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Creating Change Together

SIGMA

Public Procurement

Training Manual

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Module G

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Module G1 Contract Management

Section 1 Introduction

1.1. Objectives

The objectives of this module are to make participants aware of:

1. A definition of contract management
2. The process of contract management
3. The issues and consequences around contract modifications
4. The sources of contract modifications
5. Processes for handling modifications
6. Appropriate action to ensure that payment can be authorised and made in line with the contract
7. A review of the steps necessary to close out a contract

1.2. Important issues

When a contracting authority has awarded a contract, it must monitor whether the goods, service or works being delivered is delivered to specification by the economic operator. This means being able to check two things:

- That it does what it is required to do – that is, the goods are as described, the service to be performed is being delivered well and to the agreed quality standards and price, and that the works are erected as they were intended to be erected
- The costs of the requirement are no higher than expected

Clarification

For policy, legal, good practice or other reasons it is recognised that the procurement officer who conducts the procurement may not be the person who manages the contract. To avoid the cumbersome use of multiple terms, the text below refers to the role of the procurement officer as the person who is managing the contract on behalf of the contracting authority, irrespective of their title.

1.3. Links

Links to other modules appear throughout the text of this document. This module does however contain major links to modules:

Module B2 on the procurement cycle
Module B3 on the role of the procurement officer
Module B4 on the role of stakeholders
Module C4 on procurement procedures and techniques
Module G3/B6 on measuring performance
Module G2 on alternative dispute resolution
Module E1 on preparing specifications
Module E2 on advertisement of notices

1.4. Relevance

Procurement officers need to understand that contracts and the relationships with economic operators must be managed throughout the delivery of the requirement to the contracting authority.

1.5. Legal information helpful to have at hand

The main legal requirements relating to advertising are set out in Directive 2014/24/EU:

- Article 70 confirms that the contracting authorities may lay down special conditions relating to the performance of a contract, provided that they are linked to the subject matter of the contract and indicated in the call for competition or in the procurement documents.
- Article 71 covers the general rules applying to subcontracting.
- Article 72 sets up the rules and limits on the extent to which the contracting authority may modify contracts during their term.
- Article 73 sets out general circumstances for terminating the contract during its term.

Recitals 104-112 are also relevant in this context.

Additional information

SIGMA Public Procurement Briefs:

No. 29, *Detecting and Correcting Common Errors in Public Procurement*

No. 30, *2014 EU Directives: Public Sector and Utilities Procurement*

A description of the ECJ case: *Presstext*

presstexte Nachrichtenagentur v Republik Osterreich – Bund C-454/06

Section 2 Narrative

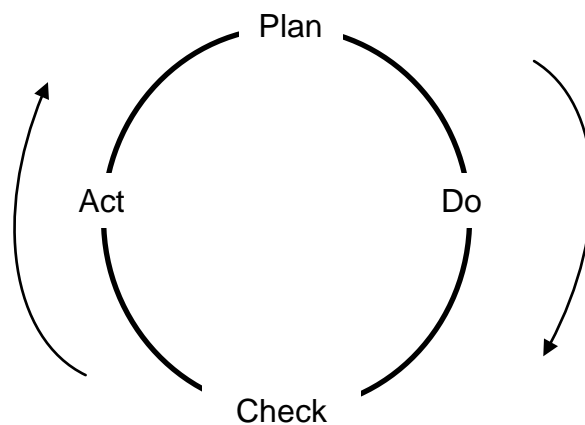
2.1 Introduction

Contract management can be defined as:

The steps that enable both the contracting authority and the economic operator to meet their obligations within the contract in order to deliver the objectives set by the contract

When a contracting authority agrees a contract with an economic operator, the arrangement cannot just be left to run itself – it must be managed. Contracts are frequently complex and they may involve many people, may take or last a long time, and may consume many resources. It is therefore vital that they are properly managed.

Key to the process of successful contract management is the recognition that procurement officers must plan, do, check and act. The plan, do, check and act cycle (PDCA) was originated by the 1950s American theorist Edward Deming, who spent considerable time advising Japanese industry on total quality management. The diagram below summarises the concept.



In terms of the procurement process, the 'plan' stage of Deming's cycle refers to the phases prior to the award of the contract and the 'do' stage refers to the activity of the economic operator throughout the life of the contract. Many procurement officers are very careful during 'plan' but they then let the economic operator 'do' and they forget to 'check' and 'act'. In the procurement context, 'check' refers to the checks and controls that are introduced to monitor performance, and 'act' refers to the activities necessary to ensure that any performance that has moved out of line is brought back within the required parameters.

Where economic operators recognise that people from the contracting authority are not monitoring their progress, they may get careless and delivery will be less than acceptable, or they may create and demand variations for items that are already within the contract, thus incurring additional costs for the contracting authority.

Good practice note – effective contract management

Effective contract management is vital to the success of a contract. It involves the procurement officer and other stakeholders in the contracting authority working proactively with people from the economic operator to deliver in accordance with the agreed specification.

Contracts without actively practiced PDCA have much less of a chance of being delivered successfully.

2.2 The process of contract management

Contract management activities can be broadly grouped into three areas, which span the do, check and act stages of PDCA. They are:

- Service delivery management
- Relationship management
- Contract administration

Service delivery management ensures that the service is being delivered at the required level of performance and quality, as stated in the contract. Service delivery management considers performance and manages risk through the 'do', 'check' and 'act' stages of PDCA. It involves setting controls and service-level agreements.

Relationship management seeks to keep the relationship between the economic operator and the contracting authority open and constructive, aimed at resolving or easing tensions and identifying potential problems at an early stage, whilst also identifying opportunities for improvement. Relationships must be wholly professional throughout the 'do' stage of PDCA, and they must also include a professional approach to managing issues and to dispute resolution.

Contract administration handles the formal governance of the contract and changes to documentation during the life of the contract. These areas of contract management ensure that the everyday aspects of making the contract run effectively and efficiently are taken care of. They may form activities relating to each stage of PDCA.

2.2.1 The inaugural or initial meeting

For any major contract it is good practice to hold a formal inaugural or initial meeting soon after the contract has officially been awarded. At this meeting people from both the economic operator and the contracting authority will come together for the first time in the context of the agreed contract. They may have met before, but this will have been whilst the parties were going through the procurement process. At this meeting it is vital that both sides (economic operator and contracting authority) move from a competitive to a co-operative approach – they will be working together for the life of the contract and both will want a successful outcome.

Everyone who is to be closely involved in the operation of the contract should be present at the meeting and ideally sitting around the same table. The objectives of the meeting include:

- Understanding the roles and responsibilities of everyone present
- Discussing the implementation and/or project plan
- Discussing issues that impact on the operation of the contract
- Discussing control mechanisms

A sample detailed agenda for an inaugural meeting is provided in section 3.2 below.

Other matters can become apparent at an inaugural meeting. These include:

- A perception by people from the contracting authority of the truth and credibility of certain statements and promises made by the economic operator prior to the award of the contract
- An understanding of the keenness of the economic operator for the contract
- Whether the economic operator has fully understood the requirement
- Specific capabilities of the people working for the economic operator
- The extent of flexibility that both sides are prepared to demonstrate within permitted parameters
- The extent to which the economic operator may seek extras or variations
- The extent to which people can work together

Whilst accommodating minor suggestions from both sides, care must be taken to avoid corrupt practices, such as changing the scope of work or becoming too familiar with each other.

Finally, this initial meeting is an important opportunity for the procurement officer managing this contract to establish personal credibility in the eyes of the people from the economic operator. His/her approach should be neither too soft nor too severe:

- An approach that is too soft may be interpreted as weakness, signalling to the economic operator that the procurement officer may be easily exploited. Giving this impression could lead to many contractual claims and requests for modifications throughout the life of the contract
- An approach that is too severe could alienate the people from the economic operator and hinder the development of a constructive working relationship. Giving this impression could lead to people from the economic operator not being prepared to give and take in the spirit of the contract.

The meeting should be conducted in a serious, firm and polite manner. Remember - you don't get a second chance to make a first impression!

2.2.2 Ongoing contract management

The economic operator will perform the contract within the agreed scope. This may include the delivery of goods and materials or the provision of services or works to the contracting authority. A vital part of the check stage of PDCA is that people in both organisations raise concerns and issues as soon as they identify them and that people on the other side of the relationship treat the issues seriously and promptly. There is nothing worse than an issue that festers between people from two organisations that are supposed to be working together. Ongoing contract management involves the administration of a range of activities, which include:

- Contract maintenance and change control
- Charges and cost monitoring
- Ordering or call-off procedures
- Receipt and acceptance procedures
- Payment procedures
- Budget procedures
- Resource management and planning

- Operational and management reporting
- Asset management
- Progress meetings

2.2.3 Issues log

An issues log is one mechanism for managing issues. It records them as they arise along with the actions taken to attempt to resolve them. A sample issues log is provided in section 3.3 below.

The aim of the issues log is to record the issue and the action taken to resolve it. An escalation procedure must be provided in the contract for issues that cannot be resolved. This procedure will involve people at more senior levels of the organisation in an attempt to resolve the issue. A final use of alternative dispute resolution or court action may be appropriate if the escalation procedure fails (see Modules F1 and G2).

2.2.4 Review meetings

Review meetings are another practical means of keeping control of a contract, particularly when it is complex or runs over several years. A typical agenda for a contract review meeting is shown below:

1. Introduction
2. Apologies
3. Minutes of last meeting
4. Actions outstanding from last meeting
5. Progress – planned and actual
6. Performance levels achieved
7. Review of issues log
8. Corrective actions required
9. Summary of actions
10. Date of next meeting
11. Circulation of minutes

In some contracts a monthly operational meeting may be part of the contract management process, together with a quarterly management or steering group meeting involving people of a high level in each organisation. These meetings need to be well-run and brief and provide a means of reporting, encouraging and rewarding progress towards the final goal.

In these ways it is possible to successfully manage the do, check and act stages of the contract. The subject of contract controls is discussed in section 2.3 below.

Good practice note – meetings

Review meetings are a productive means of communication during an ongoing contract and not having them can have negative consequences. They must be well-run and not too time-consuming. In one case, an economic operator arrived for a meeting with a senior procurement person only to be told that the person was too busy to attend the meeting as they normally did. Consider the signals that this incident sent to the people from the economic operator.

2.2.5 Managing the relationship

Contractual arrangements may commit the contracting authority to one economic operator or a small number of economic operators to a greater or lesser degree, and for some time. Inevitably this relationship involves a degree of dependency. The costs involved in changing economic operator are likely to be high and, in any case, contractual realities may make it highly unattractive. It is therefore in the contracting authority's own interests to make the relationship work. The three key factors for success are:

- Mutual trust and understanding
- Openness and excellent communication
- A joint approach to managing delivery

There must be mutual trust between the people working in both organisations if the relationship is to work and if the contract is to be delivered successfully. The factors that help to establish the relationship and achieve the right benefits include the following:

- The economic operator gains greater insight into the contracting authority's business and management style, and therefore more often pre-empts changed requirements and/or makes proactive suggestions/contributions with the expectation that this may improve the service and/or provide other sources of mutual benefit. In addition, the economic operator may become more efficient and, therefore, more cost-effective at delivering this type of service.
- The economic operator feels more confident in investing for the longer term – for example, in a more flexible infrastructure, with better systems or staff training.
- The contracting authority gains from knowing the economic operator's strengths and weaknesses and focuses contract and contract management efforts on those areas where they will bring the greatest returns.

Good practice note – Communication

Good communication can be a make or break aspect in managing a relationship. Many cases of mistrust or concern over poor performance in a service relationship result from a failure to communicate.

2.3 Contract management controls

2.3.1 The need to be able to measure

In the very first line of his book, *The Fallacies of Software Engineering*, Robert Glass uses the quotation, "You can't control what you can't measure", and the rest of the text, building on that statement, argues that we need metrics to rein in the chaos of software development.

Software is an intangible service and presents its own problems in the area of controls. One government department had 200 controls over its IT systems. This sounds horrendous until it is realised that there are 200 separate systems to control.

Control is vital, and it is true that you cannot control what you cannot measure. Measurement and control are discussed in Module G3. Control is also discussed in Modules B2 and B3.

2.3.2 Risk and risk management

Risk is defined as the uncertainty of outcome, whether it be a positive opportunity or a negative threat. In the area of contract management, the phrase 'management of risk' incorporates all of the activities required to identify and control risks that may have an impact on a contract being fulfilled. It is important to note that it is the contracting authority's responsibility to maintain the service wherever possible.

Many risks involved in contract management relate to the economic operator being unable to deliver or not delivering at the right level of quality. These risks could include:

- Lack of capacity
- The economic operator's key staff being redeployed elsewhere, eroding the quality of the service provided
- The economic operator's business focus moving to other areas after the contract award, reducing the added-value for the contracting authority in the arrangement
- The economic operator's financial standing deteriorating after the contract award, eventually endangering its ability to maintain the agreed levels of service
- Demand for the service is much greater than expected and the economic operator is unable to cope
- Demand for the service is too low, meaning that economies of scale are lost and operational costs are disproportionately high
- Staff in the contracting authority with a knowledge of the contract transferring to another department or moving to another organisation, thereby weakening the relationship
- The contracting authority being obliged to make demands that cannot be met, perhaps in response to changes in legislation
- *Force majeure*: factors beyond the economic operator's control disrupting delivery – for example, premises inaccessible due to a natural disaster
- Fundamental changes in the contracting authority's requirements, perhaps as a result of changes in policy, making the arrangement a higher or lower priority or changing the level of demand for the service
- The contracting authority's inability to meet its obligations under the contract

Where risks are perceived or anticipated, the contracting authority and the economic operator must work together to decide who is responsible for the risk, how it can be minimised and how it will be managed should the circumstance occur. Ideally, these issues should have been tackled in advance in the contract documents. The contracting authority will aim for continuity of activity in all possible circumstances, although it is unlikely to be a cost-effective aim. Questions to consider for each individual risk include:

- Who is best able to control the events that may lead to the risk occurring?
- Who can control the risk if the situation occurs?
- Is it preferable for the contracting authority to be involved in the control of the risk?
- Who should be responsible for a risk if it cannot be controlled?

- If the risk is transferred to the economic operator:
 - Is the total cost to the contracting authority likely to be reduced?
 - Will the economic operator be able to bear the full consequences if the risk occurs?
 - Could it lead to different risks being transferred back to the contracting authority?

A key point is that in most cases the ultimate responsibility for the service that the contracting authority provides to its own customers and stakeholders (patients in a hospital, passengers of a bus service, or children in a school) cannot be transferred to the economic operator.

Although the economic operator may be under severe financial pressure for non-fulfilment of its obligations, this pressure will not compensate the contracting authority for its own failure to fulfil its obligations and deliver key outcomes. For example, a critical service or building may fail, endangering the lives of citizens.

Although the economic operator may fail to deliver, the ultimate responsibility remains with the contracting authority. Prudent procurement officials are aware of this responsibility and keep it in mind during specification, economic operator selection and contract management.

It is essential to consider the whole supply chain when analysing the risks to a contract and to examine the organisations supplying an economic operator whenever a major risk is involved.

One factor that can assist the procurement officer when things may start to go wrong is the relationship that the contracting authority people have with the people from the economic operator. Where the relationship is good, open, fair and honest, an early warning of the impending risk becoming a reality may be provided through the normal working relationships and control mechanisms. Where the relationship is poor, people working for an economic operator will attempt to hide the problem, which then normally materialises as an even greater risk.

See Module A4 for further discussion of risk allocation in contracts.

2.3.3 The need for wisdom when selecting a control mechanism

Control must be tempered with wisdom. The wisdom in setting contract controls starts with the performance measures against which the specification was checked and weighted before the Invitation to Tender (ITT) was issued and against which the tenders were scored. Contract management controls must be:

- highly relevant to the essence of the contract
- understood and accepted by people from the economic operator and from the contracting authority
- capable of measurement
- robust in their operation
- able to provide more value than the cost of the activity related to their collection
- able to reflect soft and hard measures
- useful as an information source

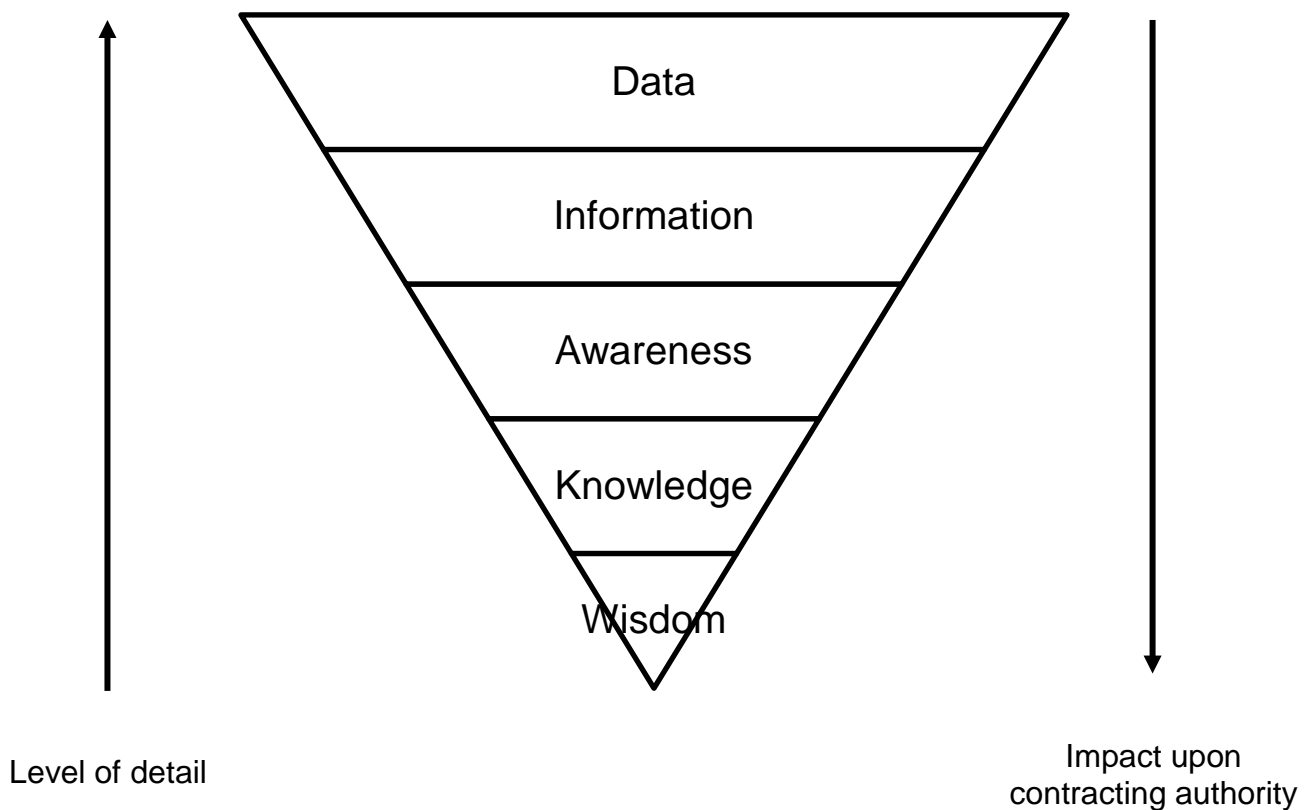
Timely high-level/summary level reporting is much more effective than accurate late information. It is essential for the information obtained to be useful, either intrinsically or because it can be processed to provide knowledge on which to base decisions and activity.

