5 REASONS WHY COMPLEX CONTRACTS GO WRONG

- and what to do about it.

By Tiffany Kemp
5 Reasons Why Complex Contracts Go Wrong
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1 Introduction

Like it or not, contracts are a fact of everyday business life. If you have a mobile phone, have a Gmail account or shop online, they’ll be a factor in your personal life too.

Given that contracts between people and businesses have been around for hundreds of years, it’s surprising that we haven’t got the hang of them yet. But we haven’t. While the number of commercial contract cases hitting the courts may be huge, the number of disputes that never get that far is many, many times higher.

Why do we care?

We care because each contract dispute represents a missed opportunity. It costs time, energy and money – and may result in terminal damage to a commercial relationship that otherwise would have flourished.

The time cost is the one that businesses often fail to take into account when calculating the damage to their company caused by contract issues. Think of it this way – if you have a customer who’s unhappy with your product or service, what are you going to do about it?

If you’re anything like the companies I work with, you’ll start off by investigating to see whether or not they have a point. If they do, you’ll look for ways to fix the problem and make the customer happy again. If you decide the customer is mistaken, and your product or service is absolutely perfect, you then have the issue of how to convince them of their error (and you might end up throwing in some goodies to make them happy, even if you don’t think you’re in the
wrong!). Either way, you’ll be investing time and energy in sorting out the issue.

Depending on how all this pans out, you might have to spend more time, money or resources to put the customer relationship back on track again. Or, if it’s beyond repair (or fixing it is too expensive), you may find yourself waving goodbye to what could have been a lucrative customer relationship. No more orders, no glowing testimonials, no referrals…

So contract disputes matter, and it’s worth taking a bit of time to see how we can avoid them rather than spending a lot of time trying to fix them later.

And surprisingly, contract disputes are no respecters of size or experience. While the value of the damages might change, the essential components and most common causes of disputes are remarkably similar across companies around the world, from tiny one-man-bands to global PLCs.

In this e-book, you’re going to learn about the five most common and expensive reasons that complex contracts go wrong, and how to avoid the same issues in your own deals. These mistakes are made every day by huge multinational companies, by tiny ones providing niche products or services, and by Government entities. If you’ve been in business for more than five minutes, you’ve probably made all of them already, even if you’ve been lucky enough not to suffer the consequences yet.

This eBook was created based on the outputs from a workshop held at a conference in London, attended by over fifty contracts and
commercial professionals from many blue-chip organisations with global operations. The objective of the workshop was to investigate common contract issues, particularly with respect to the creation and management of complex contracts. Interestingly, all of the problems identified during the workshop were ones that affect all business – large and small.

The top five contract problems facing the group were agreed to be:

1. Unclear scope
2. Poor change management
3. Revenue leakage & margin erosion
4. Payment disputes
5. Poor understanding of risk

Upon further analysis, it became clear that these issues were all closely linked and that there was a causal relationship between them. So unclear scope, for example, led to payment disputes when the parties could not agree whether what was delivered met the contracted requirements, and therefore justified payment. Similarly, poor change management led to revenue leakage and margin erosion.

The group considered how these issues might be addressed, looking at low-cost “quick win” solutions, medium-cost, medium term options, and then considering more substantial mechanisms for remedying these problems.

It transpired that many of the short and medium term solutions fell into the category of what would be considered to be current best-practice. Information sharing, clear
communication and accessible contract drafting were among the solutions that could be implemented quickly and inexpensively, to yield significant improvements. Improving the commercial and contractual education of those whose performance is intricately tied to the successful outcome of contracts, but who do not officially participate in contract negotiations, was a medium-term solution.

Surprisingly, it also became clear that as a group, the delegates were not looking for technological solutions for their challenges, and might not be aware of the tools and resources available in the marketplace to support their endeavours.

I trust you will find this report interesting and useful. If you would like to discuss how Devant can help you address some of the challenges you face in your contracting environment, you can reach us at:

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2 Context

This workshop took place on the first day of the IACCM EMEA conference, 2012. It was attended by around fifty commercial contracting professionals from a number of global organisations including Accenture, IBM, Panasonic and Schlumberger.

The workshop was facilitated by Tiffany Kemp of Devant, commercial contract and negotiation specialists, with support from Geoff Maskell of Exari, contract automation specialists. The objective was to identify common causes and consequences of contract failure, and to work with the group to identify potential mechanisms to avoid such failures in the future.

When Complex Contracts Go Wrong

We began with a brief overview of three familiar cases that hit the legal headlines during the last few years. The three cases were:

• De Beers v Atos Origin
• BskyB v EDS
• British Gas v Accenture

As many readers will be familiar with these cases, I have moved the case summaries to the Appendix.

If it can happen to them...

