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International Federation of Inspection Agencies

# Legal Committee

## Risk management conference, Geneva



**The IFIA Legal Committee Risk Management Conference**  
**Geneva, Friday 16 October 2009**

The 2009 Risk Management Conference included a series of case studies, which were discussed in work groups, with the findings presented during a plenary session. The following is a record of the questions and issues raised during these sessions and the key learning points or „take aways“ associated with each case. The case studies will be found in the appendix to this document.

**Presignature Phase**

**Case 1: Who are the contracting parties?**

**Questions and Issues Raised**

- Who is the client and how much do you know about him/her?
- If you are not contracting directly with your client, is your contracting party properly authorised to represent the client? How much do you know about him/her?
- If you are using an intermediary in order to establish the contact with a client, how trustworthy is he/she?
- How far should you go in checking foreign documentation and/or documentation in a foreign language?
- Which company should be the contracting party on your side?

**The ‘Take Aways’**

- Due diligence should be conducted prior to entering into any contractual relationship with a client, a subcontractor or an intermediary. The due diligence on a contracting party should include as a minimum :
  - Details: full name, address, registration (if incorporated)
  - Substance: office or production facilities, staff, financial information
  - Ownership or shareholding
  - Background and reputation check
- If a party is acting on behalf of a contracting party, he/she should be authorised by a power of attorney issued by representatives of the contracting party and vetted by legal personnel.
- Foreign documentation and documentation in a foreign language should not be accepted on the face of it but should be checked by local lawyers.

- The legal entity contracting on your side should preferably be the legal entity providing the service. The use of another entity should be contractually documented and checked for possible tax exposure.
- The signatory(ies) for the legal entity contracting on your side should be properly authorised, either as legal representative(s) of the entity or by a power of attorney.

### **Case 2: What is the scope of the contract?**

#### **Questions and issues raised**

- Does the client have a clear idea of what he/she wants?
- Do you have a clear idea of the services which you are expected to provide, do these make sense and does your idea of what they are coincide with that of the client?
- If you need to clarify or change the description of the services, whom do you discuss this with?
- Where should the description of the services be included in the contract?

#### **The 'Take Aways'**

- It is essential for both parties to be absolutely clear about the scope of the services.
- Legal personnel should be involved early in the negotiation process. They bring skills in formulating contractual clauses, including the description of services, and a professional viewpoint not marred by the eagerness to close a deal.
- If there is any doubt, it should be clarified before entering into the contractual relationship even at the risk of crystallizing differences of opinion with the client. It will be easier to deal with these differences before entering into a contract than when a problem arises and it is better not to enter into a contract if differences cannot be settled.
- Are your client's expectations acceptable? Will you be able to perform? Is the risk acceptable?
- Any clarification of, or change in, the scope of services should be discussed with the main negotiator on the client side (to be named in the contract where warranted by the complication of the project) and be contractually documented.
- The description of the services is an essential element of the contract and should not be subject to any other contractual clause.

**Case 3: The Importance of pre-contractual discussions and the ‘Battle of the Forms’**

**Questions and issues raised**

- What should you do when your customer has inflexible standard terms/procedures? How do you resolve internal conflicts especially the commercial imperative, “*don’t upset the customer*”?
- What should you do when customers’ standard terms contain inappropriate/inapplicable clauses: e.g. terms designed for supplies of goods, not services. How do you educate clients and persuade them that there are good reasons to depart from their standard terms?
- Are you sure that both your own company staff and your customers are fully aware of the nature of the service you are offering? Both parties need to be clear as to what it is that you are being asked to do.

**The ‘Take Aways’**

- It is essential to establish fundamental contractual principles and policies. Onerous terms may sometimes have to be accepted, but each company should identify limits beyond which it will not go, and ensure members of staff are aware of these and the reasons for them.
  - This can be achieved by staff training and also by setting clear lines of authority for contract signing.
- Efforts should be made to reconcile customer expectations with service realities and necessary limitations. (Educating and informing customers)

**Case 4: The importance of contractual documentation**

**Questions and issues raised**

- What do you do when late engagement of your company may leave no time for discussion/clarification of particular requirements? If not resolved, this can lead to misunderstandings and conflicts later.
- How do you avoid the premature initiation of services before contract terms are discussed and/or confirmed in writing?
- How do you ensure that when a framework agreement has been made on your company’s terms this is not undermined by later documentation – for example when the customer sends a purchase order on their own terms? Although this may be presented as a technical/accounting issue - “*our system requires a signed purchase order to trigger payment of your invoices*” – beware, it may result in modification of contract!