Procurement officers are advised to have a small number of effective controls rather than a huge number of controls that are used just because the information can be obtained and reported. In the following diagram, the level of detail in a control is considered against the business impact that it makes.

Raw data needs to be transformed into meaningful information that will make people aware of situations and give them the knowledge to make wise decisions.

Raw data that overwhelms people by its volume will not provide the information that will enable them to make an informed decision.

Raw data that is incomplete, late or incomprehensible will also not enable people to make informed decisions.



2.3.4 Areas where controls are necessary

Between the award of a contract and its conclusion, controls are necessary at the following steps of the procurement process. The nature of these controls will be discussed in Module G3. The nature of these controls will be discussed in Modules B7 and G3. They are only noted here:

- Step 27 Acknowledgement – to ensure that the contract terms and conditions are not changed by the later document
Localisation on legal system

Step 28	Control to ensure on-time delivery
Step 29	Control to test the quality of the work in progress/delivery
Step 31	Control to count receipts
Step 32	Control to ascertain acceptance of delivery
Step 34	Control to ensure that only permitted people withdraw items from stock
Step 35	Control to make sure that what has been accepted is paid for
Step 37	Control to make sure that lessons are learned from this procurement for the future
Step 38	Control to ensure that disposal gives value-for-money and is environment-friendly
Step 39	Control to close the contract in accordance with good practice

Module B2 describes the full procurement cycle.

2.3.5 Service-level agreements

Service-level agreements are one excellent way of ensuring control of a contract. There should be a detailed agreement concerning the required service levels and thus concerning the expected performance and quality of service to be delivered. These service-level agreements are incorporated as part of the contract, often in the form of schedules in the contract. Frequently these agreements are comprised of key performance measures (KPIs). Module G3 will discuss this issue in more detail. The contract should define the service levels and terms under which a service or a package of services is provided. It should state mutual and individual responsibilities.

By clearly stating the required and agreed quality of services, both the contracting authority and the economic operator know and understand what targets have to be met in the delivery and support of services.

Both parties should pre-agree on the compensation for the contracting authority if agreed service levels are not achieved. Similarly, the contracting authority may receive a benefit if the economic operator exceeds the agreed service levels and it could agree on a regime of bonus payments as a means of incentivising the economic operator.

Service levels and incentivisation must relate to the key criteria on which the specification was based, the ITT weighted, and the contracting authority's tender judged. In that way it can be seen that those issues, which originated in the formative steps of the procurement cycle, are carried through to delivery.

See Module A4 for further discussion on measuring service levels.

2.3.6 Special conditions relating to the performance of the contract

Special attention must be paid to environmental, social or employment-related considerations. Such considerations must be indicated from the beginning, in the contract notice, in the prior information notice as a call for competition, or in the procurement documents, as mandatory conditions for contract performance.

The obligation to take appropriate measures to ensure that in the performance of public contracts economic operators comply with applicable obligations in the fields of environmental, social and labour law established by European Union law, national law, collective agreements or by the international environmental, social and labour law provisions is now explicitly provided in the 2014 directives. Such obligations are also extended to the level of subcontractors.

It is for that reason that the contracting authority, at the latest when the performance of the contract commences, shall require the main contractor to indicate the name, contact details and legal representatives of its subcontractors involved in works or in respect of services to be provided at a facility under the direct oversight of the contracting authority, in so far as the information is known at that point in time. The contracting authority shall require the main contractor to indicate any changes in this information during the course of the contract and the required information concerning any new subcontractors that the main contractor might subsequently involve in such works or services.

Contracting authorities may verify whether the subcontractors are subject to any of the situations that are defined as grounds for mandatory exclusion. Where such measures are applied to subcontractors, the main contractor shall be required to replace the subcontractor concerned. Under national rules, such a verification procedure may also be extended to non-compulsory grounds for exclusion.

2.4 Modifications of contracts during their term

2.4.1 When is a contract modification necessary?

The contracting authority must conclude a contract with the winning tenderer in accordance with the terms and conditions of that tenderer's offer. In other words, the terms of the concluded contract should reflect the commitments made in the offer that was selected as the most economically advantageous. Ideally, if contracts are well founded, they should be fulfilled without modifications, but in practice contracting authorities may be faced with situations where additional works, supplies or services become necessary.

A modification to a contract may be necessary in the following circumstances:

- When the scope of work changes to become greater or lesser
- Where there is a change in the resources or facilities required
- When the rates charged under the contract change
- Where there is an extension of the duration of the contract
- Where terms and conditions of the contract change
- Where national laws make a change that impacts on the contract

2.4.2 Behind the need for modifications

Behind the need for modifications are circumstances where:

- price indexation is needed;
- the price of the contract is determined based on the unit prices of the estimated quantities;
- obsolescence has occurred;
- adaptations to the contract are rendered necessary by technical difficulties that have appeared during operation or maintenance;
- legislative changes have been made;
- genuine unforeseeable circumstances occur;
- upstream planning has been inadequate;
- assessment and evaluation of economic operators' tenders have been inadequate;
- poor contract management occurs.

Price indexation

In particular when the performance of the contract covers a long period, well-defined price modification mechanisms/methods (provided in the tender documents and regulated in the contract) may serve as useful tools for achieving a reasonable balance in the contract's economy.

Good practice note – price indexation

A contractual price indexation formula may take the following general pattern:

$$P_{final} = P_{initial} * (C1 * I1 + C2 * I2 + ... + Cn * In)$$

P_{final} = the indexed contract price

P_{initial} = the initial contract price

C1, C2, ... Cn = weighting coefficients dependent on the specifications of the contract, as defined and published by the contracting authority

I1, I2, ... In = technical price indexes dependent on the specifications of the contract, as usually computed and published by statistical institutions

Price of the contract is determined based on the unit prices of the estimated quantities

It is rarely possible to perform a large construction project exactly as foreseen in the original proposals and drawings. In practice, marginal variations of the quantities provided for the project have a huge potential to generate difficulties, if this issue is not diligently regulated in the contract. In such cases, payments may be made according to the bill of (real) quantities for approved work executed, multiplied by the relevant unit prices stated in the tender for each item.

Obsolescence

The supply market may have moved on and the equipment as specified in the contract may now be obsolete and unobtainable. Computer hardware and software are classic examples. However, the specification should be forward-looking and anticipate a development roadmap. In this type of situation, a framework agreement, with mini-competitions or a dynamic purchasing system, may be a better approach so as to reflect the changing needs.

Legislative changes

Changes in legislation may entail contract modifications.

Genuine unforeseeable circumstances

With the wide variety of contracts established with contracting authorities, it is inevitable that some contracts will require modifications, either to meet changing requirements or to meet a reasonable request from the economic operator. The notion of unforeseeable circumstances refers to circumstances that could not have been predicted, despite reasonably diligent preparation of the initial award by the contracting authority, taking into account its available means, the nature and characteristics of the specific project, good practice in the field in question, and the need to ensure an appropriate relationship between the resources spent in preparing for the award and its foreseeable value.

Inadequate upstream planning

Inadequate upstream planning is a major cause of modifications. They occur when the people carrying out the procurement process do not devote enough time to upstream activities, such as involving stakeholders, specification, setting performance criteria, and considering terms and conditions. Therefore the specification and the ITT may not contain enough information or the correct information to enable economic operators to make their tender.

Inadequate tender assessment

Modifications may originate from an insufficient analysis of economic operators and of the tenders that they submit to the contracting authority, which results in a different understanding by the economic operator and the contracting authority of vital aspects of the services, works or goods to be provided.

Human beings can be devious (meaning that they deviate from a correct, accepted or common course) and even deceitful. People working for economic operators assess a need, prepare a tender and sign the contract. They may then 'discover' that an extra, but essential, piece of work needs to be done before the main work can start. The procurement officer may have assumed that this work was included, but the wording of the economic operator's tender may clearly exclude the extra work, even though common sense would dictate that such work was necessary.

Good practice note – modifications

Economic operators will sometimes bid low in the tender in an attempt to secure the contract and then afterwards generate increased profits through modifications. If the low-price tender looks too good to be true, then it probably is too good to be true!

Poor contract management

Näive procurement officers and other stakeholders may be subjected to arguments, from persons working for the economic operator, that a particular part of the service is not within the contract

and that a modification is therefore necessary. Care needs to be taken not to pay additionally for items that are already included in the contract.

The wording of the contract may be ambiguous, despite all of the previous attempts at clarity, and a modification may have to be agreed. These cases must be fed back into the learning from this contract in order to avoid such issues in future contracts.

2.4.3 When and how a contract may be modified during its term

The 2014 directives clarify when the modifications to a contract during its performance are possible and how to proceed to make these changes.

Taking into account the relevant case law of the Court of Justice of the European Union, the general rule remains unchanged, namely that **a new procurement procedure is required in case of material changes** to the initial contract (or framework agreement), in particular to the scope and content of the mutual rights and obligations of the parties (including the distribution of intellectual property rights). Such changes demonstrate the parties' intention to renegotiate the essential terms or conditions of that contract. This is the case in particular if the amended conditions would have had an influence on the outcome of the procedure, had they been part of the initial procedure.

The 2008 "Presstexte" case (Presstexte Nachrichtenagentur v Republik Österreich Bund C-454/06) considered the circumstances where a variation to a contract would constitute the award of a new contract, which should be the subject of further competition. The court emphasised the importance of how "material" the changes are to the original contract:

"In order to ensure transparency of procedures and equal treatment of tenderers, amendments to provisions of a public contract during the currency of the contract constitute a new award of a contract ... when they are materially different in character from the original contract and, therefore, are such as to demonstrate the intention of the parties to renegotiate the essential terms of that contract."

The Court provided guidelines on when a variation to a contract may be regarded as 'material'. It will be material where:

- it introduces conditions that, had they been part of the initial award procedure, would have allowed for the admission of tenderers other than those initially admitted, or would have allowed for the acceptance of a tender other than the one initially accepted;
- it extends the scope of the contract considerably to encompass services not initially covered;
- it changes the economic balance of the contract in favour of the contractor in a manner that was not provided for in the terms of the initial contract.

Compared to the 2004 directives, the 2014 directives provide much more legal certainty with regard to the situations where contracts may be modified without having to start a new procurement procedure. These situations can be divided into two main categories:

- modifications that meet certain conditions that are not necessarily linked with a specific value
- modifications having values that are below certain *de minimis* thresholds

Modifications subject to certain conditions

Contracts and framework agreements may be modified without a new procurement procedure in any of the following cases:

(a) "where the modifications, irrespective of their monetary value, have been provided for in the initial procurement documents in clear, precise and unequivocal review clauses, which may include price revision clauses, or options. Such clauses shall state the scope and nature of possible modifications or options as well as the conditions under which they may be used".

According to the above-mentioned conditions, the contracting authority has the possibility to provide for modifications to a contract by way of review or option clauses. Such clauses should not give unlimited discretion to the contracting authority. "Such clauses shall not provide for modifications or options that would alter the overall nature of the contract or the framework agreement".

Review or option clauses that have been sufficiently and clearly drafted may, for instance, provide for price indexation or ensure that communication equipment to be delivered over a given period will continue to be suitable so that it meets updated communication protocols or other technological changes. It should also be possible, with sufficiently clear clauses, to provide for adaptations of the contract that may be rendered necessary by technical difficulties appearing during operation or maintenance. It should also be recalled that contracts could, for instance, provide for both ordinary maintenance as well as extraordinary maintenance interventions that may become necessary in order to ensure the continuation of a public service.

(b) "for additional works, services or supplies by the original contractor that have become necessary but were not included in the initial procurement and where a change of contractor:

(i) cannot be made for economic or technical reasons, such as requirements of interchangeability or interoperability with existing equipment, services or installations procured under the initial procurement; and

(ii) would cause significant inconvenience or substantial duplication of costs for the contracting authority."

However, any increase in price shall not exceed 50% of the value of the original contract (this condition is not applicable for contracts awarded by entities operating in the water, energy, transport, and postal service sectors). Where several successive modifications are made, that limitation shall apply to the value of each modification. Such consecutive modifications shall not be aimed at circumventing the Directive.

(c) "where all of the following conditions are fulfilled:

(i) the need for modification has been brought about by circumstances that a diligent contracting authority could not have foreseen;

(ii) the modification does not alter the overall nature of the contract;

(iii) any increase in price is not higher than 50% of the value of the original contract or framework agreement. Where several successive modifications are made, that limitation shall apply to the value of each modification (this condition is not applicable for contracts awarded by entities operating in the water, energy, transport, and postal service sectors)."

The situations that may occur due to unforeseen circumstances are regulated by the 2014 directives in a different way than they were by the old 2004 directives. One of the main differences is that the 2004 directives included this type of situation within the cases justifying the use of the negotiated

procedure without publication of a contract notice, whilst the 2014 directives do not impose a new procurement procedure for modifying the contract. However, this provision cannot apply in cases where a modification results in an alteration of the nature of the overall procurement, for instance by replacing the works, supplies or services to be procured by something different or by fundamentally changing the type of procurement.

Modifications without particular conditions

Without any need to verify whether the conditions set out above are met, contracts may be modified without a new procurement procedure being necessary where the value of the modification is below both of the following values:

- below the EU thresholds; and
- below 10% of the initial contract value for service and supply contracts and below 15% of the initial contract value for work contracts.

The 2014 directives address more pragmatically and more efficiently the approach to minor modifications that may be made during the performance of contracts.

In this context, it is worth mentioning that the possibility to make such modifications to an ongoing contract does not depend on the nature of the reasons that may determine the modifications. For instance, certain minor omissions/discrepancies (even errors) of the initial project may generate the need for minor supplementations/changes to some of the work items that have to be performed. Such omissions/discrepancies may have a disputable predictability/unpredictability nature, but there are no legal impediments to making modifications if their main characteristic remains their non-substantiality – both in terms of value and in terms of the impact on the overall nature of the work contract (see the “Presstexte” case).

Where several successive modifications are made, the value shall be assessed on the basis of the net cumulative value of the successive modifications. This provision means that limitations shall not apply to the value of each modification, but to the cumulative value of all of the modifications.

On the other hand, the text of the 2014 directives refers to the **net** value, which means that for calculating the value of the modifications (in relation to the two limitations), **the value of new works minus the value of works waived** should be taken into account. However, it should also be kept in mind that the net impact of the modification must not affect the overall nature of the contract. For these reasons, a net modification of price of 5% (consisting in 40% of new works and 35% of abandoned works) shall be considered as a substantial modification if such changes affect the initial nature of the contract.

Warning note

A new procurement procedure, in accordance with the 2014 Directive, is required for any modification of the provisions of a public contract or framework agreement during its term other than those modifications provided for in the above-mentioned exceptions.

Contracting authorities must be very careful when considering the possibility of introducing modifications to an agreed contract, in particular outside the scope of a pre-agreed, transparent and contractual cost-variation mechanism. Such modifications run a significant risk and could result in the award of a new contract for the purposes of the Directive, even where an exception apparently applies. If the changes render the contract materially different in character from the one initially concluded, they shall be tantamount to the award of a new contract, and a new procurement procedure must be organised, in compliance with the Directive. The failure to comply with the provisions of the Directive where the changes amount to the award of a new contract would be considered as an illegal direct award.

2.4.4 When and how the contracting authority may be replaced during the term of the contract

In line with the principles of equal treatment and transparency, the successful tenderer should not be replaced by another economic operator without reopening the contract to competition. However, the successful tenderer performing the contract will be able to make, in particular where the contract has been awarded to more than one undertaking, certain structural changes during the performance of the contract, such as purely internal reorganisations, takeovers, mergers and acquisitions, or insolvency. This approach is logical, since such structural changes should not automatically require new procurement procedures for all public contracts performed by that tenderer.

In accordance with the 2014 directives, contracts and framework agreements may be modified without a new procurement procedure in the case where a new contractor replaces the economic operator to which the contracting authority had initially awarded the contract as a consequence of:

- “an unequivocal review clause or option” in the initial procurement documents; or
- “universal or partial succession into the position of the initial contractor, following corporate restructuring, including takeover, merger, acquisition or insolvency, of another economic operator that fulfils the criteria for qualitative selection initially established, provided that this does not entail other substantial modifications to the contract and is not aimed at circumventing the application of this Directive”; or
- “in the event that the contracting authority itself assumes the main contractor’s obligations towards its subcontractors where this possibility is provided for under national legislation”.

In any event, for any cases other than those mentioned above, the modification of a contract or framework agreement during its term shall be considered to be substantial where a new contractor replaces the economic operator to which the contracting authority had initially awarded the contract.

2.4.5 The impact of modifications

Modifications can have direct and indirect impacts. Direct impacts can include:

- Increased/decreased cost of the contract
- Contract over/under budget
- Delays and extension of time for supply or works projects

Indirect impacts can include:

- Wasted design work
- Additional design work
- Wasted or unnecessary activity
- Changes to or cancellation of orders that the economic operator may have placed with its own supply base
- Placement of additional orders by the economic operator and its supply base
- Increased/decreased time and delays
- Unproductive labour costs
- Reprogramming of the contract to mitigate the effects of increased/decreased time and costs
- Additional head office time and money spent by the economic operator, which may seek to recover its fixed costs

2.4.6 Managing modifications – minimising the number of modifications

Stated policy should be to avoid modifications wherever possible, and this should be made clear at the inaugural meeting. Another policy must be that only thoroughly investigated modifications, i.e. those that are permissible under the EU *acquis*, will be agreed and then only in writing by the authorised procurement officer.

The inaugural meeting should also be used to advise the economic operator of the modifications procedure (see the sample agenda in 3.2 below).

When an economic operator submits a request for a modification, procurement officers must ask themselves and other stakeholders a number of searching questions:

1. Is this request clearly within the scope of work that was agreed and understood?
2. Is the request a misinterpretation of the existing specifications or of the terms and conditions? Would clarification mean that the need for the modification would disappear?
3. Is this modification really needed, or is it simply "nice to have"? Work out the direct and indirect implications.
4. Is there another way of proceeding that might be more cost-effective?
5. Is the change really a modification to the current contract or is it new work requiring a new contract?
6. Will the modification breach national procurement regulations or conflict with any policy on competitive tendering?

2.4.7 Managing modifications – minimising the impact of modifications that cannot be avoided

If a modification really is necessary and is permissible, the contract should contain a change control provision. The change control procedure should ensure that an authorised person, and only that authorised person, has responsibility for agreeing to a modification. Some contracting authorities invoke a high-level committee to review the need for modifications and to search for alternatives.

To minimise the impact of a modification:

- Use the same diligence in agreeing to a modification as you would in awarding a contract.
- Always obtain a firm quotation for the price of the modification. Remember that economic operators will try to use modifications to maximise the profit of the contract and may very well price high (it is effectively a direct award without competition), so always challenge the price.
- Understand the concept of marginal costing: the economic operator will have built fixed costs into the base contract price, but these costs may not be relevant for extras and should be excluded from the costing of modifications.
- Do not agree to a modification to the contract until both you (as procurement officer) and the person from the economic operator agree in writing to the total consequences of the modification in terms of time and cost (including any secondary effects on other parts of the procurement).
- Do not hesitate to issue a modification for a reduction in price. All too often it is thought that modifications only result in increased cost. Sometimes you may decide to delete something

from the work scope, which could result in a reduction in price. Again beware of the possible secondary effects.