The really interesting thing about all of these cases is that the suppliers concerned were all experienced, well-qualified and professional organisations that had successfully delivered complex contracts in the past. Each organization has excellent legal resources, who spent a
considerable length of time drafting and negotiating these contracts. And in each case, not only did the project itself go wrong, but both the client and the supplier were sufficiently confident that they were in the right to take their dispute all the way to the courtroom.

In the Accenture and EDS cases, the court rulings contained some surprising decisions regarding admissibility of certain costs and damages. The Accenture case has, in fact, put paid to the long-held legal position about the effectiveness of standard drafting on exclusions and limits of liability. Many of us on the supply side who have used similar drafting for many years were left shaking our heads, and wondering how best to protect our organisations in the future.

However, a quick show of hands in the room identified that less than 10% of those present had ever been involved in a contract litigation. Considering the number of contracts negotiated and managed by each participant each year, the fact that more than 90% had never encountered a dispute that made it all the way to court should give us some comfort.

A further show of hands (or lack of them!) indicated that all of us had experienced contracts that failed to deliver all of the benefits that were anticipated for them. Not surprisingly, on the spectrum from perfection to disaster, most of us were some way along the line between the two. It was this area between the poles that we sought to explore during the workshop session, as further described below.
3 Problem Definition

How do poor outcomes arise?

As the first stage in this analysis, the audience was divided into working groups and asked to think about situations where they had experienced poor contract outcomes. Within their groups, they were asked to put forward their ‘top 3’ contract-related problems, and to consider issues that arose during the contract negotiation, the delivery phase, and post-delivery.

We then took the top issues from each group around the room (which were from a mix of sell-side and buy-side professionals) to arrive at the following list:

- Internal disconnects
- Unclear scope
- Loss of relationship between seller and buyer
- Poor team building on both sides
- Lack of compliance with contract terms
- Poor change management
- Unrealistic expectations
- Over-commitment by the vendor
- Revenue leakage & margin erosion
- Payment disputes
- Poor understanding of risk
- Time management failings
Which are the most common contract-related issues?

A vote from those in the room identified the five issues that caused the most difficulties and had the most significant financial impact on member organisations:

1. Unclear scope
2. Poor change management
3. Revenue leakage & margin erosion
4. Payment disputes
5. Poor understanding of risk

Each working group was then allocated an issue to which it gave further consideration and analysis. Having considered the various causes of each of these problems, each group was tasked to identify a range of solutions that could contribute to either reducing the occurrence of the problem, or mitigating its effects. They were asked to consider small, easily implemented solutions, medium-term solutions that would incur some amount of cost or effort, and longer-term ‘dream’ solutions.

The following sections take each of these top-5 issues, and set out the thoughts of the various groups with respect to their causes and possible solutions.
4 Unclear Scope

Suggested Causes of “Unclear scope”

• Inability to define clearly what's wanted
• Complex stakeholders – hard to manage, and get agreement
• Commodity pricing mentality in a solutions world
• Poor handover from sales to delivery
• Sales don't understand what it will take to deliver
• Different measurement & reward systems for different people

Analysis of causes

The issue of unclear scope rippled through all elements of the workshop, impacting upon all of the other major problem areas. Interestingly, it became a ‘hot topic’ during the subsequent days of the conference, identified as having a negative impact on many areas of business performance and contract management.

So is it new?

The notion of “commodity pricing mentality in a solutions world” helps to throw some light on how scope has become such a big issue. From the discussions that developed in the course of the workshop, and throughout the conference, it appears that our commercial contracting models are still built upon the legacy environment where commodities were bought and sold. Certainty of scope was relatively easy to come by. As one delegate said, “I used to sell
rolled steel. I knew all of the parameters of the steel, and was able to define the scope with great accuracy and low uncertainty. Now I’m selling complex systems that are hard to define. As a result, defining a clear scope is a real challenge."

Of course, complex projects are hardly a new occurrence. But it seems that the mechanisms we have established for contracting for and managing them have not evolved at the same speed as the projects themselves. Consequently, it is common to commence delivery of a complex project when neither party has a clear idea of exactly what a ‘successful delivery’ looks like.

Given the expanded scale and complexity of today’s projects, it is little wonder that managing an ever-increasing number and variety of stakeholders is presenting its own challenges. When projects affect everyone, from technical, operational, sales and financial staff, establishing a common set of objectives across the board is almost impossible. Add to this the other issue highlighted by our delegates, that of different measurement and reward systems for different members of the delivery and management team, and the true magnitude of this challenge becomes starkly clear.

Delegates highlighted the difference on the sell-side between incentivisation for sales staff (generally linked to revenue invoiced), and project staff (usually linked to the P&L for the project – so cost matters in addition to revenue). These often conflicting incentives pitch sales and delivery teams against one another, discouraging early discussion of scope and
capability. While many of the well-established and commercially mature organisations belonging to IACCM have extensive processes that attempt to bring together the demands of the sales and delivery teams, it seems as though in many cases they are fighting a losing battle. The perception of conflict may in fact be greater than the frequency of conflict itself – but it remains a significant feature of the day-to-day operational landscape of many of the workshop delegates.

