



# CONTRACT TERMS A WINDOW ON THE SOUL

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**U**nderstanding how an organisation behaves towards third parties is often difficult to gauge and some approaches may prove to be counter-productive. Trade fairs, press conferences and publications often present an opportunity to present a persona to the public that may not ring true post contract award. Once a contractual relationship has been established the true behaviour of a party will come to light, which if very different from the pre-contract position will be difficult to both rectify and reconcile with expectation. When negotiating a contract there are certain terms that provide an insight into an organisation's psyche. We identify a total of twelve clauses, nine arguably more influential than the other three, that can provide an insight into the contracting entity's behaviour:

**Liability** – Does an organisation take a reasonable and

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proportionate view to the value of the services, or products, being supplied? Or is the buyer looking for a gilt-edged insurance policy? What about delay, and the ability to recover costs? There are occasions when the impact of a failed service far exceeds the cost of the service provided; in such an instance the supplier would be reluctant, or refuses, to provide

suitable cover. While there is a delta in positions, and potential impasse, it is the willingness, or reluctance, of the buying entity to make a risk-based decision that will decide the next steps. Striving for unduly high contract cover will almost certainly drive in cost.

**Payment Terms** – Perhaps the most obvious indicator of an organisation's perspective. Whilst public sector organisations have a duty to pay in accordance with the government mandate, the same cannot be said for the private sector. Delaying payment has a divisive effect and has the potential for creating pricing premiums, as suppliers look to alleviate cashflow challenges, or in extremis exclude certain suppliers, such as small to medium size enterprises who are unable to sustain their businesses on unfavourable terms. Delayed payment will alienate suppliers, with the resultant loss of goodwill, the potential of driving in additional cost and potentially making businesses fail.

**Termination** – The right to terminate is included in nearly every contract, the specific termination rights sought by the buying organisation not only generates a view of the organisation but also the ability to better understand the market in which they operate. The right to terminate for a single breach is

unusual, the right to terminate for repeated breaches becomes more commonplace and the right to terminate for irrecoverable breaches more so. Perhaps the most emotive right to terminate is the right to terminate for convenience. Many question the nature of an organisation that would seek such a right, especially if the agreement was for a key service or product. Seeking termination for convenience does not create the image of an organisation that either has faith in the supplier or views the agreement with any longevity. Furthermore, termination for convenience drives in considerable cost.

**Service Levels** – Comparing the level of service sought by an organisation in light of the activity they undertake provides the insights of criticality of service, service expectation and market knowledge. Determining the appropriate service levels will determine the appropriate cost, the level of liability and the level of shared risk. Avoiding the situation of champagne tastes for a lemonade market is key and the buying organisation should seek identify necessary service levels rather than over-provisioned levels.

**Service Credits** – Again, bringing together the elements of cost, risk and liability determines the appropriate service credits. Seeking, or creating, a service credit regime that is out of kilter with cost, risk and liability identifies a party as wishing to operate outside of the boundaries of appropriateness. Buying entities seeking greater credits than justified will be seen as demanding; whereas suppliers looking to minimise their exposure will be seen as shirking their responsibilities. Where suppliers present the unusual offering of service debits or earn backs this should be viewed accordingly.

**Intellectual Property Rights (IPR)** – Not all agreements will have, or need, IPR; however, for some agreements the entire relationship hangs around IPR ownership. The IPR lens needs to focus at three specific points: the situation prior to agreement, the situation during the term of the agreement and the period post the end of the agreement. Adopting an appropriate position on these three instances and overlaying these with the wider terms of the contract, although specifically cost should determine a suitable approach for the benefit of both parties.

**Innovation** – Whether the buying entity seeks innovation at the pre-contract stage highlights an intent towards both the relationship and the services being provided. Generating and sharing the costs and benefits of innovation explicitly demonstrates a partnering approach to the contractual relationship. Embedding innovations forums into meeting structures, and reviewing outcomes, is a means of embedding innovation post-contract agreement. The productivity of such forums and the parties' commitments to such forums are bell-weather of the relationship.

**Governance** – Not all agreements have a section addressing the governance of the relationship. Of

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course, not all agreements warrant specific governance but key strategic agreements do, and when there is the absence of governance in essential agreements it is a key indicator as to the maturity of the buying organisation's supply chain management. Assessing the importance of suppliers and managing them accordingly is not only a fundamental responsibility of the Procurement function it is fundamental to the success to the entire organisation. Buying organisations that ensure governance commensurate with the value and importance of the agreement have not only provisioned for suitable management but have made a commitment to the supplier that they will play an active role in the agreement and a commitment to themselves to deliver the corporate strategy enabled by the agreement.

**Exit** – Understandably most of the focus in contract formation is based upon mobilisation and the run service, exit provisions can often be the last detail to be considered. However, for those buying organisations that have experienced difficult or distressed agreements the exit provisions are often the key takeaway lesson from that experience and shape future engagements with suppliers. Striking the right balance at the outset of the negotiations will help deliver a measured approach. With the effort and focus on mobilisation and run services in forming the agreement preventing the exit provisions from drifting incomplete through the term to the point of their invocation is key. By inserting the rights hooks into the agreement, a buying organisation can maintain the importance of exit provisions to a time limited period after contract signature. Remembering the leverage dynamic between both parties post award is key!

The nine clauses provide significant indications as to the type contractual relationship a buying organisation is seeking to achieve, either intentionally, or otherwise. An organisation relying on suppliers' terms makes an overt statement about their 'ownership' of the relationship and overall contracting strategy. The nine points discussed are not the sole indicators to a developed contracting strategy and the following three points also help to complete the commercial picture.

Whilst not as significant as the nine points above these three terms are insightful and can help typify an organisation.

**Change** – The inclusion of Change protocols in an agreement provides an indicator as to whether this agreement (and relationship) is viewed as static or dynamic. Articulating the specification is key to ensuring not only accurate pricing and sound management adding the ability to vary the agreement provides flexibility and the opportunity for the vendor to add further value to the buying organisation. Considering the requirement for change also accommodates the ability to drive innovation; creating a vehicle change helps move the dynamic away from the transactional.

**Term** – This might seem a straight forward attribute but often the structuring around term indicates an organisation's approach to flexibility. Adding the ability to extend the initial term provides not only flexibility but also encourages suppliers to act in a collaborative fashion, especially if there is the opportunity for further work without competition. Some organisations take an evergreen approach, providing an initial term with the contract running on until one party terminates. Evergreen contracts demand forward planning and buying organisations must act in a way to avoid suppliers thinking that the ongoing contract is a way of raising prices and becoming complacent.

**Spend** – Consideration of spend volumes and commercial approaches will shape the commercial levers available to the buying organisation. Balancing planned and potential spend will be instrumental in ensuring the right mix of interested suppliers and the correct outcomes. Buying organisations using levers such as rebates and committed spend volumes should do so only having fully understood the consequences, modelled the scenarios and documented the rationale behind doing so.

Contract terms and the corresponding approach that buying organisations take with their supply chain during contract formation creates a representative picture for how the long-term post contract award relationship will be. Behaviours set through contract negotiations and embodied in the contractual agreement will fundamentally set the tone for the ongoing relationship. Taking the appropriate approach, with appropriate terms commensurate with the agreement being sought will not only set both parties up for success but also create a blueprint for future aligned behaviours.