- Make sure that full records are kept from the start of the contract. It is a good idea to record in a contract logbook any incidents that could result in modifications.
- Do not be tempted to use an economic operator to get extra work done just because it is already present on your site.
- Keep all relevant stakeholders involved in the consideration of any modifications; these stakeholders may include procurement, contracts, legal, finance, end-users and/or the budget-holder.
- In an emergency, instruct the economic operator orally, but confirm in writing without delay, the same day if possible.

2.4.8 A simple change control procedure

A single change control procedure should apply to all changes in the contract. The various parts of the contract should not have different change control mechanisms. However, flexibility needs to be built into this procedure to make it possible to deal with urgent issues, such as emergencies. A change control procedure should provide a clear set of steps and clearly allocated responsibilities covering:

- Request for change
- Assessment of impact
- Prioritisation and authorisation
- Agreement with economic operator
- Control of implementation
- Documentation of change assessments and orders

Responsibility for authorising various types of changes may rest with different persons in the contracting authority, and documented internal procedures will need to reflect this shared responsibility. **In particular, changes in the overall contract, such as changes in prices that are outside the scope of agreed price indexation mechanisms, must have senior management approval.** In many cases, however, it will be possible to delegate limited powers to procurement officers to authorise minor changes that affect particular services or service-level agreements using agreed processes. **Localisation.**

There should be an agreed procedure for placing additional demands on the economic operator, including the specification of the requirement, contractual implications, charges for the additional goods/works/services, and delivery time frames. This procedure should be used in consultation with those responsible for monitoring the provision of goods/works/services, and where it fits within internal legal guidelines it must be treated as a new purchase. **Localisation. This requirement must be genuine and not an attempt by people working for the economic operator or the contracting authority to circumvent procurement legislation.**

Appropriate structures need to be established, with representatives of the management of both the contracting authority and the economic operator, to review and authorise change requests. These structures may fit in with existing management committees, or new change advisory roles may be required.

2.5 Payment

Payment of economic operators is a control in itself, but the power that contracting authorities have at this stage of the procurement process must not be used to unjustly delay or withhold payment from economic operators that have completed work. To do so would damage the relationship between the economic operator and the contracting authority. There are three stages to the payment process:

- 1 Receipt of request for payment
- 2 Authorisation and matching
- 3 Transfer of funds

This process is discussed in Module B2 (step 35 of the procurement process).

The 2014 directives set out explicitly that the contracting authority may transfer due payments directly to the subcontractor for services, supplies or works provided to the economic operator to which the public contract has been awarded (the main contractor), but such payments will be without prejudice to the main contractor's liability. Such an arrangement may include appropriate mechanisms permitting the main contractor to object to undue payments and, in any event, must be applied according to the rules advertised from the beginning in the procurement documents.

2.6 Performance review and continuous improvement

Performance review (step 37 of the procurement process) reflects a comparison by the contracting authority of the performance of the goods, works and services against the quoted, specified and agreed criteria. Modules A4 and G3 include more details on performance measurement, and important activities must also be undertaken in close-out, which is covered in step 39 of the procurement process (see also 2.7 below).

Measurement is a vital part of the procurement process, but it is sometimes forgotten when procurement officers are concentrating on a subsequent project. With a large procurement, a post-implementation review is an appropriate tool.

Continuous improvement (step 37 of the procurement process) involves looking at the procurement process and the goods, works and services bought and identifying areas for improvement that can be applied when carrying out future procurement.

The purpose of a post-implementation review is to assess whether the procurement has delivered the benefits for which it was first conceived. It is also an opportunity to record lessons learned, to capitalise on best practices, and to record the performance of the economic operator and the whole of the project management team for future reference when another similar project may be undertaken.

2.7 Close-out

The objective of the close-out phase is to ensure that the contracting authority is satisfied with the delivery of the goods, works and services it has purchased. Close-out will frequently review the whole procurement process from step one onwards, and it may involve both the person who ran the procurement and the person who managed the contract – both may have lessons to learn.

It also provides the opportunity to identify how well the procurement officer and other members of the stakeholder team have performed on the project as well as to review what lessons have been learned for the future as part of the continuous improvement of the procurement process.

A contract may not be considered as concluded when the actual physical work has been completed or the goods delivered. The true end of the contract is the end of a warranty, retention or defects liability period. However, there are several stages to undergo until that point is reached. Not all of these stages will be necessary for every procurement exercise, and procurement officers must select the process that meets the requirement itself and the risk inherent in the procurement.

Localisation: there may be different names in different industries for these stages in different countries. Amendment of this generic text may be required.

Good practice note – close-out

Close-out is the final opportunity for people working for the contracting authority to indicate that they consider something in the procurement process to be unacceptable.

2.7.1 Joint inspection of the completed requirement

Once the economic operator declares that all of the work (whether it be installation, construction or delivery) has been completed, the first task will be to undertake a comprehensive check to confirm completion. This task may be that of the procurement officer or of a technical specialist stakeholder.

It is always advisable to ensure that a thorough inspection of the work completed is jointly undertaken with the economic operator. This inspection will ensure that nothing has been overlooked and that there is a common understanding (without disagreement) of the state of the finished delivery, with an itemised list of any omissions or defects found. This inspection can be carried out by the procurement officer and a technical specialist stakeholder from the contracting authority together with the project manager or contract manager from the economic operator. Any defects agreed with the economic operator as a result of this inspection should be rectified as soon as possible.

2.7.2 Snagging list

During the inspection the group will draw up a snagging list (sometimes referred to as a ‘punch list’). Snags are minor deficiencies that do not constitute incomplete work or have a major impact on the functionality of the finished requirement. The snagging list should be transmitted to the economic operator and realistic dates agreed for the repair of the snags. These repairs are then checked by the technical specialist stakeholder on behalf of the contracting authority. Items on a snagging list could include:

- Typographical errors on documents provided by economic operators
- Windows that do not close on a building
- A list of improvements from participants in a pilot training programme

- Software screens that do not clear properly and present new data

2.7.3 Final 'as built' documents completed and stored

With any procurement, but particularly for works contracts, it is vital to keep complete records of all diagrams, specifications, lists, data files, drawings and documents describing the finished specification of the requirement that is now in situ. There are two reasons for this record-keeping:

Firstly, the economic operator must be able to manage any actions necessary under the warranty, retention or defects liability period.

Secondly, the contracting authority must have a full set of information about the detailed design and specification to ensure that the requirement is maintained properly. If any modifications are subsequently required, full information is available on which to base the amended design.

In some industries there may be statutory requirements to maintain detailed records for the lifetime of the plant until final decommissioning, which in these cases may be more than 100 years from the original construction date.

2.7.4 Commissioning and testing completed

Where necessary, commissioning and testing should form an integral part of the process of transferring ownership of the works (building or bridge), goods/equipment (vehicle, computer system or photocopier), or service (vehicle or aircraft service) to the contracting authority. The purpose of this process is to eliminate initial problems in the operation of the requirement so that it is fit for the purpose for which it was originally specified.

On complex projects, sometimes an independent commissioning engineer may be engaged to undertake this process with both parties.

2.7.5 Handover/contracting authority acceptance

This is a formal procedure for accepting the finished requirement from the economic operator, and documentation should include all testing and commissioning data, operation and maintenance manuals, and drawings.

On some major high-profile public contracts, a handover ceremony is sometimes held to mark the change of ownership and the start of the use of the requirement by the contracting authority or its customers or stakeholders.

2.7.6 Warranty, retention or defects liability period

The terms and conditions of the contract include a provision for a warranty, retention or defects liability period. This period will vary with the requirement and with the specification issued by the contracting authority, but the warranty will include the replacement of faulty parts or corrective action, as specified in the contractual document.

A distinction must be made between corrective action, which will be taken in accordance with the terms of the agreement, and maintenance and development, which unless specified will normally fall outside the terms of the agreement.

Localisation required.

See also Module C2 on contract terms.

2.7.7 Issue of final certificate

Where appropriate, a final certificate may be issued. A typical contract condition describing the issuing of a final certificate might state:

“The final certificate to be issued by the contracting authority at the end of the defects liability period shall be binding on both parties and shall provide conclusive evidence that the work has been completed to the satisfaction of the contracting authority and in accordance with the contract.”

This certificate confirms the final completion of the project.

2.7.8 Final accounts agreed and payments made

Once the final certificate has been issued, there should be no outstanding payments and the procurement officer should check to ascertain that the final accounts have been agreed and that all payments have been made. The contracting authority may wish to check that the economic operator has paid its own economic operators.

2.7.9 Release of any performance bonds, retention monies or other forms of security

Localisation required

Once the warranty, retention or defects liability period has been satisfactorily completed and the final accounts have been agreed, there is no need for holding any retention monies, performance bonds or other forms of security, and so these may be released. See Module C3 for further information on bonds and other forms of security.

2.7.10 Formal end of contract

Localisation required

The end of the warranty, retention or defects liability period is considered to be the ‘end of the contract’. From this point on, the only legal recourse the contracting authority has if the product fails to live up to expectations is to sue for damages in the courts. It is extremely important therefore that a full and final check is carried out to satisfy the contracting authority that the requirement is fully fit for purpose before issuing the final certificate.

2.8 Termination of contracts

Contracting authorities may sometimes face circumstances that require the early termination of a public contract in order to comply with obligations under European Union law in the field of public procurement.

According to the 2014 Directive, contracting authorities must have the possibility, under the conditions determined by national law, to terminate a public contract during its term, at least under the following circumstances:

- Where the contract has been subject to a substantial modification that would have required a new procurement procedure (which has not been organised);
- Where the contractor has, at the time of the contract award, been in one of the situations defined as mandatory grounds for exclusion and should therefore have been excluded from the procurement procedure;
- Where the contract should not have been awarded to the contractor in view of a serious infringement of the obligations under the treaties and the directives, which has been declared by the Court of Justice of the European Union in a procedure pursuant to article 258 TFEU.

Narrative Appendix

Sample documents

1 Introduction

This section contains a sample agenda for the inaugural meeting, a sample issues list and a close out checklist.

Appendix 1 Sample agenda for the inaugural meeting

A sample agenda for an inaugural meeting is shown below:

Inaugural Meeting

- 1 Object of Meeting and Introductions**
- 2 Management Organisation**
 - 2.1 Contracting authority roles and responsibilities
 - 2.2 Economic operator roles and responsibilities
 - 2.3 Sub economic operator's involvement
- 3 Performance and Administration**
 - 3.1 Procedures for contract modifications
 - 3.2 Invoicing processes
 - 3.3 Performance levels required
 - 3.4 Performance linked payment arrangements
 - 3.5 Joint inspections
 - 3.6 Audit arrangements
 - 3.7 Authority to stop work
 - 3.8 Environmental questionnaire
 - 3.9 Operational and management review meetings
 - 3.10 Safety management
 - 3.11 Escalation procedures
 - 3.12 Processes for raising and handling issues
- 4 Security**
 - 4.1 Economic operators ID cards
 - 4.2 Proof of identity/security checks required
 - 4.3 Withdrawal of access to site
- 5 Site amenities**
 - 5.1 Use and location of site amenities
 - 5.2 Restrictions applied to economic operator's staff
 - 5.3 Use of utility supplies
 - 5.4 Economic operator's accommodation
 - 5.5 Use of economic operator's equipment
- 6 Any other business
- 7 Date and venue of next meeting

Appendix 3 Close out checklist

This checklist is taken from the office of administration for information technology at the state of Pennsylvania USA. <http://www.oit.state.pa.us> This site contains a number of useful templates.

Access	
Have all security badges been secured?	Y/N
Have outlook access accounts been disabled?	Y/N
Has access to applications been disabled or modified?	Y/N

Deliverables	
Have all deliverables been completed and signed off on?	Y/N
Have all deliverables and related financial records been placed in a centralized repository for easy access?	Y/N
Have source files been obtained for all deliverables (No PDF documents)?	Y/N

Knowledge Transfer	
Has appropriate knowledge transfer occurred on key components of the project?	Y/N
Have all key administrators of the system been identified and trained?	Y/N
Does the maintenance team have access to all the artefacts that could help them maintain the project's deliverables?	Y/N

Transition	
Has communication been issued indicating that the project (or project phase) is ending?	Y/N
Have all project staff been released or re-allocated?	Y/N
Have all invoices and financial obligations been resolved?	Y/N

Section 3 Exercises

Note on amendments to Exercises: The Trainer's Manual has not been updated to reflect the amendments below.

Exercise 1: Contract Management

In a previous module we defined contract management as one of the four texts below. Can you remember which one it is? We have been quite subtle here: there are elements of the appropriate approach in all of the definitions, but one is the preferred one.

Contract management:

1. Is working closely with people from the economic operator to ensure that they stick to the letter of the contract and meet the needs of the contracting authority, while giving as little away as possible to ensure that the procurement is delivered at lowest overall cost
2. Is about keeping the economic operator happy, to ensure that they complete the procurement on time and within budget
3. The steps that enable both the contracting authority and the economic operator to meet their obligations within the contract in order to deliver the objectives required from the contract
4. The steps that relate to organising delivery of the contract once the documents have been signed by both parties so that the economic operator can deliver the goods and services required.

Exercise 2: 10 questions

The ten questions below require true or false answers. Read them carefully and then decide whether the statement is true or false. We have changed the words from the text you have seen to make it more difficult in some cases.

No.	Question	True	False
1	There is no pressure for the inaugural meeting to take place		
2	Activities in the contract management process include service delivery management, relationship management and contract administration		
3	It is appropriate to take a hard approach at the inaugural meeting		
4	Review meetings are a necessary evil, where we treat economic operators in a hard way		
5	The three key factors for success in managing relationships are: <ul style="list-style-type: none"> ◦ A common understanding of the economic climate ◦ Openness and excellent communication ◦ A joint approach to managing delivery 		
6	In a good relationship, an economic operator will feel more confident in investing for the longer term – for example, in more flexible infrastructure, better systems or staff training		
7	Issues logs are where we record economic operators' moans and groans		
8	It is better to reschedule a review meeting than for the senior person from the contracting authority not to attend at short notice		
9	During a contract, the contracting authority will gain an insight into the economic operator's strengths		
10	During the inaugural meeting perceptions can be gained by people from the contracting authority about the truth and credibility of given statements and promises made by the economic operator prior to the award of the contract		

Exercise 3: Minimising the Number of Modifications and Their Impact When They Occur

This document contains a table of fifteen statements/questions to be asked about modifications. In their context all of the statements are true, but from the information you have it is not clear whether the statements can be said to:

- minimise the number of modifications, or
- minimise the impact of the modifications on the contracting authority when it occurs

Your task is to determine which of the two options each statement refers to. Each statement can only go one way, left or right. To help you, the second one has been answered correctly.

Minimise the number of modifications	No.	Statement	Minimise the impact of the modification
	1	Is this request clearly within the scope of work agreed and understood?	
	2	Use the same diligence in agreeing a modification as you would in letting a contract.	
	3	Always obtain a firm quotation for the price of the modification. Remember that economic operators will try to use modifications to maximise profit in the contract and may well price high – it is effectively direct award without competition action – so always challenge the price.	
	4	Understand the concept of marginal costing – the economic operator will have built fixed costs into the base contract price, but these may not be relevant for extras and should be excluded from modifications.	
	5	Is this really needed, or is it a "nice to have"? Work out the direct and indirect implications.	
	6	Is there another way of doing it, which may be more cost-effective?	
	7	Do not agree a modification to the contract until both you (as procurement officer) and the person from the economic operator agree in writing the total consequences in time and cost of the modification (including any knock-on effects to other parts of the procurement).	
	8	Is it really a modification to the current contract or is it new work needing a new contract?	
	9	Will the modification breach the national procurement regulations or conflict with any policy on competitive tendering?	
	10	Make sure that full records are kept from the start of the contract. A contract logbook to record any happenings that could result in modifications is a good idea.	
	11	Do not be tempted to use an economic operator to get extra work done just because they are already on your site.	

Minimise the number of modifications	No.	Statement	Minimise the impact of the modification
	12	Is it a misinterpretation of the existing specification or of the terms and conditions? Would clarification mean that the need for the modification disappears?	
	13	Keep all relevant stakeholders involved in any modifications being considered. This may include procurement, contracts, legal, finance, end users and/or the budget holder.	
	14	In an emergency, instruct the economic operator orally, but complete the written confirmation as soon as possible – the same day if possible.	

Section 4 Chapter Summary

Note on amendments to Self-Test Questions: The Trainer's Manual has not been updated to reflect the amendments below.

Self-test questions

No.	Question
1	What does PDCA stand for, and why is it relevant in contract management?
2	Contract management activities can be broadly grouped into three areas that span the do, check and act of PDCA. What are they?
3	There is pressure for the inaugural meeting to take place as soon as possible once the contract is signed. True or false?
4	What are the objectives of the inaugural meeting?
5	<p>Complete the gaps in the text below:</p> <p>The aim of the issues log is to record the issue and _____ to resolve it.</p> <p>An _____ must be provided within the contract for issues that cannot be resolved.</p>
6	Lack of capacity, fundamental changes and force majeure were three of the risks involved with contract management. Can you remember three more risks?
7	<p>Contract management controls must be highly relevant to the essence of the contract. This was one of the six key factors about contract controls. Is it true that the following statements are also key factors? Contract controls must be:</p> <ul style="list-style-type: none"> ◦ Capable of measurement ◦ Robust in their operation ◦ Able to provide more value than the cost of the activity related to their collection
8	<p>Complete the gaps in these sentences:</p> <p>Service level _____ are one excellent way of _____ within a contract.</p> <p>There should be a detailed agreement of the required service levels and thus the _____ expected of service to be delivered.</p>
9	Are modifications <i>normally</i> good news for the contracting authority or the economic operator?
10	What are the possible circumstances behind the need for a permitted modification?

Module G2 Dispute Resolution

Section 1 Introduction

1.1. Objectives

The objectives of this module are to make participants aware of:

1. The importance of maintaining working relations with economic operators whenever possible
2. The need to draft suitable contract provisions addressing dispute resolution, including negotiation and escalation clauses
3. The precise meaning of a range of alternative dispute resolution procedures, namely: mediation, conciliation, adjudication, arbitration and litigation
4. The basic procedures involved in using these alternatives
5. The respective advantages and disadvantages of the above procedures
6. The role of various bodies concerned with international dispute resolution
7. Recent developments across the European Union relating to dispute resolution

1.2. Important issues

- The commercial impact of disputes and how best to minimise their costs/negative impact to the procurement organisation
- Attempts by the European Union and individual countries to improve the processes for dispute resolution through legislative measures and voluntary arrangements, *e.g.* codes of practice

1.3. Links

Links to other modules appear throughout the text of this document. There are, however, major links to modules:

Module B2 on procurement processes

Module B3 on the role of the procurement officer

Module G1 on contract management

Module G3 on measuring performance in public procurement

1.4. Relevance

Disputes are time-consuming and costly activities for procurement officers; they need to be handled effectively and efficiently. Procurement officers need to understand what a dispute resolution process may involve, so that they are able to assist in the most effective way in that process.

1.5. Legal information helpful to have at hand

This section will link to other areas referring more closely to legal information.