Conflicting objectives are not, of course, the sole preserve of sell-side organisations. Within the buy-side, the primary objective of procurement teams is achieving savings. Phrases like ‘best value’ and ‘lowest lifetime cost of ownership’ are used by more sophisticated buying teams, whereas ‘lowest price’ remains the preserve of a dispiritingly large number of buyers. Compare this to the objectives of the operational buyer. In order to secure investment in the new product, system or service, the operational buyer will have had to develop an extensive and comprehensive business case. This business case will often build a picture of the improvements to be delivered by the new solution. These might be improvements in functionality, speed, efficiency or reduced operational cost, or they might be taking the organisation towards other, less concrete, organisational goals. At this level, ‘the price’ is often the least significant factor in determining success.

So how does a mature organisation manage these conflicts? How do we work towards clarity of scope, to enable us to have a sharply focussed vision of ‘success’?
Proposed Solutions for “Unclear scope”

- Handover document from sales to delivery team
- Contract awareness slide deck for handover
- Map RFP to deliverables & contract, identify & resolve mismatches
- Communication – internal & external
- Involve right people
- Better contract drafting - make it reflect the business needs, & easier for business to understand

Considering how big an issue poor scope definition appears to be for the IACCM community, many of the solutions offered by the group are refreshingly simple – at least, on paper. Like much ‘common sense’, however, they are likely to prove more difficult to implement on a day to day basis.

The solutions focus their beginning, quite rightly, during the sales process. The delegates emphasised the importance of getting the right team involved early on, to ensure that there is a common understanding of what is to be delivered and how. Participation from sales, legal and the delivery team was identified as being key to proposing a solution that would not only meet the buyer’s expectations, but be deliverable by the selling organisation. On the buy-side, active participation in the process by all stakeholders was also described as very important, and in particular the involvement of the ‘business user’ was seen as essential to help
the procurement team focus on key value areas rather than price, payment and liability issues. While it was understood that these are important short-term objectives for procurement, those in the room felt that the ‘total lifetime cost of ownership’ issues, and quality and value assessments, could not be properly considered without input from the business users.

Interestingly, clear contract drafting, enabling the contract to function as a ‘business document’ rather than just a ‘legal document’ was highlighted in this group, in advance of the same issue being flagged in subsequent conference sessions. So it is not only essential to ensure that those involved in the sales and negotiation process have a common understanding, but also to make sure that this understanding is captured accurately, clearly and unambiguously in the contract documentation.

One process advocated by a delegate was a detailed cross-checking of the requirements listed in the buyer’s RFP document against the seller’s technical response, and then of both of these documents against the completed contract documentation. Identifying how the detailed deliverables match the original requirements from a contractual perspective will provide a valuable opportunity to resolve any misunderstandings or ‘fudging’ at an early stage, before disputes arise.

Communication was also a major focus for improvement. As well as some general encouragement to ‘communicate more, and communicate better’, both internally and externally, the group shared some best practice
from their own organisations as to how this might be done.

Delegates described their ‘Contract Handover Document’, which sets out the key issues of the contract that the delivery team should be aware of in order to deliver the contract effectively. Others went further, advocating a comprehensive ‘Contract Awareness’ slide presentation, with the commercial team actively walking the delivery team through the key contract issues of a complex deal. Relatively inexpensive and easy to implement, both of these mechanisms were agreed to add value and reduce issues around lack of clarity in the scope of the agreement.

Whether these would address lack of clarity in the specification of technical deliverables is debatable. In this regard, the cross-checking exercise above is likely to add more value.
5 Poor Change Management

Suggested causes

- Lack of planning for change
- Lack of communication – what is process
- Impact/risk of change
- Change seen as bad – parties avoid discussing change
- Vendor sees change as revenue
- Client says “it’s not a change, it’s a clarification!”
- Failure to anticipate change
- No agreed documentation of verbal changes
- Buyer didn’t realise they’d asked for changes until the invoice arrived

Analysis of causes

Like “unclear scope”, poor change management has impacts throughout the delivery process.

At its most essential level, we must ask the question “How can we measure change, if we don’t first have a clear scope?” This question is reflected in a number of the symptoms of poor change management identified above – the discussion of whether something is a change or a clarification is inevitable, if there is no clear scope before we begin. After all, how do you determine a change if you don’t know what your starting point was?

