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Contract review: How effective are your contracts? - Legal challenges and opportunities for smarter government and operational efficiency

01/02/10

The obvious quick fix

For many public sector bodies areas of annual expenditure are largely pre-set either through the need to continue to fund key public services or due to long term contractual commitments. That typically leaves only a small “discretionary” element that is often the first in which cuts are focused. However, the need to make quick savings can be achieved by more than these discretionary cuts, without affecting frontline services.

Is there another option with quick results?

The public sector will have entered into many contracts that may not be being enforced or regularly reviewed and thus not driving the value for money service that may have been promised in business cases or expected when contracts were first signed. The regularity with which significant elements of committed expenditure in long term contracts are reviewed will need to be addressed if the Government’s budgets are to be achieved.

The key factors

The contract itself is at the heart of the value for money to be achieved from any contractual commitment. However, the operational management of that contract and the relationship of the parties involved will also have an impact on the financial out-turn, particularly in the context of long term contracts over several years (or decades).

The Contract

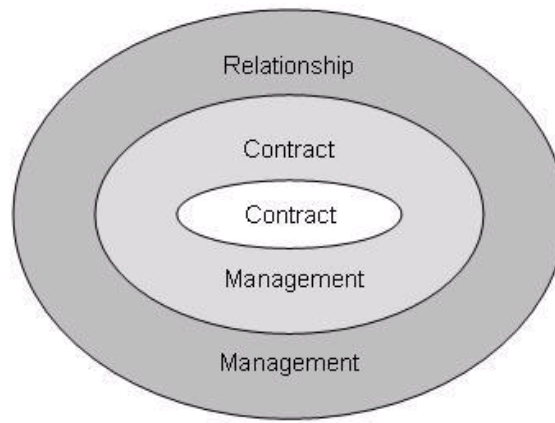
There are a wide range of specific cost saving and efficiency opportunities within any contractual arrangement. The following are just a few examples of the type of questions to consider:

- Do the mechanisms in the terms and conditions allow for refinancing or efficiency savings? For example the contract may require the private sector to look at refinancing a scheme to achieve a gain if (a) the scheme has been operating successfully for some time and therefore the risk for a funder is perceived to be lower, and/or (b) long term interest rates are more favourable now than when the contract was initially entered into.
- Are there any provisions for benchmarking or market testing of services, costs or income? These provisions may allow the public sector to amend their service requirements and thereby drive revenue savings.
- Is the specification clear, consistent and complete? Is it right for current circumstances? Is there an opportunity to vary the service requirements? Variation procedures may be complex and involve effective engagement and negotiation with the private sector. Overall savings may be achieved even if there is a cost to bring the variation into effect.
- Can cost savings be driven under the in place arrangements? For example, are any pass through costs from the private sector such as energy or insurance charges being adequately examined and challenged?
- Can current contracts be renegotiated and/or terminated? Where the original requirements of long terms contracts have changed radically, it can be more cost effective to terminate the contract than to continue with the current arrangement. Early termination fees are commonplace in most recently concluded long term contracts but it is worth examining older contracts to check whether the same charges apply. Early no fault termination will always carry a cost because the innocent party will be entitled to the cost return that they would have achieved had the contract not been terminated. However, in contracts where it is believed that the private sector may not be getting a viable return an early, negotiated, termination may be worth exploring, particularly if both parties agree that the contractual relationship is not working to their advantage.



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The management of the contract

Many contracts are tainted or delivered sub-optimally not because of the terms and conditions or specifications but because of human factors:

- Lack of trust between the parties. The traditional interface between public and private sector is one of suspicion of each side's motivations. Just like any other relationship, contractual relationships need to be worked at. Trust may develop over time but failing relationships can be difficult to save.
- Lack of continuity of staff between those procuring and those monitoring or delivering the contracts. Those monitoring or delivering the contract may not understand its detail because they were not involved in the detailed procurement process. Substantial contract terms, schedules and specifications can be rather daunting and therefore the temptation may be to refer to them only if there is a problem. There may also be a loss of corporate understanding as to why contracts were structured a particular way. These factors may mean that what the parties delivering the contracts believe the contract requires can differ (sometime substantially) from what is actually required by the contract, leading to either over-delivery or underperformance.
- Mismatched expectations. If users of the contract services were expecting something different from what they actually receive then this can lead to the perception of a failed procurement even if the service provider is delivering exactly what the contract requires. This perception can affect the relationship between the parties to the contract and ultimately the success of the procurement.
- Lack of visibility. It may be easier to blame lack of delivery under a contract upon those who procured the contract or were involved in the early stages of implementation, rather than to investigate the root cause of failures and address them.
- Lack of organisation and/or resources. Complex contracts, particularly those with detailed payment mechanisms, require a level of organisation and commitment of resources in order to ensure they are managed effectively and in accordance with the contract terms. Particularly in the early stages of contract implementation, it can often

come as a surprise that the level of resourcing on the client's side is far higher than expected. This should level off over time but "front loading" of organisation and resourcing in the first few months will reap rewards in the later phases of the contract.

- Misunderstanding or ignorance of the contract terms and conditions or specification. Often the operation of contracts turns on the understanding of the most junior members of teams, e.g. does the person logging a call within the helpdesk or reviewing a performance monitoring report know what and how the contract requires reporting to be undertaken. They may not have read the contract in full but early training and support for all levels within the client team should result in optimum delivery.

Take action

Reviewing existing contract commitments does not require any new or cutting edge thinking, or long term procurements. However, even small changes to contract management can deliver savings quickly, easily and with minimal cost.

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Bethan Evans

Partner

e: bethan.evans@bevanbrittan.com



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