



Session Code: BI  
Contracting for Services  
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# Contracting for Services Distinctions & Critical Issues

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## Contracting for Services – Distinctions & Issues

- **Services versus Commodities Contracts**
  - What are the substantive differences?
  - How are hybrid contracts for both classified?
- **Legal Issues**
  - What laws apply?
  - Appropriate terms and conditions?
  - Performance on Purchaser's premises?
  - What law(s) for international services contracts?
  - Can we form services contracts electronically?

# Contracting for Services – Distinctions & Issues

- Practical issues in Services Contracts
  - Critical success factors
  - SOW/service description
    - Contract performance metrics
  - Services contract administration/management
    - What? When? How often?
- Special issues for service contracts
  - Indemnification v. Limitation of Liability
  - Intellectual Property protection
- Considerations for Outsourcing contracts

## Services Contracting – Legal distinctions

- UCC (state commercial codes) does NOT apply
  - No clear, consistent law
  - “buyer favored” clauses not available
    - Warranty
    - Damages
  - Uncertainty in the Battle of the Forms
  - Electronic contracting may require a “writing”?
- Performance often on Purchaser’s premises
  - Significant legal issues regarding liability for damages and/or injury
- Different & more complex contracts needed
  - Standard commodity contract generally inadequate

## Services Contracting – What Laws Apply?

- State common law or statutes on contract law
  - Substantively different than UCC
  - Requires comprehensive assessment and contractual allocation of risk(s)
- Intellectual Property Protection (IP)
  - IP provides competitive edge to an organization
  - critical component of any services contract
  - especially problematic in foreign environments
- Privacy Protection
  - employee health records (HIPPA)
  - company financial information (SEC & State regs)
  - other sensitive information requiring protection?

## Contracting for Services – Hybrid Contracts

- What if contract covers BOTH goods and services
  - How will it be classified?
  - What laws apply?
- “Predominant purpose” of contract determines the classification
  - If classified as “goods”, UCC applies
  - If classified as “services”, common law or other state law applies
  - Could BOTH be applied?
  - e.g.: telecommunications WITH equipment
    - courts split on how to treat; therefore, agree in contract

# Services Contracting – Critical Perspective

- The contract defines *risk(s)* and allocates that *risk* among the parties
- Never defer definition of a necessary component
  - TBD or to be agreed upon?
  - Deferred definitions will affect price and/or schedule!
- Contract terms & conditions (T&C)
  - Do not use standard P.O. – unless specifically designed for services contracts
  - Each service will likely require customization of T&C, e.g.: janitorial service, versus roof repair?
  - Use a comprehensive checklist to ensure critical elements are considered and included in the contract
- Utilize templates cautiously!
- Quality RFx = Quality Proposal = Quality Contract<sub>8</sub>

## Services Contracting – Electronic Contracts

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

## Uniform Electronic Transactions Act (UETA)

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

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

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

## e-Contracts for Services

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

# Contracting for Services – General Categories

- Traditionally acquired through Supply Management
  - Facility maintenance/repair
  - Freight/logistics
- Non-traditional
  - Travel
  - IT support
  - HR services
    - Health or life insurance?
- Outsourcing
  - Complete relinquishment of responsibility for a business process and/or function
  - Becoming more prevalent; contracts are more challenging

# Uniqueness of Non-traditional Categories

Travel \*

Fleet vehicles \*

Security Services \*

Freight audit/payment \*

Courier services

Telecommunications

H.R. Benefits Service

- Medical, dental, vision, prescription

Payroll processing \*

International Logistics

Energy/Energy Management \*

\* *Outsourced ?*

# Service Contracts – Specific Contractual Considerations

## ✓ Changes

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

## • Unexpected conditions

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

## ✓ Work disruption

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

## Service Contracts – Specific Contractual Considerations

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

## Service Contracts – Specific Contractual Considerations

- ✓ Contractor employees
  - ✓ OSHA and other regulations will apply; therefore, who will assure compliance with rules & regulations?
  - ✓ Contractor employees committed to follow our safety rules when on our premises?
- ✓ Behavioral issues – *Contractor on our premises*
  - ✓ Drug possession or use
  - ✓ Sexual harassment (*definition?*)
  - ✓ Smoking or drinking on premises
  - ✓ Ensure clear, written organizational policy
  - ✓ Require that contractor and subcontractor employees agree to comply as condition to admission on our premises

## Service Contracts – Specific Contractual Considerations

- ✓ Warranty
  - ✓ No UCC implied warranties available
  - ✓ How to judge the quality of work? What criteria?
  - ✓ What will be the remedy if work is unsatisfactory?
- ✓ Subcontracts
  - ✓ Control approval of any subcontractors
  - ✓ Ensure subcontractors provide required expertise!
- ✓ Payment
  - ✓ Progress payments needed?
  - ✓ Assure that subcontractors are paid in timely manner
  - ✓ Require indemnification against mechanics liens

# Service Contracts – Specific Contractual Considerations

## ✓ Taxes

- ✓ What tax liability for services? (*state, federal, local*)
  - ✓ not just sales tax
- ✓ Determine classification of the contractor
  - ✓ employee versus independent contractor
  - ✓ considerably different tax liability

## ✓ Termination

- ✓ What conditions warrant default termination of contract?
- ✓ How to replace contractor in event of termination?
- ✓ Are there alternate service providers?
- ✓ What is contractor liability if termination is required?
- ✓ Liability if our organization defaults?

