

Payment Types

The method of payment has a direct impact on how the statement of work is written and how the contract is managed. Agencies must measure or verify that the work is complete and how much and how often the agency will pay the contractor. As with specification types, there are also various payment types. The payments should be consistent with the type of product or service delivered. Payments should be structured to fairly compensate the contractor and encourage timely and complete performance of work. As a general rule, payment should be approximately equal to the value of the completed work.

The following table illustrates the various common types of payments and how each applies to various types of contracts.

COMMON TYPES OF PAYMENT

Payment Type	Commonly used for:	Payment based on:
Cost Reimbursement	Client services contracts, usually associated with state and federal grants. Example: Contracts for services in remote areas.	Reimbursement of allowable costs in accordance with the approved budget. See the Uniform Grants Management Standards published by the Governor's Office. (www.governor.state.tx.us/division/stategrants/guidelines/view) <i>See Note 1</i>
Cost Plus Incentives	Materials contracts wherein the materials are unknown at the time of contract award. Example: Construction contracts.	Contractor's cost plus a percentage of cost or cost plus a fixed fee. This type of payment is usually discouraged as there is no incentive for the contractor to minimize the cost to the State.
Fee For Service	Contracts wherein a fee can be established for a unit of service. Example: Providing flu shots to patients. Unit of service is one flu shot.	A specific fee for a unit of service. Payments are made for each unit of service completed.

Firm Fixed Price	<p>Contracts wherein a firm fixed price can be established for work to be performed. Requires that the statement of work provide clear and accurate specifications.</p> <p>Example: Common goods and services such as office supplies, furniture, etc.</p>	<p>A firm fixed price at the time the contract is awarded. Contractor carries all risk as the payment does not change, regardless of how much it costs the contractor to provide the goods or services.</p>
Firm Fixed Price with Escalator	<p>Same as above and for longer term contracts and or contracts where the costs of material and labor are subject to market fluctuations. Because the contract allows for market adjustments, contractors are less likely to inflate prices to protect themselves against possible increases in operating costs.</p> <p>Example: Lumber, steel, paper.</p>	<p>Same as above except includes a provision for price escalation. Escalators are typically based on the Consumer Price Index.</p>
Progress (not allowed in client services contracts)	<p>Construction contracts or contracts that are completed in phases or stages.</p> <p>Example: Building, Construction, Consulting Services.</p>	<p>Payment is based on pre-established deliverables. Deliverables must be measurable. See Note2</p>
Time and Material	<p>Labor contracts wherein the amount of labor or material required for the work cannot be forecast. Recommend other payment types if possible. For example – instead of paying the contractor \$25 per hour for labor plus the cost of the materials, establish pricing for common units of work such as “labor and material to install a 120 power outlet”.</p> <p>Example: Electrician, plumber, carpenter, etc.</p>	<p>Payment is based on the number of hours worked for a specific scope of work, i.e. install a 120 power outlet.</p>

Note 1: Agencies may reference the State of Texas Travel Allowance Guide published by the Comptroller of Public Accounts when including travel costs as an allowable expense within a contract. (<https://fm.x.cpa.state.tx.us/fm/pubs/travallow/index.php>)

Note 2: For example, a contractor has a contract to conduct an analysis of a specific business process and prepare a report with recommendations for improvement. A method of payment might be that the contractor is paid 30% of the contract amount upon completion of the analysis. The agency must specify what documentation will be required to indicate proof of this deliverable, such as a copy of the analysis. The remaining 70 percent is paid upon receipt and acceptance by the agency of the final report. It is important to note that with this payment type, agencies must be careful not to shift the financial risk to the State by paying the contractor for more than the amount of work the contractor has completed. Agencies must also consider the importance of the deliverable. In the above example; the agency may agree to pay the contractor 80 percent of the contract amount upon completion of the analysis since the analysis takes a significant amount of labor. This change shifts the financial risk to the State because the agency has paid for 80 percent of the service, but will have nothing to show for the dollars spent if the contractor fails to complete and submit the report and recommendations.

Good business practice suggests that each payment should reflect the value of the work performed. Agencies can control the payment process by dividing the overall contract payments into smaller amounts that each reflect a small increment of work or deliverable. This is an effective technique for managing financial risk. If there is a dispute, by using the deliverable elements, the scope of the dispute can be contained to a discrete deliverable rather than the entire contract. Likewise, the amount of money associated with the deliverable is also known and limited. In slightly different ways, each of the deliverable elements either lessens risk or shifts risk from the State to the contractor.

Chapter 6 - Contract Formation contains a detailed explanation of the required elements of a contract.

Define the Agency's Role

Clearly define the role the agency will play in the work to be performed and any specific contributions, resources or tasks the agency will provide. Detail any background data or work already accomplished that the anticipated contract will build on and make it available during the solicitation phase of the procurement. Specify whether the contractor should rely on the accuracy of any such background data or work or whether the data or work is provided for information purposes only. If provided for informational purposes only, advise if the contractor is responsible for verifying the accuracy of the information to the extent necessary to perform the contract. Define the roles of the agency staff that will administer the contract and monitor the contractor's progress.

Quantity

The solicitation document must quantify the amount, frequency and/or location required to meet performance.