LOCALISATION WILL NEED TO REFER TO SPECIFIC LEGAL DOCUMENTS AND DISPUTE RESOLUTION PROCESSES USED LOCALLY

Section 2 Narrative

1 Overview

This narrative considers the importance of maintaining working relations with economic operators and then investigates what is meant by ADR (Alternative Dispute Resolution), mediation, conciliation, adjudication, arbitration and litigation. A description is provided of what happens in each of these cases and then the advantages of each ADR option are considered. The narrative then examines the arrangements that have been made for international arbitration and recent developments to encourage greater use of mediation, before describing EU initiatives and other initiatives that are currently underway relating to ADR. Finally, specific examples are provided of contractual clauses for ADR.

The narrative will include discussion of the following topics:

- Examples of the types of issues that can lead to conflict and disputes with suppliers (inappropriate specification, etc.)
- Definitions of mediation, conciliation, adjudication, arbitration and litigation
- Comparison of the processes involved
- Evaluation of the respective pros and cons of each of the above procedures
- International arbitration, especially the role of the London Court of International Arbitration
- Recent developments around the world to encourage mediation prior to compulsory dispute resolution
- European Union and UK initiatives related to alternative dispute resolution currently underway
- Contractual clauses and mediation agreements to address potential disputes
- National and international enforcement mechanisms related to awards

Materials referred to in the narrative include:

- EU Directive on Alternative Dispute Resolution (2008)
- EU Green Paper on ADR 2002 (arguments in favour leading to the new Directive)
- Model ADR clauses from the Centre for Dispute Resolution (UK-based organisation encouraging the use of mediation)
- CEDR Model Mediation Agreement 10th Edition (2008)
- UK Ministry of Justice Report on ADR within UK central government departments – examples and statistics (2008)
- Examples of mediation and arbitration disputes and their outcomes

Throughout the training manual, use of the above materials will be encouraged, especially the model ADR clauses and the model mediation agreement. Wherever appropriate, statistical information will be included to suggest trends and relative significance. Practical examples of ADR procedures will be provided.

Clearly, there will be considerable differences in the procedures adopted between the various member states of the European Union, e.g. regarding litigation processes. Localisation of the material, where appropriate, will be an important requirement in this element of the module.

2 Approach

Section 2 contains the following sub-sections:

- 2.1 Why is it important to maintain working relations with economic operators?
 - 2.2 What is meant by:
 - ADR?
 - Mediation?
 - Conciliation?
 - Adjudication?
 - Arbitration?
 - Litigation?
 - 2.3 What happens in each of the above processes?
 - 2.4 What are the advantages of mediation/conciliation?
 - 2.5 What are the advantages of adjudication?
 - 2.6 What are the advantages of arbitration?
 - 2.7 What are the advantages of litigation?
 - 2.8 What arrangements have been made for international arbitration?
 - 2.9 What recent developments have taken place to encourage greater use of mediation?
 - 2.10 What EU and UK initiatives related to ADR are currently underway?
 - 2.11 What types of contractual clauses for ADR should be considered for inclusion in a commercial contract with an economic operator?
 - 2.12 Summary
-
- Appendix 1 EU Directive 2008/52/EC
 - Appendix 2 CEDR Model Mediation Agreement

2.1 Why is it important to maintain working relations with economic operators?

As you will have already seen in Module B2 (Procurement Processes), it is important to adopt many upstream activities in order to avoid later problems when managing the contract downstream.

For that reason, it is important to adhere to the basic principles and procedures already indicated in Module B2. Failure to do so would increase the risk of encountering serious problems with economic operators and could easily lead to costly disputes.

However, even with suitable upstream processes in place, there are occasions when disputes will take place and these disputes will have to be resolved.

Such disputes can arise for a variety of reasons. There could be a change in government policy that has significant consequences on contract performance requirements. Budgets may be reduced, which again could have implications for future contractual relations. Government reorganisation can result in contracts being transferred to another, newly formed contracting authority – and sometimes to more than one. Transitional arrangements may not run as smoothly as would be desired. New regulations and legislation (either from domestic legislation or as a result of EU directives and treaties) can require substantial modifications to existing contractual arrangements. All of the above can place major stresses on the relations between the contracting authority and the economic operators with which it has commercial contracts. Sometimes these stresses produce disagreements – disputes. Appropriate procedures should be in place to provide a mechanism for resolving these disputes.

The following narrative will show you a range of alternatives for dealing with the problem.

The narrative will identify these alternative dispute procedures, define each one, compare and contrast their strengths and weaknesses, and describe some recent developments taking place within the European Union and elsewhere.

Localisation: Throughout this module, there will be frequent occasions where local laws and procedures will vary from the standard text. Consequently, there will be a need to alter the material to fit the needs of the various audiences, depending on which country is involved.

2.2 What is meant by alternative dispute resolution (ADR)?

Dispute resolution, in its widest sense, includes any process that can bring about the conclusion of a dispute. Dispute resolution techniques can be seen as a spectrum ranging from the most informal negotiations between the parties themselves, through increasing formality and more directive intervention from external sources, to a full court hearing with strict rules of procedure.

Alternative Dispute Resolution (ADR) is a commonly used term that includes a range of processes involving the use of an external third party and that can be regarded as an alternative to litigation (there is some debate as to whether arbitration is or is not a form of ADR). Dispute resolution techniques include:

Negotiation - the most common form of dispute resolution, where the parties themselves attempt to resolve the dispute.

Mediation - a private and structured form of negotiation assisted by a third party that is initially non-binding. If settlement is reached, it can become a legally binding contract.

Conciliation – the same as mediation, but a conciliator can propose a solution.

Adjudication - an expert is instructed to rule on a technical issue – for instance, as used in the UK for construction disputes, as set out in the Housing Grants, Construction and Regeneration Act 1996, where awards are binding on the parties at least on an interim basis, i.e. until a further process is invoked.

Arbitration - a formal, private and binding process where the dispute is resolved by the decision of a nominated third party, the arbitrator or arbitrators.

Litigation - the formal process whereby claims are taken through the civil courts and conducted in public. The judgments are binding on the parties, subject to rights of appeal.

Below some more information is provided on each method, including an indication of each method's advantages.

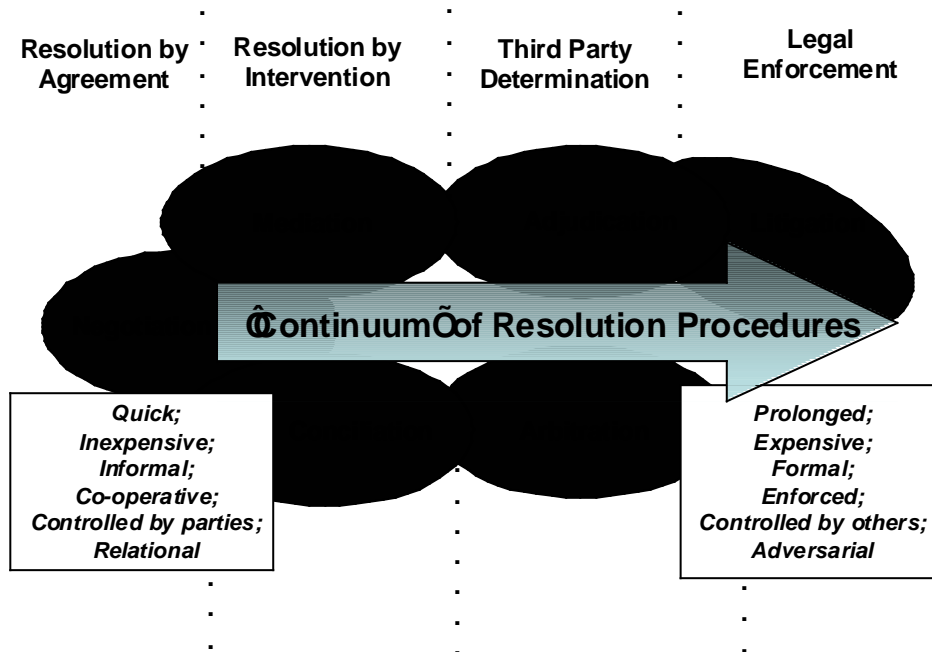
2.2.1 ADR (All forms)

Its advantages are:

- speed
- cost savings
- confidentiality
- preservation of relationships
- range of possible solutions
- control of process and outcome

If you are unable to achieve a settlement through negotiation, you will need to consider what other method or methods of dispute resolution would be suitable. Remember that it may still be possible or even necessary to continue negotiating as part of or alongside other forms of dispute resolution. However, in some jurisdictions, for example, once formal court proceedings have started, other forms of dispute resolution can no longer be used. [Localisation required.](#)

Here is a diagram showing the different types of alternative dispute resolution and how they relate to each other.



2.2.2 What is meant by mediation?

Mediation is negotiation with the assistance of a neutral third party. The mediation process is somewhat like shuttle diplomacy – the parties meet in joint and separate meetings, the mediator moving between them, attempting to find points of common ground and build on them. It has to be treated as an entirely voluntary exercise, and either side can withdraw at any stage.

Mediation does not require pre-agreed contractual terms for it to be adopted, but if such a provision has been drafted into the contract (e.g. an alternative dispute resolution clause) it can oblige the parties to use the process, even though one or both may have changed their minds.

Although a settlement is initially not legally binding on the parties, it is usual for it to be documented and signed as a contractually enforceable agreement.

Example:

Mediation is now being used extensively for commercial cases in the UK (including cases involving government departments), frequently for multi-party and high-value disputes. Over 75% of commercial mediations result in a settlement, either at the time of the mediation or within a short time thereafter.

In the UK, mediation is being encouraged through the court system. Since 1999, new court procedures state that:

“Active case management includes ... encouraging the parties to use an ADR procedure if the court considers that appropriate”.

A number of UK courts, including the Commercial Court, frequently make ADR orders, even in the face of objections from one or more of the parties.

Local information relating to the use of mediation and its success rate will be appropriate to cover the above section.

2.2.3 What is meant by conciliation?

This means something very similar to mediation, with one difference. Apart from acting as a facilitator encouraging the two parties to settle their dispute, a conciliator will be able to make a recommendation as to the outcome of the dispute. The recommendation is not binding and the parties may choose to ignore it. However, the process will tend to take a bit longer than mediation because the conciliator will need to become more familiar with the arguments and issues in order to arrive at a suitable recommendation.

2.2.4 What is meant by adjudication?

Example:

The term “adjudication” is used almost exclusively in the UK for dispute resolution involving building and construction contracts. Under the Housing Grants, Construction and Regeneration Act 1996, construction contracts must include a provision for adjudication, with the adjudicator giving a decision within 28 days of referral. The adjudicator’s decision is binding until a final determination is reached by agreement, arbitration or litigation, or until the parties take the adjudicator’s decision as final. For this reason, adjudication is different in kind from other forms of ADR, which are optional and less tied to a single subject area. Like litigation and arbitration, adjudication is an adversarial process.

Local information relating to the use of adjudication will be appropriate to cover the above section.

Adjudication and arbitration have much in common - the parties agree on who is to play the ‘judicial’ role, present their cases, and receive a judgment. There are nevertheless significant differences in approach, although there remains widespread confusion in business as to their respective meanings. In fact, the terminology used in the contract is not conclusive as to which process would apply in the event of a dispute. For example, the contract may specify that ‘adjudication’ will be used. If the contract goes on to describe procedures that are essentially similar to arbitration, the courts may insist on arbitration being used.

Localisation required to reflect the approach adopted by local courts.

2.2.5 What is meant by arbitration?

Arbitration is a process by which the parties agree that an independent third party is to be brought in to make a decision that is binding on the parties. The power (jurisdiction) of the arbitrator may be derived from the mutual consent of the parties, from a court order or from a statute that clearly indicates the use of arbitration. The choice of arbitrator will be for the parties to decide, or according to a method to which they have consented. The arbitrator must act impartially and fairly, applying the principles of natural justice to the proceedings (see below).

2.2.6 Some differences between arbitration and adjudication

Bearing the above points in mind, some clear differences can be identified between arbitration and adjudication. The adjudicator makes a decision that is non-binding (unless specifically agreed otherwise). He/she examines the evidence and makes appropriate enquiries. As an expert, his/her own skills and judgment are used to formulate a decision.

An arbitrator, conversely, makes a decision that is final and binding, after receiving the presentations of both parties according to the principles of natural justice. The ‘judge’ must be impartial (e.g. by having no personal interest in the dispute or connection with the parties) and he/she provides both parties with a fair opportunity to present their cases. This requirement has implications for ensuring adequate time for preparation and the right to legal representation when presenting the case. Arbitration is therefore more thorough and time-consuming.

2.2.7 Why has adjudication emerged in recent years?

The introduction of adjudication was a reaction to some of the growing failings of arbitration. Originally, arbitration was established to provide a more informal, quicker and cheaper method of resolving disputes than proceeding to the courts. By the early 1990's, however, opinion viewed arbitration as increasingly formal, slow and expensive, partly as a result of increased lawyer involvement. Among other criticisms it was argued that the procedure imitated court actions, which made hearings as lengthy as litigation and could cost even more. It was also relatively easy to appeal against the decision of the arbitrator, and the subsequent appeal case could take years in the courts to reach a decision.

It was argued that, although there are some occasions where disputes are so important and/or complex to justify elaborate arbitration proceedings, there are many others that do not require such thoroughness. What is more important is a speedy resolution to the dispute, even if it is achieved at the expense of detailed scrutiny. Adjudication provided this alternative, albeit more superficial, approach. Because adjudication it is a quicker and cheaper approach, it would not be appropriate to make the decision final and binding. However, the parties can elect to make it so by agreement.

Localisation: the above paragraphs describe the situation in the UK and so localisation may be required or this section could be left as an illustration.

2.3 What happens in mediation and conciliation

Format - Mediation is essentially a flexible process with no fixed procedures, but the format tends to be along the following lines. At an opening joint meeting each party briefly sets out its position. This is followed by a series of private confidential meetings between the mediator and each of the teams present at the mediation. This may lead to joint meetings between some or all members of each of the teams. If a settlement is reached, its terms should be written down and signed.

Timing - Most commercial mediations last one day, with very few running for more than three days. A considerable number take place within a month of being initiated, and this period can be shortened to days where necessary.

The mediator - The mediator's role is to facilitate the negotiations. The mediator will not express views on any party's position, although he/she may question the parties on their positions to ensure that they are being as objective as possible about the strengths and weaknesses of their own and the other party's(ies') legal and commercial arguments. The mediator will try to get the parties to focus on looking to the future and their commercial needs rather than analysing past events and trying to establish their legal rights. It is essential for the mediator to have had mediation training; it is not essential for the mediator to have experience, or even knowledge, of the subject matter of the dispute.

Participants - The team attending the mediation should be kept as small as possible but must include somebody ('the lead negotiator'), preferably a senior executive or official from each participating organisation, with full authority to settle the dispute on the day of the mediation, without having to revert to others not involved in the mediation. The lead negotiator should ideally not have been closely involved in the events relating to the dispute.

Where it really is not possible for the lead negotiator to have full authority to settle, the person attending must be of sufficient seniority that his/her recommendation on settlement is likely to be followed by whatever person or body makes the final decision. The fact that a binding settlement agreement cannot be reached on the day of the mediation and the reason for this should be made clear to the other parties in good time before the mediation. Most mediation teams include a lawyer, but a large legal representation on the team is rarely useful or necessary.

Preparation - Each party usually prepares a brief summary of its position (not just its legal case) for the mediator and the other party, together with the key supporting documents. These documents are exchanged between the parties, and sent to the mediator, at least a week before the mediation. The parties should enter into a mediation agreement once the details of the mediation (e.g. place, time, name of mediator) have been agreed.

There is considerable similarity between mediation and conciliation. Conciliation is entirely voluntary and is undertaken on a confidential basis. The parties prepare statements of their view on the disputed issue to send to the conciliator, who starts an investigation by interviewing the parties. Unlike an arbitrator, he/she does not have to observe the principles of natural justice (see above). The conciliator adopts an inquisitorial method, controlling the collection of evidence and questioning the parties involved. A meeting is then arranged at which the conciliator begins to form an opinion (possibly with an 'expert' present to assist and advise on technical issues). He/she will express his/her views on the strengths and weaknesses of the parties' cases and offer an opinion as to how an arbitrator might view the dispute. This is partly done to encourage a possible settlement between the parties. Failing this, the conciliator will issue his/her own recommendation.

Good practice note:

The following points can be made about the conciliator's recommendation:

- It is only the opinion of the conciliator.
- It is not justified with reasons (unless specifically requested).
- It is not binding ('without prejudice').
- It is a practical solution, not necessarily in strict accord with the relevant law.
- The process may take about three months to complete.

2.4 Advantages of mediation/conciliation

- Speed (for mediation just a few days; for conciliation not exceeding two to three months)
- Inexpensive (sometimes less than 1% of disputed amount)
- Confidential
- Non-binding
- Parties able to agree on settlement
- Flexible outcomes (commercial trade-offs, etc.)
- Encourages future trade relations with the other party

Mediation or conciliation should always be considered in cases where:

- the cost of litigation is expected to be disproportionate to the claim;
- the parties are deadlocked in settlement negotiations;

- complexities of law, facts or relations are likely to lengthen proceedings and to probably result in an appeal of any judgment;
- there are multi-actions involving several parties;
- the issues are highly complex and involve several parties;
- the issues involved are sensitive or require the disclosure of sensitive information;
- the parties do not wish to have any publicity.

However, not suitable for mediation or conciliation is a small group of cases where:

- a legal, commercial or other precedent needs to be set;
- a summary judgment is available quickly and efficiently;
- parties require emergency court intervention for protective relief;
- publicity is actively sought;
- there is no real interest in settlement.

2.5 What are the advantages of adjudication?

- Rapid: fixed 28-day time frame in UK **Localisation**
- Less expensive (than arbitration or litigation)
- Adjudicator acts as an expert rather than an arbitrator (rules of evidence are less demanding on an adjudicator)
- Decision of adjudicator based on skill and experience as well as evidence
- Non-binding, unless otherwise agreed as a contractual term

Some disadvantages of adjudication compared with arbitration:

- Less thorough process, with fewer opportunities for the parties to present all of the evidence
- Temporary decision, unless made binding by agreement between the parties
- No legal representation permitted (in UK) - **Localisation**

As can be seen above, the main reason for the development of adjudication was to overcome some of the problems faced by arbitration during the last 30 years of the 20th century. What was needed was a process that would be relatively rapid and, inexpensive, free of the time-consuming thoroughness and rigour of arbitration rules and requirements.

2.6 What are the advantages of arbitration over litigation?

- Can be cheaper
- Frequently quicker
- Less damaging to business reputation (private)
- Easier to continue doing business with the other party (less confrontational)
- Less risk of disclosing confidential information (private)
- Business expertise of the arbitrator
- Greater discretion (more ability to produce a pragmatic decision)

2.7 What are the advantages of formal litigation?

The advantages of litigation are:

- Thorough examination of the evidence and arguments
- Decisive, final and binding
- Ideal if dispute is over a point of law
- Speed of procedure can be forced by court rules (unlike arbitration)
- Legal aid (financial support) is available if litigant is poor (in the UK)

Remember, however, that in the great majority of cases, the disadvantages of litigation seriously outweigh the benefits (see advantages of arbitration compared with litigation).

