



RDTL–MINISTRY OF FINANCE

Procurement Service

BEST PRACTICE GUIDE 6: ESTABLISHING CONTRACTS

RDTL—Procurement Guidelines

The Procurement Legal Regime—Decree Law sets out new procurement processes which must be carried out by government procurement officers for purchases on behalf of the Government of Timor Leste. The revised processes and documentation system is explained in this series of Guides. There are now ten new Guides available that broadly summarize the updated key procurement process set out within the new Decree Law. They are available on the Ministry of Finance website (<http://www.mof.gov.tl>) and from the Procurement Service of the Ministry of Finance to assist government officers in their work.

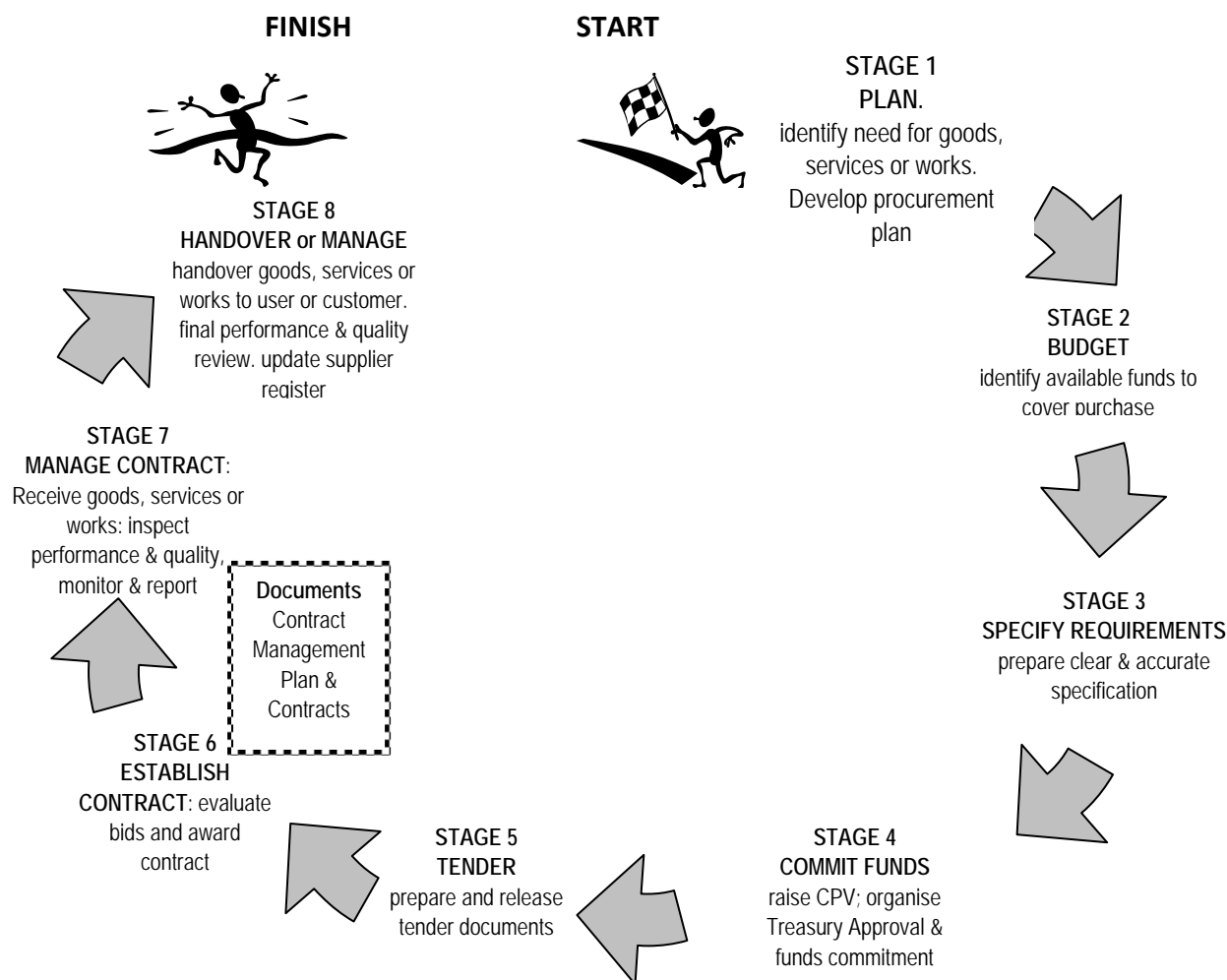
What is this Guide?

