

Commercial notes

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ADVANCE ISSUE

MANAGING CONTRACTS IN THE PUBLIC SECTOR

In Commonwealth procurement, public accountability obligations mean that agencies are held to a higher standard of contract management than private sector organisations. Poor contract management in Commonwealth procurement is an ongoing issue that is highlighted in ANAO reports and Senate Estimates hearings. This note outlines some important contract management considerations, including commonly occurring legal issues in contract management.

What is contract management?

Contract management is the process through which agencies seek to effectively manage the inherent risks of a commercial relationship to ensure that the rights and interests of the Commonwealth are safeguarded.

In the Commonwealth context, managing a commercial relationship is more complex because agencies must adhere to Commonwealth legislation and policies (e.g. the *Financial Management and Accountability Act 1997*, the *Commonwealth Authorities and Companies Act 1997*, the *Archives Act 1983* and the *Auditor-General Act 1997*).

This note discusses issues that may arise in the management of a goods or services contract under the *purchaser/provider model*, as this represents the 'standard' form of Commonwealth procurement. For specialised contracting models, such as strategic alliances and public private partnerships, a tailored contract management plan is required.

How can the procurement process assist the contract manager?

The procurement process will have an impact on how successfully a contract will be managed, but it is beyond the scope of this note to discuss the procurement cycle – specifically, the pre-contract (Request for Tender preparation), tender evaluation to contract and contract implementation phases. Nonetheless, the importance of these stages to contract management cannot be overemphasised. Careful consideration – and in some cases specific advice – is required.

To allow for effective management in the contract management phase of a procurement, the following prerequisites need to be considered:

- The contract should properly define the services or the scope of work.
- The contract should contain appropriate risk mitigators (e.g. warranties, indemnities, liquidated damages, financial undertakings and performance guarantees).



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- Appropriate performance measures should be included in the contract.
- The contract should comply with Commonwealth legal and policy requirements (e.g. privacy, confidentiality and security concerns).

If the contract is deficient in any of these respects then potentially there will be significant inherent issues to manage.

What are the key elements of effective contract management?

To manage a contract effectively, the contract manager must ensure *that they actively engage with the contractor to achieve agreed outcomes*. The extent of this engagement will depend on the contracting environment and the scope of the risks to each party that flow from the contract.

Effective contract management will also involve:

- ensuring that the commitments and obligations of both parties are met
- diligently managing identified risks to the agency
- monitoring contractual events to ensure problems do not occur
- dealing with problems that do occur in a proactive manner to limit their effect.

Poor contract management is a major cause of disputes. It can lead to dysfunctional and adversarial relationships between the parties which may culminate in litigation. Without effective contract management, agencies may also fail to obtain value for money through the life of the contract.

From the outset, *contract objectives should be clearly defined*. Also, appropriate processes should be set in place to help monitor progress and provide feedback to contractors. This will ensure that contract deliverables, including services, are provided:

- as required
- to the agreed standard

and that inadequate standards are detected as early as possible and promptly addressed.

In 2007, the ANAO and the Department of Finance and Administration produced the *Developing and Managing Contracts: Better Practice Guide* (February 2007), which is a useful reference tool for agencies when managing contracts.

This note provides a summary of some of the important contract management tasks and issues that will confront contract managers during the life of a contract. It is not intended to be a contract management manual. If a manager is faced with specific contract management issues outside their experience and expertise, AGS recommends that the manager seek advice from the agency's procurement area and/or seek legal advice.

Legal and policy environment

The legislative framework within which an agency must conduct its procurement activities includes:

- For FMA bodies:
 - *Financial Management and Accountability Act 1997* (FMA Act)
 - *Financial Management and Accountability Regulations 1997*
 - any Finance Minister's Orders
 - Agency Chief Executive's Instructions (CEIs), policies and procedures

Poor contract management is a major cause of disputes. It can lead to dysfunctional and adversarial relationships between the parties which may culminate in litigation.

- For CAC bodies:
 - legislation which establishes the body
 - the *Corporations Act 2001* (for CAC companies)
 - *Commonwealth Authorities and Companies Act 1997* (CAC Act)
 - *Commonwealth Authorities and Companies Regulations 1997*
 - Finance Minister's (CAC Act Procurement) Directions 2009
- *Public Service Act 1999* for most FMA bodies and some CAC bodies
- *Archives Act 1983*
- *Auditor-General Act 1997*
- *Commonwealth Procurement Guidelines* for all FMA bodies and most CAC bodies
- Agency operational instructions on, for example, Procurement of Goods and Services.

This list is not exhaustive.