Example:

An extreme example of the negative aspects of litigation occurred recently in the UK.¹ A High Court case between ***Multiplex Constructions (UK) Ltd v Cleveland Bridge UK Ltd (2008)*** was decided in a dispute involving the building of the new Wembley Football Stadium, England's national football ground. After several years of litigation between the two construction companies, a judgment was finally made. The judge criticised the two companies for their failure to attempt to settle the dispute at several stages during pre-trial and trial. As a result, legal costs had been increasing rapidly. These costs included photocopying of the trial papers (550 ring files) costing nearly 1 million GBP. Each side had employed a team of experts, senior lawyers and large numbers of support personnel. In total, the two parties had spent 22 million GBP in legal fees – far greater than the losses they were claiming against each other. According to the judge, huge sums of money and a large amount of management time had been spent for no useful purpose.

Local examples of the problems of using litigation should be used by way of illustration.

2.8 What arrangements have been made for international arbitration?

Several international bodies have been established to provide arbitration services for parties based in different countries. These bodies include the International Court of Arbitration of the International Chamber of Commerce, the international branch of American Arbitration Association, the [London Court of International Arbitration](#) (LCIA), the [Hong Kong International Arbitration Centre](#), and the [Singapore International Arbitration Centre](#) (SIAC).

The following information provides a description of the work of the London Court of Arbitration. The other international arbitration bodies listed above provide similar services and have similar strengths.

2.8.1 Casework

Many major international businesses entrust their disputes to the London Court of Arbitration (LCIA). Many cases are technically and legally complex and sums disputed can run into billions of US dollars. Parties come from a very large number of jurisdictions and from both civil law and common law traditions.

The subject matter of contracts in dispute is wide and varied, and includes all aspects of international commerce, including telecommunications, insurance, oil and gas exploration, construction, shipping, aviation, pharmaceuticals, shareholders' agreements, IT, finance and banking.

3.8.2 Arbitrators

The LCIA maintains an extensive database of arbitrators with a range of professional qualifications and expertise (legal and non-legal). The database is not a closed list, however, and parties are free to nominate arbitrators who are not in the database. Similarly, the LCIA will look for arbitrators outside its own database when necessary.

2.8.3 Charges

The LCIA's charges, and the fees charged by the tribunals it appoints, are not based on the sums at issue. Costs are based on time actually spent by the administrator and arbitrators alike.

2.8.4 Enforcement of Awards

For the many parties for whom a final and binding settlement is paramount, the enforcement argument is perhaps the most persuasive and enduring.

The rules of the major international arbitration institutions, including the LCIA, expressly provide that any award will be final and binding and will be complied with without delay. By agreeing to be bound by such rules, the parties usually also exclude any right of appeal on the merits to a national court that may have jurisdiction to hear such an appeal.

The ability to resolve disputes in a neutral forum and the enforceability of binding decisions are often cited as the main advantages of international arbitration over the resolution of disputes in domestic courts. There is solid legal support for this view. An international award originating in a country that is a party to the New York Convention of 1958 may be enforced in any other country that is also a signatory as if it had been decided by a domestic court. Here is an example of this important concept: assume that parties from countries A and B have agreed to resolve their disputes in country C, and all three countries are parties to the New York Convention. This will mean that even though the arbitration will take place in country C, the resulting award can be enforced in country A (or country B) as if it were a court decision rendered in a domestic court of that country. (By contrast, there is no

equivalent treaty for the international recognition of court decisions.)

Thus parties to international contracts can decide to set the site for the arbitration of their dispute in a third, neutral country, knowing that the eventual award can be easily enforced in any country that is a signatory to the New York Convention. The large majority of free-market nations have ratified the convention.

2.8.5 Neutrality

Parties to international agreements may be concerned that the national courts of the party with which they are contracting may have an instinctive, or even a manifest, bias towards a party of the same nationality. Whether or not such concerns are well-founded, international tribunals and the administration of a recognised arbitral institution may be seen as offering greater neutrality than the courts.

This section on international arbitration will need to be adapted to local needs, depending on which international body tends to be used for such disputes.

2.9 What recent developments have been taking place inside the European Union and elsewhere to encourage greater use of mediation?

In Appendix 3, there is an article showing some of the main developments related to mediation taking place around the world. It also highlights the reasons for these initiatives, which are varied.

2.10 What EU and UK initiatives are currently taking place relating to Alternative Dispute Resolution (ADR)?

The European Union has shown increasing interest in alternative dispute resolution (ADR) over the past decade. In April 2002 the European Commission published a Green Paper (discussion document) on alternative dispute resolution. In July 2004 the Commission organised the launch of a [Code of Conduct for Mediators](#), which was approved and adopted by a large number of mediation experts, and in October 2004 the Commission adopted and submitted to the European Parliament and to the European Council a proposal for the preparation of a directive focusing on certain aspects of mediation in civil and commercial matters. The [Directive](#) was adopted on 21 May 2008.

The Green Paper, the Code of Conduct and the Directive on mediation all form part of the European Union's current work on establishing an area of freedom, security and justice, and particularly on improving access to justice. It is the Commission's view that "encouraging the use of Mediation and other forms of ADR assists in the resolution of disputes and helps to avoid the worry, time and cost associated with court-based litigation and so assists citizens and businesses in a real way to secure their legal rights".

2.10.1 Code of Conduct for Mediators

The Code of Conduct for Mediators sets out a series of norms that can be applied to the practice of mediation and that can be observed by mediation organisations. It was drafted in co-operation with a large number of organisations and individuals, including skilled mediators and others interested in seeing mediation develop in the European Union. The Code was adopted by a meeting involving these experts in July 2004, and the Commission “*was very pleased to be involved in and to have the opportunity to assist this process*”.

2.10.2 Directive on Alternative Dispute Resolution (Directive 2008/52/EC)

The Directive on Alternative Dispute Resolution continues this process of encouraging the use of mediation (or ADR) as part of its goal of increasing access to justice. It only strictly applies to **cross-border disputes** (where the organisations in dispute are based in separate countries). However, the Commission has made it clear that EU Member States could adopt the Directive on a wider basis so as to include disputes that are within a single country.

According to the Directive, member states should authorise the courts to *suggest mediation to the litigants*, without compelling them to use it. Although the settlement agreements reached through mediation are generally more likely to be implemented voluntarily, the Directive requires all member states to establish a procedure whereby an agreement may, at the request of the parties, be confirmed in a judgment, decision or other instrument by a court or public authority. This would allow mutual recognition and enforcement of settlement agreements throughout the EU under the same conditions as those for court judgments and decisions.

To encourage the more effective use of mediation, member states must ensure that the parties are not later prevented from starting judicial proceedings or arbitration in relation to the dispute due to the expiry of limitation periods during the mediation process.

Again, to encourage the use of mediation, neither mediators nor those involved in the mediation process are compelled to give evidence in judicial proceedings regarding information obtained during the mediation process.

Although the Directive was adopted in 2008, EU Member States will not be required to implement it until May 2011. As with all EU Directives, there is a period of delay, allowing member states the opportunity to consider how best to implement the requirements, given their existing laws and procedures.

2.10.3 Centre for Effective Dispute Resolution (CEDR)

The following text can be used to illustrate how mediation has been making rapid progress in one EU Member State. Additional local examples of significant progress could be used to supplement the illustrations in the manual.

In the UK, there has been considerable progress in the use of mediation in both the public and private sectors.

The **Centre for Effective Dispute Resolution** (CEDR) is a London-based [mediation](#) and [alternative dispute resolution](#) body. It was founded as a non-profit organisation in 1990, with the support of the Confederation of British Industry (CBI) and a number of British businesses and law firms, to encourage the development and use of Alternative Dispute Resolution (ADR) and mediation in commercial disputes.

Initially, CEDR's focus was by necessity focused on the UK, where in the early 1990s mediation was not well established in business disputes. Through its campaigning and training work, CEDR helped influence the civil justice system. In 1996 the then Lord Chief Justice of England, Lord [Harry Woolf](#), published his 'Access To Civil Justice Report', which encouraged the use of ADR, followed by the Civil Procedure Rules in 1999, which enabled judges to impose cost sanctions on either party when ADR was refused or ignored. These guidelines saw the growth of the use of ADR, and in particular mediation, in the UK. Parallel to this was a growth in demand for CEDR's services in dispute resolution and training. From the mid-1990s onwards, CEDR's focus became international, to begin with by encouraging mediation in other European countries and working on international cases and then by establishing the MEDAL international mediation service provider alliance (2005) and creating the first international mediation centre in China with the China Council for the Promotion of International Trade (CCPIT).

CEDR Solve is the dispute-resolution service arm of CEDR. Any business or law firm facing a dispute can call a case adviser, who will provide advice and be able to recommend an accredited mediator or neutral person to resolve its dispute. A number of the world's top mediators are only available via this service, but CEDR Solve indicates that it has over 130 accredited mediators on its panel of experts, including 50 mediators directly available (including Lord Woolf). The service has advised on over 13,000 disputes to date and mediates approximately 700 disputes per year.

In 2007 CEDR set up a Commission on International Arbitration, chaired by Lord Woolf and Professor Kaufmann-Kohler, to investigate settlements in international arbitration and to make recommendations on how arbitral institutions and tribunals can give parties greater assistance. The Commission is composed of 75 experts from the field and is consulting 45 organisations from various jurisdictions.

The CEDR has been training mediators for over 15 years, and its 'Mediator Training Skills' programme is widely thought to be the best in the world. With a faculty of 30 experienced mediators, the CEDR has trained to date more than 3,000 mediators from different countries.

Within the UK central government, there has been considerable encouragement of mediation in commercial disputes with economic operators. In a **Ministry of Justice Progress Report (April 2009)**, the UK Government was able to show evidence of the

increased use of mediation involving central government departments and agencies.

2.10.4 Actual cases using ADR

During the latest reporting period (2007/08), ADR has been used in 374 cases, with 271 leading to settlement, saving costs estimated at 26.3 million GBP.

Compared to the previous year's returns (2006/7), ADR was attempted in more cases (374 as against 311, with a slightly higher settlement rate of 72%, as against 68%).

Here are some examples of actual disputes:

Her Majesty's Revenue and Customs (HMRC)

A legal partnership had a dispute with HMRC about income tax liabilities going back over many years. A mediation took place using the county court mediation scheme, employing the services of an accountant as the mediator. A settlement was reached, which reflected the evidential weaknesses on both sides, saving both parties the considerable time and cost that would have been incurred by a two or three-day county court trial.

Department for Environment, Food and Rural Affairs (Defra)

In September 2007, Defra mediated a dispute with a company in the business of collecting and selling bovine semen under a licence granted by Defra in accordance with the Artificial Insemination Regulations. The mediation related to one issued claim and a number of potential claims between Defra and the company. The company had two separate claims against Defra for negligence arising from the testing of bulls for disease infection. Errors had been made in carrying out the necessary health checks on bulls and in the recording of the results. These errors had led to significant disruption of the quarantine processes that the animals were required to undergo before semen was collected, with consequent losses to the claimant's business. Defra also had a number of debt claims against this company for unpaid fees, which it was hoping to set off against any damages claimed in the litigation.

A barrister mediator in chambers in Manchester conducted the mediation, and a favourable settlement was achieved, which reflected the litigation and reputational risk to Defra.

Department for Works and Pensions / Department for Health (DWP/DH)

DWP/DH Legal Services, acting on behalf of Jobcentre Plus (JCP), successfully mediated the settlement of a disputed claim to a share of the proceeds from the sale of the property of a sheltered workshop. JCP claimed that it was entitled to 75% of the proceeds from the sale of the property. However, neither the claimant nor the defendant could produce a signed copy of the agreement, and therefore neither could legally prove their claim.

The building in question was sold for over 1 million GBP, but there were other creditors. DWP/DH Legal Services negotiated a settlement with the defendant's solicitors, after ensuring that payments to all other creditors had been met. The settlement avoided the cost

that would have been associated with a potentially protracted court case.

DWP/DH Legal Services successfully acted on behalf of Jobcentre Plus (JCP) to reach an agreement with a training provider over disputed training service payments. JCP alleged that the documentation did not support the outcome payments that they had claimed. The dispute was mediated whereby the defendant agreed to repay 60,000 GBP to JCP.

Just a couple of examples of small claims involving private citizens, who were helped by mediation in their disputes with economic operators:

The 'wonky' tattoo

The claimant was dissatisfied with his tattoo because it appeared 'wonky' (i.e. it was not straight) and took out a claim for 2,500 GBP against the owner of the tattoo parlour to cover the cost of removing it. The owner said that the claim should have been made against the specific 'artist' because all of the artists were self-employed. Nevertheless, the mediation took place, the tattoo was shown, and the tattoo parlour owner agreed that it was indeed crooked. The owner said that he would dispense with the services of the artist concerned due to the poor standard of his work. However, the claimant did not want the responsibility of having someone lose his livelihood. Instead, the defendant therefore offered to correct the work by covering the offending tattoo with a design that could incorporate the existing work. A design was agreed between the parties and the matter was settled with no money changing hands.

The wedding dress

A claim for 1,950 GBP was issued against a shop for the full refund of a wedding dress. The claimant had tried on a dress of the same design, paid a deposit, and when the dress arrived, she had her first fitting and paid the balance. However, she insisted that the design was not the same as the sample she had tried on when she had placed the order. She alleged that the stress that this incident had caused her had led to the postponement of her wedding, and that she had bought another dress instead. The defendants said that they had first known of this issue when her boyfriend had contacted them to say that she had had to buy another dress as she was disappointed with the one they had sold her. The mediation resulted in an agreed settlement to the effect that the defendants would sell the dress on behalf of the claimant on a commission-free basis as a sale item in their shop at a starting price of 900 GBP.

2.11 What types of dispute resolution contractual clause should be considered for inclusion in a commercial contract with an economic operator?

Including in a contract a clause requiring the parties to attempt to settle any dispute arising out of the contract by some form of ADR should increase the chances of settling such a dispute before the parties went to court or used arbitration.

Inserting a mediation clause in a contract has the advantage of:

- prompting the parties to consider a process that, unlike negotiation, may not necessarily occur to them;
- introducing a specific process that gives the parties a clear framework for exploring settlement;
- involving a neutral third party who is trained to work facilitate communication between parties that is geared towards an agreed durable settlement;
- changing the focus of the parties away from the events of the past and towards the reality of the present and the needs of the future;
- potentially achieving a binding solution, as over 70% of mediations reach an agreed and binding solution, despite an earlier impasse;
- keeping and/or moving the negotiation process out of the public arena;
- reaching an early and successful conclusion to the dispute, thereby providing substantial savings in legal and management costs and freeing up the business for more productive endeavours.

Examples of Mediation Clauses

Localisation – the following examples could be retained and local examples added.

Mediation clauses (often called 'ADR' clauses) can be simple in content, like the following example:

"If any dispute arises in connection with this agreement, the parties will attempt to settle it by mediation in accordance with the CEDR Model Mediation Procedure. Unless otherwise agreed between the parties, the mediator will be nominated by CEDR." **LOCALISATION**

The mediation clause can be more detailed and specific in requirement. Here is an example:

"If any dispute arises in connection with this agreement, the parties will attempt to settle it by mediation in accordance with the **LOCALISATION** CEDR Model Mediation Procedure. Unless otherwise agreed between the parties, the mediator will be nominated by CEDR. To initiate the mediation, a party must give notice in writing ('ADR notice') to the other party [ies] to the dispute, requesting mediation. A copy of the request should be sent to CEDR. The mediation will start not later than [] days after the date of the ADR notice. No party may commence any court proceedings/arbitration in relation to any dispute arising out of this agreement until it has attempted to settle the dispute by mediation and either the mediation has

terminated or the other party has failed to participate in the mediation, provided that the right to issue proceedings is not prejudiced by a delay.”

The following clause can be adopted for international contracts where the parties are based in different countries:

“If any dispute arises in connection with this agreement, the parties will attempt to settle it by mediation in accordance with the CEDR Model Mediation Procedure. Unless otherwise agreed between the parties, the mediator will be nominated by CEDR. The mediation will take place in [city / country of neither / none of the parties] and the language of the mediation will be []. The Mediation Agreement referred to in the Model Procedure shall be governed by, construed and take effect in accordance with the substantive law of [England and Wales]. The courts of [England] shall have exclusive jurisdiction to settle any claim, dispute or matter of difference that may arise out of, or in connection with, the mediation. If the dispute is not settled by mediation within [] days of the commencement of the mediation or within such further period as the parties may agree in writing, the dispute shall be referred to and finally resolved by arbitration. CEDR shall be the appointing body and administer the arbitration. CEDR shall apply the UNCITRAL rules in force at the time arbitration is initiated. In any arbitration commenced pursuant to this clause, the number of arbitrators shall be [1 – 3] and the seat or legal place of arbitration shall be [London, England].”

Before any mediation procedure is adopted, it is advisable to encourage negotiation to achieve the necessary settlement. A clause explicitly requiring the parties to enter into voluntary negotiations would be a useful provision. This clause could include a dispute escalation requirement, specifying that, if initial negotiations are unsuccessful, the matter will be transferred to a higher level of management within the two organisations (specified by job title). The senior managers will then be given a time frame within which to attempt a settlement. If this fails, the above ADR provision could become operational.

Here is an example of the type of provision involved, often called a ‘dispute escalation clause’:

#. Dispute Resolution

#.1 Escalation Procedure

If any dispute arises out of the Contract the parties will attempt to settle it by negotiation. In the event of any dispute, difference or question of interpretation arising between the parties, neither shall take recourse to any other resolution (whether by reference to mediation as set out in this Clause #, or by litigation), until the escalation procedure included in Schedule [...] has been fully exercised.

#.2 Mediation

If the parties are unable to settle any dispute in accordance with Clause #.1 within 21 days,

the parties will attempt to settle it by mediation in accordance with the Centre for Dispute Resolution (CEDR) Model Mediation Procedure ('the Model Procedure').

#.3 Initiating the mediation

To initiate a mediation a party by its Authorised Officer must give notice in writing ('ADR notice') to the other party (addressed to its Authorised Officer) requesting a mediation in accordance with Clause #.2. A copy of the request should be sent to CEDR.

#.4 Disagreements on mediation

If there is any point on the conduct of the mediation (including as to the nomination of the mediator) upon which the parties cannot agree within 14 days from the date of the ADR notice, CEDR will, at the request of any party, decide that point for the parties, having consulted with them.

#.5 Timing of mediation

The mediation will start not later than 28 days after the date of the ADR notice.

#.6 Mediation in parallel

Any party that commences court proceedings or an arbitration must institute a mediation or serve an ADR notice on the other party to the court proceedings or arbitration within 21 days.

#.7 Mediation before litigation

No party may commence any court proceeding or arbitration in relation to any dispute arising out of the Contract until they have attempted to settle it by mediation and that mediation has terminated.

Section 3 Exercises

1. Identify the main upstream stages to be carried out prior to awarding the contract
2. Identify potential problems that could occur if the above stages are not observed correctly

Exercise 2

Complete the following diagram by identifying each of the different types of dispute resolution procedure:

DESCRIPTION	TYPE
A formal, private and binding process where the dispute is resolved by the decision of a nominated third party	
A private and structured form of negotiation assisted by a third party that is initially non-binding. If settlement is reached it can become a legally binding contract.	
The most common form of dispute resolution, where the parties themselves attempt to resolve the dispute	
The formal process whereby claims are taken through the civil courts and conducted in public. The judgments are binding on parties subject to rights of appeal.	
An expert is instructed to rule on a technical issue – primarily used in the United Kingdom for construction disputes as set out in the Housing Grants, Construction and Regeneration Act 1996, where awards are binding on the parties at least on an interim basis – <i>i.e.</i> until a further process is invoked	
A private and structured form of negotiation assisted by a third party that is initially non-binding, but the third party can make a recommendation as to the outcome	

Exercise 3

Identify which type of dispute resolution most closely matches the following statements. In one or two cases, more than one procedure may be correct:

STATEMENT	PROCEDURE(S)
1. It is something like shuttle diplomacy	
2. This process is ideal if the dispute is over a point of law	
3. This process is usually completed in one day, but may take up to three days	
4. The decision is binding until a final determination is reached	
5. The rules of natural justice must be observed	
6. He adopts an inquisitorial method, controlling the collection of evidence and questioning the parties involved	
7. In the United Kingdom, the process has to be completed inside 28 days	
8. It is not binding but a practical solution, not necessarily in strict accord with the relevant law	

Exercise 4

Arbitration v Litigation?