This **Guide** is for Government Procurement Managers and senior officers.

This **Guide** explains how to **establish a public contract** when procuring goods, services and works for the Government of Timor-Leste.

The establishment of public contracts with suppliers occur within **STAGE 6** of the Cycle of Procurement detailed in the diagram below.

Diagram: CYCLE of Procurement



Standard Procurement Contracts

Public contracts need to be drafted with a view to promoting the best value for government. Use of the Procurement Service standard procurement public contracts (called standard form contracts) is a preferred but not mandatory requirement for government.

The Procurement Service has developed a range of standard form contracts in order to:

- establish uniform terms and conditions for the purchase of goods and services;
- protect the rights and interests of government;
- minimise risk; and
- familiarise suppliers with government contract arrangements.

Customising standard form contracts

- Ministries and government agencies may change and customise the standard form contract to meet the specific needs of their purchase, supplier relationships and commercial arrangements.
- A customised contract should be consistent with, and reflect the general principles and approach of the commercial terms of a standard form contract.

Project Specific Contracts

Legal advice is to be sought regarding the suitability of standard form contracts for high risk and/or more complex projects where it may be better to develop a contract specific to the project.

General principles for contracts

Commitments by government

Generally contracts worth a lot of money that will run over a long time may include:

- ☑ fixed term of the commitment with options to extend;
- ☑ no guarantees of extension at the end of the contract, but the current contractor has the right to compete for renewal;
- ☑ specific products covered by contract;
- ☑ clearly defined payment terms;
- ☑ commitment to continuous improvement.

Commitments by supplier

The supplier is usually required to commit to:

- ☑ quality of product;
- ☑ ongoing availability of product;
- ☑ price;
- ☑ delivery arrangements;
- ☑ prompt and appropriate after-sales service;
- ☑ commitment to continuous improvement.

Appropriate form of contract

Departments have a range of standard form contracts available for their use:

Contract Type	Purpose
[to be inserted following contract reviews]	[to be inserted following contract reviews]

Annex to include standard form document templates

CHECKLIST: 22 commercial principles for procurement contracts

Contracts need to be drafted with a view to promoting the best value for government.

The following commercial principles are provided as a guide for establishing a contract. Contracts should also be tailored to the particular requirements of its engagement with the local and international economic market.

The principles are listed below, and then discussed in more detail in the pages following

A. Basics

- specifications of all goods and services
- price basis and payment terms
- ownership and changes in ownership (of goods included in the contract)
- continuous improvement to the project
- supplier management and responsiveness
- management of the contracted goods or services
- regional or district sourcing of goods (if appropriate)
- environmental requirements and considerations of the project (if appropriate)
- confidentiality and privacy of government information
- public access to records of supplier
- dispute resolution

B. Responsibility and ownership

- intellectual property rights (who owns the rights to any new ideas that are created)
- common law liability (who is responsible for any breaking of common law)

C. Risk and insurance

- risk assessment and solution
- insurance

D. Contract and change

- term of contract
- contract flexibility
- changes in status of the supplier's business
- termination for default or non-performance
- assignment of contractual benefits or obligations to others
- technical obsolescence or outdating of goods
- Planning for transition to new contracts

The 22 commercial principles for procurement contracts

1. Specifications

The specification comprises the government requirements detailed in the RFT (ITB or RFP) and any relevant representations made by the contractor during the contract period. Goods are to be supplied against a functional specification, which describes the performance requirements, technical constraints (if any) and quality standards required to meet tender needs.