FMA agencies: Financial Management and Accountability Act framework

The FMA Act regulates the exercise of powers by chief executives of agencies regarding the spending of public moneys (among other things). Chief executives usually devolve these powers by delegation or authorisation to specified officers in the agency. The CEIs of each agency provide guidance to the particular agency on the application of aspects of the FMA Act framework. CEIs often include instructions on topics such as 'Approving and Authorising Proposals to Spend Public Money', 'Procurement of Property and Services' and 'Contract Management and Variations'.

An 'approver' under the FMA Act framework needs to approve entering into a contract. Similarly an approver needs to approve any variations to the contract.

It can therefore be helpful if contract managers are 'approvers'. If they are, they should be aware of the ambit of their delegated power. If they are not, they will need to work in close collaboration with a person who is an approver.

It is not uncommon for officers who are not 'approvers' (i.e. hold no financial delegation) to be involved in routine contract administration tasks (e.g. processing claims for payment, reporting requirements under the contract etc.).

Australian Public Service (APS) Code of Conduct

Most public sector contract managers are APS employees and as such must comply with the APS Code of Conduct set out in s 13 of the *Public Service Act 1999* (PS Act). To comply with the code, APS employees must, among other things:

- behave honestly and with integrity in the course of APS employment
- act with care and diligence in the course of APS employment
- when acting in the course of APS employment, treat everyone with respect and courtesy, and without harassment
- when acting in the course of APS employment, comply with all applicable Australian laws. For this purpose, 'Australian law' means:
 - any Act (including the PS Act), or any instrument made under an Act, or
 - any law of a State or Territory, including any instrument made under such a law
- use Commonwealth resources in a proper manner

Most public sector contract managers are APS employees and as such must comply with the APS Code of Conduct set out in s 13 of the Public Service Act 1999.

- not provide false or misleading information in response to a request for information that is made for official purposes in connection with the employee's APS employment
- at all times behave in a way that upholds the APS values and the integrity and good reputation of the APS.

Acting fairly and reasonably

The APS Code of Conduct and the FMA regime are consistent with a number of judicial statements requiring the Commonwealth to act fairly and reasonably at all times in its commercial dealings. For example, the Federal Court referred to this requirement in *Hughes Aircraft Systems International v Air Services Australia* (1997) 146 ALR 1. Essentially, this means that the Commonwealth may be held to a higher standard than commercial parties.

CAC bodies: Commonwealth Authorities and Companies Act framework

CAC authorities

The authority's enabling legislation and the CAC Act and associated regulations, orders and directions establish the framework under which CAC authorities carry out procurement activities. Powers and functions of CAC authorities are usually vested in either the board of the body or the chief executive, but delegations and authorisations to other officers of the body can be put in place.

In some cases, significant contracts (including significant variations to existing contracts) must be approved by the relevant minister.

Officers of CAC authorities will need to ensure that they have appropriate authorisation to carry out procurement activities and contract management and are acting in accordance with the body's internal procedures and instructions.

Under the CAC Act, officers and employees of CAC bodies are obliged:

- to exercise care and diligence
- to act in good faith
- not to use their position or information gained through their position to gain advantage for themselves or others or to cause detriment to the body.

CAC companies

For CAC bodies that are companies, the *Corporations Act 2001* imposes similar obligations to the CAC Act on officers of the company in relation to good faith obligations etc. The company's constitution will also establish the framework that the company's business is carried out under by identifying which decisions are to be made by shareholders (e.g. the minister) and directors. Most companies will have specific authorisations and procedures, issued by the board or the chief executive, for company officers who carry out procurement and contract management activities – particularly those involving spending money.

Contract manager's role

Complex or significant contracts often have a designated 'contract manager' who is responsible for day-to-day administration and management of the contract; and a designated 'contract authority' who is responsible for strategic decision making under the contract (e.g. approving variations, dispute resolution).

The term 'contract manager' is used generically in this note to refer to the primary agency representative with whom the contractor has dealings, who has legal and contractual oversight of the contract and is generally responsible for defining the relationship between the agency and the contractor. The contract manager will be required to actively manage the working relationship between the agency and the contractor.

The APS Code of Conduct and the FMA regime are consistent with a number of judicial statements requiring the Commonwealth to act fairly and reasonably at all times in its commercial dealings.

Officers of CAC authorities will need to ensure that they have appropriate authorisation to carry out procurement activities and contract management and are acting in accordance with the body's internal procedures and instructions.

