

UNDERSTANDING CONTRACTS & CONTRACTING

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SUB-TOPICS

1. Types of contracts and procurement contracts
2. The contracting process
3. Considerations in procurement contracts

- ▶ A contract is an agreement between entities that creates mutual obligations that are legally binding.
- ▶ Contracts are legally binding agreements between two or more parties that outline the terms and conditions of their relationship.
- ▶ A procurement contract is a legal agreement defining each party's roles, responsibilities, and expectations for a project or procurement that binds a buyer and seller. It is a formal, written agreement between a purchasing organization and a supplier that establishes the terms and conditions governing the purchase of goods or services.
- ▶ A procurement contract minimizes risks in transactions by establishing legal safeguards, while also creating a foundation for secure and trustworthy business relationships.
- ▶ A procurement contract goes beyond the basic outline provided by purchase orders, offering a more comprehensive and protective framework for both parties. While beneficial for reducing risks and ensuring smooth operations, poorly drafted procurement contracts can lead to misunderstandings, disputes, and financial losses. As businesses evolved and the use of outsourcing increased, procurement became more critical. It became apparent that simple purchase orders were insufficient, which led to the widespread adoption of comprehensive procurement contracts. Procurement contracts have become an essential tool for businesses to establish clear expectations, mitigate risks, and foster strong supplier relationships. They provide a solid foundation for successful procurement transactions and help businesses achieve their operational and financial goals.

WHAT IS A PROCUREMENT CONTRACT?



Procurement contracts are crucial for ensuring compliance with legal, regulatory, and ethical standards, as well as for managing costs, quality, and relationships with suppliers, making them an indispensable tool for any organization's success. Here's a detailed breakdown:

- ▶ When you clearly define the terms and conditions of the procurement process, contracts help mitigate potential risks, such as supplier non-performance, quality issues, or delivery delays. They provide a legal framework for holding suppliers accountable and protecting the buyer's interests.
- ▶ Procurement contracts allow buyers to negotiate favorable pricing and payment terms, helping to control costs and maintain budget adherence. By specifying prices, discounts, and payment schedules upfront, businesses can better manage their cash flow and avoid unexpected expenses.
- ▶ Contracts can specify quality standards and acceptance criteria, ensuring that the goods or services provided meet the buyer's requirements. This helps to maintain consistency in the quality of procured items and reduces the risk of receiving subpar or defective products.
- ▶ Procurement contracts ensure compliance with relevant laws, regulations, and industry standards. They can include clauses related to ethical sourcing, environmental sustainability, data protection, and other compliance requirements, helping businesses mitigate legal and reputational risks.

IMPORTANCE OF PROCUREMENT CONTRACTS



For a contract to be legally binding and enforceable, it must include certain essential elements. These elements ensure that the agreement is clear, mutual, and lawful. Here are the key elements of a valid contract:

1. Offer

A clear, definite, and communicated proposal by one party (the offeror) to another (the offeree) indicating a willingness to enter into a contract under specific terms. E.g: "I will sell you my Toyota wish car for 25 million shillings."

2. Acceptance

An unqualified agreement to the terms of the offer by the offeree. Acceptance must be communicated to the offeror and must mirror the terms of the offer exactly (the "mirror image rule"). E.g: "I accept your offer to buy your Toyota wish car for 25 million shillings."

3. Consideration

Something of value exchanged between the parties, such as money, goods, services, or a promise to perform or refrain from an action. Consideration ensures that both parties have a stake in the contract. E.g: In a sale, the buyer provides money (25M) and the seller provides the goods, in this case, a Toyota wish car.

4. Mutual Consent

Both parties must fully understand and agree to the same terms without coercion, fraud, or misrepresentation. This ensures that the agreement is voluntary and mutual. E.g: Both parties agree on the price, delivery date, and condition of the car.

ELEMENTS OF A CONTRACT



5. Capacity

The parties must have the legal ability to enter into a contract. This means they must be of legal age (usually 18 or older), mentally competent, and not under the influence of drugs or alcohol. E.g: A minor or someone declared mentally incompetent cannot enter into a binding contract.

