery date passes without delivery.

  - The contractor sends a letter stating that it is having supplier problems and cannot meet a delivery date.

  - The contractor sends a letter asking for more time and money, because some of the assumptions about the job were incorrect, or worse, accuses the State of changing the work.

- Make prompt decisions concerning contractor entitlement to more time and money.

ATTACHMENT A

Performance Remedies - A Manager's Checklist

General

- Establish a "tickler" system to follow up on expected delivery dates.

- Insure that personnel inspecting supplies/services know what specifications or standards the supplies the supplies or services have to meet.

- Make sure the follow-up system provides for immediate notice of defects or deficiencies before "acceptance" documents are executed.

- If performance is defective, **READ THE CONTRACT**. Know specific remedial provisions in the contract that define or limit remedial rights, such as inspection and rejection, termination, limitation of liability clauses, etc.

- In addition to specific performance requirements, and specifications, identify terms of express or implied warranties.

- In supply contracts, assess the content of "implied warranties" of merchantability and "fitness for particular purpose" as they apply to the transaction. See Sections 4-2-314 and 4-2-315, CRS.

    - Check for disclaimers of implied warranties in contract.

    - Viability of "implied warranties" may depend on opinions of experts familiar with industry practice with these kinds of supplies.

- Determine whether the contract has specified types of delay that are not the responsibility of the contractor, (e.g. "excusable delay").

- Know the rates and conditions in any liquidated damages clause in the contract.

- Evaluate options that might be proposed and discussed, such as reductions in payment, substitution of "additives" or "extras", or other consideration in exchange for waiving breaches or extending performance schedules.

Supply Contracts Without Remedies

- In the event of defects, late deliveries, or breach of warranty, assemble documents and other evidence and seek immediate legal advice if it is anticipated that there is a need to reject or "revoke acceptance" pursuant to the Uniform Commercial Code.

- -Make preliminary assessments of defenses available due to excusable delays, implied acceptance, or unreasonable delay in rejection

- Prepare written notice to contractor announcing intent to reject and stating reasons for rejection. Give the contractor three days, or reasonable time under the circumstances, to reply, and offer suitable options (e.g. downward adjustment in price in exchange for acceptance of defective supplies).

- Do nothing inconsistent with seller's ownership, (e.g. do not use the supplies).

- Evaluate the seller's response and send a confirming letter stating the reasons for rejecting the goods or accepting the seller's offer of substitute terms.

- When revoking acceptance, follow the same procedure and assess:

- Whether the defect "substantially impairs" value of the goods.

- Whether the acceptance was induced by "difficulty of discovery" or seller's assurances that defects would be corrected.

Service Contracts Without Contract Remedies

- Insure that personnel inspecting services know what scope of work or other contract provisions govern the standards that services must meet.

- Upon observation of defective performance, notify the contractor orally.

- Make preliminary assessment of defenses available due to excusable delay.

- If the oral communication is not successful, assemble documents and other evidence, seek immediate legal advice, and consider sending a written communication signed by the State representative that notifies the contractor of the breach.

- Next, consider sending the contractor written notification that specifically states that the "service deficiency" is considered a breach of the contract.

- If performance remains defective, assemble documents and other facts and consult legal counsel.

Suggested Procedure in Liquidated Damages

- Document evidence and reasons for delay.

- Determine whether contractor has made claims of "excusable delay" and make preliminary assessment of grounds for excusable delay.

- Send the contractor written notice of intent to assess liquidated damages stating the grounds for the assessment and giving a reasonable time, (e.g. seven days), for the contractor to respond.

- Consider and evaluate, with advice of legal counsel, contractor claims of excusable delay, impossibility of performance, and "substantial completion".

- Send a confirming notice stating the decision, and withhold liquidated damages if the contract language gives the right to do so.

Waiver of Delivery Schedules

- Make rejection/acceptance decisions quickly.

- Consult legal counsel concerning ways to record agreements to waive and substitute delivery schedules.

- Generally liquidated damages are not waived if delivery schedules are waived, although it is best to reach agreement on liquidated damages when reestablishing delivery schedules.

- Make sure, in cases of waiver, that reasonable delivery schedules are established, preferably with the consent of the contractor.

- This can be done by giving written notice to the contractor in accordance with termination for default clause, if one is contained in the contract, and notifying the contractor that the State intends to execute its rights to declare the contractor in breach.

- Obtain a written confirmation from contractor concerning a new delivery schedule, and negotiate if necessary.

- Send a bilateral amendment, or at least a confirming letter, agreeing that the date is a reasonable date for completion and substituting that date as the new delivery date.