The contract manager will generally:

- act as an initial point of contact for the contractor for all correspondence and legal and operational communications under the contract
- negotiate and agree contract variations
- maintain records of all interactions with the contractor
- seek to resolve disputes (in accordance with the relevant contract provisions)
- provide advice on purchasing and contractual issues, as required, including liaison with other branches and other agencies on contracting matters including policy and procedures.

Getting to know your contract

The contract manager should be familiar with the contractual requirements, including:

- key provisions of the contract
- timetables and deadlines for key activities
- the contractor's commitments
- the agency's commitments
- a list of potential risk areas.

There are generally two types of contract provision: background provisions and moving provisions. Background provisions set out the parties' agreed legal framework – for example, the intellectual property rights of the parties or confidentiality and privacy obligations. Moving provisions affect the day-to-day relationship between the parties – for example, the payment and reporting requirements.

Sometimes there can be an overlap between the provisions – for example, the confidentiality provisions can require subcontractors to provide undertakings as they commence work on the project. The contract manager needs to understand the difference between these two types of provisions in order to design an appropriate contract management system.

Timetables and deadlines

The contract manager should maintain a list of tasks and commitments, which should be updated regularly and include such items as scheduled completion dates, responsible individuals, and a description of the last action taken by each party on each commitment or responsibility. This list should be checked against the contract to monitor and confirm the completion of tasks. In order for this process to be effective, each of the contractor's and agency's commitments must be properly defined in the contract.

Potential risk areas

The contract manager should understand the risk allocation mechanisms in the contract. By definition, a contract is a risk allocation mechanism between the agency and the contractor. All contracts, regardless of their size or type, will involve some form of risk that may adversely impact on the achievement of their objectives. The risk allocation mechanisms in the contract should reflect the risk assessment conducted at the beginning of the procurement process. Major procurements often have a specific risk management plan.

The contract manager will be required to actively manage the working relationship between the agency and the contractor.

All contracts, regardless of their size or type, will involve some form of risk that may adversely impact on the achievement of their objectives.

The risk assessment should be updated throughout the life of the contract to address changes in circumstances and risks associated with the performance and management of the contract. Commonly used risk mitigators include:

- provisions for the reduction and/or the deferral of fees for failure to perform, which tend to be quite common in service contracts
- an indemnity clause (Indemnity is a promise to reimburse the loss suffered by the indemnified party where it has arisen as a result of an event covered by the indemnity.)
- provisions limiting the agency's (or the contractor's) liability²
- clauses for the provision of performance guarantees (Performance guarantee is a promise by a third party to either perform work or pay money or both in the event the contractor defaults.)
- liquidated damages (LD) clauses (LD clauses should be a genuine estimate of loss that the agency would suffer if the contractor breaches its obligations. If the contractor breaches its obligations under a liquidated damages clause it is required to pay the agency the amount specified in the clause as compensation for the agency's loss.)
- insurance requirements (Contract will usually require the contractor to insure for the risks it takes on under the contract. Standard insurance categories for contractors include public liability, professional indemnity and workers' compensation. Specialised insurance, such as product liability, may be specified depending on the nature of the goods or services. For most Commonwealth agencies, insurance arrangements for the agency itself are with Comcover and Comcare for employees.)
- warranties (Warranty is a promise whereby one party provides certain assurances to another party.)
- rights of termination for default (The general law a party to a contract may terminate the contract and seek damages from the other party where the other party has defaulted in a way that goes to the 'root of the contract' or is a 'fundamental breach'. Generally, a termination clause is exercised where a party is unable, or no longer willing, to perform its obligations under the contract.)
- clauses that allocate responsibility to one party to either deal with or pay for particular contingencies that may arise (e.g. rectification clauses, which make one party responsible for particular costs that may arise during the project; or clauses that provide for an adjustment to fees in the event that certain contingencies arise, such as changes in the law).