The conflicting perspectives of buyers and sellers
also came into sharp relief during this discussion, with sellers perceived as viewing change as a revenue opportunity, and buyers considering it to be a cost and a risk. As a result of these very different perspectives, it appears that ‘change management’ is not given the air-time it deserves during the contract structuring process, but is pushed to one side as though both parties hope it can be avoided altogether. So rather than being embraced as a natural consequence of the evolutionary nature of the complex project, change is seen as a ‘problem’ to be dealt with.

Another common theme of discussions on this topic was the conflict between pragmatism – the desire to ‘get the job done’ – and process – the need to document it clearly. The ‘finish the project first, and sort the paperwork out later’ approach was recommended by a number of delegates, who had obviously experienced strong and co-operative buyer-seller relationships. Others identified this approach as being the trigger for significant problems when the project reached the ‘reckoning up’ stage, and each party had a different expectation of the cost of changes that had been rushed through in the heat of the project.

A number of other sessions throughout the conference touched upon this topic. The panel discussion between Stephen Beeching of Cobham, Margaret Smith of Accenture, Richard Given of HSBC and Heather Rogers of Centrica underlined the importance of effective change management on successful project outcomes. We’ll look at some of the solutions this panel suggested when we examine the solutions
suggested by our workshop delegates, below.

Solutions for “Poor change management”

- Talk to each other
- Define change management process in contract
- Multi-disciplinary vendor-client meeting
- Focus on the small contracts – big ones look after themselves
- Document everything
- Long term planning for potential change/apply learning/Embrace change as inevitable

Having a clearly defined change-management process set out in the contract, and following it rigorously, was a fairly obvious means of improving the change management situation suggested by many in the room. The fact that this was identified as a potential solution to this very common problem indicates that, despite its obviousness, many organisations still lack a comprehensive and effective change management process.

It would be interesting to examine in more detail exactly why so many organisations still struggle to manage change. It seems unlikely that a significant number of the IACCM delegates lacked any form of change management provision in their contracts. So perhaps we should be looking at their effectiveness, and the quality of their implementation within projects.

Subsequent panel discussions and keynotes in the main conference addressed the issue of
change control from various different angles, reflecting the different approaches of delegates at our workshop. Those on the buy-side favoured the very loose, “get it right first, and sort out the money later” approach. Not surprisingly, those on the sell side were less enthusiastic about this way forward as many had been bitten before, by changes of personnel, changes of heart, or simply about-turns on the part of buyers when it was time to settle the bill.

Many delegates proposed that all changes should be micro-managed, so that nothing happened without the relevant signoffs to approve any price, risk or timescale changes. One interesting suggestion was that all changes should be documented, and agreed by both buyer and seller, but that only the major ones should go through the full ‘change management’ process. The idea behind this was that it is better for the supplier to be able to show their client how many changes had been ‘given away’ than it was for the supplier to either simply swallow these changes without being given any credit for doing so, or to ‘nickle and dime’ the client, ensuring that each tiny change is paid for.

An alternative approach was to accept the inevitability of change, discuss up-front where changes were likely and what the scope was for things to vary throughout the course of the project, and then to plan for the inevitable. This suggestion requires both buyer and seller to embrace change as a positive consequence of innovation, rather than to see it as a problem.

From a practical perspective, it was proposed that this ‘change embracing' approach could incorporate a ‘change budget’, to prevent the
buyer from having to seek additional budget approval mid-project. The idea was that the parties could agree a price for the baseline project, plus a sum for changes, at the contracting stage. The ‘change budget’ could then be drawn down against individual changes as they were agreed and approved by the parties, with any surplus remaining at the end of the project to be retained by the buyer.

‘Talk to each other’ was one of the suggestions made by multiple delegates as a way of reducing problems with change management. Encouraging regular, open dialogue on the subject of change was felt to be a useful tool in identifying useful and good-value changes, and in agreeing the appropriate party to bear the cost of the change. Ensuring that such dialogue included members of each discipline, on both the supplier and buyer side, was considered to be essential to make sure that the changes were properly understood, priced and documented.

The suggestion of ‘focus on the small contracts, as the big ones look after themselves’ was an interesting variation on the theme of ‘looking after the pennies’. It is certainly true, however, that on a small contract even a modest change can, if not properly managed and funded, turn a profitable project into a loss-making one. On bigger contracts, the opportunities for changes to balance each other out are more evident.
6 Revenue leakage & margin erosion

Suggested causes

• Complex price models – have we skills to manage these?
• Pre vs Post contract perception of revenue - “conspiracy of optimism”
• Unclear pricing model – constant negotiation
• Unbalanced model
• Not using the contract
• Lack of flexibility – changing market conditions
• Cultural differences
• Liquidated Damages as source of revenue!