Quality

The solicitation document must identify the level of quality required for acceptable performance. For example: *All dusting shall be done so as to ensure cleanliness of surfaces, as determined through inspection by the contract administrator.*

Established Standards

If established standards (international, national, state, local) are available, they can be used to assist in defining the contract performance requirements. Examples of national and international standards include

American National Standards Institute (ANSI), American Society for Testing and Materials (ASTM) and International Organization for Standardization (ISO). Using established standards provides consistency in measuring acceptability, quality or accuracy of the performance of one or more parties to a contract.^{ix}

Contracts will often incorporate by reference “standards” maintained by entities representing particular industries such as Generally Accepted Accounting Principles (GAAP), Institute of Electrical and Electronic Engineers (IEEE) or ISO. If a standard is incorporated by reference, identify any industry, state or agency standards of performance that relate to each activity, task, work product or deliverable. Merely referring to “industry standards” is usually inadequate. If an industry standard is used, specifically identify the standard by number.

Warranty as a Standard

A warranty is a type of standard that can describe performance.^x Consider including warranty language as a contractual standard of performance. An express warranty and an implied warranty are technically different. However, each standard works to describe a type of contractually based performance.^{xi}

Unless excluded or modified by the language in the contract, warranties or standards may be implied or imposed into a contract by a statute or case law. For example, in the sale or lease of some types of personal property or goods there may be statutory warranties implied into a contract, such as: a warranty of title,^{xii} a warranty that the goods shall be merchantable,^{xiii} or a warranty that goods are fit for a particular purpose.^{xiv}

The best practice is to include clear standards for the contractual performance or an express warranty describing the objective expectation of performance rather than relying on an implied warranty. Generally, it is not necessary to the creation of an express warranty that the seller use formal words such as “warrant” or “guarantee” or that the seller have a specific intention to make a warranty. However, a mere affirmation of the value of the goods or a statement merely purporting to be the seller’s opinion or commendation of the goods does not create a warranty.

i Black’s Law Dictionary (7th ed. 1999), defines: standard, n.2. A criterion for measuring acceptability, quality or accuracy. A legal standard that is based on conduct and perceptions external to a particular person. In tort law, for example, the reasonable person standard is considered an objective standard because it does not require a determination of what the defendant was thinking. *Subjective standard.* A legal standard that is peculiar to a particular person and based on the person’s individual views and experiences. In criminal law, for example, premeditation is determined by a subjective standard because it depends on the defendant’s mental state.

ii See Southwestern Bell Tel Co. V. FDP Corp., 811 S.W. 2d 572,576 (Tex. 1991) (“The UCC recognizes that breach of contract and breach of warranty are not the same cause of action. The remedies for breach of contract are set forth in section 2.711, and are available to a buyer “[w]here the seller fails to make delivery.” Tex. Bus. & Com. Code §2.711(a). The remedies for breach of warranty, however, are set forth in section 2.714, and are available to a buyer who has finally accepted goods, but discovers that the goods are defective in some manner. Tex. Bus. & Com. Code §2.714, §2.711 (Comment 1); see also 1 J. White & R. Summers, Uniform Commercial Code 501 (3rd ed. 1988). Indeed, “the whole purpose of the law of warranty is to determine what it is that the seller has in essence agreed to sell.” Tex. Bus. & Com. Code § 2.313(Comment 4). No sound reason exists to apply a different standard when the contract is for services instead of goods.”)

iii Generally, a warranty describes then “character, quality or title” of that which is being sold and “by which seller promises or undertakes to insure that certain facts are or shall be as he then represents them.” Black’s Law Dictionary 1586 (6th ed. 1990). An express warranty is a definitive affirmation of fact or promise which becomes part of the basis for the bargain and upon which the parties rely. See Morris v. Adolph Coors Co., 735 S. W. 578, 587 (Tex.App.-Fort Worth 1987, writ ref’d n.r.e.). Implied warranties are based in tort law and are judicially interjected into agreements whenever necessitated by public policy to ensure that parties receive that for which they bargained. See Melody Home Mfg. Co. v. Barnes, 741 S. W. 2d 349, 353(Tex. 1987); see also Parkway Co. v. Woodruff, 901 S. W. 2d 434, 438 (Tex. 1995). A contract term identifies what is being sold; warranties described the attributes, suitability for a particular purpose and ownership of what is sold. Cf. Donnelley Mktg. v. Lionel Sosa, Inc. 716 S. W. 2d 598, 604 (Tex.App. – Corpus Christi 1986, no writ) (court held supplier’s provision of wrong mailing list to advertiser was tantamount to no delivery at all and amounted to breach of contract). See Chilton Insurance Company v. Pate & Pate Enterprises, Inc. 930 S.W.2d 877 (Tex.App.-San Antonio 1996, rehearing overruled).

iv Warranty of Title and Against Infringement; Buyer’s Obligation against Infringement. Tex. Bus & Com. Code §2.312

v Implied Warranty: Merchantability; Usage of Trade. Tex. Bus. & Com. Code §2.314 (merchantability – Goods to be merchantable must be at least such as: 1) pass without objection in the trade under the contract description; and 2) in the case of fungible goods, are of fair average quality within the description, and 3) are fit for the ordinary purposes for which such goods are used; and 4) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and 5) are adequately contained, packaged, and labeled as the agreement may require; and 6) conform to the promises or affirmations of fact made on the container or label if any.); Tex. Bus. & Com. Code §2A.212. Implied Warranty of Merchantability (lease of personal property).

vi Implied Warranty: Fitness for Particular Purpose. Tex. Bus. & Com. Code §2.315 (implied warranty that the goods shall be fit for such purpose, where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods); Tex. Bus. & Com. Code §2A.213 Implied Warranty of Fitness for Particular Purpose (lease of personal property).