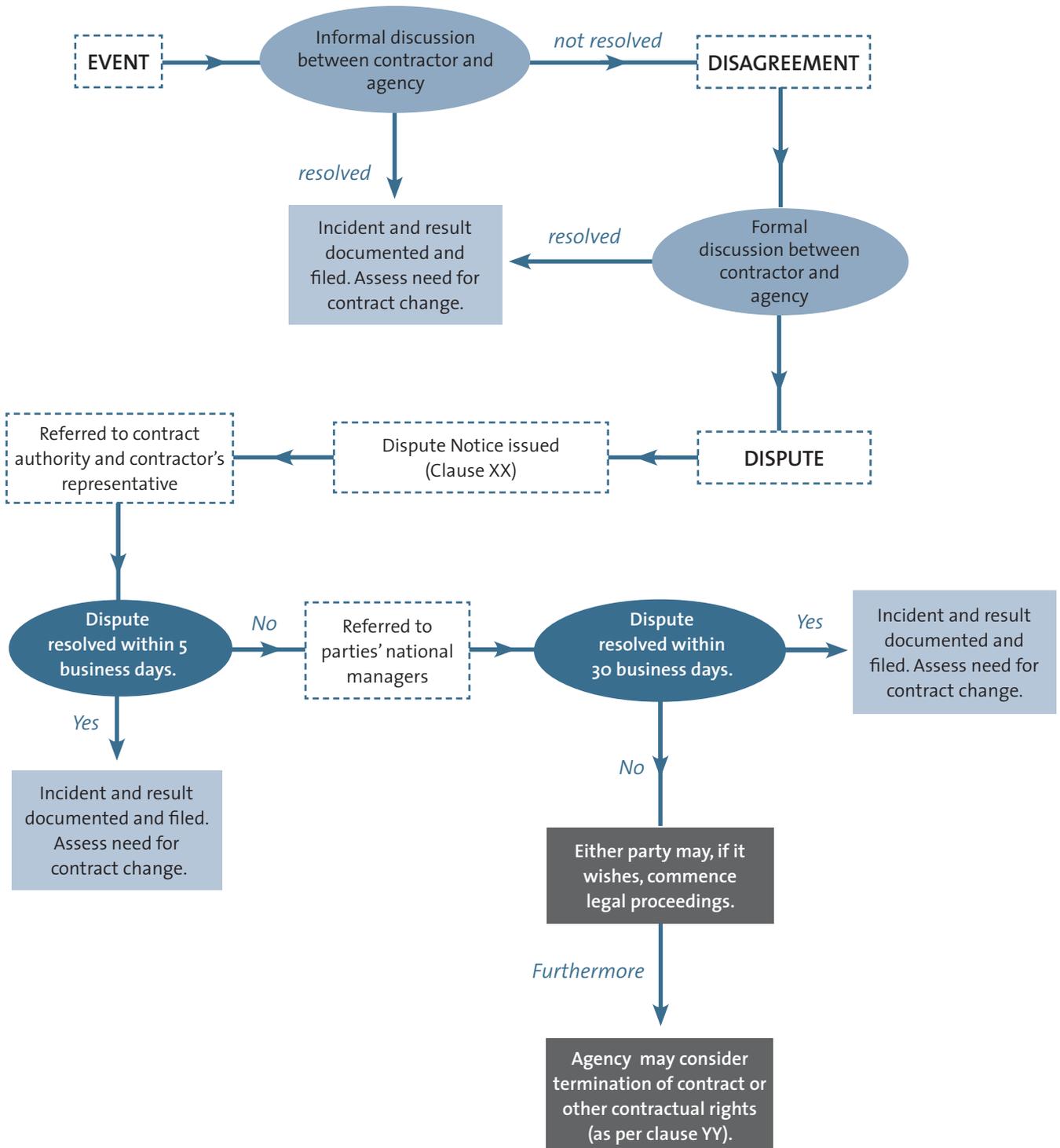
The use of flow charts or tables to break down internal processes and the requirements of the contract can be useful educative and management tools. They are commonly used to break down a variety of processes under the contract, including:

- dispute resolution processes
- performance management regimes
- payment regimes
- processes for contract change proposals.

To the right is an example of a flow chart for the dispute resolution process under a significant and complex services contract.

The risk assessment should be updated throughout the life of the contract to address changes in circumstances and risks associated with the performance and management of the contract.

The contract dispute resolution process



Relationship management

Relationship management is a key role for the contract manager. After contract signature, the contractor will be sensitive to indications as to how the contract manager intends to work with them. The contractor will most likely respond to the contract manager's approach with a similar approach on their side. Therefore, adopting a strict 'manage to the contract' approach will probably produce a similar approach from the contractor.

If the contract manager demonstrates a more flexible, outcomes-focused (rather than process-focused) approach, the contractor is likely to be more flexible. The challenge for a contract manager is to implement an approach that combines the benefits of flexibility and a focus on the business outcomes, with the administrative rigour required to manage risk and satisfy the agency's and the contract manager's accountabilities.

While the legal requirements of the contract determine the proper course of conduct in contract management, the exercise of skill and judgment is often required to effectively protect the agency's interests. It is important to manage and not seek to control the contractor. Equally, it is important not to be 'captured' or controlled by the contractor. Contract managers should not fall into the trap of abdicating decision-making responsibilities and allowing the contractor to use its judgment to determine direction.