Analysis of causes

First, it was necessary to define the terms we are using to describe this problem. “Revenue leakage” was agreed to refer to the situation where the vendor failed to manage the contract so as to invoice all sums and price increases to which they were entitled. So this might relate to an annual RPI (Retail Price Index) escalator on professional services fees, or support and maintenance fees, which fails to be implemented because the contract is not being actively monitored and managed. Revenue leakage would arise, therefore, from ‘not using the contract’, as identified above.

“Margin erosion” related to the many instances where a contract failed to deliver the forecast
margin between cost and revenue – and is closely linked to both unclear scope and poor change control, as described above.

Among the noted causes of these two issues, the complexity of pricing models was deemed to be a significant factor. It seems that as projects and their contracts become more complex, so the mechanisms we use to determine the billable amounts do too. In the consumer sector there has been significant push-back in recent years, against complex billing models that purport to offer advantage to the consumer but actually serve to render the whole process incomprehensible, and make it difficult for the consumer to assess whether they are receiving the best price. From the discussions during our workshop, it seems that the business-to-business sector is on the verge of a similar rebellion, as such complexity leads to disputes, misunderstandings and a constant environment of negotiation.

One of the most intriguing concepts to be described during this session was the ‘conspiracy of optimism’. This was described as the situation, particularly common in large public procurement and MoD projects, where:

1. the customer knows that the budgeted sum is not sufficient to cover all of the functionality it requires; and
2. the supplier knows that it cannot deliver the requested functionality for the stated price; but
3. the supplier ‘pretends’ that it will be able to meet the customer’s requirements within the price (by taking the most

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narrow interpretation of the requirements that is possible); and

4. the customer believes that it will be able to secure additional budget to ‘expand’ the narrow interpretation back to the level of the originally intended scope, once the project is underway; and

5. both customer and supplier “collude” to make the journey back to the required scope, and a more realistic budget, through the process of change control.

One possible interpretation of this ‘conspiracy of optimism’ is that many of the public procurement projects that are widely considered to have failed, and to have been significantly over budget and over time, were simply victims of this conspiracy. In other words, they were never going to be completed on budget as the budget was, itself, a fiction – and the change control process was simply the balancing mechanism for bringing that fiction back in line with the reality of the client’s requirements, and the actual cost of delivering them.

The discussion around ‘cultural differences’ explored what happens when two organisations with very different attitudes to change management are joined through a complex project. It appears that margin erosion for suppliers occurs as a result of many of the issues explored under ‘unclear scope’ and ‘change management’, above. In particular, if the client expects areas of unclear scope to be resolved within a fixed price, but the supplier expects them to be paid for under change control, getting paid for changes will always be a
Solutions for “Revenue leakage & margin erosion”

- Create register of small changes. Look for trend in revenue leakage
- Opportunity vs Risk – get the balance right
- Get everyone aligned: objectives, reward, risk …..
- Right skills – identify, train
- Read the contract!

Tackling change control was identified as a key solution to the problems of revenue leakage and margin erosion. One suggestion was that the seller should maintain a register of the small changes that were not billed to the buyer, but absorbed by the seller. Frequently, these small changes are quickly forgotten by the buyer as being ‘minor concessions’ or ‘quick amends’. Although they may each be small and low in cost, over time, these small changes will add up. The idea was that this register could be used to demonstrate a store of goodwill that the seller had accrued with respect to the buyer, and prevent the succession of minor changes being forgotten and taken for granted.

Having created this register, it could then be used to monitor specific areas of creeping changes and minor issues that were contributing to revenue leakage. For example, if many were in the area of ‘tweaks’ to an agreed report format, this could indicate that the parties should invest more time in defining detailed report
layouts up-front, or that the seller should include a greater contingency when quoting for new reports.

Ensuring that all stakeholders’ objectives are aligned was a ‘fix’ that cropped up in a number of discussions. The common tension between the aims of the different parties involved appears to drive many of the issues that result in revenue leakage and margin erosion. Specifically, the following conflicts were identified:

- sales person’s aims to get the contract signed as quickly as possible, and earn commission
- sell-side project manager’s objective to deliver a successful project that the client is happy with
- sell-side business unit manager’s goal to ensure the project makes a profit
- buy-side project manager’s objective to get an outcome that meets all of their requirements
- buyer’s objective to pay as little as possible
- buy-side business unit manager’s goal to have an investment that delivers a good ROI against the original business-case

While bringing all of these parties together behind a common set of goals was identified as being a potential solution for this issue (and doubtless, many others too), there were no concrete and practical suggestions as to how one would go about doing this. If we were to come up with some tools to facilitate this
process, business outcomes could be greatly improved!

Identifying the skills required to structure and manage the contract so as to reduce revenue leakage and margin erosion, and delivering training to develop them where necessary, was a rather more achievable ‘fix’ proposed by the delegates, as was actually reading the contract.

