

Advances in Project Management Series¹

Planning for Contract Management

By Louise Hart

The delivery method for many projects is to engage a contractor to deliver the project. This is common even for – perhaps especially for – the huge Government infrastructure projects that cost billions and take years to deliver.

Governments and other organisations generally outsource delivery because they don't have the capacity to do it themselves. They enter into contracts to pass the delivery risk to a contractor who does have the capacity. While this aligns with the principle that a risk should be allocated to the party best able to manage it, there is a critical distinction between allocation of risk and elimination of risk. Too often, contract management is ignored or downgraded because of a misguided belief that a risk which has been allocated to the contractor ceases to exist.

It is often possible to eliminate certain risks, and it can be a very good thing to do. Every risk eliminated is one less to worry about, and there is generally quite enough to worry about as it is. But risk allocation is just that – allocation. No matter where the risk is allocated, it still exists. Allocation of a risk to the contractor does *not* eliminate it, as evidenced by the many contracted projects that run over time and over budget, sometimes spectacularly so.

Delivery risk continues to exist. If you choose to pass it to a contractor, that just means you will now have to manage the risk by managing the contract, instead of managing it directly. The time to recognise this is *before* you enter the contract, while there is still time to do something about it. Once a contract has been entered into, it can be very difficult to amend it. Many infrastructure projects are structured as Public Private Partnerships (PPPs), which means the 'contract' is really a suite of contracts covering design, construction, finance and operations and involving a number of different parties, consortia and syndicates: amending these complex arrangements is deliberately designed to be very difficult indeed. But even a simple design and build contract can't be amended without the cooperation of the other party, who is unlikely to be receptive to changes that aren't in their favour.

If you want a contract that helps rather than hinders contract management, you need to plan for the management phase as part of contract procurement. The contract is one of the most powerful tools you have for managing risk and you sign it only once. Some risk management controls can be introduced or eliminated at any time, but controls in the contract are either there on day one or not there at all. You need a contract with the right

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provisions, and you need a contract manager who will use those provisions to manage the contract effectively.

The Contract

There are three key factors in designing a contract that will facilitate successful contract management:

1. The structural incentives;
2. The specification; and
3. Specific contract management provisions.

Contract incentives

Contractors are in business to make money. The contract is the means by which they make it. The implication for contract management is simple. If there is anything you need the contractor to do, make sure they get paid for doing it. If there is anything you want the contractor NOT to do, make sure they don't make money by doing it.

Some incentives are inherent in the contract structure you choose for the procurement. This should influence your choice of structure. It is almost inconceivable, for instance, that you would choose to deliver a mega-project through a 'cost-plus' contract. The contractor, paid more if the costs incurred are higher, is encouraged to push costs as high as possible. Mega-project costs will already be sufficiently stratospheric without creating an incentive to increase them.

If the contract is 'design and build', where the contractor receives a fixed price for delivering the asset, the inherent incentive is to build the asset as cheaply as possible. There is also at least some time incentive, because delays increase costs. There is no inherent quality incentive, which is a problem. When you procure a major asset, you want value for money on a whole of life cost basis, not just on construction. A cheap structure may require more maintenance or more frequent replacement, so that overall it may cost more.

An alliance contract is often used where there is significant uncertainty on costs. Initial work is done to establish a reasonable target cost, with overs and unders then shared with the contractor. In alliance contracts, the contractor's agreed profit is made when costs come in exactly on the target cost. To make a greater profit, the contractor must bring the job in *below* the target cost: since the client takes a share of the savings, the more profit made by the contractor, the lower the cost to the client. This usually makes for a good, easy-to-manage relationship – unless the target cost is too wide of the mark, in which case it is not easy at all.

The PPP is a common model for very large projects. In a PPP, the contractor is remunerated with 'availability payments' or 'access payments'. They build the bridge or the hospital or whatever at their own expense, then when the asset is built they receive payments for allowing people to use it: the payments are sufficient over the life of the asset to pay off the

loans raised to finance construction. The payments are fixed, which clearly provides an incentive to reduce costs. Less obviously, there is a very strong time incentive. Since the contractor provides the construction finance for an asset costing a billion or two, and access payments only kick in when the asset is delivered and the money has been spent, the financing costs associated with delay are huge.