A strategic relationship with the contractor is also important. Although there is a formal contractual relationship, the parties need to recognise their mutual dependence and mutual interest in developing a cooperative relationship. The relationship is more likely to be successful if:

- there is shared qualitative understanding of the task to be achieved and the objectives of the contractual relationship
- the expectations of both parties are realistic
- there are effective mechanisms for clear, open and effective communication to permit the contractor to accommodate the agency's specific needs.

Managers must provide guidance in setting responsibilities for the contractor, managing the performance of the contractor according to those responsibilities and facilitating the delivery of the services by the contractor. Contract managers should be alert to opportunities to assist the contractor. This will also include managing client or stakeholder expectations of the contractor's performance, including:

- establishing realistic expectations of the contractor's capabilities and desired outcomes
- establishing the limits of the contractor's responsibilities
- educating clients or stakeholders about how the contract will fit into the agency's business strategy
- ensuring that the agency complies with any obligations it has under the contract
- developing processes for service delivery and interaction with the contractor.

If the contract manager demonstrates a more flexible, outcomes focused approach, the contractor is likely to be more flexible.

Communication and contract amendments

Effective contract management requires the agency (i.e. the contract manager) to establish and maintain clear and effective lines of communication and reporting procedures with the contractor, including mechanisms to address performance issues and resolve disputes. Systematic contacts and formal communication procedures can ensure that a continuous dialogue is maintained

with the contractor so that the contractor is aware of developments within and outside the agency – particularly changes that might impact on the scope of work and service delivery.

A crucial part of managing the flow of information between the contractor and the agency involves understanding the implications of such communication. As illustrated in the decision of the Federal Court of Australia in *GEC Marconi Systems Pty Limited v BHP Information Technology Pty Limited* (2003) 201 ALR 55 (see *AGS Commercial Notes* No. 8 (17 January 2004)), a contract can be varied by conduct (including by waiver and/or estoppel) or oral representation.

In Australia there are no statutory requirements concerning the form of contract variations except for certain limited classes of transactions such as dealings in land. A contract will usually have a standard clause providing, at a minimum, that the contract can only be amended by agreement in writing. Notwithstanding this writing requirement, a contract can be amended at common law by:

- waiver (the renunciation of some legal right)
- oral representation
- acting inconsistently with the terms of the contract ('estoppel', the prevention of a party from asserting in legal proceedings a position contrary to that established by other means).

It is important for contract managers to assess the implications of their communications. They should consider whether the verbal directions they intend to give the contractor accord with the terms of the contract. If they do not, the contract manager may unintentionally create a contract variation. Where contract managers are dealing with what may be an out-of-scope requirement, they should minimise the risk of unintentionally varying the contract by making it clear in any communications (including oral and email communications) they have with the contractor that discussions are subject to agreement being reached in writing and signed by both parties.

Monitoring performance

A significant obligation of the contract manager is monitoring performance according to the contractual performance measurement system and making timely decisions.

The contract manager can monitor performance effectively by using the following steps:

- Ensure good internal corporate knowledge of the performance measurement system. (Ideally, performance indicators and measures should be integrated with both parties' management, accounting and financial systems. Intrusive reporting will be counterproductive and costly, placing administrative burdens on both parties.)
- Ensure good internal project planning, particularly if the contract is being performed in stages or as an ongoing service.
- Hold timely meetings with the contractor regarding day-to-day operations and performance, including problem and risk management.
- Promptly follow up on the cause of performance problems and remedial efforts undertaken by the contractor to prevent the recurrence of problems.
- Periodically review and, where necessary, vary the contract requirements in order to reflect changing business priorities, lessons learned from experiences in the relationship, and improved performance capabilities.

Where contract managers are dealing with what may be an out-of-scope requirement, they should minimise the risk of unintentionally varying the contract by making it clear in any communications (including oral and email communications) they have with the contractor that discussions are subject to agreement being reached in writing and signed by both parties.

Record management: the audit trail

Well-kept records provide information that is critical to competent contract management. Records should include performance monitoring, decision making and dispute resolution. A complete audit trail should be maintained to ensure that decisions or processes can be reviewed and to demonstrate accountability to program managers (and ultimately to parliament). The extent of the documentation required largely depends on the circumstances and likely consequences, but it is also dependent on satisfying the legislative requirements for Commonwealth record keeping (under the *Archives Act 1983*, the *FMA Act* and the *CAC Act*).

