

## Contracts and negotiations: search terms

### Analysing contracts can help the hard-pressed CFO cut costs

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One way for CFOs to navigate the current financial storm is to dust down those contracts both parties hoped would be left on the top shelf. A review for loopholes and strategies may help in a renegotiation of the terms/price or enable the parties to sever the relationship without resorting to litigation. In any negotiation, knowledge is power and it pays to understand where your strengths and weaknesses lie.

The potential for savings is limitless. A careful and systematic review across different contracts and sectors can bring cost saving benefits or alter the negotiating position in the CFO's favour.

Consider those contracts where your business is the customer or purchaser of services and goods.

These can range from contracts for the purchase of raw materials, property management, cleaning, facilities management, security and IT contracts to catering arrangement all are worthy of scrutiny.

Cost cutting efficiencies with suppliers can take a number of routes: (i) a negotiated reduction in the price/scope of the services, (ii) termination of the relationship, or (iii) a negotiated termination and settlement. All parties will be mindful that any ongoing relationship should not be irreparably damaged and that they are potential customers and suppliers for the future.

### What should you look for?

Is the relationship documented? A contract need not necessarily be in writing or in a bound agreement signed by both parties. A course of dealing between businesses over a period of time or an exchange of emails between commercial managers can form the basis of its terms. The law also implies certain terms into the relationship so that, for example, even if there are no service levels or KPIs the contractor is required to use reasonable care and skill. Even where there are written payment terms the actions of the parties can alter those. If parties have always accepted payment after 60 days rather than the documented 30 days they may well have actually varied the terms to 60 days.

### Know your rights

To ascertain the balance of power, finance chiefs should check for minimum periods and rights to terminate the relationship. A supplier is more likely to be receptive to change or a renegotiation of the price if there is a real risk that you, as customer, exercise termination rights thus bringing to an end what is, from the their perspective, a profitable contract.

Even when exercising rights to terminate, adhere to the notice provisions. Notices clauses, if strictly drafted, can require notices to be given in a certain way and by a specific date, so check carefully.

Equally, rights to terminate for material breach should be exercised with care. The potential for a customer claiming for damages for wrongful termination are great, therefore, exercise caution.

### **Exclusivity or dual sourcing?**

Consider if the supplier was granted exclusivity or has benefited from de facto exclusivity? In order to obtain bulk discounts or competitive prices some businesses grant exclusivity as a quid pro quo.

Where practicable, the threat of dual sourcing may well incentivise an underperforming supplier to sit up and offer either a lower price or enhanced service levels.

### **Minimum volumes/commitments**

Check any minimum volume commitments or spend commitments on your part as customer before exercising any rights to terminate or renegotiate.

Failure to meet these may mean that the supplier is entitled to a cash equivalent or to claim damages in certain circumstances. Not a welcome result if you were actually looking to cut costs.

### **Pricing structure/adjustment**

Scrutinise the wording of the pricing structure. Is the price fixed or is the supplier entitled to apply increases automatically?

Must any increases be notified and within a specific time period? Failure by the supplier to comply with such provisions may mean it has waived its right to increase prices for that particular year.

Is price linked to an external factor, for example RPI, all items indexed, the employment index or the CPI index? If the RPI decreases then check the drafting are you also entitled to a corresponding decrease in the price? Contracts can provide that any revisions or changes to prices must be agreed by both parties.

### **Benchmarking**

These provisions can allow customers to compel suppliers to be compared against other equivalent suppliers both in terms of value for money or quality. Check carefully to see what the impact of benchmarking is and if it can be turned to commercial advantage.

### **Continuous improvement clauses**

Often regarded as innocuous at the beginning of a relationship, these can be used to great advantage. They are a useful tool to require suppliers to provide cost free improvements and even cost savings or improved service levels. Make use of these and any other clauses which require the supplier to negotiate or act in good faith.

## **TUPE employment issues**

One of the consequences of appointing suppliers is that, pursuant to the Transfer of Undertakings Protection of Employment Regulations 2006 (TUPE) upon termination of the contract, the employment contracts of employees of the supplier who have been dedicated to the activity can as a matter of law transfer in certain circumstances to the new incoming supplier or even to you the customer if the activity is brought back in-house.

Check if the contract contains provisions dealing with employees and allocation of these costs and liabilities or other appropriate protections.

Even if the contract is silent, consider taking advice if there is a real risk of TUPE applying as there are obligations to consult and the liabilities attaching to those employees will also transfer. TUPE can have a real cost impact particularly on second generation outsourcing if a new supplier is inheriting employees and their liabilities. Similarly, it can negate the cost benefit of bringing an activity in house.

## **Governing Law**

It may sound mundane but check the governing law of the contract and take appropriate advice. If the activities are being undertaken abroad, local law considerations may well apply and have a bearing.

Finally be aware just as you are reviewing your contracts with suppliers your own customers may well be reviewing their contracts with you.

## **The devil's in the detail**

Check the fine print but remember that the commercial dealings of the parties may have altered the terms of the contract.

Check the governing law and take local law advice.

No written contract? Be aware that terms are implied by law. Just simply walking away may not be an option and reasonable notice may be required depending on the circumstances.

Notices often have to be given in a very specific way so check these terms carefully and comply.

Waiver. By disregarding the terms of a contract or by their actions the parties may waive their rights – so take advice and act quickly.

Look for continuous improvement and benchmarking clauses to give an upper hand.

Don't just consider terminating the contract, use its terms to enhance your negotiating position either in respect of price, service levels or agreeing a settlement.

Exclusivity. Consider whether you have granted the contract or exclusivity or if you could dual-source.

Be aware of the TUPE Regulations, which can alter the negotiating position considerably. Check if there are any indemnities in favour and provisions which will protect you as customer during any notice period.