There is also an inherent quality incentive in a PPP, but it is much less robust. In theory, the contractor makes money by keeping down the whole of life costs. It is not in their interests to deliver a poor quality asset, because they will lose all the money saved on construction through increased repair and maintenance costs and lost access payments when the asset is out of service for maintenance. In practice, if things start to go wrong, contractors come under so much financial pressure from the time incentive they are likely to cut corners on construction anyway, regardless of the impact in future years. They will then struggle financially for the whole period of the contract, which always increases the likelihood of claims and disputes, and may even go bust, leaving behind a poorly constructed asset.

The imperatives for each project will be different. The incentives inherent in the contract structure you have adopted may not be sufficient, so consider including additional focused incentives where you need to change the balance.

Additional incentives may be particularly useful where subsidiary obligations are important to you but are not on the contractor's critical path for the main deliverable. If a contractor needs a temporary worksite on land you are waiting to use for something else, a one-off payment on release of the site will encourage the contractor to hand it over sooner rather than later.

Care is needed in structuring incentives, particularly in relation to the delivery of services in the operational phase of a PPP. Too little thought and you will saddle the contract with *perverse* incentives, that is, incentives which have a negative rather than positive impact on contractor behaviour.

For instance, incentive payments can be made for reducing the number of people on a hospital waiting list for service. If the service is provided more quickly, which is the behaviour you want to encourage, the number of people on the waiting list will fall.

Unfortunately, the number of people on the waiting list will also fall if the contractor instead makes it difficult for people to be put on the waiting list in the first place. This is usually much cheaper for the contractor than improving the service, so which do you think is more likely to happen?

Do not be optimistic about a contractor's ability to resist the temptation to make money. Design the incentives to be resistant to gaming.

Contract specification

The overwhelming majority of disputes that arise on contracts relate to the specification. Probably everyone recognises the importance of specifying what the contractor must do correctly. Variations made necessary by an inadequate or ambiguous specification always end up costing a lot more to deliver than if the right words had been in the contract to start with, and managing variations is a real headache.

What is sometimes overlooked is the importance of also correctly specifying what the *client* is obliged to do – and making sure, before you enter the contract, that the organisation is genuinely capable of doing it.

Do not take on obligations to the contractor that the organisation is not capable of delivering. Do not take on *any* obligation to the contractor unless you can identify an individual who will accept responsibility for delivering it. Make sure that person has understood the nature and extent of the obligation and put their signature at the bottom of a document that says so.

If the organisation needs to review design documents, for instance, your engineer might tell you the standard turnaround time is five working days. Do not take this as a green light to accept an obligation to review design documents in five working days. That ‘standard’ may well be optimistic at the best of times and it will reflect the current throughput of design documents. Resourcing may be wholly inadequate to deal with the volume generated by the project. Get a realistic commitment from the engineer. In writing.

Bear in mind that making life easy for your engineers does not necessarily reduce cost or risk to the organisation. The cost of putting in place special arrangements to enable fast document turnaround may well be dramatically less than the cost of requiring the contractor to plan their project around lengthy review processes. And while you’re at it, check whether the engineers should be reviewing the documents at all. What value is being added? Are they importing risk instead of reducing it? If the engineers don’t have to be on the contractor’s critical path, get them off it.

Contract management provisions

Everyone wants to have contractors who are easy to manage. It is possible to put behavioural aspirations into the contract: they are most commonly seen in alliance contracts, which often talk about the parties having a responsibility to model the sort of collaborative behaviours that make alliance projects successful. You don’t have to limit this to alliance contracts, since collaborative behaviours are also useful in other project structures – uncollaborative behaviours such as lying, bullying and shooting messengers have adverse impacts in pretty much any context.

However, writing such words into the contract will not overcome the structural incentives. The behaviours most likely to emerge from the contractor are those driven by the money. If

there are behaviours you don't want to see from the contractor, don't give them a financial incentive to indulge in them.

Other types of contract management provision can be more useful. Managing a contract requires knowledge. Since the contractor is the one doing the work, you won't know what is happening unless the contractor tells you. What do you want to know? What do you *need* to know? How are you going to find out?

Don't overlook the value of including specific provisions in the contract. It may seem superfluous to include an obligation on the contractor to attend regular meetings – you'll be talking to them every day, why clutter the schedule with unnecessary meetings? In fact, it is often useful, because it provides a minimum level of interaction.