6. Legality

The purpose and subject matter of the contract must be legal. Contracts for illegal activities (e.g., selling illegal drugs) are not enforceable. E.g: A contract to sell a car is legal, but a contract to sell stolen goods is not.

7. Certainty and Possibility of Performance

The terms of the contract must be clear and specific enough for the parties to understand their obligations. Additionally, the contract must be capable of being performed. E.g: A contract to deliver a specific product by a certain date is clear and possible, whereas a contract to deliver an impossible task (e.g., "turn fire into water") is not enforceable.

8. Intent to Create Legal Relations

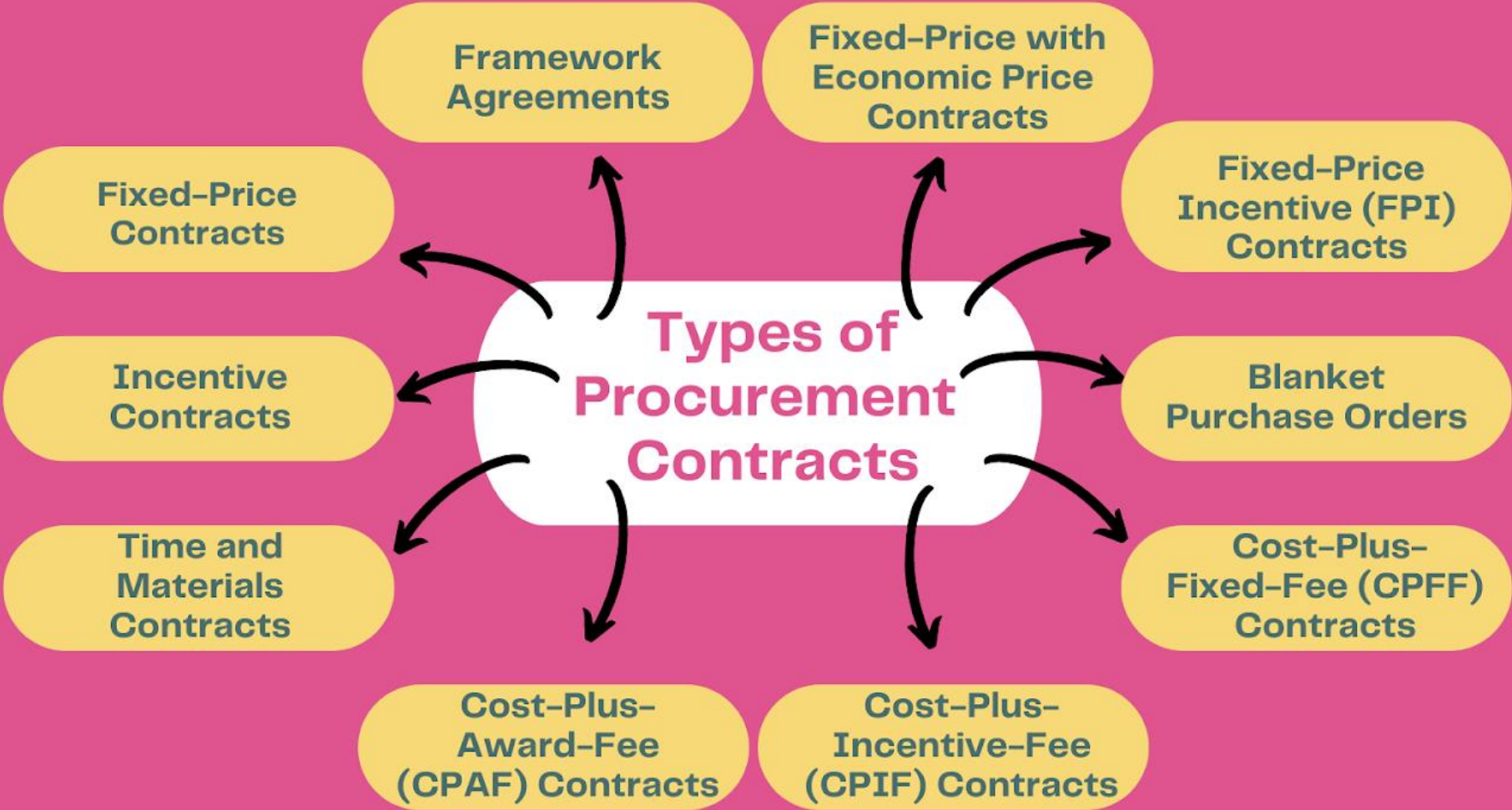
The parties must intend for the agreement to be legally binding. Social or domestic agreements (e.g., a promise to take a friend to lunch) typically lack this intent. E.g: A business agreement is presumed to have legal intent, while a casual promise between friends does not.