1. How many advantages of arbitration over litigation can you identify?

Advantages of arbitration over litigation
1.
2.
3.
4.
5.
6.
7.
8.
9.

2. Give a short explanation for each of the above points, showing in what way they are advantageous compared to litigation.

Exercise 5

Complete the following boxes, with suitable responses. It only requires you to provide answers that are relative to the other forms of dispute resolution. Take, for example, *Speed to establish*: for Negotiation, the answer is “quick”; for Litigation, the answer could be “can take years”.

	Negotiation	Mediation	Conciliation
Speed to establish			
Speed to resolve			
Expense			
Confidentiality			
Effect on business relations			
	Adjudication	Arbitration	Litigation
Speed to establish			
Speed to resolve			
Expense			
Confidentiality			
Effect on business relations			

Exercise 6

Please read the article on the next few pages and then answer the following question:

Identify where mediation (or ADR) is being developed across the world and establish the reasons why this development is happening.

Lessons from Recent Experiences

By James South, Director of Training, CEDR

Published in the IBA Mediation Committee Newsletter, September 2008

A quick look at CEDR's recent work pattern highlights the increase in interest globally in the use of mediation for civil and commercial disputes. In 2005, 90% of training and consultancy work was UK-based, in 2008 50% of our training and consultancy is international and 15% of CEDR cases involve international parties. These figures illustrate that the increased interest in mediation internationally in the last two years has been dramatic and where training leads, mediation services follows: and the converse is true: as the use of mediation spreads we begin to learn lessons about best practice.

Mediation is now a well-known antidote to civil disputes, and a number of civil justice projects have been set up. As these projects involve learning how mediation can work in particular countries, one can distil key learning points about developing civil mediation that we can take to different jurisdictions.

There is never just one motivating reason or force for the adoption of mediation in a particular location. Normally there are a number of reasons for mediation being considered, and this article seeks to examine some of the reasons and illustrate them with some specific examples and from these, distil some lessons we can all learn about developing this field.

Without delay

Reducing the delay to litigants in resolving their disputes and subsequently decreasing case backlogs in the courts is, unsurprisingly, one of the key motivators for jurisdictions around the world to consider mediation. Delay and backlog are uncommon problems, yet in some jurisdictions they can be acute.

An example is India, where its civil justice system has relatively low costs for litigants, an almost unrestricted right of appeal and a less than efficient system of case management in the courts. Consequently it is not unusual to hear instances of well over five years for cases to come to trial (and that is before any appeal). As a result of this India is interested in mediation as one of the methods to alleviate this problem. A number of court-based mediation programmes have been started, for example a form of mandatory mediation in the lower courts in Delhi. CEDR is currently working in India on a project funded by the World Bank, advising a state funded ADR body, on how to stimulate

growth in mediation as well as training mediators so that the judiciary can have confidence in referring cases to competent mediators.

The business case

If the costs of pursuing an action are high, delays long, and enforcement of contracts difficult, this will increase the costs to domestic business in increasingly competitive markets. This is especially so for Small and Medium Enterprises (SMEs) where costs of enforcing contracts are often disproportionate to the amount in dispute. In turn this can impact on the international business, as investors will be discouraged if they cannot enforce contracts effectively. Accordingly an ADR system which minimises these issues is seen as a way of improving the business environment.

In the instance of Pakistan, the World Bank's 'Doing Business' report showed that, at a conservative estimate, in Karachi, the commercial capital of Pakistan, it takes 880 days to enforce a contract with 47 procedures required. In addition, 90% of cases initiated in the courts actually go to trial. Compare this to around 10% in the UK. It was these statistics that prompted the International Finance Corporation (IFC), to fund a \$1 million+ project to establish mediation in the Karachi Courts.

CEDR has been working with the IFC on this project since 2006. The project has established the Karachi Centre for Dispute Resolution (opened February 2007), and trained 56 mediators to provide quality mediation services to the centre. In turn this has given the Karachi Court confidence to refer cases to mediation in an attempt to reduce back-log and improve the business environment, with 65 commercial cases mediated in the first year.

In a similar fashion to the way in which parties in litigation can extend or hide behind the process to suit their own ends, the same is possible in a mediation. With the first mediations in Karachi, there was a danger of parties using the process as another low cost system, where frequent adjournments and delays are possible. Because lawyers and parties were used to this way of resolving disputes it was a natural pattern to fall into and therefore mediators had (and still have) to work hard to change behaviour by anticipating problems (such as the need for authority), signalling it as a different process and working hard to keep parties at the table and resisting calls to adjourn.

Style and substance

Mediation can also be seen as a part of wider Civil Justice Reform. In England and Wales this started with the Woolf Reforms, leading to the Civil Procedure Rules introduced in 1999, allowing a stay of proceedings for mediation, as well as costs penalties for unreasonably refusing mediation. These rules, and the court's willingness to use them, have had a well-documented impact on the use of mediation in the UK.

Hong Kong has undergone a similar review with new civil procedure rules due to be published this year which will likely see mediation heavily encouraged for civil cases. This has led to both the Hong Kong Bar and Law Society of Hong Kong to work with CEDR to train mediators in order to anticipate the likely increases in demand for mediation services.

Mediation can also be attractive as a means of signalling wider social reforms. China, for example, in moving towards a more market-based economy has recognised the importance of its use to resolve international trade disputes. Accordingly the Government's conciliation service, CCPIT, in

partnership with CEDR, has formed an Anglo-Chinese Dispute Resolution Centre and we have been working with them to establish a mediation centre.

The best example of mediation contributing to wider social reform is in the development of mediation in a number of Eastern European states. As these Post-communist societies, twenty years on, move to market-based approaches, the way the state interacts with its citizens is being transformed – from protection of individuals' rights to individual empowerment. Combined with this is a focus on improving the reputation of the State through increased efficiency and less corruption. Mediation is seen as a process that reinforces these messages.

In Croatia I have just finished working on a two-year project to establish a mediation pilot programme in the Commercial Court of Zagreb. Apart from requiring considerable work integrating mediation into the court's processes, it also required thinking 'outside the box'. In this programme sitting judges were acting as mediators, something we initially, with our common law experience found unusual. However the pilot has worked well with over 200 cases referred to mediation in the first year and the court has now been held out as a model for providing a wider service to the citizens of Croatia.

Another example is Bosnia and Herzegovina, which since the cessation of hostilities has undergone massive social reforms at all levels. It also has the most comprehensive mediation system for Civil Disputes in the region. The IFC has funded a project to establish two court-based programmes in Sarajevo and Banja Luka, and there is a Mediators Association which now has state authority to licence mediators. Over 1500 mediations have taken place in the last three years, resulting in €9.3million of tied up funds being released. Mediation is now a central part of the justice strategy for Bosnia and Herzegovina. CEDR has been engaged this year by the Ministry of Justice, to draft the mediation action plan for the next four years, which details the steps to be taken to continue to develop mediation.

Global neighbourhood

Interestingly I have noticed that there is an emerging trend of supra-national motivations for countries to consider mediation as indicator of ambitions to join and interact in the proverbial 'global village'. This trend is one which I think we should watch in years to come, as it will begin to play increasing importance.

Europe presents good examples of these trends. *Firstly there are the former member states of Yugoslavia, now interested in acceding to the European Union. Effectiveness of local civil justice is a criterion looked at for accession and therefore the adoption of 'modern' justice processes, such as mediation, are considered an indicator of suitability in this field.*

Secondly the acceptance this year of the EU Directive on cross-border mediation by the European Parliament means that all member states will encourage parties to use mediation to resolve international disputes.

The EU directive has wider implications, for as business in Europe gets used to mediating cross-border disputes they will also look at doing the same in other parts of the world where problems of contract enforcement, delay and poor business environments exist. Ultimately if the demand for

mediation is there, in a desire to become part of global villages, countries which have not developed mediation will begin to take it more seriously.

[Another example of global development of mediation is found in Ukraine. In 2008, a programme for training mediators had been established at the Mediation Centre in Kyiv, encouraging mediation of corporate governance disputes and a cheaper alternative to litigation].

SECTION 4 CHAPTER SUMMARY

Self-test questions

1. What are the advantages of mediation/conciliation over the other forms of dispute resolution (adjudication, arbitration, litigation)?
2. When would it be appropriate to use mediation or conciliation to resolve a dispute with an economic operator?
3. When would it not be appropriate to use mediation or conciliation to resolve a dispute with an economic operator?
4. What are the main advantages of litigation?
5. What are the main advantages of using international arbitration procedures in comparison to domestic courts when in dispute with a foreign economic operator?
6. How has the European Commission been encouraging the adoption of mediation in commercial disputes since the year 2000?
7. In what ways does the European Directive on Mediation (2008) attempt to encourage mediation in international disputes between companies based in different countries?
8. What are the reasons (or advantages) for inserting a mediation clause into the contract when negotiating with economic operators?
9. What dispute resolution stages would be appropriate to progress through when attempting to settle a dispute with an economic operator?

Other resources

The following websites have information on ADR:

Localisation

European Union: <http://eur-lex.europa.eu>

(Directive on ADR, Code of Conduct for Mediators, Green Paper on ADR)

Centre for Dispute Resolution: www.cedr.co.uk

(CEDR Model Mediation Agreement)

International Arbitration Bodies:

ICC International Court of Arbitration: www.iccbo.org

London Court of International Arbitration: www.lcia-arbitration.com

International branch of American Arbitration Association: <http://adr.org>

Hong Kong International Arbitration Centre: www.hkiac.org

Singapore International Arbitration Centre: www.siac.org

New York Convention: www.uncitral.org

(enforcement of international arbitration awards)

English Court System: www.hmcourts-service.gov.uk

Appendix 1 EU Directive 2008/52/EC

Directive 2008/52/EC of the European Parliament and of the Council

of 21 May 2008

on certain aspects of mediation in civil and commercial matters

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 61(c) and the second indent of Article 67(5) thereof,

Having regard to the proposal from the Commission,

Having regard to the Opinion of the European Economic and Social Committee [1],

Acting in accordance with the procedure laid down in Article 251 of the Treaty [2],

Whereas:

(1) The Community has set itself the objective of maintaining and developing an area of freedom, security and justice, in which the free movement of persons is ensured. To that end, the Community has to adopt, inter alia, measures in the field of judicial cooperation in civil matters that are necessary for the proper functioning of the internal market.

(2) The principle of access to justice is fundamental and, with a view to facilitating better access to justice, the European Council at its meeting in Tampere on 15 and 16 October 1999 called for alternative, extra-judicial procedures to be created by the Member States.

(3) In May 2000 the Council adopted Conclusions on alternative methods of settling disputes under civil and commercial law, stating that the establishment of basic principles in this area is an essential step towards enabling the appropriate development and operation of extrajudicial procedures for the settlement of disputes in civil and commercial matters so as to simplify and improve access to justice.

(4) In April 2002 the Commission presented a Green Paper on alternative dispute resolution in civil and commercial law, taking stock of the existing situation as concerns alternative dispute resolution methods in the European Union and initiating widespread consultations with Member States and interested parties on possible measures to promote the use of mediation.

(5) The objective of securing better access to justice, as part of the policy of the European Union to establish an area of freedom, security and justice, should encompass access to judicial as well as extrajudicial dispute resolution methods. This Directive should contribute to the proper functioning of the internal market, in particular as concerns the availability of mediation services.

(6) Mediation can provide a cost-effective and quick extrajudicial resolution of disputes in civil and commercial matters through processes tailored to the needs of the parties. Agreements resulting from mediation are more likely to be complied with voluntarily and are more likely to preserve an amicable and sustainable relationship between the parties. These benefits become even more pronounced in situations displaying cross-border elements.

(7) In order to promote further the use of mediation and ensure that parties having recourse to mediation can rely on a predictable legal framework, it is necessary to introduce framework legislation addressing, in particular, key aspects of civil procedure.

(8) The provisions of this Directive should apply only to mediation in cross-border disputes, but nothing should prevent Member States from applying such provisions also to internal mediation processes.

(9) This Directive should not in any way prevent the use of modern communication technologies in the mediation process.

(10) This Directive should apply to processes whereby two or more parties to a cross-border dispute attempt by themselves, on a voluntary basis, to reach an amicable agreement on the settlement of their dispute with the assistance of a mediator. It should apply in civil and commercial matters. However, it should not apply to rights and obligations on which the parties are not free to decide themselves under the relevant applicable law. Such rights and obligations are particularly frequent in family law and employment law.

(11) This Directive should not apply to pre-contractual negotiations or to processes of an adjudicatory nature such as certain judicial conciliation schemes, consumer complaint schemes, arbitration and expert determination or to processes administered by persons or bodies issuing a formal recommendation, whether or not it be legally binding as to the resolution of the dispute.

(12) This Directive should apply to cases where a court refers parties to mediation or in which national law prescribes mediation. Furthermore, in so far as a judge may act as a mediator under national law, this Directive should also apply to mediation conducted by a judge who is not responsible for any judicial proceedings relating to the matter or matters in dispute. This Directive should not, however, extend to attempts made by the court or judge seized to settle a dispute in the context of judicial proceedings concerning the dispute in question or to cases in which the court or judge seized requests assistance or advice from a competent person.

(13) The mediation provided for in this Directive should be a voluntary process in the sense that the parties are themselves in charge of the process and may organise it as they wish and terminate it at any time. However, it should be possible under national law for the courts to set time-limits for a mediation process. Moreover, the courts should be able to draw the parties' attention to the possibility of mediation whenever this is appropriate.

(14) Nothing in this Directive should prejudice national legislation making the use of mediation compulsory or subject to incentives or sanctions provided that such legislation does not prevent parties from exercising their right of access to the judicial system. Nor should anything in this Directive prejudice existing self-regulating mediation systems in so far as these deal with aspects which are not covered by this Directive.

(15) In order to provide legal certainty, this Directive should indicate which date should be relevant for determining whether or not a dispute which the parties attempt to settle through mediation is a cross-border dispute. In the absence of a written agreement, the parties should be deemed to agree to use mediation at the point in time when they take specific action to start the mediation process.

(16) To ensure the necessary mutual trust with respect to confidentiality, effect on limitation and prescription periods, and recognition and enforcement of agreements resulting from mediation, Member States should encourage, by any means they consider appropriate, the training of mediators and the introduction of effective quality control mechanisms concerning the provision of mediation services.

(17) Member States should define such mechanisms, which may include having recourse to market-based solutions, and should not be required to provide any funding in that respect. The mechanisms should aim at preserving the flexibility of the mediation process and the autonomy of the parties, and at ensuring that mediation is conducted in an effective, impartial and competent way. Mediators should be made aware of the existence of the European Code of Conduct for Mediators which should also be made available to the general public on the Internet.

(18) In the field of consumer protection, the Commission has adopted a Recommendation [3] establishing minimum quality criteria which out-of-court bodies involved in the consensual resolution of consumer disputes should offer to their users. Any mediators or organisations coming

within the scope of that Recommendation should be encouraged to respect its principles. In order to facilitate the dissemination of information concerning such bodies, the Commission should set up a database of out-of-court schemes which Member States consider as respecting the principles of that Recommendation.

(19) Mediation should not be regarded as a poorer alternative to judicial proceedings in the sense that compliance with agreements resulting from mediation would depend on the good will of the parties. Member States should therefore ensure that the parties to a written agreement resulting from mediation can have the content of their agreement made enforceable. It should only be possible for a Member State to refuse to make an agreement enforceable if the content is contrary to its law, including its private international law, or if its law does not provide for the enforceability of the content of the specific agreement. This could be the case if the obligation specified in the agreement was by its nature unenforceable.

(20) The content of an agreement resulting from mediation which has been made enforceable in a Member State should be recognised and declared enforceable in the other Member States in accordance with applicable Community or national law. This could, for example, be on the basis of Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [4] or Council Regulation (EC) No 2201/2003 of 27 November 2003 concerning jurisdiction and the recognition and enforcement of judgments in matrimonial matters and the matters of parental responsibility [5].

(21) Regulation (EC) No 2201/2003 specifically provides that, in order to be enforceable in another Member State, agreements between the parties have to be enforceable in the Member State in which they were concluded. Consequently, if the content of an agreement resulting from mediation in a family law matter is not enforceable in the Member State where the agreement was concluded and where the request for enforceability is made, this Directive should not encourage the parties to circumvent the law of that Member State by having their agreement made enforceable in another Member State.

(22) This Directive should not affect the rules in the Member States concerning enforcement of agreements resulting from mediation.

(23) Confidentiality in the mediation process is important and this Directive should therefore provide for a minimum degree of compatibility of civil procedural rules with regard to how to protect the confidentiality of mediation in any subsequent civil and commercial judicial proceedings or arbitration.

(24) In order to encourage the parties to use mediation, Member States should ensure that their rules on limitation and prescription periods do not prevent the parties from going to court or to arbitration if their mediation attempt fails. Member States should make sure that this result is

achieved even though this Directive does not harmonise national rules on limitation and prescription periods. Provisions on limitation and prescription periods in international agreements as implemented in the Member States, for instance in the area of transport law, should not be affected by this Directive.

(25) Member States should encourage the provision of information to the general public on how to contact mediators and organisations providing mediation services. They should also encourage legal practitioners to inform their clients of the possibility of mediation.

(26) In accordance with point 34 of the Interinstitutional agreement on better law-making [6], Member States are encouraged to draw up, for themselves and in the interests of the Community, their own tables illustrating, as far as possible, the correlation between this Directive and the transposition measures, and to make them public.

(27) This Directive seeks to promote the fundamental rights, and takes into account the principles, recognised in particular by the Charter of Fundamental Rights of the European Union.

(28) Since the objective of this Directive cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the action, be better achieved at Community level, the Community may adopt measures in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective.

(29) In accordance with Article 3 of the Protocol on the position of the United Kingdom and Ireland, annexed to the Treaty on European Union and to the Treaty establishing the European Community, the United Kingdom and Ireland have given notice of their wish to take part in the adoption and application of this Directive.

(30) In accordance with Articles 1 and 2 of the Protocol on the position of Denmark, annexed to the Treaty on European Union and to the Treaty establishing the European Community, Denmark does not take part in the adoption of this Directive and is not bound by it or subject to its application,

HAVE ADOPTED THIS DIRECTIVE:

Article 1

Objective and scope

1. The objective of this Directive is to facilitate access to alternative dispute resolution and to promote the amicable settlement of disputes by encouraging the use of mediation and by ensuring a balanced relationship between mediation and judicial proceedings.

2. This Directive shall apply, in cross-border disputes, to civil and commercial matters except as regards rights and obligations which are not at the parties' disposal under the relevant applicable law. It shall not extend, in particular, to revenue, customs or administrative matters or to the liability of the State for acts and omissions in the exercise of State authority (*acta iure imperii*).