- How do you or your company ensure there is sufficient understanding of legal/contractual implications by commercial staff? Do you have sufficient legal oversight of documentation and sufficiently clear lines of authority for acceptance of modifications?
- What do you do when dealing with Government contracts where there is no scope for negotiation, and terms issued by different departments of the same government may vary? If it is impossible to influence the legal terms, might there be some scope for mitigating risk by ensuring clarity in technical specifications?
- Does your company generally rely too strongly on insurance coverage? How do you ensure commercial staff understand what limitations/exclusions will apply?

### **The ‘Take Aways’**

- A standard “frame” agreement should be negotiated to control relationships whenever possible, with clear rules for the authorisation of changes.
- Clarity and specificity should be demanded in all contractual undertakings.
- Appropriate client registration (intake) processes should be in place, to ensure work is not commenced prematurely before the client is properly identified and clear instructions are received and authorised.
- Before making any contract, check the “four Cs”: Clarity, Capability, Capacity, and Compatibility with Mission, Coverage and Compliance.

### **Case 5: Ethics**

#### **Questions and issues raised**

- Doing business with a friend requires extra caution.
- “Facilitation payments” are likely to lead to problems, although not strictly illegal under FCPA.

### **The ‘Take Aways’**

- Payment of a brokerage fee to a consultant is inappropriate, especially if it is recorded as something different.
- Use of an external company to deal with arrangements with local officials does not absolve you from responsibility if they are in fact making improper payments.

**Performance and delivery**

**Case 6: Which resources are adequate?**

**Questions and issues raised**

- Can you guarantee the availability of the appropriate resources? Failure to do so has cost implications
- Do you have a capability and training log for all of your human resources so as to be able to match your analysis of the resources required to perform the contract with available human skills?
- How can you ensure the team appointed to undertake the work is justifiable in terms of the analysis of the contract against the company's skills base?
- Ideally there should be flexibility in contracts to increase the price if more expensive human resource becomes necessary
  - If this is not achieved, the company must review the contract so as to reduce its losses, but be prepared to finish the job at a loss

**The 'Take Aways'**

- Every contract should be checked to identify the inherent risk. Acceptance of a contract without availability of appropriate resources (in particular human skills) would be to risk a claim
- Causes for alarm at the initial contract review stage for whatever reason (unusual customer requests, conditions, offers) should be reviewed up the management line
- A technical review should be performed before a contract is signed off
- A company must understand the limitations of training: trained generalists are not the same as professional experts
- Systems should be established to ensure continual management oversight is in place, in order to identify where more or different resource may be required
- All reports or other form of result must have a cross-check by a competent counter-signatory

**Case 7: Administration and progress monitoring**

**Questions and issues raised**

- How do you identify all changes to the scope of a contract, which may come about formally or by stealth?
- How do management and operations ensure a common understanding of the changes and the impact on resourcing the contract?
- What measures should be put in place to ensure the form of the deliverable is reconsidered to reflect changes to the scope of a contract?
- What sort of training and procedures should be in place so that both operations and management know when they should stand up to the customer?

**The 'Take Aways'**

- All contractual changes, regardless of how they originate, should be treated with the same degree of review as a new contract in terms of risk assessment, approval and capability
- Assessment of the risk of going ahead with a changed scope of specification should include a review of whether the activity is covered by the company's insurance

**Case 8: Impartiality and independence**

**Questions and issues raised**

- How do you balance your obligations to your customer against your wider duty of care to other parties, including confidentiality?
- How do you ensure company personnel know when to point out limitations in the value of a report, for example, that a sample is not representative of a whole cargo?
- Should there be a greater emphasis in both company and IFIA Compliance Codes on common aspects of integrity and conflicts of interest?

### **The ‘Take Aways’**

- Training of staff in the management of conflicts of interest between their responsibilities to immediate customers and to other parties who rely on results should be one of the major attributes of companies in the independent testing, inspection and certification industry
- It is sometimes necessary to point out your wider duty of care to your immediate customer and to be prepared to deny him what he wants or even walk away
- Company personnel should receive training in how to maintain their impartiality when they have to explain, for example, differing test results

### **Case 9: Issuance of Certificates or Reports**

#### **Questions and Issues Raised**

- To what extent should your organisation rely on third party declarations?
- How much should your employees really be expected to know about the context in which they are operating?
- How much due diligence should you be expected to carry out in order to clarify their understanding?
- Does your company have a responsibility to find out the purpose of a certificate which is requested of it?
- Where specific wording or an omission of wording is requested on a certificate and this differs from custom and practice, could you be found culpable or a party to fraud?
- When a non-routine situation emerges, does your company have routines and procedures to assess the risks?
- At what level in your organisation is a view taken on commercial risk versus moral, ethical and reputational considerations?

### **The ‘Take-Aways’**

- Ensure you and your team are fully aware of your company’s policy regarding certificate drafting and do not deviate from it.