If any of these elements are missing, the contract may be deemed invalid, unenforceable, or voidable. It's always advisable to consult a legal professional when drafting or entering into a contract to ensure compliance with applicable laws.

ELEMENTS OF A CONTRACT



TYPES OF PROCUREMENT CONTRACTS



FIXED PRICE CONTRACTS

Fixed-price contracts are the most straightforward type of procurement contract. In this arrangement, the price is set at the outset and remains constant throughout the contract duration. The supplier bears the risk of cost overruns and is responsible for delivering the goods or services at the agreed-upon price, regardless of the actual costs incurred. This type of contract is suitable for well-defined projects with predictable costs and minimal risk of changes. E.g, if a company needs to purchase a specific quantity of deliverables with clearly defined specifications, a fixed-price contract would be appropriate. The supplier would commit to delivering the materials at the agreed-upon price, and the buyer would have certainty over the total cost of the procurement. Fixed-price contracts can be further categorized into several subtypes:

- ▶ **Firm Fixed-Price (FFP) Contracts:** In an FFP contract, the price remains fixed and is not subject to any adjustment based on the supplier's actual costs. This type of contract is suitable when the requirements are well-defined, and the risks can be accurately estimated.
- ▶ **Fixed-Price with Economic Price Adjustment (FP-EPA) Contracts:** FP-EPA contracts allow for price adjustments based on predefined economic indices or factors, such as changes in labor rates or material costs. This type of contract is suitable when there is a possibility of significant economic fluctuations during the contract period.
- ▶ **Fixed-Price Incentive (FPI) Contracts:** FPI contracts incorporate incentives for the supplier to achieve or exceed predefined performance targets. If the supplier meets or surpasses these targets, they may be entitled to additional payments or bonuses. Conversely, if they fail to meet the targets, they may face reduced payments or penalties.



COST-REIMBURSEMENT CONTRACTS

Cost-reimbursement contracts involve the buyer reimbursing the supplier for the actual costs incurred during the project, plus a predetermined fee or profit margin. In this arrangement, the buyer assumes more risk as the final cost is not known upfront. The supplier is required to provide detailed documentation of the costs incurred, and the buyer has the right to audit these records. Cost-reimbursement contracts are suitable for complex projects with uncertain costs or requirements that may change over time. They provide flexibility for the buyer to make adjustments as needed and ensure that the supplier is fairly compensated for their efforts. Cost-reimbursement contracts can be further categorized into several subtypes:

1. **Cost-Plus-Fixed-Fee (CPFF) Contracts:** In a CPFF contract, the buyer reimburses the supplier for allowable costs incurred and pays a fixed fee, which is calculated as a percentage of the estimated costs. The fixed fee remains constant, regardless of the actual costs incurred.
2. **Cost-Plus-Incentive-Fee (CPIF) Contracts:** CPIF contracts include an incentive fee in addition to the reimbursement of allowable costs. The incentive fee is tied to the supplier's achievement of predefined performance targets, such as cost savings or schedule adherence.
3. **Cost-Plus-Award-Fee (CPAF) Contracts:** In a CPAF contract, the buyer reimburses the supplier for allowable costs and pays an award fee based on the supplier's overall performance, as determined by the buyer's subjective evaluation. The award fee is designed to motivate the supplier to achieve excellent results.