3. In this Directive, the term "Member State" shall mean Member States with the exception of Denmark.

Article 2

Cross-border disputes

1. For the purposes of this Directive a cross-border dispute shall be one in which at least one of the parties is domiciled or habitually resident in a Member State other than that of any other party on the date on which:

(a) the parties agree to use mediation after the dispute has arisen;

(b) mediation is ordered by a court;

(c) an obligation to use mediation arises under national law; or

(d) for the purposes of Article 5 an invitation is made to the parties.

2. Notwithstanding paragraph 1, for the purposes of Articles 7 and 8 a cross-border dispute shall also be one in which judicial proceedings or arbitration following mediation between the parties are initiated in a Member State other than that in which the parties were domiciled or habitually resident on the date referred to in paragraph 1(a), (b) or (c).

3. For the purposes of paragraphs 1 and 2, domicile shall be determined in accordance with Articles 59 and 60 of Regulation (EC) No 44/2001.

Article 3

Definitions

For the purposes of this Directive the following definitions shall apply:

(a) "Mediation" means a structured process, however named or referred to, whereby two or more parties to a dispute attempt by themselves, on a voluntary basis, to reach an agreement on the settlement of their dispute with the assistance of a mediator. This process may be initiated by the parties or suggested or ordered by a court or prescribed by the law of a Member State.

It includes mediation conducted by a judge who is not responsible for any judicial proceedings concerning the dispute in question. It excludes attempts made by the court or the judge seized to settle a dispute in the course of judicial proceedings concerning the dispute in question.

(b) "Mediator" means any third person who is asked to conduct a mediation in an effective, impartial and competent way, regardless of the denomination or profession of that third person in the Member State concerned and of the way in which the third person has been appointed or requested to conduct the mediation.

Article 4

Ensuring the quality of mediation

1. Member States shall encourage, by any means which they consider appropriate, the development of, and adherence to, voluntary codes of conduct by mediators and organisations providing mediation services, as well as other effective quality control mechanisms concerning the provision of mediation services.

2. Member States shall encourage the initial and further training of mediators in order to ensure that the mediation is conducted in an effective, impartial and competent way in relation to the parties.

Article 5

Recourse to mediation

1. A court before which an action is brought may, when appropriate and having regard to all the circumstances of the case, invite the parties to use mediation in order to settle the dispute. The court may also invite the parties to attend an information session on the use of mediation if such sessions are held and are easily available.

2. This Directive is without prejudice to national legislation making the use of mediation compulsory or subject to incentives or sanctions, whether before or after judicial proceedings have started, provided that such legislation does not prevent the parties from exercising their right of access to the judicial system.

Article 6

Enforceability of agreements resulting from mediation

1. Member States shall ensure that it is possible for the parties, or for one of them with the explicit consent of the others, to request that the content of a written agreement resulting from mediation be made enforceable. The content of such an agreement shall be made enforceable unless, in the case in question, either the content of that agreement is contrary to the law of the Member State where the request is made or the law of that Member State does not provide for its enforceability.

2. The content of the agreement may be made enforceable by a court or other competent authority in a judgment or decision or in an authentic instrument in accordance with the law of the Member State where the request is made.

3. Member States shall inform the Commission of the courts or other authorities competent to receive requests in accordance with paragraphs 1 and 2.

4. Nothing in this Article shall affect the rules applicable to the recognition and enforcement in another Member State of an agreement made enforceable in accordance with paragraph 1.

Article 7

Confidentiality of mediation

1. Given that mediation is intended to take place in a manner which respects confidentiality, Member States shall ensure that, unless the parties agree otherwise, neither mediators nor those involved in the administration of the mediation process shall be compelled to give evidence in civil

and commercial judicial proceedings or arbitration regarding information arising out of or in connection with a mediation process, except:

(a) where this is necessary for overriding considerations of public policy of the Member State concerned, in particular when required to ensure the protection of the best interests of children or to prevent harm to the physical or psychological integrity of a person; or

(b) where disclosure of the content of the agreement resulting from mediation is necessary in order to implement or enforce that agreement.

2. Nothing in paragraph 1 shall preclude Member States from enacting stricter measures to protect the confidentiality of mediation.

Article 8

Effect of mediation on limitation and prescription periods

1. Member States shall ensure that parties who choose mediation in an attempt to settle a dispute are not subsequently prevented from initiating judicial proceedings or arbitration in relation to that dispute by the expiry of limitation or prescription periods during the mediation process.

2. Paragraph 1 shall be without prejudice to provisions on limitation or prescription periods in international agreements to which Member States are party.

Article 9

Information for the general public

Member States shall encourage, by any means which they consider appropriate, the availability to the general public, in particular on the Internet, of information on how to contact mediators and organisations providing mediation services.

Article 10

Information on competent courts and authorities

The Commission shall make publicly available, by any appropriate means, information on the competent courts or authorities communicated by the Member States pursuant to Article 6(3).

Article 11

Review

Not later than 21 May 2016, the Commission shall submit to the European Parliament, the Council and the European Economic and Social Committee a report on the application of this Directive. The report shall consider the development of mediation throughout the European Union and the impact of this Directive in the Member States. If necessary, the report shall be accompanied by proposals to adapt this Directive.

Article 12

Transposition

1. Member States shall bring into force the laws, regulations, and administrative provisions necessary to comply with this Directive before 21 May 2011, with the exception of Article 10, for which the date of compliance shall be 21 November 2010 at the latest. They shall forthwith inform the Commission thereof.

When they are adopted by Member States, these measures shall contain a reference to this Directive or shall be accompanied by such reference on the occasion of their official publication. The methods of making such reference shall be laid down by Member States.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

Article 13

Entry into force

This Directive shall enter into force on the 20th day following its publication in the Official Journal of the European Union.

Article 14

Addressees

This Directive is addressed to the Member States.

Done at Strasbourg, 21 May 2008.

For the European Parliament

Model Mediation Agreement



consistent with the CEDR Solve Model Mediation Procedure and the CEDR Code of Conduct for Mediators current at the date of this Agreement.

Authority and status

2 The person signing this Agreement on behalf of each Party warrants having authority to bind that Party and all other persons present on that Party's behalf at the Mediation to observe the terms of this Agreement, and also having authority to bind that Party to the terms of any settlement.

3 The Mediator is an independent contractor and not an agent of CEDR Solve, and neither the Mediator nor CEDR Solve is an agent for any of the Parties in relation to the Dispute or this Agreement.

4 Neither the Mediator nor CEDR Solve shall be liable to the Parties for any act or omission in relation to the Mediation unless the act or omission is proved to have been fraudulent or involved wilful misconduct.

Confidentiality and without prejudice status

5 Every person involved in the Mediation:

will keep confidential all information arising out of or in connection with the Mediation, including the fact and terms of any settlement, but not including the fact that the Mediation is to take place or has taken place or where disclosure is required by law to implement or to enforce terms of settlement; and

5.2 acknowledges that all such information passing between the Parties, the Mediator and CEDR Solve, however communicated, is agreed to be without prejudice to any Party's legal position and may not be produced as evidence or disclosed to any judge, arbitrator or other decision-maker in any legal or other formal process, except where otherwise disclosable in law.

6 Where a Party privately discloses to the Mediator any information in confidence before, during or after the Mediation, the Mediator will not disclose that information to any other Party or person without the consent of the Party disclosing it, unless required by law to make disclosure.

7 The Parties will not call the Mediator or any employee or consultant of CEDR Solve as a witness, nor require them to produce in evidence any records or notes relating to the Mediation, in any litigation, arbitration or other formal process arising from or in connection with the Dispute and the Mediation; nor will the Mediator nor any CEDR Solve employee or consultant act or agree to act as a witness, expert, arbitrator or consultant in any such process.

8 No verbatim recording or transcript of the Mediation will be made in any form.

Settlement formalities

9 No terms of settlement reached at the Mediation will be legally binding until set out in writing and signed by or on behalf of each of the Parties.

Fees and costs of the Mediation

10 The Parties will be responsible for the fees and expenses of CEDR Solve and the Mediator (**“the Mediation Fees”**) in accordance with CEDR Solve’s Terms and Conditions of Business current at the date of this Agreement.

11 Unless otherwise agreed by the Parties and CEDR Solve in writing, each Party agrees to share the Mediation Fees equally and also to bear its own legal and other costs and expenses of preparing for and attending the Mediation (**“each Party’s Legal Costs”**) prior to the Mediation. However, each Party further agrees that any court or tribunal may treat both the Mediation Fees and each Party’s Legal Costs as costs in the case in relation to any litigation or arbitration where that court or tribunal has power to assess or make orders as to costs, whether or not the Mediation results in settlement of the Dispute.

Legal status and effect of the Mediation

12 Any contemplated or existing litigation or arbitration in relation to the Dispute may be started or continued despite the Mediation, unless the Parties agree or a Court orders otherwise.

13 This Agreement is governed by the law of [England and Wales] and the courts of [England and Wales] shall have exclusive jurisdiction to decide any matters arising out of or in connection with this Agreement and the Mediation.

14 The referral of the dispute to the Mediation does not affect any rights that exist under Article 6 of the European Convention of Human Rights, and if the Dispute does not settle through the Mediation, the Parties’ right to a fair trial remains unaffected.

Changes to this Agreement

15 *All agreed changes to this Agreement and/or the Model Procedure are set out as follows:*

Signed

Party A _____

Party B _____

Mediator

CEDR Solve

Appendix 3 International Developments in Mediation

Lessons from recent experiences

By James South, Director of Training, CEDR

Published in the IBA Mediation Committee Newsletter, September 2008

A quick look at CEDR's recent work pattern highlights the increased interest globally in the use of mediation for civil and commercial disputes. In 2005, 90% of training and consultancy work was UK-based, in 2008 50% of our training and consultancy is international and 15% of CEDR cases involve international parties. These figures illustrate that the increased interest in mediation internationally in the last two years has been dramatic and where training leads, mediation services follows: and the converse is true: as the use of mediation spreads we begin to learn lessons about best practice.

Mediation is now a well-known antidote to civil disputes, and a number of civil justice projects have been set up. As these projects involve learning how mediation can work in particular countries, one can distil key learning points about developing civil mediation that we can take to different jurisdictions.

There is never just one motivating reason or force for the adoption of mediation in a particular location. Normally there are a number of reasons for mediation being considered, and this article seeks to examine some of the reasons and illustrate them with some specific examples and from these, distil some lessons we can all learn about developing this field.

Without delay

Reducing the delay to litigants in resolving their disputes and subsequently decreasing case backlogs in the courts is, unsurprisingly, one of the key motivators for jurisdictions around the world to consider mediation. Delay and backlog uncommon problems, yet in some jurisdictions they can be acute.

An example is India, where its civil justice system has relatively low costs for litigants, an almost unrestricted right of appeal and a less than efficient system of case management in the courts. Consequently it is not unusual to hear instances of well over five years for cases to come to trial (and that is before any appeal). As a result of this India is interested in mediation as one of the methods to alleviate this problem. A number of court-based mediation programmes have been started, for example a form of mandatory mediation in the lower courts in Delhi. CEDR is currently working in India on a project funded by the World Bank, advising a state funded ADR body, on how to stimulate growth in mediation as well as training mediators so that the judiciary can have confidence in referring cases to competent mediators.

The business case

If the costs of pursuing an action are high, delays long, and enforcement of contracts difficult, this will increase the costs to domestic business in increasingly competitive markets. This is especially so for Small and Medium Enterprises (SMEs) where costs of enforcing contracts are often disproportionate to the amount in dispute. In turn this can impact on the international business, as investors will be discouraged if they cannot enforce contracts effectively. Accordingly an ADR system which minimises these issues is seen as a way of improving the business environment.

In the instance of Pakistan, the World Bank's 'Doing Business' report showed that, at a conservative estimate, in Karachi, the commercial capital of Pakistan, it takes 880 days to enforce a contract with 47 procedures required. In addition, 90% of cases initiated in the courts actually go to trial. Compare this to around 10% in the UK. It was these statistics that prompted the International Finance Corporation (IFC), to fund a \$1 million+ project to establish mediation in the Karachi Courts.

CEDR has been working with the IFC on this project since 2006. The project has established the Karachi Centre for Dispute Resolution (opened February 2007), trained 56 mediators to provide quality mediation services to the centre. In turn this has given the Karachi Court confidence to refer cases to mediation in an attempt to reduce back-log and improve the business environment, with 65 commercial cases mediated in the first year.

In a similar fashion to the way in which parties in litigation can extend or hide behind the process to suit their own ends, the same is possible in a mediation. With the first mediations in Karachi, there was a danger of parties using the process as another low cost system, where frequent adjournments and delays are possible. Because lawyers and parties were used to this way of resolving disputes it was a natural pattern to fall into and therefore mediators had (and still have) to work hard to change behaviour by anticipating problems (such as the need for authority), signalling it as a different process and working hard to keep parties at the table and resisting calls to adjourn.

Style and substance

Mediation can also be seen as a part of wider Civil Justice Reform. In England and Wales this started with the Woolf Reforms, leading to the Civil Procedure Rules introduced in 1999, allowing a stay of proceedings for mediation, as well as costs penalties for unreasonably refusing mediation. These rules, and the court's willingness to use them, have had a well-documented impact on the use of mediation in the UK.

Hong Kong has undergone a similar review with new civil procedure rules due to be published this year which will likely see mediation heavily encouraged for civil cases. This has led to both the Hong Kong Bar and Law Society of Hong Kong to work with CEDR to train mediators in order to anticipate the likely increases in demand for mediation services.

Mediation can also be attractive as a means of signalling wider social reforms. China, for example, in moving towards a more market-based economy has recognised the importance of its use to resolve international trade disputes. Accordingly the Government's conciliation service, CCPIT, in partnership with CEDR, has formed an Anglo-Chinese Dispute Resolution Centre and we have been working with them to establish a mediation centre.

The best example of mediation contributing to wider social reform is in the development of mediation in a number of Eastern European states. As these Post-communist societies, twenty years

on, move to market-based approaches, the way the state interacts with its citizens is being transformed - from protection of individual's rights to individual empowerment. Combined with this is a focus on improving the reputation of the State through increased efficiency and less corruption. Mediation is seen as a process that reinforces these messages.

In Croatia I have just finished working on a two-year project to establish a mediation pilot programme in the Commercial Court of Zagreb. Apart from requiring considerable work integrating mediation into the court's processes, it also required thinking 'outside the box'. In this programme sitting judges were acting as mediators, something we initially, with our common law experience found unusual. However the pilot has worked well with over 200 cases referred to mediation in the first year and the court has now been held out as a model for providing a wider service to the citizens of Croatia.

Another example is Bosnia and Herzegovina, which since the cessation of hostilities has undergone massive social reforms at all levels. It also has the most comprehensive mediation system for Civil Disputes in the region. The IFC has funded a project to establish two court-based programmes in Sarajevo and Banja Luka, and there is a Mediators Association which now has state authority to licence mediators. Over 1500 mediations have taken place in the last three years, resulting in €9.3million of tied up funds being released. Mediation is now a central part of the justice strategy for Bosnia and Herzegovina. CEDR has been engaged this year by the Ministry of Justice, to draft the mediation action plan for the next four years, which details the steps to be taken to continue to develop mediation.

Global neighbourhood

Interestingly I have noticed that there is an emerging trend of supra-national motivations for countries to consider mediation as indicator of ambitions to join and interact in the proverbial 'global village'. This trend is one which I think we should watch in years to come, as it will begin to play increasing importance.

Europe presents good examples of these trends. *Firstly there are the former member states of Yugoslavia, now interested in acceding to the European Union. Effectiveness of local civil justice is a criterion looked at for accession and therefore the adoption of 'modern' justice processes, such as mediation, are considered an indicator of suitability in this field**. Secondly the acceptance this year of the EU Directive on cross-border mediation by the European Parliament means that all member states will encourage parties to use mediation to resolve international disputes.

The EU directive has wider implications, for as business in Europe gets used to mediating cross-border disputes they will also look at doing the same in other parts of the world where problems of contract enforcement, delay and poor business environments exist. Ultimately if the demand for mediation is there, in a desire to become part of global villages, countries which have not developed mediation will begin to take it more seriously.

[Another example of global development of mediation is found in Ukraine. In 2008, a programme for training mediators had been established at the Mediation Centre in Kyiv, encouraging mediation of corporate governance disputes and a cheaper alternative to litigation].

* italics added

Module G3 Measuring Contract Performance

Section 1 Introduction

1.1. Objectives

The objectives of this chapter/section are to explore, explain and understand:

1. Why performance measurement of contract implementation is an important and necessary activity
2. How performance measurement methodologies can be used to gauge the performance of contracts for services, goods and works
3. The preconditions for creating and implementing a supporting environment for performance measurement

1.2. Important issues

The most important issues are understanding:

- That performance measurement is a key factor for ensuring that contract objectives and targets are met and for ensuring that the rights and obligations of the parties to the contract (purchaser/provider) are correctly fulfilled
- The need for a systematic approach to the design and implementation of the performance measures
- That the elaboration of a performance measurement methodology should be an integral part of the preparation of tender and contract documentation, as well as understood and agreed by all parties when entering into the contract

1.3. Links

There is a particularly strong link between this chapter and:

- Module B6 on performance measurement of procuring organisations
- Module B2 on responsibilities of the contracting authority
- Module C2 on contract terms
- Module E1 on preparing tender documents

- Module G1 on contract management

1.4. Relevance

This module is important for all professionals involved in public procurement, including policy makers, procurement specialists, contract managers, technical specialists, auditors, and (not least) economic operators.

1.5. Legal Information helpful to have at hand

This module is not governed by any specific legal requirement, except for the possible implications of national contract law concerning performance measurement of contract execution. However, indirectly, the principles and objectives laid down in the EU Directives and the Treaty for the role and conduct of public procurement provide strong arguments for making performance measurement a priority area.

Section 2 Narrative

1 Overview

This section will deal with contract performance in an *individual contract* and not with the performance of the contracting authority in general. The issue of measuring the performance of the contracting authority is covered in Module B6.

In this section we will look at a number of performance measurement issues that are common to all types of contracts, and then highlight some specific issues that arise in measuring performance under services, supplies and works contracts.

This section is closely linked to the Module G1 on contract management and also to Modules A2 and A4, which cover different types of contracts.

2 Introduction

Correct and accurate measurement of contract performance and its linkage with payments can incentivise better and higher-quality delivery of contract requirements. It also provides the ultimate answer to the question of whether a particular contract – but also, a public procurement system, at all levels and in all its parts – works efficiently and delivers “value-for-money”.

Performance measurement and the contract

The main purpose of the written contract between the contracting authority and the economic operator is to clearly and comprehensively set out the rights and obligations of the parties towards each other and other third parties concerned. In terms of performance measurement, key elements of the contract include:

- The specification, which should set out clearly the requirements of the contracting authority – including what will be delivered, when, how, and to what standards. The increased use of performance-based specifications and incentive contracts accentuates the importance of performance measurement (see Module A4 for a discussion of incentive contracts).
- General conditions, which include:
 - Generic performance requirements such as compliance with legislation and common standards for all contracts;
 - Special performance requirements applying to the particular contract;
 - The basis for determining the price to be paid;
 - How the economic operator is to enforce payment for orderly performance in accordance with the required standards;
 - A performance schedule that sets out the contract-specific performance measures and the consequences of failure to perform to the required standard, including the sanctions that can be applied.