These two solutions are very closely allied - if those in day to day control of contract and project management are to read and understand the contract, they will often require training to help them do so. The other factor that would assist with this solution is clear contract drafting – proposed in response to the issues of ‘Unclear Scope’ in section 0. Taken together, more readable, usable contracts and good training of non-legal staff in how to read, use and understand their contracts, could deliver significant improvements in margin retention.
7 Payment disputes

Suggested causes of “Payment disputes”

• Failure to deliver
• Unclear billing milestones
• Budget issues
• Vendor uses payment as a negotiation strategy

Analysis of causes

Many of the payment issues that were raised were also related to the ‘unclear scope’ and ‘change management’ issues above.

What did emerge is that this is one area where lack of clarity in drafting can have measurable impact on payment. More than in other areas, the parties involved in drafting invoicing milestones tend not to be the same as the ones required to enforce them, and things that appeared very clear to the signing parties were less so when invoicing time arrived.

Budget issues were a practical symptom of the changing commercial landscape – they arose when a party had committed to a multi-year project by signing the contract but, because of the way that budgets were managed within the client organisation, the relevant department was then unable to secure sufficient budget to meet its contractual obligations for subsequent years. This is a typical example of a situation where the supplier is ‘right’, but such ‘rightness’ is of little practical use without recourse to litigation.

The issue around vendors using payment as a negotiation strategy referred to the situation
where a vendor might agree to extended payment terms in exchange for a client signing off a particular change request, for example.

**Solutions for “Payment disputes”**

- 100% payment in advance!
- Incentives for resolving problems. Sales rewarded for successful projects
- Invoice correctly
- Have payment schedule that aligns with milestones, pay for what’s been delivered.

The suggestion that sales should be rewarded for successful project outcomes ties in with the ‘align objectives' proposal under section 0, above. It would certainly encourage the clear drafting of invoicing terms.

One of the Devant team described a recent experience of a sales person who’d constructed a complex mechanism for invoicing for forecasted hours worked, with a reconciliation to take into account differences between previous forecasts and actuals. It was not until he was faced with the question “What will you actually put on the invoice?” that he was forced to acknowledge that his mechanism didn’t actually allow a clear and unambiguous billing amount to be determined.

Ensuring that the payment schedule aligns with delivery milestones is a very good preventive measure for payment disputes. Delivery milestones should be clear and objectively measurable so that all parties know when they have been met, and the corresponding
payments are due.

Invoicing correctly might sound like an obvious fix for payment disputes, but it appears that the question “What information do you need from us in order to be able to pay our invoices in a timely fashion?” is rarely asked during the contracting process. Understanding the nuts and bolts of the buyer’s payment process can be invaluable in helping the seller provide everything required for prompt payment. Putting some energy into obtaining and properly documenting this understanding would seem to be well worthwhile.
8 Poor understanding of risk

Suggested causes

- Someone needs to own risk
- Not understanding impact of risk
- No thought put into how to mitigate risk
- Not defining/determining risk
- Poor risk assessment

Analysis of causes

The discussion around understanding risk covered the full gamut from the deeply philosophical (“Uncertainty and risk are not synonyms”) to the very practical (“It is necessary for an individual to ‘own’ each risk, if it is going to be managed properly”).

The starting point, however, was to try to reach a common definition of what ‘risk’ actually is.

We examined the traditional “Probability x cost” model. So, for example, if I identify an event (“Risk 1”) which is very unlikely to occur (with only a 0.1% chance of occurring in this particular project), but would have very high impact if it did occur (say, it would cost the organisation £100,000,000 to put right), I might give Risk 1 a weighting of 100,000. I could use this weighting to compare the magnitude of this risk with another in which the event (“Risk 2”) has a 50-50 chance of occurring but a much lower cost (say, £100,000) – giving a weighting of 50,000.

The group discussing this issue felt that this sort of risk calculation was of only limited use, and it’s easy to see why. While Risk 1 has a much higher
weighting than Risk 2, the very high probability of Risk 2 occurring on a project would probably mean that significant efforts would be employed in mitigating it. So despite the lower weighting, Risk 2 might actually be of far more concern to the organisation than Risk 1.

The challenge of accurately assessing the probability of an event occurring was also discussed. Humans are notoriously poor at determining probabilities – hence the wealth of bookmakers and casinos!

On a more practical level, identifying areas where risks may arise, understanding their potential impact, and planning how to mitigate them was a key issue. Essentially, it appears that the delegates did not feel that risk management was given sufficient priority in their organisations. The tools and processes in use do not provide enough visibility of those risks throughout the business, and therefore allocating risk to the area of the business best placed to mitigate it becomes difficult.