In contract management, routine matters can quickly and easily escalate into non-routine and/or expensive disputes. Having access to all relevant correspondence and records of events can be vital in settling a dispute before it escalates. It can also be crucial in litigation, as it is likely that the agency will be called upon to produce a wide range of documents on the procurement process and management of the contract. Accurate record keeping will also ensure the agency retains valuable corporate knowledge and expertise gained through contract management. Corporate memory of key issues, lessons learned, the strengths and weaknesses of the contract and the parties, and possible improvements are valuable assets which can be retained by maintaining good contract records and disseminated by documenting contract procedures.

Having access to all relevant correspondence and records of events can be vital in settling a dispute before it escalates.

Skills required for effective project management

The skills and experience of the people assigned to contract management functions is an important consideration. The ideal mix of skills will change as the procurement moves through its life cycle. Nevertheless, relevant skills and experience include:

- an understanding of the project's needs
- experience in managing projects
- good negotiation and interpersonal skills
- an understanding of government accounting and financial principles, including the ability to control budgets and expenditures
- knowledge and understanding of Commonwealth procurement processes and the legal framework in which the agency is required to manage projects (e.g. *FMA Act* or the *CAC Act*, *Auditor-General Act 1997*)
- knowledge and some understanding of relevant aspects of commercial law, including the principles of contract law
- an understanding of risk management techniques and contingency planning
- the ability to work effectively as a member of a team
- well developed analytical skills
- the ability to exercise sound judgment
- the ability to work reliably under pressure and prioritise competing demands
- technical expertise sufficient to provide the agency with correct advice on the contractor's performance.

The ideal mix of contract management skills will change as the procurement moves through its life cycle.

Legal issues commonly encountered in contract management

Common contract management issues with legal implications include the following.

Work commences before execution

The parties have acted as if a contract is in place when the contract has not yet been signed or is still being negotiated. Disputes arise later about whether or not there is a contract, and if so, the scope of the contract, its duration and conditions.

Incomplete records

There are deficient or incomplete documentary records of contract management decisions (such as directions given to the contractor) or the outcomes of significant interactions with the contractor (whether each party has a common understanding of how to proceed). Where the agency and the contractor have a difference of view on a particular issue, it is important for the agency to ensure that it documents its position with the contractor and does not leave unanswered any correspondence from the contractor asserting a particular position. This may imply that the agency accepts the contractor's position.

Variations not in the appropriate form

This follows and is linked to the previous area, particularly the requirement that any amendment to the contract be in writing and signed by both parties. It is relatively common to find instances of a contract being amended orally (in meetings or over the telephone), by conduct (especially failure to act consistently with the contract), by email exchanges or by informal 'letter agreements' kept in 'bottom drawers' (i.e. not on file).

Variations or waivers not properly authorised

A complex contract will often specify that only the 'contract authority', not the designated 'contract manager', can formally approve variations or waivers.

Breach of insurance provisions

Over time, particularly in longer-term contracts, the contractor may not renew its insurance policies or the coverage or terms of those policies may change so as to reduce the protection that they afford. It is not unusual for contractors to be in breach of the insurance provisions of a contract, so agencies should have an annual process for checking the extent to which the contractor maintains the required insurance policies on an ongoing basis.

Payment not properly authorised

Decisions to approve payments are not made by an officer with the appropriate level of financial delegation.

Incorrect payments or payments not made within required timeframe

Amounts may be paid to a contractor without regard to the specific payment requirements of the contract or the contractor's performance. It is important for contract managers to make the agency's accounts/finance area aware of any need to defer, withhold or otherwise change the fees payable.

Contract managers should also communicate to the accounts/finance area the timeframe within which fees are required to be paid under a contract. Ensuring payments are made in time is particularly important in light of Finance Circular 2008/10 *Procurement 30 Day Payment Policy for Small Business*, which requires FMA Act agencies to adopt maximum payment terms 'not exceeding 30 days' from the date of receipt of a correctly rendered invoice when dealing with small businesses.

Often a contractor may claim reimbursement for the full amount of an expense, including GST paid, where it is also able to claim an input tax credit for that expense.

GST under the contract not managed effectively

Most contracts contain provisions dealing with GST. However, in addition to having the right GST clause in the contract, it is often necessary to manage particular GST considerations, particularly for contracts that are cost plus or allow for reimbursement of expenses. Often a contractor may claim reimbursement for the full amount of an expense, including GST paid, where it is also able to claim an input tax credit for that expense. This in effect gives the contractor a windfall.

Plans not followed up

Contracts often provide for various matters to be dealt with under plans that are developed and approved post signature (e.g. risk management plans or transition out plans) and are required to be implemented. In many cases, agencies do not follow up on these plans. Then, when the time comes to implement the plan (e.g. on transition out), they may find that the contractor has no plan and is uncooperative.