Benefits of measuring contract performance

A number of benefits arise from measuring contract performance:

- Performance measurement, both during the performance of the contract and after completion of a contract, provides hard evidence regarding the achievement of efficiency and effectiveness (value-for-money) in response to the objectives, goals and requirements set up for the individual procurement operation.
- It also provides information and guidance on the quality, capacity and capability of the public procurement system at both the national and contracting authority levels.
- The contracting authority will receive valuable feedback and confirmation of the extent to which the procurement process has been efficiently planned and managed, in particular with regard to the design of the technical specifications or terms of reference; the choice of contracting strategy and contract model; the choice of procurement procedure; the setting of selection and award criteria; and the conduct of the tender evaluation and the award of the contract.
- The continuous process of “lessons learned”, resulting from an effective system for performance measurement through which strengths and weaknesses can be identified, will generate good arguments and incentives for change and improvements of the procurement process in all its parts, and in the internal and external relationships;
- Where benchmarking is used as a performance measure (see below), a contracting authority will be in a position to compare its own performance and results with the contracting authorities responsible for similar types of operations.

Common features for setting and measuring contract performance

There are a number of common features for setting and measuring performance in most contracts, whether they are for works, supplies or services. It is important that for all contract performance measures there is clarity and certainty on:

- the specific performance areas and indicators
- the baseline under respective performance areas
- the performance target
- the specific performance measure to be applied

Performance requirements and measurement will typically be set out in the agreed specification (the tender specifications together with the technical proposal by the winning economic operator and any modifications to those specifications that might have been agreed as part of a permitted clarification process); the performance standards set out the required service levels and the performance measurement scheme. These should be incorporated as a schedule or schedules to the contract.

The performance requirements that are common to most contracts for works, supplies and services are:

- time
- benefits/costs
- quality (applied in a wide meaning)

Time

Almost all contracts fix the time (or times) by which the economic operator is expected to perform their obligations under the contract, regardless of whether those obligations relate to the completion of works, the delivery of supplies, or the completion of services. For smaller contracts, particularly those that have a short life span, this contractual deadline and the economic operator's success or failure to respect the deadline may be sufficient for measuring contract performance, but on larger contracts and particularly those that have a longer life span, it is important to have an accurate means of monitoring progress towards achieving the final deadline. This would be the case for example for a contract for works (other than very minor works), a contract for supplies involving more than one delivery or a long fabrication/delivery period, or a contract for services to be provided in stages.

The baselines that can be used in order to monitor this progress may consist of one or more of the following:

- a schedule of key dates
- a programme (which can range from very simple to very detailed)
- a cash flow forecast
- a manpower curve

The schedule of key dates provides clear targets for the economic operator to meet, and their failure or success in meeting these key dates will give an immediate indication of their performance. However, it should be borne in mind that many contracts entitle the economic operator to more time in which to perform if they are delayed by the contracting authority or by certain circumstances not under their control. Any measure of the economic operator's performance with respect to time must take account of their entitlement (if any) to additional time. In other words, before deciding whether or not the economic operator has succeeded or failed to meet the key dates, it is necessary to consider whether the key dates must be adjusted to take account of any additional time to which they are entitled.

As stated above, for a contract with a long life span, it is important to be able to monitor progress throughout the life of the contract and not merely at key dates. This is because important decisions

may have to be made that depend upon that progress (e.g. allocation of budgets, allocation of staff, award of related contracts). Furthermore, a record of actual progress will be a useful source of information for “lessons learned” and for comparison with other projects.

The record of progress can be established by recording actual start and finish dates of activities shown on an agreed programme against the planned dates. However, programmes must be adapted to take account of circumstances that arise such as may be necessary to overcome delay in order to respect key dates. Therefore, it is important to update the programme regularly and to record progress against the updated programme.

Progress can also be monitored by recording the actual cash flow against the forecast. This is normally done by producing a graph showing the total amount forecast to be invoiced and the total amount actually invoiced by the economic operator at any time during the period of the contract. Such a graph normally shows two curves in the form of the letter S. If the economic operator is performing well, the two curves will be very close together. If progress is weak, the curve of actual progress will be flatter than the forecast.

A third indicator of progress can be the level of manpower deployed. By comparing actual manpower with the forecast of manpower needs, variations in progress can be anticipated since, in most cases, output will be proportional to the means utilised.

A failure to achieve forecast rates of progress is not usually a failure to perform in the contractual sense (although in severe cases it can be), but such a failure is usually an advance warning that the key dates will not be met.

Benefits/Costs

Whereas almost all contracts fix the time by which the economic operator is required to perform their obligations, it is certain that they all indicate the price that the EO is to be paid. This price may be fixed or it may be subject to adjustment under defined circumstances. The price that the economic operator is paid represents the cost to the contracting authority. When the price paid to the economic operator is subject to adjustment, it is of fundamental importance for the contracting authority to compare the actual cost against a budget.

In most cases, this comparison will be a measure of the contracting authority’s own performance rather than a measure of the performance of the economic operator. It is only a measure of the performance of the economic operator when the contract provides for the economic operator to be paid on the basis of “actual cost + fee”, or when the contract requires the economic operator to achieve certain performance criteria that have an impact on the contracting authority’s operating costs – for example, the energy consumption of a machine or of a building.

As for the monitoring of time, for small contracts this monitoring can consist of a simple comparison between the contract price and the amount finally paid to the economic operator. For more complex contracts however – particularly those with a long life span or which provide for adjustments to the contract price – the contracting authority will wish to monitor costs throughout the contract period (and perhaps, in the case of works or machinery, during the operating life of the finished product), in order to forecast any budget overrun and to take corrective action. It will also want to check that the benefits achieved correspond well to the cost incurred – in other words, that it obtains good value-for-money.

The starting point for monitoring costs must be a well-prepared budget. At regular intervals, actual costs incurred to date and an estimate of the costs to completion must be compared against this budget. Variances between actual costs and budgeted costs must be investigated so that corrective measures can be taken, and to serve in relation to future contracts. For example, on a works contract, the cost increase may be the result of changes in design requested by the contracting authority due to poor preparation for the project, which can be avoided for future projects. Or, it may be due to underground conditions that no one could have foreseen and which are limited to the area of this particular project.

Where necessary, adjustments will have to be made to the budget, but these must be explained and justified.

In addition to monitoring the final cost of the contract, the contracting authority will need to monitor cash flow – that is, its need for funds at any point in time. The contracting authority must ensure that funds are available to pay the economic operator at the required time, particularly when the contract amount is substantial and payments must be made at intervals over a long period. To do this, it will need a cash flow forecast against which to compare actual cash flow (similar to that used for the monitoring of progress – see above). Historical cash flow data can be used to check whether the contracting authority accurately forecast its needs at the outset. It can be also very useful for establishing cash flow forecasts for future projects of the same nature.

As stated above, the contracting authority will usually want to determine whether it has obtained “good value-for-money”. One way of doing this is by means of ratios established at the outset and then recalculated when the works, supplies or services are put to use. These recalculated ratios can be used as the basis for a comparison with similar contracts. For example:

- the cost/km for the construction of a road, or
- the cost/bed for the construction and running of a hospital, or
- the cost/inhabitant for refuse collection

Quality (applied in a wider meaning)

The subject of “good value-for-money” is very closely related to the subject of quality. The contracting authority must verify that the end product that results from the contract (whether supplies, works or services) meets expectations. The authority will want to ensure that it was free from defects when accepted from the economic operator and will do so by means of inspection, testing or review processes that are specified in the contract. The authority will also wish to verify that the product remains usable for the required life span subject to normal maintenance, and that it continues to satisfy performance criteria. This can be done by comparing operation and maintenance costs to a budget, or by means of ratios (as outlined above), or by means of user satisfaction surveys.

Thus, in relation to a new hospital the contracting authority will wish to have records to show that the required tests and inspections were properly carried out during construction and upon completion. It will wish to monitor the extent and ensure the proper execution of repair work by the economic operator during the guarantee period. It will wish to monitor repair costs against a budget over a period of, say, 10 years after the guarantee period. It will want to monitor the number of days when operating theatres or other facilities cannot be used because of a defect. It will wish to monitor the consumption of energy and of water. It should seek staff feedback at regular intervals to determine whether the functionality meets their needs. It should also survey patients to determine

whether they are satisfied. For example, elderly or disabled people may find that the distances they have to walk within the hospital are excessive. They may be dissatisfied with the number of seats available in waiting rooms, or with the availability of toilets.

In monitoring quality, the contracting authority should also check whether social and environmental criteria are/were satisfied by the economic operator. How many jobs were created? Were handicapped persons employed? How much training was given? How many safety incidents occurred? How many complaints were received from the local community about noise, dust or pollution emanating from the site of works?

For use in relation to future contracts, the contracting authority should compile information with respect to the responsiveness and attitude of the economic operator and relations between the economic operator and the contracting authority. Such information can cover, for example, the respect of procedures (invoicing, quality assurance, reporting), the accuracy of information given by the economic operator, the number of “complaint letters” or non-compliance notices issued to the economic operator (or the converse), and the rate of failure of tests and/or inspections.

Performance measures in service contracts

As mentioned above, the key documents for measuring performance in service contracts are the agreed specification (tender specifications together with the technical proposal by the winning economic operator and any modifications to those that might have been agreed as part of a permitted clarification process), and the performance standards setting out required service levels and performance measurement scheme. They should be incorporated as schedules to the contract.

These documents should be harmonised and consistent as concerns objectives, tasks and activities, outputs and deliverables and time schedule, including milestones and possible incentive mechanisms. When a contracting authority has awarded a service contract, it must monitor whether the service is being delivered well and to the agreed standards and timetable, and verify that the costs of the service are no higher than expected. It is the responsibility of the contracting authority to monitor the quality of the service to ensure that it is satisfactory and to put into place appropriate measures to rectify poor performance, as well as determining the performance measures.

Managing service performance involves more than simply determining whether services are being delivered to agreed levels or volumes, or within agreed timescales. The quality of the service being delivered must also be assessed.

Measuring service quality means creating and using quality metrics – measurements that allow the quality of a service to be measured. Some aspects of service quality that could be assessed are completeness, availability, capacity, reliability, timeliness, responsiveness, security, standards, usability, accuracy, auditability and satisfaction.

Some service aspects are measurable numerically; they can be counted and measured in a simple, mathematical way, such as transaction volumes. Other service aspects are more difficult to measure and would need a subjective assessment, such as customer satisfaction.

It is common to set a *baseline* for service performance or service quality. This could be the level at which the service is delivered under an existing contract, although the tendering out of a new contract provides an ideal opportunity to review the current service performance and service quality standards, and revise them if that is appropriate.

The baseline is normally incorporated as part of the contract in the schedules – either in the specification or in a specific schedule. Performance and quality measures, and any improvements in performance or quality, are tracked against the baseline. It is important to set the baseline

accurately in order to gauge how well the service performs, and how much value the new service is providing compared with previous arrangements. Since the economic operator's targets and performance will be calculated relative to the baseline, they will take a keen interest in this.

Some aspects of a service will be hard to measure because they involve subjectivity. However, it is still important to agree what is to be measured and how the information will be acquired – interviews, user surveys and documentation reviews are examples. Subjective aspects should not be neglected simply because mathematical techniques cannot be applied to them; it is a question of gathering information and analysing it with as much objectivity as possible. Often it is the subjective aspects of a service that are gauged over the longest term, and where hindsight will offer the clearest perspectives. They are also likely to be the aspects that offer the most pertinent lessons to be taken forward to the procurement of future services. Module A4 contains further discussion on measuring this type of performance.

Benchmarking may involve measuring the economic operator that is providing the service against the best in their industry, making comparisons between similar processes and/or comparing prices for similar services. Benchmarking economic operators that are providing services helps to offset the risk, in a long-term service arrangement, of underlying pricing and tariffs getting progressively out of line with market or industry norms (if a price mechanism is included in the contract). It also helps to identify and prioritise areas for improvement.

Benchmarking can moreover be used to assess the extent to which different arrangements are achieving their desired returns on investment, outcomes or impacts. This will be primarily about learning from other organisations' successes and translating those lessons into programmes of action or better ways of working.

Performance measures in supply contracts

The methodologies for measuring performance in connection with supply contracts are the same as those discussed in the context of service contracts; they revolve around the three basic factors of time, benefits/costs and quality.

The main governing documents linked to the contract for performance measurement here are the same as those applying to service contracts: the agreed specification (tender specifications together with the technical proposal by the winning economic operator and any modifications to those that might have been agreed as part of a permitted clarification process) and the performance standards setting out required service levels and performance measurement scheme. These should be incorporated as schedules to the contract.

A further important influencing factor is the nature of the products and associated services (where relevant), and the complexity and size of the contract. These factors affect the choice of contract model. The type of contract and performance measures used can differ considerably between, for example, a one-off procurement contract for the supply for highly sophisticated equipment, and a time-based four-year framework contract for the supply of food and meals to hospitals in a large city.

As with service contracts, the increasing tendency to use performance-based technical specifications and incentivised contracts, and the stronger emphasis on the way a contract is managed in terms of (*e.g.*) logistics, administration, serviceability and environmentally friendliness, together add to the

complexity of both contract delivery and designing performance measures that allow for a proper and productive measuring of contract performance.

The basic performance measuring functions may include the following *verification* actions:

- Delivery dates and schedules in accordance with the contract, and imposition of sanctions if those schedules are exceeded (liquidated damages);
- Proper quality and quantity of supplies;
- The satisfactory provision of all associated services such as installation, training, after-sales service and maintenance;
- The proper quality and efficiency in the processing of documentation (*e.g.* invoices and payments);
- The quality of communication with the contracting authority (*e.g.* review progress of the project);
- Costs in accordance with the contract and acceptable cost adjustments and extensions where allowed.

The performance measuring exercise may include a *user satisfaction survey*. *Benchmarking* also may be a useful tool for measuring performance under supply contracts.

Performance measures in works contracts

Introduction

A number of important decisions have to be taken at an early stage of the project cycle – among them, the choice of method for carrying out the works and the corresponding form of contract. The performance measures to be used depend greatly on the nature, size and complexity of the works to be carried out; the chosen contracting strategy; the contract arrangements decided; and the performance targets and measures agreed. Projects based on performance and output specifications, including possible incentive schemes, require much stronger monitoring and a clearer assessment methodology compared with more traditional works contracts.

Comment

The fact that performance measuring should be a key activity in all contracts, but particularly in large works contracts, is confirmed by a performance study that was undertaken on behalf of the UK government in 1999. The study revealed a real need of improvements: of 66 central government

departments' construction projects with a total value of GBP 500 million, three-quarters of the projects exceeded their budgets by up to 50%, and two-thirds had exceeded their original completion date by an average of 63%.

Performance assessment methodologies

The performance measuring will basically follow the same route as described earlier in this module by defining performance areas, performance targets and baselines, indicators, measures, information gathering and analyses. However, works contracts, and particularly large infrastructure projects, normally require the design of a more complex performance measurement system than is needed for service and supply contracts. The technical, economics and time-related dimensions under such a contract require a well-prepared assessment framework and management review organisation. Since the prerequisites and conditions vary from project to project; there is a need to customise the performance methodology with respect to the nature of the individual contract.

Generally speaking, performance measurement required in the implementation of larger works contracts is the activity of checking actual performance against targets throughout the life of the project, during construction and, in principle, through the operational life of the completed facility. It includes the establishment of a framework for performance measurement covering measures such as:

- Satisfaction surveys
- Defects
- Construction time and cost
- Productivity
- Profitability
- Impact on the environment
- Waste

In addition to the use of the performance methodology described above, the performance of large works contracts is further monitored by other means. Below there follows a brief introduction to those methods.

Gateway reviews and project evaluation

Gateway review is a method designed and practised in the United Kingdom. In simple terms, it is a review of a project carried out at a number of key decision points by a team of experienced people independent of the contracting authority. The purpose is to ensure that the project is justified and that the proposed procurement approach is likely to achieve value-for-money. The gateway process should consider the project at critical points in its development, known as gates. There are five such gates during the life cycle of a project: three before contract award and the other two at contract implementation and confirmation of the operational benefits. A "gate" cannot be passed through unless full acceptance of the process in this phase is reached. The review team prepares reports with its findings and recommendations for actions.

Project evaluation is an ongoing check of how well the project is performing, and should be the responsibility of the contracting authority irrespective a gateway review process. These reviews

include assessments of how well the facility is performing in terms of realising identified benefits, progress against quality, cost and time and the purchaser's capability, seeking opportunities to improve over time.

Post-project review

A post project review is carried out after construction is completed, and focuses on how well the project was managed. It considers how well the construction project performed against the performance targets and indicators, such as cost and time predictability, safety, defects and contracting authority satisfaction. It also considers lessons learned; these lessons should be documented in a "Lessons Learned Report" and feed back into the contracting authority's standards for managing projects.

Post-implementation review

A post implementation review should be carried out when the facility has been in use sufficiently long to determine whether the benefits have been achieved (typically, twelve months after completion and while the change is still recent enough for users to be aware of the impact of the change). This review establishes:

- whether the expected operational benefits have been achieved from the investment in the facility, as justified in the feasibility review and project documents (business case);
- if lessons learned from the project will lead to recommendations for improvements in performance on future projects.

As a minimum this review will assess:

- the achievement of objectives to date;
- whole life costs and benefits to date against those forecast, and other benefits realised and expected;
- the effectiveness of improved operations (which may include functions, processes and staff numbers);
- ways of maximising benefits and minimising whole life cost and risk;
- the sensitivity of the service to expected operational change;
- user satisfaction.

There should be regular post implementation reviews over the operational life of the facility.

Benchmarking

As discussed above, benchmarking is another important management tool that can help contracting authorities understand how their performance measures up in relation to that of their peers. It helps them compare their own internal processes with those of similar projects managed by contracting authorities of verified excellence, with a view to identifying priorities for improvement.

Section 3 Exercises

Exercise 1

The management of the contracting authority has been strongly criticised in media and by the politicians over the past years for a number of projects showing poor performance in terms of delays and huge cost overruns. Something needs to be done urgently in order to remedy the situation.

Working in a group, please undertake the following tasks.

Task 1

Using Table 1, prepare a list of the most common areas and reasons for poor performance in the delivery of works, supply and services contracts.

Task 2

Using the list you have prepared in Table 1, draft a short action plan/guidelines for the contracting authority for improving performance in the problem areas you have identified.

Table 1. What are the main reasons for poor performance?	
Reasons for poor performance – contracting authority side	Reasons for poor performance – contractor side

Please use more space if you need it.

Exercise 2

What basic performance measurement verification actions could you use for the following contract?

A two-year contract for the supply of medical dressings and bandages to a hospital. The contract requires weekly deliveries plus “top-up deliveries” where additional supplies are required due to emergencies or other unforeseen circumstances.

Section 4 Chapter Summary

Self-test questions

1. State the main reasons why performance measuring of contracts is such an important and necessary activity.
2. Give examples of measuring performance related to time.
3. Give examples of measuring performance related to benefits/costs.
4. Give examples of measuring performance related to quality.
5. Give examples of measuring performance in service contracts.
6. Give examples of measuring performance in supply contracts
7. Give examples of measuring performance in works contracts.
8. What is a gateway review process?
9. What is a post project review process?