2. Price basis and payment terms

The basis for the price and payment terms must be noted clearly in the contract. Other issues to be considered are as follows.

- Payment for services is to be made subject to the government's opportunity to inspect the deliverables or outputs, to ensure that they meet the specification, quality standards and timelines agreed to. Payment is only made following complete acceptance.
- Where a variable price contract is agreed, the method of calculating variations and the times those variations can be applied for should be clearly specified. Indices used in price variation formulae should be industry-dependent wherever possible.
- The calculation of total cost of a procurement can be greatly affected by the residual value of goods or assets at the end of the contract. Where procurement contracts include service or maintenance provisions, these should be checked make sure all service or maintenance provisions have been carried out so that the asset's condition at the end of a contract is optimal and increases the residual value.
- The government in collaboration with the contractor should seek continuous improvement in value, price reductions and/or progressive discounting. There may be a sharing of identified price discounts. They may also consider incentive pricing, if the contractor can improve on specified performance targets and the government is willing to pay for such improvements.
- Pricing arrangements are to provide for cost reductions for industry-wide productivity and technological improvement during the life of a product, throughout the contract term. The process for this arrangement must be detailed in the contract.

3. Ownership and changes in ownership of the goods

Ownership of the goods transfers from the contractor to the government after acceptance and payment must be detailed in the contract.

Acceptance means when the goods are fully operational and comply with the functionality, performance standards, and any acceptance test detailed in the contract.

If the goods develop a pattern of poor performance, they will be replaced promptly at no cost.

Government contracts for goods should include an obligation for the contractor to advise when ownership is to change. The government has the right to accept a change in control or not accept it.

4. Continuous improvement

The contractor will be required to produce measurable improvements in providing better value for the goods and associated services every year. These will include but are not limited to:

- cost
- service
- quality
- timelines
- specifications

The government in collaboration with the contractor should seek continuous improvement in value (such as in service quality or new methodologies) and price. This could be based on the supplier's increased productivity or efficiency over the period of a long-term based contract or based on the supplier and customer finding ways of reducing costs.

5. Supplier management and responsiveness

There is an obligation on the supplier to implement a management structure to ensure:

- appropriate seniority of the nominated supplier representative;
- an environment of continuous improvement and cooperation to create value for money throughout the term of the contract;
- quality of relationship management and resourcing to allow the tracking, analysis and resolution of service and supply issues;
- provision of all requested performance reporting data as required under contract and availability for meetings with departments with reasonable notice;
- responsiveness and accessibility during working hours and after-hours of appropriate supplier representatives.

6. Contract Management

A responsibility chart should be prepared, identifying key tasks during the contract term, and the responsible parties. It is essential that for each task there is a responsible party, with this communicated to all stakeholders (see *Procurement Best Practice Guide 7: Managing Contracts-Contract Management Plan*)

The government will periodically assess the contractor's performance through an assessment process incorporating:

- a service level agreement
- performance scorecard measures, including targets
- customer satisfaction surveys
- audit reviews as required
- action plans to rectify identified performance problems.

The contractor and government are to nominate suitable senior officers as the relationship managers and their supervisors. A contract manager should be named in the contract agreement. The contractor can replace their nominee with an officer of equal or higher seniority.

The service level requirements would include appropriate performance measures and targets, and a customer survey, aligned to the performance measures and targets.

Unless specified otherwise to meet a determined purpose, goods supplied under the contract are to be the latest technology on the market and only the latest model/versions are to be offered for sale to the government.

7. Regional and district sourcing

Opportunities for regional and district sourcing should be increased and any barriers to such potential suppliers should be removed.