## Service Contracts – Unique Contractual Considerations

- ✓ Completion
  - ✓ What event(s) constitute completion?
  - ✓ What rights/obligations if performance not complete?
  - ✓ Advisable to provide for “*liquidated*” damages in event of failure to perform in timely manner
    - ✓ Agreed upon cost of non-performance?
- ✓ Dispute resolution
  - ✓ What is the process in event of disagreement?
  - ✓ Avoid litigation! (ADR clause for arbitration?)
- ✓ Scope of work
  - More frequent performance issues necessitate more comprehensive coverage

# Services Contract Writing

- Use of a checklist
  - Not just for the novice!
  - Address all substantive issues
  - Consider experience with service provider
    - both positive and negative
  - Determine need for clause(s) and content
  - Selecting the “right” checklist
  - Assess critical clauses, such as *indemnification and limitation of liability*

# Critical Clauses in Services Contracts

- Indemnification *versus* Limitation of Liability
  - Consider the circumstances
  - Law Department guidance advisable
- *Indemnification* = Supplier agrees to stand in for Purchaser in event of incident and/or litigation with third parties; subject to expressed limitations
- *Limitation of liability* = agreement of Parties on the limits of their respective liability to each other, under stated circumstances
- Financial stability of supplier should be considered

# Critical Clauses in Services Contracts

- Indemnification *versus* insurance – which one or both?
  - Depends upon the circumstances
  - Obtain Law Department guidance
- *Indemnification* = Supplier agrees to stand in for Purchaser in event of incident and/or litigation; subject to expressed limitations
- *Insurance* = insurer is engaged to provide financial protection in event of incident and/or litigation; subject to expressed coverage & limits
- Financial stability of supplier and/or insurer should be a factor in determining which is appropriate (or *both?*)

Contract Formation – Letters of Intent (LOI)  
or Letter Agreements (LA)

RISK?

Purchaser and Seller hereby agree that it is their intention to enter into a contract for the purchase of *(description of the service)*

This letter is not intended to bind either party to proceed with the cited transaction.

*-and/or-*

This letter will be subject to the negotiation of mutually acceptable terms & conditions to govern the intended transaction.

# Contract Formation

- Letters of Intent or Letter Agreements
  - Why?
    - “Intended to obtain a supplier commitment, but maintain flexibility”
  - RISK?
    - Is it generally a “contract”? (commitment?)
    - If not, then what is the value?
  - Use cautiously, and recognize that it likely establishes a contract
    - Do not leave critical elements to chance
      - Clearly establish essential items in the LOI or LA

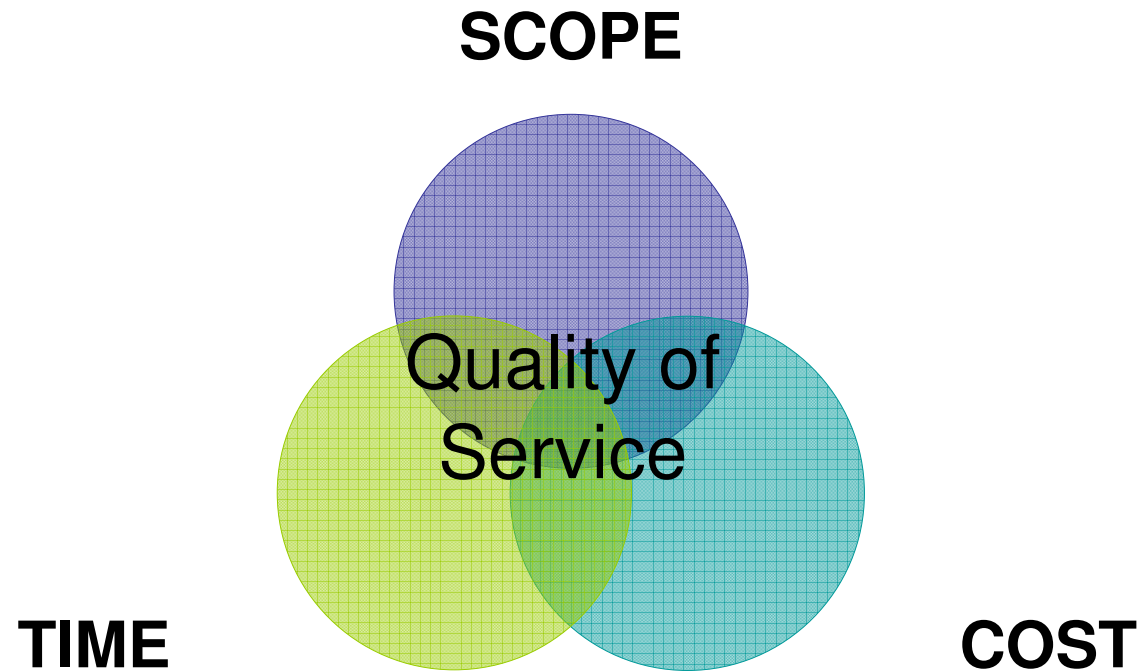
# Services Contracting – Critical Perspective