TIME AND MATERIALS CONTRACTS

Time and materials contracts are similar to cost-reimbursement contracts, but with a focus on the time spent by the supplier's personnel and the cost of materials used. In this arrangement, the buyer pays for the actual hours worked by the supplier's team at agreed-upon hourly rates, as well as the cost of any materials or expenses incurred during the project. Time and materials contracts are suitable for projects where the scope of work is not well-defined or may evolve over time. They provide flexibility for the buyer to adjust the project requirements as needed and ensure that the supplier is compensated fairly for their time and resources.

INCENTIVE CONTRACTS

Incentive contracts are designed to motivate suppliers to exceed performance targets or achieve cost savings. In this arrangement, suppliers are rewarded for meeting or surpassing predefined performance metrics, such as timely delivery, quality improvements, or cost reductions. Conversely, suppliers may face penalties for falling short of these targets. Incentive contracts are suitable for projects where supplier performance is critical, and the buyer wants to align the supplier's interests with their own. By offering financial incentives, buyers can encourage suppliers to innovate, optimize processes, and deliver superior results.



FRAMEWORK AGREEMENTS

Framework agreements, also known as umbrella agreements or master service agreements, establish the general terms and conditions for future procurement transactions between a buyer and a supplier. These agreements do not specify the exact quantities or delivery dates but rather set the foundation for ongoing collaboration. Framework agreements are suitable for long-term relationships with suppliers where multiple orders are expected over time. They streamline the procurement process by eliminating the need to negotiate terms and conditions for each individual purchase order.

BLANKET PURCHASE ORDERS

Blanket purchase orders are similar to framework agreements but typically cover a specific period and have an estimated total value. They provide a streamlined process for recurring purchases of goods or services, allowing buyers to place multiple orders over time without the need for separate contracts or purchase orders. Blanket purchase orders are suitable for high-volume, low-value transactions with a trusted supplier. They reduce administrative overhead and enable buyers to take advantage of volume discounts or preferred pricing.



CLASSIFICATION OF CONTRACTS & PROCUREMENT CONTRACTS

1. Based on Formation

- ▶ Express Contract: Terms are explicitly stated, either verbally or in writing.
- ▶ Implied Contract: Terms are inferred from the actions, conduct, or circumstances of the parties.
- ▶ Quasi-Contract: Not a true contract but imposed by law to prevent unjust enrichment (e.g., paying for unsolicited services).

2. Based on Performance

- ▶ Executed Contract: All parties have fulfilled their obligations.
- ▶ Executory Contract: Obligations are yet to be fulfilled by one or more parties.

3. Based on Validity

- ▶ Valid Contract: Meets all legal requirements and is enforceable.
- ▶ Void Contract: Lacks enforceability from the beginning (e.g., illegal agreements).
- ▶ Voidable Contract: One party has the option to enforce or void the contract (e.g., contracts with minors).
- ▶ Unenforceable Contract: Valid but cannot be enforced due to legal technicalities (e.g., expired statute of limitations).

4. Based on Nature of Consideration

- ▶ Bilateral Contract: Both parties exchange promises (e.g., a sale agreement).
- ▶ Unilateral Contract: One party makes a promise in exchange for an act (e.g., a reward offer).



CLASSIFICATION OF CONTRACTS & PROCUREMENT CONTRACTS

5. Specialized Contracts

- ▶ Sale of Goods Contract: Governs the sale of tangible items.
- ▶ Service Contract: Outlines terms for providing services (e.g., consulting or maintenance).
- ▶ Employment Contract: Specifies terms of employment between an employer and employee.
- ▶ Lease Agreement: Governs the rental of property or equipment.
- ▶ Partnership Agreement: Defines the terms of a business partnership.
- ▶ Non-Disclosure Agreement (NDA): Protects confidential information.
- ▶ Franchise Agreement: Outlines terms for operating a franchise.
- ▶ Construction Contract: Governs construction projects, including timelines, costs, and responsibilities.
- ▶ Insurance Contract: Specifies terms of coverage between an insurer and insured.