8. Environmental requirements

If there are specific requirements related to environmental considerations such as waste or environmental degradation suppliers responsibilities in this regard must be clearly noted in the contract and be subject to quality checks by the relevant environmental authorities.

9. Confidentiality and privacy

Contracts should have adequate provisions for protecting confidential government information that may be disclosed to contractors. However, the name of the contractor, the contract value and the general terms of the contract can be published under the RFT (ITB or RFP) and ROI conditions of contract. Current government policy requires disclosure of certain contracts or certain details of a contract. Refer to the **Best Practice Guide 9: Suppliers Registry** for further details.

10. Public access to records

Where government functions are being performed under contract, it is often necessary to access the contractor's records to meet public interest, legislative or audit requirements. A clause dealing with this issue is included in the standard contracts. It allows access to the contractor's records and publication of performance-related information.

11. Disputes

If no alternative dispute resolution process has been negotiated with the contractor it is recommended that the following the procedures be considered. The insertion of these paragraphs in the contract should also be considered:

If a dispute arises between the government and its contractor then both must agree to undertake the following steps.

- a) The complainant shall raise the matter with the other party (individual or organisation) in the contract, setting out the background and the issues in dispute, and the outcome desired.
- b) If the dispute is not resolved in accordance with clause (a) the complainant shall raise the matter with other party's representatives. Both parties shall make every effort to resolve the dispute fairly. In doing so each party agrees to use their best efforts to:
 - clearly communicate the background facts leading to or causing the dispute;
 - set out clearly what action is required to settle the dispute;

- select a way of resolving the dispute and explain why that way of resolving the dispute can be said to be a fair resolution of the dispute;
- identify, if the dispute is resolved, how the resolution of the dispute has or could enhance the business relationship between the parties or the future. In particular, by identifying specific means of avoiding such disputes arising between the parties in the future.

If the dispute is not resolved in accordance with clause (b) then the party may refer the matter to the Procurement Service, Ministry of Finance, Government of Timor Leste

12. Intellectual property rights

In general, the Government would expect to own intellectual property in materials paid for by it and developed to meet its specific requirements (for example, preparation of guidelines, reports). However, intellectual property in pre-existing tools, methodologies or modules incorporated in the delivered product may be retained by the contractor or relevant third party, provided the Government obtains a licence to use those materials as part of normal use of the delivered product.

13. Common law liability

Common law liability applies in all government contracts. In other words, the liability of the parties will be as determined by, and as limited by, the law applied in courts, including any relevant statutory provisions, but having regard to the provisions of the contract.

As an exception to this general position, the liability of a supplier may be capped in a particular contract. This is subject to a risk assessment by the purchasing department. It is also subject to a requirement that the department negotiate with the supplier the limit on liability, if deemed necessary, as part of the acquisition process. Where a department makes a decision to cap a contractor's liability, the department will be exposed to liability beyond the cap.

14. Risk assessment and solution

In principle, a party to a contract should bear a risk where:

- The risk is within the party's control.
- The party can transfer the risk through insurance (and it may be the most economically beneficial arrangement to deal with the risk in this fashion).
- The greater economic benefit of controlling the risk lies with that party.
- If the risk eventuates, the loss falls on that party in the first instance and there is no reason under the principles above to cause expense and uncertainty by attempting to transfer the loss to another.

Risk allocation table

A risk allocation table, based on realistic claims, should be determined for each tender, and included in the contract arrangements. A risk allocation table would look like the following:

RISK	WHO IS RESPONSIBLE FOR RISK	PRINCIPLE FOR CONTRACT
Design suitability	<i>Identify here which party is responsible for risk</i>	<i>Identify here the principle or means to be used in the contract to deal with the allocation of risk.</i>
Delivery schedule		
Environmental issues		
Transport of assets		
Price escalation		
Asset performance		
Asset availability		
Staff training		
Changes in demand		
Change or upgrade in goods or services		

Other specific issues may be applicable to the particular purchase. The analysis will determine proportional risk, not liability in proportion to contribution to an incident.