**Solutions for “Poor understanding of risk”**

- Risk workshop to evaluate
- Continuous updates
- Training in risk management

Once an agreed mechanism has been determined for the assessment of risk, conducting regular risk workshops to review existing and new risks was considered to be essential. A central repository for the risk register that enables all stakeholders to update it, plus training to help them do so effectively, was another suggestion.
9 Conclusions

The problems identified during this workshop were played out over and over again during the course of the subsequent two days of the IACCM conference. They regularly crop up on ‘Ask the Expert’ calls, in seminars and on discussion groups. What, then, can we conclude?

**Common problems may not have common solutions.**

Despite the frequency of occurrence of each of the issues raised, there was a clear disparity in the preferred approach for tackling them. Examples? Consider the “describe everything in great detail” vs. the “have a loose spec and work it out as you go along” responses to the challenge of unclear scope. Similarly, the “Document all changes immediately and in detail” vs. “Sort out the problem first, and decide who’ll pay for it later” responses to the challenge of poor change management.

This indicates that the most appropriate solution to each of these issues will be determined at least in part by the risk tolerance and priorities of the parties involved. When those differ as between buyer and seller, prospects for finding a harmonious way through these challenges diminish significantly. In such circumstances it may be expert mediation skills that will be of most benefit in helping parties find a mechanism that works for both of them.

**There is still a significant gap between what we believe should be done, and what we do.**

The delegates at the workshop are experienced commercial and contract managers. Between
them, they identified a number of potential solutions that would be relatively cheap to implement and would deliver significant improvement to contract outcomes.

It seems unlikely that all of these ideas were entirely novel, and had not been encountered (or even expressed) by the delegates before. And yet, the simple fact that they were proposed as solutions suggests that they are not universally embraced. The difference between what we understand to be ‘best practice’ and what we execute in our day-to-day business lives provides ample opportunity for growth and benefit, without the need for dramatic and revolutionary change.

Extending the reach of commercial education offers significant benefits.

“The world would be a better place if only XXXX understood better what we were trying to achieve, and what consequences could flow from their actions or inaction.” This view was expressed in various forms during the workshop, in response to a variety of problems.

This suggests that the commercial community does not suffer from the self-serving “knowledge is power” attitude that has stunted growth and development in some sectors. It indicates that we have a clear understanding that only by sharing some of our wisdom, knowledge and experience with those in the sales and delivery space (sell-side) and the procurement and implementation teams (buy-side) will we be able to deliver value to the best of our potential.

We do not naturally consider technology as a means to address these issues.
Interestingly, although there are many ways in which technology could be used to support our community in addressing the issues considered during this workshop, very few were identified during the session.

It may be that this is because we have a tendency to be inward-looking when it comes to finding our solutions, although the strong support for cross-functional training does not bear this out. Another reason could be that technology in the field of contract creation, negotiation and management still has adoption levels too low for a significant body of case studies to have been developed, and a critical mass of support to exist.

Whatever the reasons for the absence of technology from our ‘solutions menu’, it seems like a missed opportunity, and surely merits further investigation.
10 How can we help?

The Devant is a niche commercial contract consultancy. Its team are specialists in helping organisations overcome barriers to effective commercial operations.

Devant offers a number of consultancy, support and education services to:

• Determine how well your commercial process meets the needs of your business

• Identify (and help you implement) ways to improve its effectiveness

• Develop commercial contract and negotiation competence across different functional areas of your business, to enable your organisation to close sales quickly, manage risk, and deliver better contract outcomes

• In partnership with our technology partners, Exari, support you in implementing contract automation and management solutions to make you more effective and productive, improving quality and consistency of contracting and improving visibility of risk across your contractual estate
ANNEX A

Case Summaries

ANNEX A.1 De Beers v Atos Origin

In this case, de Beers sought an integrated diamond-aggregation solution to be used across its multiple sites in Africa. As a long-established organisation, each of de Beers’ locations had developed its own ways of doing things. They shared little in terms of process, tools or technical infrastructure, but expected Atos Origin to provide a unifying solution.

Because there was a significant lack of clarity in the specification for the works, it was decided that a flexible development methodology should be used. This was based around the facilitation of a number of user workshops, during which the specification would be jointly developed by the parties.

While agile development methods have been used with great success in certain projects, in this scenario they were unable to deliver a reasonable outcome in combination with a tight timescale for completion and a fixed price.

From the beginning, the project ran into difficulties. It quickly became apparent that the various departments to be served by the new solution did not have a clear idea of what they wanted from it. The Atos Origin team found it difficult to understand the complexities of the diamond aggregation business, and the requirements capture workshops were poorly structured and did not deliver anything like the level of firm information that the team needed. At the end of this process, concerns were expressed within de Beers that the Atos Origin
team didn’t really understand what they’d let themselves in for. The two sides disagree over whether de Beers shared this view with Atos Origin at that stage, but it seems that de Beers took the view that if Atos Origin was offering a fixed price, the risk of the project was on their shoulders – so it wasn’t de Beers' problem.

