



REMEDIATION



KIAH
CONSULTING

Snap shot

Context

Government client seeking resolution to contract stalemate.

Objective

To break a three-year dispute over service delivery and costs that had put a \$1 billion-plus contract on the brink of failure.

Kiah approach

Together with Norton Rose provided legal advice, negotiating strategy and support for mediation.

FAILING CONTRACT TO A SUSTAINABLE FUTURE

Once upon a time a government client outsourced their nationwide requirement for maintenance, warehousing and distribution services.

Following a competitive tender, and re-tender process, a six-year contract (with options for extensions) was awarded to a project-specific joint venture company.

The contract was worth \$130–150 million per annum.

Almost immediately, disagreements arose over differing expectations of: the scope of services; service performance; how variations in transaction volume were to be handled; and almost all aspects of the contract.

Problems appeared to be a consequence of several convergent events.

The contractor's bid margin was low and the business model unsustainable—possibly a result of the size of the contract opportunity and the competitiveness of tender environment.

Much of the risk—uncertain and uncontrollable—had been transferred to the contractor. Losing money, the contractor refused to accept new work and exploited ambiguities in the contract, which under normal circumstances could have worked with the willingness of both parties.

The client was of the attitude that the contractor be held to all contractual obligations, as interpreted by client staff and advisers, and no change in price would be entertained.

A dramatic change in international economic conditions, with marked increase in fuel prices, imposed additional costs on the contractor. They claimed an increase was necessary due to unforeseen cost increases. This was rebuffed by the client who argued that an actual cost increase—after mitigations—could not be demonstrated, and, therefore, was not allowable under a strict interpretation of the contract.

Disagreements escalated to claims and counter-claims without resolution. Three years into the contract only three CCPs had been agreed. One matter was in arbitration and mediation—this was seen as the only mechanism to resolve the 130-plus disputes worth several hundred million dollars.

Norton Rose and Kiah Consulting were invited to provide legal advice, a negotiating strategy, and support for the mediation.

Entering the fray, Norton Rose and Kiah waded through tomes of minutes, letters and legal advice defending the contractual position of the client.

Initial arbitration hearings had not gone well, services were at an appallingly low level, and termination by the contractor was a real possibility. This would have had dire consequences for the client financially and resulted in the loss of mission-critical services.

Initial strategy work with the client established three objectives:

- ▶ continuity of services was an essential condition
- ▶ a reasonable resolution to historical matters could be considered but needed to be cost-neutral in future years
- ▶ a re-aligned contract needed to be sustainable and manageable.

The corollary to this was that a sustainable contract needed to be profitable for the contractor. If there was to be no net increase then savings needed to be found from within the contract and the client management team.

During strategy sessions, it was agreed that:

- ▶ historical claims would be poisonous to any ongoing relationship, and needed to be resolved
- ▶ a commitment to ongoing service delivery was essential while negotiations were underway, before a discussion about the future could be entertained.

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This position was taken into mediation. The orthodox mediation process was not adopted for this dispute. In fact, traditional mediation really only covered the resolution of the historical disputes. Nevertheless it was a useful mechanism for engagement, particularly across the public-private sector divide. Mediation provided a formal, safe and private place for discussions and the airing of grievances, feelings and exploration of alternative options. The mediator also provided structure to what was, at times, a robust discourse.

In mediation there is a tendency to force parties to explore their view and explain their decision making. Time does need to be dedicated for each side to air their grievances. Being heard is an important step in moving forward. Too often commercial matters escalate when one party believes they are speaking to deaf ears, however, in this case no amount of justification was going to change the other side's mind.

These sessions provided an understanding of the factors to be addressed to resolve the dispute, but were not a mechanism for coming to agreement. In fact, the historical matters were reasonably easy to resolve once the 'you promised' / 'we said' positions were abandoned. With both parties focussed on future opportunity, dealing with the past was pragmatic and commercial, albeit not without some pain. Arbitration was also diverted to this process and was resolved rapidly, successfully, and cost-effectively.

Building a future, at no net cost, was a much more difficult and lengthy process. Agreeing on a course of action in mediation would have been simple, but insufficient for a sustainable future.

Norton Rose and Deloitte were engaged to assist in hypothesis-based reviews of the costs, contract and processes to identify where opportunity and weaknesses lay. The use of an hypothesis approach allowed the intuition and experience of the client to be focussed on areas of high value without undertaking the traditional and expensive exhaustive analysis. The analysis was also capped by the Pareto Principle—that 80 per cent of value comes from 20 per cent of the factors—and team management was put in place to ensure the analysis did not divert into unfruitful areas.

The analysis revealed some astonishing findings:

- ▶ Existing contractor-client processes sometimes saw the same paperwork—for work orders valuing only a few hundred dollars—handled by up to 16 people. We changed the processes.
- ▶ \$500,000 was expended on checking invoices for a total annual return of \$25,000. We stopped this.
- ▶ One of the contractor's business activities was very profitable but revenue was being diverted to a joint venture partner and was not used to offset losses elsewhere. We reduced the price paid for that service and returned the value to the client.
- ▶ The client and the contractor were buying the same parts and consumables, for different requirements, at different prices. We altered the contract so that best benefit was realised.

Negotiating these changes—internally within the client organisation and externally with the contractor—provided the savings necessary to allow the contract to be re-established in a sustainable way.

Removing anomalies in the contract and statement of work would help to avoid future disputes. The result was a more prescriptive contract than was usual, but a clear and unambiguous contract was essential to help the client and contractor to overcome the significant behavioural challenges needed.

A performance framework was also seen as essential to move the regime from an activity to outputs focus. Performance provided a measurable incentive, and did not need to be large to have an effect.

Using performance parameters to link payment to a small number of outputs, rather than process, created a remarkable effect.

Equipment that had taken an average of 72 days to repair was returned to service, on average, inside 18 days. Other parameters saw similar turnarounds. The performance framework was not simply locked to key performance indicators but the team also developed a measurable relationship to compliance of all obligations under the contract and an innovative approach to drive and share ongoing efficiency dividends.

Finally, in building a sustainable future it was recognised that disagreements would occur but needed to be resolved quickly rather than developing into a contractual abscess.

The approach provided for tiers of joint obligation to meet, report and escalate so that matters could not fester at low levels. Unavoidable timing for contract changes and other matters for escalation were incorporated to ensure senior levels dealt with difficult and unresolved problems. In the event that matters could not be resolved at the senior level, an innovative defusing mechanism was adopted from construction industry ADR processes to provide independent advice on resolution. The governance processes included a strategic as well as an operational context, providing a measurable mechanism for evaluating the strategic value of the relationship and its future, not just a transactional near-term operational focus.

It is arguable that this was the most complex mediation conducted in Australia, but it was undoubtedly successful.

A \$1 billion-plus contract at the brink of failure with significant disputes running into the hundreds of millions was remediated to provide secure services, and significantly improved performance at virtually no cost increase. The excellent result was achieved by a team including client staff, external legal and consulting teams integrated and led by a lead negotiator from Kiah Consulting.

Such an outcome could not have been achieved without the courage of a client willing to step away from the traditional approaches, remove advisers escalating disputes, dislocate the process of argument and seek a negotiated resolution. 