Deferral or reduction of fees not enforced when appropriate

Contracts often contain a clause allowing the agency to defer or reduce payments if the services are not being performed by the contractor to the agency's satisfaction. It is not unusual for an agency to continue to make payments to the contractor despite poor performance. In addition to raising questions about the extent to which such payments are an 'efficient and effective' use of public money under the FMA Act, in some circumstances, payments to the contractor can waive the agency's right to remedies under the contract and at law.

Difficulties in identifying confidential information

Contracts typically contain confidentiality clauses that allow parties to identify material that is to be regarded as commercial-in-confidence for a specified period, subject to specific agency accountability processes. Over time, where there are many interactions between contractor and contract manager with a mixture of confidential and non-confidential material, clearly identifying which material is covered by the confidentiality clause can become difficult if a process is not set up from the beginning.

Extension of the contract not managed effectively

The question of whether to retender or extend the contract is often considered too late. Where a contract is extended, often this gives rise to a new procurement and requires consideration of the *Commonwealth Procurement Guidelines* December 2008 and the Department of Finance and Deregulation's guidance on extensions and variations to contracts.³ For FMA agencies, FMA Regulation approvals will need to be obtained if the term of a contract is extended. Also, contracts are often extended without a corresponding extension to the terms of any risk mitigation mechanisms under the original contract, such as unconditional financial undertakings or performance guarantees.

This list is not exhaustive. Contract managers will need to assess the extent to which the areas outlined above may arise in their contracts and develop an appropriate contract management system.

When to seek legal advice

A contract manager cannot be expected to deal with every possible situation that arises in relation to a contract. An important skill in contract management is recognising when to seek legal advice. As a contract manager has the ability to affect the agency's rights through their actions, it is important to be proactive throughout the life of the contract and seek legal assistance before issues escalate.

It is important to be proactive throughout the life of the contract and seek legal assistance before issues escalate.

It would be prudent to consider obtaining legal advice in the following situations:

- the contract manager believes that the contractor may be in default under the contract
- the agency is considering terminating or reducing the contract's scope for convenience
- it is necessary to change the nature or scope of the contract
- the agency is in dispute with the contractor about any material matter or the contract manager considers that dispute is likely
- incorrect amounts have been paid to a contractor
- a conflict of interest arises
- a security breach or a breach of confidentiality occurs.

Again, this list is not exhaustive. Contract managers will need to exercise their judgment if other contract management issues arise that could require legal advice.

Note that the *Legal Services Directions 2005* (LSDs) require agencies to endeavour 'to avoid, prevent and limit the scope of legal proceedings wherever possible' (Model Litigant Directions, Appendix B to LSDs). Accordingly, it is Commonwealth policy that, in the event of a dispute, agencies should explore alternative dispute resolution methods such as mediation or arbitration in the first instance.

The LSDs also provide that an FMA agency is to report as soon as possible to the Attorney-General or the Office of Legal Services Coordination on 'significant issues' that arise in the provision of legal services, especially in handling claims and conducting litigation. The LSDs provide guidance on what constitutes a 'significant issue'. There may be situations arising under strategic contracts involving whole-of-government interests (e.g. service delivery to a number of stakeholder agencies) where actual or perceived breaches of the contract (e.g. disclosure of confidential contract information) should properly be reported.

It is Commonwealth policy that, in the event of a dispute, agencies should explore alternative dispute resolution methods such as mediation or arbitration in the first instance.

Ten key principles of contract management

The following principles apply to any contracting situation and should be borne in mind for successful contract management:

- Be proactive in contract management – do not allow minor problems to become major ones.
- Communicate regularly and effectively with the contractor – work for a strategic relationship with the contractor.
- Understand the contract and what is required of all parties – clearly define roles and responsibilities.
- Identify the particular risks in relation to the contract and monitor events to limit their effect – actively manage risks.
- Ensure the contractual obligations of both the agency and the contractor are fulfilled in accordance with the contractual requirements.
- Behave ethically and honestly at all times, and require the same standards of the contractor.
- Regularly review the requirements of the contract and the contractor's performance.
- Seek professional advice when warranted – advice from the agency's procurement area and legal advice should be sought where required.
- Be reasonable and fair when dealing with the contractor but enforce the contractual terms and conditions when appropriate – there are limits to conciliation.
- Ensure variations to the contract are justified, provide value for money and do not diminish the agency's requirements or interests.