15. Insurance

The Government requires that, where possible and appropriate, a contractor be insured so that it is not required to meet any liability that may arise from the negligent act or omissions of the contractor and also any other act under their control. However, it is important to ensure that departmental requirements are not excessive for procurement risks in the supplier’s control.

The Government generally retains a right to terminate a contract for its convenience. The relevant clause may provide for the payment of specified compensation to the contractor. A ‘termination for change in policy’ clause is intended to protect the Government where, for example, there is a change of government policy and a department no longer requires the relevant supplies or services.

16. Term of contracts

The contract term needs to be determined on a case-by-case basis, and can include option(s) to extend the contract period. The selection of the term, and the length of option(s), needs to be a balance of getting the most use from the arrangement, against the requirement to test the market at reasonable intervals. To achieve maximum flexibility and to aid planning, options should be available in three, six or 12 month increments.

A process for exercising the options should be included in the contract, such as notification by the department to the contractor and a review arrangement.

Notwithstanding the above, the following applies to determining an appropriate term (and renewal):

- Government retains the flexibility to adopt a term which provides the optimal value for money outcome subject to justification on cost/benefit grounds.
- Government should hold options for renewal terms. It should not grant options to suppliers.

17. Contract flexibility

The contract arrangements between the government and suppliers should anticipate changes in market conditions and products during the contract term. Contract flexibility, such as variations to the contract, should be considered as a routine contract management task.

18. Changes in status or ownership of contractor's company

If the status of the company changes (e.g. solvency, legal action against it, failure to perform to high ethical standards), the government reserves the right to terminate without compensation to the contractor. The government reserves the right to claim losses from the contractor.

If there is a change of ownership of supplier or contractor the government agency should conduct due diligence by investigating the background of the new owner(s), to ensure that they meet government standards for contractors. Matters which should be investigated include:

- compliance with ethical employment standards
- environmental impact and reporting
- regional, small and medium business impact
- financial viability
- the ability to meet the requirements in the original RFT (ITB or RFP).

In the event that the new owners do not meet the standards, the department may terminate the contract, at its absolute discretion, if the contractor proceeds with the change in control. The government reserves the right to claim losses from the contractor.

19. Termination for default or non-performance

Contracts should specify when a contract might be terminated, for example, in the event of default or non-performance of contractual terms and conditions.

20. Assignment of contractual benefits or obligations to others

An assignment clause provides that no-one involved in the contract (either government or contractor) can assign or delegate contractual benefits or obligations without the other's consent to anyone else. Ministries should only consent after conducting a due diligence of the assignee, examining matters such as financial viability to ensure compliance with the specification and government procurement policies.

21. Outdating of goods and services

Changes in work practices, requirements and technology have become a natural part of procurement.

Contracts should balance current technology and the potential for future change. If there is doubt about the longevity of any particular procurement, arrangements should be made either to vary the contract

arrangements by changing the term, or to overcome the outdating of goods and services by requiring an upgrade to the next generation of goods, without re-contracting.

Care needs to be taken to ensure that a cheaper price or service and maintenance package is not a way for a supplier to sell off a particular line of stock before a replacement product is announced.

22. Planning for transition to new contracts

Planning for transition to new contracts must be developed and incorporated into contracts where:

- the contract will develop assets or intellectual property that is to be handed over to the contracting authority either during the contract or at its conclusion; and
- the function or activity is to continue past the term of the contract.

The decision to change suppliers at the end of a contract term can involve substantial costs. These costs should not be viewed as a reason for deferring the decision. Care is required if a current supplier does not anticipate any transition costs, whereas any replacement supplier will incur or cause government to incur such costs.

ANNEX

A COPY OF EACH STANDARD FORM DOCUMENT TEMPLATE TO BE INCLUDED