An approach to drafting contracts for agile projects

Agile is becoming an increasingly popular approach to deliver technology solutions. This article sets out some of the benefits and risks of adopting an agile approach, and how these risks can be mitigated through careful drafting of the underlying contract.

What is agile delivery?

An agile approach to the delivery of technology solutions is an approach in which requirements and solutions are allowed to evolve through the close collaboration of the customer and supplier. It typically involves the delivery of small pieces of working software, in accordance with the customer’s prioritisation, at set intervals (or iterations) during the course of the project. This gives the customer early visibility of the software so that requirements can be re-prioritised if necessary, or some original requirements can be replaced with new ones. The final set of requirements may look very different from those envisaged at the commencement of the project.

In contrast to the agile approach, the traditional waterfall approach typically involves the customer and supplier agreeing the full set of requirements at the start of the project. This means that it will be clear from the start of the project exactly what the supplier will deliver to the customer, as long as the project is a success. The supplier will be required to work through the list of requirements until they are complete, usually without the need to deliver any interim software. The customer may only have the opportunity to see the solution for the first time during acceptance testing at the end of the project. This late exposure of the solution to the customer significantly reduces the opportunity to incorporate feedback into the final solution.

Benefits of an agile approach

Proponents of an agile approach argue that although customers may not know exactly what the final solution will look like at the start of the project, they will end up with the solution that they want because their feedback is continuously incorporated. They argue that trying to define requirements in detail at the start of the project, as required by a waterfall approach, is inherently dangerous because it is impossible to account for the many unknowns that will inevitably make themselves known during the course of the project. For example, the needs of the business may change during the project, unanticipated technical performance issues may arise, or the customer may simply discover that the original requirements do not cover every possible scenario that needs to be covered. An agile approach can provide customers with the flexibility needed to deal with these types of issues.

Risks of an agile approach

Despite the potential benefits of an agile approach to delivery, the approach does present certain associated risks. Customers face the obvious risk that it is not known at the start of the project exactly what the supplier is required to deliver by the end of the project. As a consequence, it is difficult for the customer to know at any one time how much the project will cost and how long the project will take. Even where the customer demands a fixed price or fixed schedule, or both, the customer will not know exactly what they will get for that price or by that date. This is because agile projects, by definition, require flexibility of scope.

Customers can mitigate this risk to some extent by engaging either the supplier or a third party to scope and estimate the effort required to deliver the envisaged solution prior to the commencement of solution delivery. While the list of requirements produced by this engagement should not be treated as final, it can at least provide the customer with a baseline from which the budget and schedule implications of a change to requirements can be assessed during the course of the project.
Suppliers also face particular risks in agile delivery projects. The collaborative nature of agile projects is such that the supplier will be unable to perform its services effectively if the customer does not fulfil its obligations. For example, the supplier will typically require the customer to provide a prioritised list of requirements in accordance within an agreed timeframe. If the customer fails to do this, the supplier may be unable to commence delivery of those requirements on schedule. Similarly, if the customer fails to follow the agreed acceptance process, the supplier may be unable to continue to develop parts of the solution that are the subject of acceptance testing. Such delays can put the supplier at significant risk, particularly if the supplier has committed to a final delivery date, or if the supplier is unable to assign other tasks to project resources.

Drafting contracts for agile projects

The contract for an agile project is likely to look quite different from the contract for a waterfall project. For a start, an agile contract cannot simply refer to an agreed set of requirements that the supplier must deliver, and then set out the price which the customer must pay upon delivery of those requirements. Agile projects are more complex than this. They inherently rely on the close collaboration between the customer and supplier who must both act in accordance with the agreed process. This collaboration and the agreed process to be followed must be clearly articulated in the contract to prevent both parties from being exposed to unanticipated risks and misunderstandings that can so easily lead to project failure and dispute.

Contract term examples

Here are some examples of how certain issues can be addressed in a contract for an agile project.

Dispute over effort required to deliver requirements

Agile projects typically define a process by which the customer and supplier agree which requirements will be targeted for a particular iteration. The agreed process can vary significantly across projects, but one approach might require the customer to provide the supplier with a set of prioritised requirements to be targeted for the next iteration. This list may need to be provided, for example, by no later than one week before the start of the next iteration. During the last week of the current iteration, the supplier may then be required to estimate the effort required to deliver those requirements. Finally, the supplier will confirm with the customer how many of the target requirements can be delivered, depending on effort estimates and the current resource profile.