- Any offer of indemnity should be viewed with deep suspicion – it may mean there is something suspicious about the situation and it certainly warrants further investigation. In certain circumstances an indemnity may be worthless. You may then be left with a situation where you have an increased commercial exposure.
- Where time is an issue and decision taking is at a local level, always ensure a message is sent outlining the situation to your legal department or line supervisor. Try to ensure no contract is fully binding until their approval has been given.

### **Case 10: When should issues be addressed?**

#### **Questions and Issues Raised**

- Does a member of field staff, a third party inspector or a self-employed subcontractor have the authority to change a contract?
- Does the client contact person have the authority to change a contract?
- Is there or should there be a financial limit placed on contract changes made in the field?
- At what stage should an amended contract be drawn up and by whom?
- Does your company have a credit risk management procedure and do you know what it is?
- Are clear credit limits in place for contract amendments?
- Have field staff been sufficiently trained in contract review management and how frequently is that training reinforced?

#### **The 'Take-Aways'**

- Frequently, audit teams are not involved with budgeting. Systems and procedures should be in place and training should be available to ensure these are adhered to.
- Documentation is vital, even if it is via an exchange of emails, to evidence agreed amendments.
- Certification should not be issued without payment.

## Appendix: The case studies

### Case 1: Who are the contracting parties?

Commodinspect (Co)'s intermediary, the FlybyNight Company, has put you in touch with a potential partner in Central Asia, Mr Crookov, who claims to act on behalf of his government. He shows you a letter signed by his Finance Minister.

- Under discussion is a contract with Crookov's company Tscheck All, to inspect all border trade (in order to avoid the import or export of all listed illegal or dangerous goods). You see a translated version of Tscheck All's Memorandum of Association.
- A subcontract agreement with Tscheck All is prepared, with the Co contractor's name left blank. It is agreed that a FlybyNight manager will sign the contract on behalf of Crookov.
- News reports tell you that the Finance Minister has been replaced.
- The head of your division insists the deal must be done through your offshore subsidiary, a dormant branch office in Spain. The branch manager left a year ago, so either an accountant employed by a Co subsidiary in Spain, will sign on his behalf, or you will sign it personally.

*Can you have this contract executed? What needs to be checked?*

*Can you identify the roles, authority and entities?*

### Case 2: What is the scope of the contract?

- Co has received an invitation to provide services for a Middle Eastern client. You are asked to develop documents for a new-build offshore facility that are intended to work alongside the existing documents for their onshore process plant.
- On seeing the client specifications, you feel they are asking for a prescriptive set of 'how to' manuals, with no real policy or strategy to make them work.
- In the tender document you propose an alternative approach, setting out a detailed policy and implementation strategy.
- The contract includes your proposal, as a tied-in schedule some way down the precedence list. At the start-up meeting it seems as if both sides understand what work will be performed.
- The first piece of work is provided and dialogue becomes strained. They want their original concept delivered and maintain that the engineer you had talked to did not have the authority to agree a revised scope.

### Case 3: The importance of pre-contractual discussions and the 'battle of the forms'

- You have presented your standard agreement to a household appliances manufacturer, *Happy Homes (HH)*. The contract is to assess HH products for conformity to standards and their eligibility for certification and inspection services.
- General professional standards apply. Fees include one examination and set of tests as considered appropriate for each product sample. If the product conforms and is eligible, HH can use Co's Certification Mark. The agreement releases Co from all liability, claims or loss and indemnifies and holds Co harmless against 3<sup>rd</sup> party claims in relation to HH's products.
- HH requires Co to sign their Standard Supplier Agreement (SSA), under which merchandise must be provided in conformity with their 'order'.
  - Although 'supplier' is not defined, 'order' is any approved purchase and 'merchandise' is defined as all products, goods, materials, equipment, articles and tangible items, and any services included with them. A price guarantee must be provided, with HH claiming lowest price or most favourable terms benefits. The supplier must agree that title of the merchandise will transfer to HH and the merchandise be of workmanlike quality, fit for purpose etc. The supplier must indemnify HH against all claims, lawsuits and damages, including injury and death.

#### Case 4: The importance of contractual documentation

- Following the satisfactory performance of a contract, Co is invited to enter into a 5 year contract with Asia-Pacific Foundry (APF), granting Co exclusivity on all mineral inspections for APF. There are c2-3 inspections pa, each requires extensive work and specialised skills and a fee of c\$500k.
- APF table a contract for immediate signing, saying it is their standard contract and 'they have never had problems with it'. For tax purposes the contract will not be with APF but with its sister company, APF International, based in Gibraltar.
- Co's corporate lawyers always insist on a limitation of 10x fee. The contract is amended to reflect this.
- Co's work is always performed using their own General Terms. You ask for these to be referenced in and attached to the contract. APF refuse since Co's terms are on the back of Co's certificates.
- After you have agreed on the terms you shake hands and sign the contract on the spot.