Checklist for Termination for Default Situation

- READ THE CONTRACT to find the procedural requirements and basis for termination in the contract's termination for default clause.

- Gather all contract language defining the requirement, proposal clarifications and representations, if any, and correspondence concerning the performance problems.

- Provide the documentation to legal counsel in advance, summarizing by memo any information or facts not otherwise documented.

- Make a preliminary assessment of justification for "excusable delay," or anticipated defenses such as "constructive change" by the State, impossibility, defective specifications, interference by the State, unreasonable delay by the State, etc.

- Consider a meeting with legal counsel and key agency or institution personnel having first-hand knowledge of contractor's performance problems and communications with the contractor.

- Decide if there is preliminarily a basis for the termination.

- Consider other options such as:

- Termination for convenience (assess the likely costs).

- Waiver of delivery schedule, re-establishment of new reasonable delivery date, and liquidated damages assessment (if available).

- Mutual agreement to amend schedule in exchange for reduction in payments or other consideration.

- Send written "cure" letter (return receipt requested) consistent with the written notice requirements in the termination for default clause, giving the required time for response, or 10 days if not otherwise specified.

- Send copy of correspondence to surety, if applicable (return receipt requested).

- Evaluate responses and issue termination notice, if deemed appropriate, after the expiration of the "cure" period.

- If waiver of delivery schedule is deemed appropriate, negotiate a contract amendment reciting new delivery schedule and reduction in payments, if possible.

- Consult with legal counsel concerning how to reprocure or finish the performance in order to protect the right to collect "excess costs".

Complete the Appropriate Letters, Contract Amendments, Memos

- Complete the contractually required notices to the contractor, those required by the UCC, or those recommended in this *Guide* for rejecting, revoking acceptance, assessing liquidated damages, etc.

- If the contractor is offering increased or changed performance, or a reduction in price, in exchange for waived or modified delivery schedules, make sure the agreement is written in a properly executed contract amendment.

- See Section 6 for guidance concerning negotiation, dispute resolution, and contract amendments resolving disputes.

- Complete memoranda summarizing reasons for the action, and admissions by the contractor or other facts supporting the action taken.

Section 8

Contract Close-Out

8.1 Evaluating and Documenting the Results

An effective evaluation of contract performance will determine if full value was received, if the results satisfied the needs, and if experience with the current contract holds any lesson for future contracting. Although early monitoring of contract activity is the best guarantee of successful contract performance, post-completion evaluation is a necessary and valuable requisite for proper contract administration. A proper evaluation will document answers to the questions: Was full value received? Did the results satisfy the needs? Are there any lessons to be learned for future contracting?

Approaches to Evaluating Contractor Performance

There are four primary approaches to evaluating contractor performance, depending on the magnitude and complexity of the contract activity.

- Evaluation by an in-house expert (or the contract manager).
- Evaluation by another agency or institution (comparison).
- Evaluation by a knowledgeable committee.
- Evaluation by an internal or external auditor.

Techniques for Conducting the Evaluation

An effective technique for the conduct of an evaluation is to review primary attributes of the contract activity.

- Structure: Were all facilities and equipment adequate and provided on a timely basis? Were all contractor personnel and subcontractors performing adequately? Was the staff skill level appropriate? Were the proper personnel available when needed?
- Process: Were the proper services rendered, relative to type, quantity and standard of service? Was the timing of the provision of service acceptable?
- Outcome: What was the ultimate result of the contract? Was progress made, were skills learned, or were the original needs satisfied? Were original expectations realistic? Did the agency or institution receive the intended benefit contemplated in the contract?

A complete evaluation will consider any residual claims, guarantees, or warranties as well as the actual work performed.

8.2 Renewals and Options, Extensions, and Resolicitation

Sometimes, at the end of the original contract performance it is necessary to continue the contract. This is usually accomplished through renewal (option exercise), extension (contract amendment), or resolicitation.

Renewals and Options

Many contracts are in effect for longer than one year. However, because the State is on a fiscal year spending cycle, contracts commonly start with a one year period of performance, with options to renew the delivery of goods or services every July 1st. State procurement rules prohibit contracting periods in excess of five years without the approval of the State Purchasing Director. See State Procurement Rule 24-103-503.

Some contracts are written with multiyear terms, with automatic renewals subject only to "availability of funds." Often, those contracts require only that the State deliver evidence of available appropriations to the contractor within some period of time before the beginning of the fiscal year, and specify procedures for termination if funds are not appropriated. In this kind of contract, the only reason the State can stop the contract is for nonappropriation. This kind of contract is typically used in lease-purchase agreements, where the contractor (often a bank) wants some assurance that the obligation is considered a long term one by the State, subject only to nonavailability of funds.