6. Based on Duration

- ▶ Fixed-Term Contract: Has a specific start and end date.
- ▶ Indefinite Contract: No fixed end date and continues until terminated.



CLASSIFICATION OF CONTRACTS & PROCUREMENT CONTRACTS

7. Based on Complexity

- ▶ Simple Contract: Basic agreement, often informal.
- ▶ Complex Contract: Detailed, formal, and often involves multiple parties or high stakes.

8. International Contracts

- ▶ Joint Venture Agreement: Collaboration between parties from different countries.
- ▶ International Sale of Goods Contract: Governs cross-border transactions (e.g., under the CISG).

9. Digital Contracts

- ▶ Clickwrap Agreement: Accepted by clicking "I agree" online.
- ▶ Browsewrap Agreement: Terms are accessible via a hyperlink, and acceptance is implied by use.

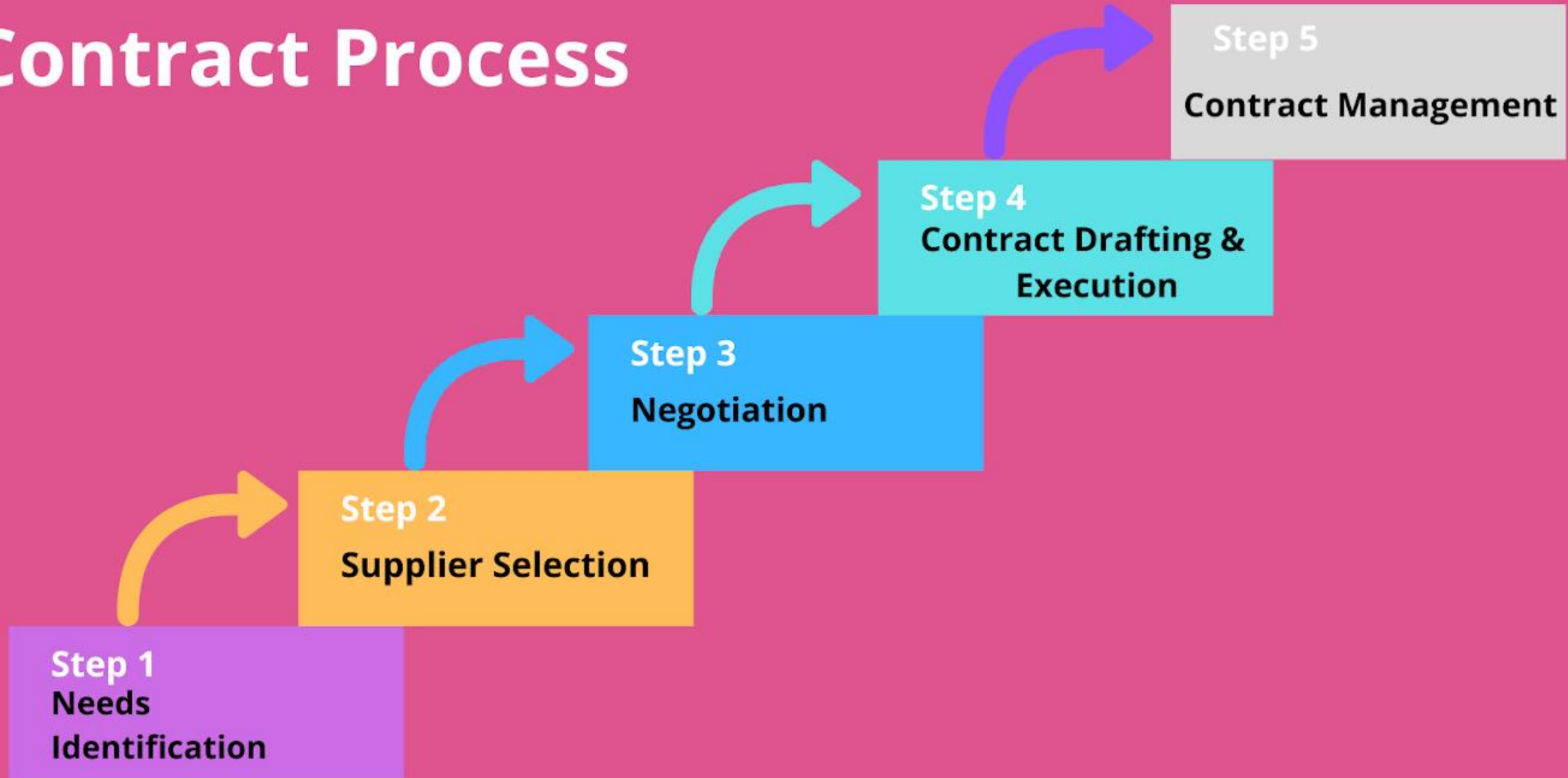


In conclusion, each classification of contract serves a specific purpose and requires careful drafting to ensure clarity, enforceability, and protection of all parties' rights. Legal advice is often recommended for complex agreements.

THE CONTRACTING PROCESS



The Procurement Contract Process



THE STEPS INVOLVED IN A PROCUREMENT CONTRACT PROCESS

The procurement contract process involves several key steps like need identification, supplier selection, negotiation, drafting, reviewing, and management.

1. Needs Identification: The procurement contract process begins with the identification of the goods or services required to meet the organization's business objectives. The procurement team collaborates with internal stakeholders, such as business units or departments, to develop clear specifications and requirements for the procurement. During this stage, the procurement team considers factors such as the quantity and quality of the goods or services needed, the desired delivery timeframes, and any specific technical or functional requirements. They also assess the potential risks and opportunities associated with the procurement and determine the budget and funding sources.

2. Supplier Selection: Once the needs have been clearly defined, the procurement team begins the process of identifying and selecting suitable suppliers. After identifying a pool of potential suppliers, the procurement team evaluates each supplier based on their capabilities, experience, reputation, and financial stability. Based on the evaluation criteria and the organization's priorities, the procurement team shortlists the most suitable suppliers and invites them to submit proposals or bids for the procurement.