Reference material for contract managers

Department of Finance and Australian National Audit Office publications

Commonwealth Procurement Guidelines, Department of Finance and Deregulation, December 2008 (Financial Management Guidance No. 1)

Guidance on Confidentiality in Procurement, Department of Finance and Administration, July 2007 (Financial Management Guidance No. 3)

Guidance on the Listing of Contract Details on the Internet (Meeting the Senate Order on Department and Agency Contracts), Department of Finance and Deregulation, January 2004 (Financial Management Guidance No. 8)

Guidance on Complying with Policies of the Commonwealth Procurement, Department of Finance and Deregulation, January 2010 (Financial Management Guidance No. 10)

Guidance on the Mandatory Procurement Procedures, Department of Finance and Administration, January 2005 (Financial Management Guidance No. 13)

Guidance on Ethics and Probity in Government Procurement, Department of Finance and Administration, January 2005 (Financial Management Guidance No. 14)

Guidance on Procurement Publishing Obligations, Department of Finance and Administration, July 2007 (Financial Management Guidance No. 15)

Commonwealth Property Management Guidelines, Department of Finance and Deregulation, October 2009 (Financial Management Guidance No. 16)

Developing and Managing Contracts – Getting the Right Outcome, Paying the Right Price: Better Practice Guide, Australian National Audit Office and Department of Finance and Administration, February 2007

Attorney-General's Department publications

Legal Services Directions 2005

Related AGS publications

Legal Briefing No. 86, 'Indemnities in Commonwealth contracting' (12 January 2009)

Legal Briefing No. 88, 'Alternative dispute resolution in the Commonwealth context' (18 August 2008)

Commercial Note No. 8, 'The GEC Marconi decision – its effect on Australian government contracting' (17 January 2004).

Commercial Note 27, 'Termination for convenience' (3 June 2008)

Commercial Note No. 28, Intellectual property issue (25 July 2008)

Commercial Note No. 32, 'Assignment and novation' (15 July 2009)

This note was prepared by Clare Derix and Henry Addison with the assistance of Kathryn Graham, Senior General Counsel and Cathy Reid, Senior Executive Lawyer.

Clare Derix joined AGS's Commercial Group in Canberra in 2002 after spending two years working in private practice in the commercial and financial services area. Clare has drafted a broad range of contracts for clients and regularly advises on how best to manage and administer contracts. She has extensive experience in providing legal and probity advice on acquisition and market-testing projects, tender documentation and the legal and Commonwealth policy requirements with respect to procurement.

Henry Addison joined AGS's Commercial Group in Canberra in 1999. Prior to that he had a varied commercial law career, including private practice in London and Los Angeles. Henry has extensive experience in contract administration and management, and a comprehensive knowledge of Commonwealth requirements and policies in relation to procurement, competitive tendering and contracting, and the use of whole-of-government arrangements. He also has broad experience as probity adviser on tender documentation and contract negotiations.

Notes

1. 'Contract' here is used generically to refer to all relevant contractual documentation, not just the terms and conditions of contract (e.g. the Schedules of the contract such as the Statement of Work or Functional Performance Specification, the Performance Measurement System, the Project Plan etc.). The term also includes documents that are incorporated by reference, such as Australian Standards or industry codes of practice.
2. Limiting liability is addressed at paragraphs 6.11 to 6.16 of the Commonwealth Procurement Guidelines. It should be noted that under Finance Circular 2006/03, *Limited liability in Information and Communications Technology Contracts*, the liability of ICT suppliers contracting with Commonwealth agencies should be capped at appropriate levels in most cases, particularly on standard breach of service delivery obligations and contractor liability arising from negligent acts or omissions (other than negligence related to personal injury, unlawful or illegal acts, damage to tangible property, intellectual property obligations, confidentiality and privacy obligations and security obligations). Agencies should undertake a risk assessment to assess what may be an appropriate limitation on liability in the circumstances. The *Liability Risk Assessment Guide for FMA Act Agencies* recently published by the Department of Innovation, Industry, Science and Research may assist in this regard.
3. Refer to guidance contained in the Department of Finance and Deregulation's Procurement Policy Framework Frequently Asked Question 'When can a contract be extended?' (currently FAQ number 70); Frequently Asked Question 'Is there scope under the CPGs for the terms of contracts to be varied?' (currently FAQ number 71); and Frequently Asked Question 'Can you vary the price in a contract?' (currently FAQ number 72).

AGS contacts

AGS has national teams of lawyers specialising in contract development and management, including managing contractual disputes. For further information on the article in this issue, or on other contract management issues please contact John Scala (development and management) or Simon Daley (disputes), the authors, or any of the lawyers listed below.

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Is your agency interested in training on contract management from a legal perspective? AGS offers workshops on contract management which can be tailored to your agency's needs.

For enquiries contact any of the lawyers listed.

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