The more common kind of renewal mechanism is the "option." An option gives the State the election to continue performance (or not) past the basic contract period. Because the State is generally committing more money, an option exercise requires legal review by the Attorney General and approval of the State Controller, unless an approved form of unilateral option exercise letter is being used that is consistent with the State Controller's policy and approved in the original contract. See Chapter 6, Appendix A, of the *Manual*, which shows the model provision and option exercise letter.

It is important to note that if the option is not exercised in time and in the manner set out in the contract, the State will lose the option rights, and most likely the agreed price. It is important to clearly understand all of the renewal provisions and exactly how and when to exercise the renewals.

Extensions

The term "extension" is used to refer to a performance extension, usually of a service contract, where the renewal option does not already exist in the contract. This type of extension is completed by using a bilateral contract amendment, in an approved form, and usually involves adjustment of the contract price or value. (See the model amendment form at Appendix B to Chapter 6 of the *Manual*.)

An extension is not effective unless it is executed before the expiration of the contract term. An expired contract cannot be extended. Further, an amendment that extends the contract term would have to be routed through all of the approving offices. Start negotiating and drafting the contract extension at least two months before the contract ends, allowing adequate time for the contract approval process to be completed.

A Note About Contract "Scope"

In contracts that are not governed by the Procurement Code, the "scope" of the contract amendment does not usually present a problem. In a grant contract with a political subdivision, for example, the parties can freely negotiate and execute a contract extension, subject only to availability of funds.

In commercial contracts, the scope of an amendment may present a problem. An extension of a supply or construction contract to grant more time for performance is probably acceptable, because no additional requirement is being added without competition. But in a service contract, where the extension is intended to provide the same level of service at the same or higher price, but for a longer time, State procurement laws have to be considered.

This is necessary because it is not fair to complete a service contract for three years, for example, and then keep adding more years of performance by contract amendment. In this example, the contract amendment is not within the scope of the original contract and the additional performance, if required, should be bid and a separate contract negotiated. A similar issue is discussed in Section 4.3 under the changes clause.

The test for the proper "scope" of amendments is to ask the question, “Would the potential competitors, at the time of the original contract or solicitation, have expected the contract extension under these circumstances?”. If the answer is "yes," then the amendment is probably "in-scope." If not, then the amendment may be "out-of-scope" and requires compliance with the procurement code’s competition requirements, or approval as a sole source contract. The State Purchasing Director, or a delegate, will make this determination at the time the contract amendment is routed for review.

Resolicitation

Assuming there is program authority and available funding, resolicitation can be used to satisfy the need for additional performance. However, if resolicitation is the solution, adequate time must be allowed prior to the original contract’s close-out to secure a new contractor to provide the goods or services. For information about purchasing requirements, lead time, etc. See Chapters 2 and 4 of the *Manual*.

8.3 Internal and External Feedback

Contract managers are often called upon to be advocates, defenders, interpreters, or arbitrators. Regardless of the other roles, the contract manager must be a communicator. State agency or institution and contractor personnel should receive periodic reports of contract progress. Such reports may include:

- Checklists and summary sheets to document successful completion of contract steps.
- Schedule of contacts made with the contractor.
- Notes of all work and modifications required, and/or approved.

- Minutes of all meetings.
- Summary of payments made (or due).
- Responses to all contractor and agency or institution requests.

In addition to the routine feedback, it is vital to thoroughly evaluate all complaints. Address all issues, conflicts, disputes, and personality clashes as serious and needing prompt attention. Hold meetings to resolve any unreal or unreasonable expectations. Advise all parties in writing of problems encountered and recommended solutions, as well as final resolutions.

IT IS VERY IMPORTANT TO GIVE FEEDBACK TO BOTH THE PURCHASING AND CONTRACTING OFFICES. Please notify State Purchasing or the State agency's or institution's purchasing director if certain contract language proved successful or if particular problems were encountered because certain other contract language was used. Prepare a "lessons learned" summary or memorandum for the purchasing/contracting office to provide feedback and suggestions for improving the procurement or the contracting process.

Two organizations have been formed to address contract improvement initiatives that have statewide implications. The Central Approval Task Force (CATF) is composed of representatives from the central approval agencies. CATF meets monthly and provides State agencies and institutions a quarterly newsletter, the *CURE* (Contract Users Red-tape Eliminator) that contains helpful information concerning the State contracting process. The Colorado Contract Improvement Team (CCIT) is composed of representatives from all State agencies. The mission of the CCIT is to implement a more effective contract process by acting as a communication link between users and approvers. To become a member of the CCIT or to be added to the *CURE* mailing list, please contact the State Controller's Office.

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