This process can sometimes result in a dispute between the customer and supplier. The customer may, for instance, believe that the supplier is deliberately over-estimating the effort required to deliver requirements so as to minimise its delivery obligations. This type of dispute can be particularly damaging in an agile project, where so much depends on the co-operation between the customer and supplier. It is essential that the contract provides for an approach to address this type of dispute as quickly and as objectively as possible.

One way in which this may be achieved could be to set out in the contract an obligation for the supplier to provide the customer with a detailed breakdown of an estimate. The supplier and customer would then be required to meet in an attempt to discuss the estimate in more detail. During the meeting, the supplier would be required to walk through the estimate breakdown, and the customer would be obliged to articulate any outstanding concerns. If the dispute is not resolved at the end of the meeting, the contract could provide that an agreed independent expert consultant would be engaged to provide expert determination of whether or not the supplier's estimates are reasonable. The contract could then also set out which party would be responsible for paying for the associated costs, to avoid any further misunderstandings.

Replacing original requirements with new ones

Some customers of agile projects may have an initial set of requirements that are likely to be required for the desired solution. However, being an agile project, it is inevitable that customers may want to replace some of the original requirements with new requirements as they see the solution take shape through the iterations. This has the potential to impose a costly change request process on both the customer and supplier, which both parties are likely to want to avoid.

Alternatively, the customer and supplier may agree a process in the contract by which requirements of equal value in terms of effort can be swapped without the need for a formal change request. This could significantly reduce the administrative burden to the project, and allow for greater flexibility to change requirements.
Fixed schedule with financial remedies payable for late delivery

In a project where the customer requires a solution to be completed by a fixed date, it will be important to the customer that the supplier maintains a minimum delivery pace. This could be achieved by providing in the contract that the supplier must deliver a certain number of “resource points” each iteration. (In this context, a resource point is simply a unit of measurement of the effort required to deliver a requirement.) If the supplier fails to deliver the minimum number of resource points over a certain number of iterations, the customer may require a right to terminate the contract. Alternatively, or in addition to, the customer may seek the right to reduce the fee payable to the supplier.

In agreeing to this term, the supplier is likely to require a right to extend the delivery date if the customer fails to fulfill its obligations in accordance with the agreed timeline. This may occur, for instance, if the customer does not provide the supplier with its list of target requirements in a timely way, or if the customer does not perform acceptance testing in accordance with the agreed acceptance process. From the supplier's perspective, this extension in time will ensure that it is not penalised as a result of the customer's failure to fulfil its obligations.

Flexibility to terminate the contract if the process is not working

Suppliers and customers of agile projects may require greater flexibility to terminate the contract than is typically required in waterfall projects. Since the success of an agile project is so heavily dependant on each party fulfilling its obligations in a timely way, both the customer and supplier are likely to seek the right to terminate the contract if the other party persistently fails to fulfil its obligations. If the failure is on the customer-side, the supplier may seek the right to receive compensation for the loss of profit it would have otherwise received. If the failure is on the supplier-side, the customer may seek a refund or reduction in fees paid or payable under the contract.

Conclusion

Adopting an agile approach to deliver a technology solution can bring benefits to both the supplier and customer. From the supplier's perspective, delivery risk can be significantly reduced because, unlike most waterfall projects, the supplier will not be bound to deliver a fixed set of requirements, within a fixed budget, and by a fixed date. At the very least, requirements will be flexible. From the customer's perspective, there may be the opportunity to ensure that the final solution truly meets its requirements through greater involvement in the development process and early visibility of the solution.

Drafting a contract that reflects the agreed process and each party's responsibilities can be challenging. Unlike waterfall projects, the process and responsibilities in agile projects can vary significantly. As a consequence, there is no fixed formula for drafting the contract. The parties will need to collaborate as early as possible to establish a common understanding of how the agile process will work and what each party's responsibilities will be. Once this understanding is in place, the contract can be drafted to ensure that the contractual rights and obligations of each party reflect this understanding. All that is then required is for the supplier and customer to perform their obligations in accordance with the contract, and hopefully to enjoy the many benefits that can be achieved with an agile approach.
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