#### Case 5: Ethics

- Co is under pressure in its Asian operations to increase revenues. Competitors' business practices are aggressive.
- A Co senior manager ('R') in Asia is visited by a long-term friend and consultant, who brings gifts for his family, which are accepted.
- The consultant tells R that one of her clients (APF) needs an inspection done quickly and proposes a brokerage fee for Co to secure the business. R agrees and records the payment as to a 3rd party for competitive information, without obtaining his manager's approval.
- Problems arise inspecting APF's shipment and a port official claims a licensing fee of \$500 in cash for access to the shipment. The fee is paid.
- In an effort to ensure such problems do not arise again, Co discovers that a local company, Practical Business Solutions, claim they can guarantee no more port difficulties in return for a fee of 5% Co's inspection revenues at the port.

#### Case 6: Which resources are adequate?

- Co have been asked to provide inspection services for a long-standing client, a manufacturer of gas turbines, Belchitout ('B') for conformity to standards and their eligibility for certification and inspection services.
- Following a rationalisation programme and Co unexpectedly winning a major contract with one of B's larger rivals, the suitably qualified and experienced gas turbine team is unavailable.
- Since the inspection services are similar to those previously performed on behalf of B and since the documentation is on file, it is decided to deploy the bathroom manufacturing team on this contract.

*What are the risks and issues?*

#### Case 7: Administration and progress monitoring

- Co has an assignment to perform a simple draft survey of consignments of copper concentrates. The trader chartered a single-hold carrier in error and intended to load 3 different grades. When the carrier arrived the trader did not reject it or seek to change it.
- Instead he agreed to build a temporary bulkhead for the loading of 2 grades at the first of 2 load ports. The construction was monitored by visits and photographs taken.
- Prior to loading a certificate was requested by the trader confirming the bulkhead suitability and he approached Co's surveyor. The certificate was issued and loading began.
- However the bulkhead construction was not adequate, it shifted under pressure and the grades were mixed.
- The cargo had to be discharged at a cost of \$1m. The trader sought recovery of these costs from various parties, including Co, and writs were issued.

*What went wrong and why was Co implicated?*

### Case 8: Impartiality and independence

- A ship is loaded with fuel oil from 5 different land storage tanks. The fuel is to be sold by Ewing Oil ('EO'). Co's inspectors make a hand blend for EO, paid for by EO.
- Co is asked to perform composite quality testing after loading, paid for 50/50 by the seller, EO and the purchaser, Milka ('M'). This test gave a better result than the hand blend. The cargo was sold to M, with the price based on the tests after loading.
- M transported the cargo, which was to be used as a blend component for bunker fuels. On arrival Co is asked by M to test the composite cargo after discharge. The results of this test are in line with the first, hand blend test.

*Did Co's inspector show impartiality?*

### Case 9 – Issuance of Certificates or Reports

- You are Co's sales manager in charge of oil and gas business development and are asked to promote and sell Co's services to a long-standing customer, Honest Jo Traders ('HJT'). HJT are mid-sized, active in niche markets and have a reputation for accepting risky trades.
- Co's business with HJT increases.
- You receive a call from HJT asking a favour – they would like you to amend a certificate in relation to a recent loading inspection in a country known NOT to enjoy generally good diplomatic relations, in order to facilitate the negotiation of a letter of credit. If it is declared as the country of origin, the bank will refuse to pay the letter or credit.
- The shipping company has already agreed to issue 2 sets of bills of lading for this purpose, indicating in one that the cargo was loaded elsewhere. HJT ask you to do similarly.
- The cargo is destined for a country with complex import and tax regulations. Under these, fuel oil is heavily taxed, crude oil is exempt. HJT suggests your certificate should be drafted to say you have 'supervised the loading of a cargo said to be crude oil at the time and place indicated on the Bill of Lading'. HJT claim this is common practice and offer to issue a letter of indemnity for any inconvenience caused.

*What are the risks if you issue the certificate as proposed?*

### Case 10 – When should issues be addressed?

- Co has a strong business certifying companies to ISO standard 000. You have a certification contract with the B Chemicals Company ('BCC') to provide them with ISO 000 certification services. If the audit is successful, BCC can use the quality management certificate in Berlin. The lump sum fee for the contract is €50k. All amendments to the contract must be in written form. The contract is signed by BCC's Director of Administration and Co's sales director.
- During the audit process, BCC's quality manager asks to extend the certificate to a further 2 BCC affiliates, also in Berlin, to be carried out with the main audit. This is agreed by Co's auditor, for a new total fee of €120k, the fee accepted by BCC and the extended audit carried out.
- On completion of the task Co's auditor informs Co's finance department and an invoice for €120k issued to BCC. Co's management try to arrange a contract amendment with BCC.
- BCC reject payment.

*What went wrong?*

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