3. Negotiation: Once the shortlisted suppliers have submitted their proposals or bids, the procurement team engages in negotiations to reach a mutually beneficial agreement. The negotiation process involves discussions and bargaining between the buyer and supplier to clarify requirements, align expectations, and agree on the terms and conditions of the contract. During negotiations, the procurement team aims to secure the best value for the organization while maintaining a fair and transparent process. They discuss various aspects of the procurement, such as pricing, delivery schedules, quality standards, and performance metrics. The procurement team may also negotiate additional terms, such as warranties, service level agreements, or risk-sharing arrangements.

THE STEPS INVOLVED IN A PROCUREMENT CONTRACT PROCESS – CONT'D

4. Contract Drafting: After the negotiations have concluded and the parties have reached an agreement, the procurement team drafts a written contract that accurately reflects the agreed-upon terms and conditions. The procurement team ensures that the contract includes all the necessary clauses and provisions to protect the organization's interests and mitigate potential risks. They work closely with legal counsel to review and refine the contract language, ensuring compliance with applicable laws and regulations. The contract typically includes sections such as the scope of work, pricing and payment terms, delivery and acceptance criteria, warranties and guarantees, intellectual property rights, confidentiality and non-disclosure provisions, termination and dispute resolution mechanisms, and compliance requirements.

5. Execution: Once the contract has been reviewed and approved, it is ready for execution. The execution stage involves the formal signing of the contract by authorized representatives of both the buyer and supplier organizations. The procurement team arranges for the contract to be signed by the appropriate signatories, ensuring that each party receives a fully executed copy of the contract for their records. After the contract has been executed, the procurement team initiates the necessary actions to commence the procurement, such as issuing purchase orders, or arranging for payments. They also establish communication channels with the supplier to facilitate ongoing collaboration and information exchange.