Things went from bad to worse, with slippages, scope-creep and delays on both sides. In March 2008, Atos Origin informed de Beers that it would not be able to complete delivery by the target date of 30th June 2008. Further, Atos Origin said that it could not continue with the project on the current fixed-price basis, as its costs had escalated to such a huge extent, and that a contract renegotiation was necessary before it would recommence development. De Beers withheld payment of Atos Origin’s outstanding invoice, citing poor quality of deliverables, and the two parties reached stalemate. Atos Origin alleged that failure to pay the invoice on the part of de Beers amounted to repudiation of the contract, which it accepted. In its turn, de Beers alleged that Atos’ suspension of the project pending renegotiation was a repudiatory breach – which it accepted.

The case was settled in 2011, with the sum of around £1.4million paid to de Beers by Atos Origin. To reflect the contribution of both parties to the issues giving rise to the dispute, the Judge had assessed de Beers’ actual damages at £4.4 million, but had also determined that around £3m of damages had been incurred by Atos. The award therefore reflected the balance of the two sums.

ANNEX A.2BSkyB v EDS
The judgement in BSkyB v EDS was also released early in 2010. The case revolved around the development of a new CRM system by EDS for BSkyB back in 2000, for which the original baseline price estimate had been £47,637,000.

At the time of awarding the contract, BSkyB had sought comfort from EDS in respect of the scheduled delivery dates for the project, which were very tight. It was assured by EDS that the dates were achievable, and subsequently awarded the contract to EDS in preference to Accenture, the other close contender.

The project went badly wrong, missing its deadlines and failing to achieve the objectives set for it by BSkyB.

As a result, BSkyB sought in excess of £700m in damages. As part of its response to this claim, EDS noted that its limit of liability, as set out in the contract, was £30m. However, BSkyB alleged that reckless or intentional misrepresentation by EDS (with regard to EDS' ability to deliver within the deadlines) induced BSkyB to enter into the contract - and liability for this type of misrepresentation cannot be excluded or limited by contract.

Much of the press coverage focussed on the issue of the misrepresentation, even though it was very specific to that case. However, the judgement also addressed many more widely applicable issues, relating to recoverability of losses for breach, the effectiveness of entire agreement provisions and exclusion clauses, and the effectiveness of parallel claims in negligence running alongside breach of contract claims.

In the final analysis, although EDS won a number
of points, BSkyB established one instance of misrepresentation by an employee of EDS, who has since been dismissed. The counsel for BSkyB effectively demolished the credibility of this employee, a salesman called Joe Galloway:

“Mr Galloway claimed that he had obtained an MBA from a college in the British Virgin Islands in 1996 but it emerged during the trial that it had been obtained from the Internet, the judge said.

Mark Howard, QC, BSkyB’s barrister, illustrated the point by presenting the court with an MBA from the same college awarded to his dog, Lulu. “Without any difficulty the dog was able to obtain a degree certificate and transcripts which were in identical form to those later produced by Joe Galloway,” the judge noted, “but with marks which, in fact, were better than those given to him.” (The Times, 27th January 2010)

As a result, EDS face a damages pay out that will not be subject to the limitation of liability of £30 million in the original contract with BSkyB.

The final award of £318m damages against EDS (by then owned by HP) was made in June 2010.

ANNEX A.3 British Gas v Accenture

This project, to deliver a billing system for all of British Gas’s 18 million gas and electricity customers, started in 2002. Things started going wrong when the two parties disputed the functionality and performance of the first two releases of the software. In 2004, they settled their initial dispute, with Centrica paying an extra
£10m, and Accenture supplying an extra 18,000 man-days of effort.

In 2006, Centrica took the billing system in-house, but experienced significant problems. In 2007, they notified Accenture of these problems in writing, but Accenture deemed that, under the contract, it was not liable for the cost of fixing these problems. It asserted that Centrica had both signed off the design and tested the system extensively before accepting and using it.

Centrica issued a writ for £183,000,000 against Accenture in April 2008.

It’s claims included:

• £18.7 million for distribution charges (on the basis it was charged for gas on an estimated consumption rather than actual consumption because the distributors were not provided with meter data for about 15% of its customers).

• £8 million in compensation it paid to its customers to reflect the billing difficulties and poor customer service.

• £2 million in additional borrowing charges due to the late billing or non-billing of customers.

• Other sums incurred in chasing debts, additional stationery and correspondence costs.

The court was asked to determine a number of preliminary issues, including interpreting what breaches could amount to a “Fundamental Defect” (as defined in the contract), what was the correct basis for calculating damages for a
Fundamental Defect and whether any of the classes of loss claimed were excluded. Despite a valiant attempt by Accenture to argue that the claims above were excluded by its exclusion clauses, both the court of first instance and the court of appeal found in favour of Centrica/British Gas.