- Appropriate performance metrics are imperative
  - What variables would indicate supplier is performing well or poorly?
  - What metrics will adequately measure appropriate variables?
  - How frequently can/should measurements be taken?
  - How and to whom will reports be made?
- Establish clear, comprehensive statement of work (SOW) or service level agreement (SLA)
  - What is the required result?
  - What penalty if result inadequate or unacceptable?
    - Establish liquidated damages?

## Ensuring an Effective SOW

- Statement of Work (SOW) is a critical part of the services contract!
- Consider the impact of each aspect of the SOW on other aspects of the SOW or contract
  - scope
  - cost
  - quality
  - time/schedule

# Successful SOW



# Ensuring an Effective SOW

- SOW is a critical part of the services contract!
- Each SOW requirement should be:
  - Correct: technically accurate
  - Complete: express a whole idea or statement
  - Clear: unambiguous; not subject to interpretation
  - Consistent: not in conflict with other requirements
  - Feasible: technically & legally possible
  - Verifiable: can be proven to meet specific requirement(s)
  - Also, whenever possible:
    - modular: one element can be changed without excess impact on other elements;
    - measurable: clearly identified, with appropriate metrics included for measurement

# Ensuring an Effective Spec/SOW

Typical problem areas for Supply Managers:

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

# Ensuring an Effective Spec/SOW

Typical problem areas for Supply Manager:

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

# Ensuring an Effective Spec/SOW

Typical problem areas for Supply Manager:

- Unrealistic expectations (wishful thinking?)
  - “100% reliable, totally safe, fully compatible”
  - If it is realistic, use clear terminology, such as “all calls will be answered by the 3<sup>rd</sup> telephone ring, or returned within 4 minutes ”
- Ambiguity
  - Use of terms which may have more than one reasonable meaning, e.g: supplier will provide documentation in the “future”
  - May enable the supplier to perform to their interpretation, rather than to our expectation or need

# Ensuring an Effective Spec/SOW

Problematic words & phrases:

- “*large*”, or other such vague adjectives, i.e.: what may be large under one circumstance, will not be under another circumstance
- “*and/or*” – which is it?
- “*not limited to*” – unless otherwise specified, the stated parameter will be a limit
- “*because*” – why explain the rationale? spec/sow should specify, not explain.
- “*etc*” – if something else is needed, define and specify; otherwise, it will not be required
- “*up to*” – avoid confusion, and clearly state the parameters, e.g.: “from \_\_\_\_ to \_\_\_\_”

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

# Special Considerations for Outsourced Contractors

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

# Special Considerations for Outsourced Contractors

- Special issues
  - Intellectual Property (IP) sharing could jeopardize ownership rights
    - clearly identify and allocate ownership in the contract
  - Hiring/transferring Purchaser employees
    - any restrictions on who they can hire from Purchaser?
    - notification to Purchaser employees required by law?
  - Contract termination generally has significant economic consequences to Purchaser
    - What rights continue post-termination? e.g.: continue service during transition back to Purchaser?
- What portion(s) of process are outsourced?
  - Assure that the outsourced process is functional before outsourcing the function!!
- Challenge is to *balance* legal issues with business issues!

# Protecting Intellectual Property

- *Identify* all types of intellectual property (IP) which may be provided to, or received from a supplier
- Clearly *mark* all such IP as appropriate to ensure assertion of proprietary/ownership rights
  - “Confidential” or ”proprietary”
  - List appropriate restrictions on legends
    - return or destroy when finished? reproduction authorized?

# PROTECTING INTELLECTUAL PROPERTY

- Create comprehensive procedures, practices or processes which will afford appropriate protection for all categories of IP - Purchaser's, Suppliers, or Customer's
  - Limit access (secure)
  - Use legends and cover sheets
  - Limit reproduction
  - Recognize special requirements for computerized/stored information

# PROTECTING INTELLECTUAL PROPERTY

- Provide training for personnel who may be exposed to any form of IP
  - Employees
  - Contractors
  - Suppliers
  
- Create a proprietary information non-disclosure agreement (NDA)
  - Define the information to be protected
    - Describe in as much detail as possible
    - Are originals or copies being provided?
    - Require clear labeling where proprietary rights are claimed
  - Work with Law Department to assure adequate protection

## Contracting for Services – International Sources

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

## Services Contracts: Administration/Management

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

## Services Contracts: Administration/Management

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

## Services Contracting - Summary

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

# Questions?

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