It is not a matter of being able to enforce the interaction (although you can: the obligation to attend meetings is just as much a legal obligation as any other in the contract). The point is that the first thing many contractors do when things start to go wrong is hide from the customer. If the meetings don't happen, or the contractor starts dodging some of the agenda items, you know there's trouble. The sooner you know, the sooner you can do something about it.

Similarly, requirements for regular reporting give you a base level of information and audit rights can come in very handy when you suspect the contractor is hiding stuff from you. On one project I was involved in, the contractor kept insisting the project was on track.

Eventually, many months in, we had an independent schedule audit done and discovered that completion was further away than it had been when we signed the contract.

It is not unusual to put very intrusive audit rights into the contract and then either get in the contractor's way by exercising the rights without due thought or, more commonly, fail to exercise them at all. Your contract management plan should include an audit programme that provides assurance without interference.

You don't have a contract management plan? Write one. Now. Trouble is heading your way.

Contract manager

Contract management is not a one way street. The contractor also sees the contract as something that has to be managed – and perhaps not in the way that you were expecting. The team that won the bid is not the team that delivers the contract. This may be literally true: key personnel restrictions in the contract can give only limited comfort about team stability and quality. But it is also true in another sense: even if the individuals don't change, the management of them does.

Behaviours driven by a desire to win the contract may not survive contract award, as the contractor's project manager becomes subject to relentless pressure to meet the monthly budget. A specification that was originally examined to see how the tenderer could deliver

something attractive to the customer is now examined to see how it can be delivered more cheaply.

Efficiency is desirable. Cutting corners indiscriminately is not. If your organisation is to receive the deliverables it is paying for, the contractor needs to know from the start that you are paying attention and will hold them to the contract.

Yes, you need a contract management plan to be in place. But even more important than the contract management plan is the contract manager who will implement it. Documents don't manage risks. People manage risks. There is no form of contract which does not require active management for success to be assured. If there is no existing capability within the organisation to manage the contract, building that capability should be top of the list of things to be done *before* signing the contract.

Skilful contract management during the delivery phase may not be enough to save a project if it was badly structured on day one, but poor contract management can bring down any project. If you wait until there is a contract before hiring a contract manager, the project is in trouble.

The transition from the tender process to the delivery phase, from contract set-up to contract management, is critical: once the contract is signed, will the project team hit the ground running or just hit the ground?

On day one, the project has no momentum behind it, and three months lost from the schedule now is three months lost. Contingency was put into the schedule to deal with the things that will go wrong later, not to give everyone a chance to put their feet up at the start. This is one of the highest risk periods in the whole project: delays and misunderstandings quickly become unrecoverable and irreconcilable. A first class contract manager ready and running during the procurement phase is the best risk mitigation you can have.

It also makes for a better contract. Developing the contract is all about making trade-offs: cost against risk, time against cost, the needs of one stakeholder against the needs of another, present cost against future cost. Having the person who will be responsible for managing the contract involved in the set-up makes an enormous difference to the dynamics of the debate. Would Britain's wildly unsuccessful poll tax have gone ahead if the civil servant who reportedly said 'Try collecting that in Brixton' had had responsibility for its design?

You are far less likely to end up with an unmanageable contract if the person who will have to manage it is in there helping to write it.

In summary

If a project is being delivered by a contractor, successful project management means successful contract management.

You only sign a contract once. If the incentives are perverse, the specifications inaccurate or the management provisions inadequate, you are stuck with them. Get it right before you sign.

If the contract manager arrives before the contract does, you have a much better chance of success.

About the Author



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Louise Hart is an independent consultant specialising in major projects and procurement. Louise's past roles span the public and private sectors and include: solicitor in international law firms in Sydney and London; adviser to the Latvian Ministry of Economic Reform; Privatisation Legal Adviser for the flotation of Railtrack PLC, then the owner of Britain's rail network; transaction manager for two major re-structurings of the Channel Tunnel Rail Link PPP project; and Project Director for the establishment of the NSW \$3.6 billion PPP for the procurement of the Waratah fleet of double deck passenger trains now serving Sydney's network.

Louise is the author of the book, *Procuring Successful Mega-Projects: How to establish major Government contracts without ending up in court*, an insider's guide for public project directors. To learn more about the book, visit <https://www.routledge.com/Procuring-Successful-Mega-Projects-How-to-Establish-Major-Government-Contracts/Hart/p/book/9781472455086>