6. Contract Management: Contract management is an ongoing process that begins after the contract has been executed and continues throughout the life of the procurement. If you are using a software for contract management, you can easily track and measure supplier performance within the platform. The software usually provides a centralized repository for all your contracts, allowing you to store, organize, and manage them effectively.

CONSIDERATIONS IN PROCUREMENT CONTRACTS

To ensure a comprehensive and effective procurement contract, consider the following:

1. Scope of Work:

- ▶ Clearly define the goods or services to be provided
- ▶ Include detailed specifications, quantities, and delivery timelines
- ▶ Specify any additional requirements or expectations

2. Pricing and Payment Terms:

- ▶ Specify the agreed-upon prices for goods or services
- ▶ Include payment schedules and methods
- ▶ Outline any applicable discounts, incentives, or penalties

3. Quality Standards:

- ▶ Define the expected quality levels and acceptance criteria
- ▶ Specify any relevant certifications, standards, or regulations
- ▶ Include provisions for inspections, testing, and acceptance procedures



CONSIDERATIONS IN PROCUREMENT CONTRACTS

4. Warranties and Guarantees:

- ▶ Include warranties or guarantees provided by the supplier
- ▶ Specify the duration and scope of the warranties
- ▶ Outline the procedures for claiming warranties or remedies

5. Intellectual Property Rights:

- ▶ Clarify the ownership and usage rights of any intellectual property involved
- ▶ Specify any licenses, patents, or trademarks that apply
- ▶ Define the confidentiality obligations related to intellectual property

6. Confidentiality and Non-Disclosure:

- ▶ Include clauses to protect sensitive information
- ▶ Define the scope and duration of confidentiality obligations
- ▶ Specify the consequences of breaching confidentiality



CONSIDERATIONS IN PROCUREMENT CONTRACTS

7. Termination and Dispute Resolution:

- ▶ Specify the circumstances under which the contract can be terminated
- ▶ Define the notice periods and procedures for termination
- ▶ Outline the dispute resolution mechanisms, such as mediation or arbitration

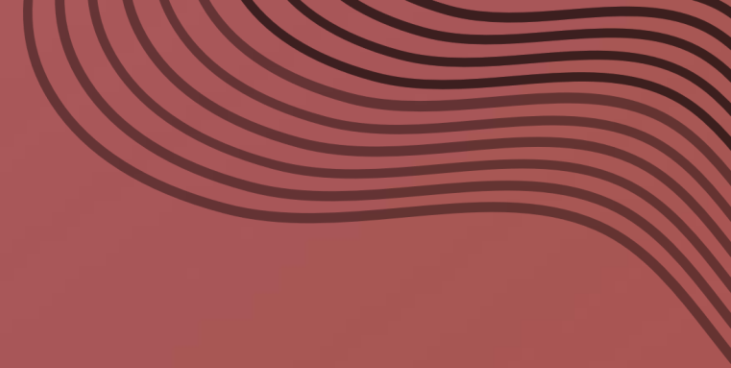
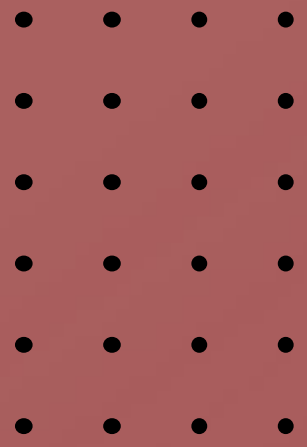
8. Liability and Indemnification:

- ▶ Define the limits of liability for each party
- ▶ Include indemnification clauses to protect against third-party claims
- ▶ Specify any insurance requirements

9. Compliance and Ethics:

- ▶ Include clauses related to compliance with laws and regulations
- ▶ Specify any ethical standards or codes of conduct that apply
- ▶ Define the consequences of non-compliance





Q&A

THANK YOU FOR LISTENING

