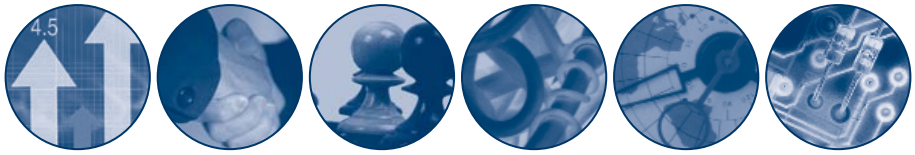

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Update

Staying Out of Court:

Dispute Prevention and Management in Outsourcing Contracts

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Think of disputes that occur in outsourcing deals as mushrooms. To grow and spawn, they need an environment that is dark and full of fertilizer. Your goal is to create an environment that is well lit, with little fertilizer for the mushrooms to feed on. Disputes are not often caused by one particular issue but are usually triggered by an accumulation of many adverse events that eventually lead the parties to start "throwing mud at each other." The case below shows how seemingly superficial events can create a "fertilized" field ready for disputes.

CASE STUDY

A state government department and a service provider signed a "partnering" business process outsourcing (BPO) deal, whereby the provider would not only maintain the facilities operated by the department but also manage leases and other tenants as well.

On the first day of the contract, the provider's full-time account manager asked the client's director where his office would be. Since it was deemed a partnership, he assumed the two parties were to be colleagues and that he would have an office near the department director. It was a reasonable assumption, since that was the arrangement in other deals with other clients.

This request came as a surprise to the client's director for a number of reasons. First, the supplier's office was only a few blocks away, so there was no logistical basis for the request. Second, he only expected to see the supplier if his help was needed in resolving issues. Third, there was a shortage of space, which was known to the supplier.

But the director wasn't going to be ungracious and refuse to provide an office. Due to the space shortage, he had difficulty locating one but did track one down. It was in the basement and not particularly welcoming. But he felt he was being quite congenial, first, by not refusing, and second, by not charging the provider for rent.

However, the account manager took the gesture as an overt signal that the relationship wasn't going to be a partnership at all. Quite clearly, the client intended a master-slave relationship and was going to try to take advantage of the supplier. As a defensive move, he put the word out that the client was not to be trusted and the provider's staff should only comply with the letter of the contract.

The first occasion to test the relationship happened within the first week, where something had to be done urgently but was out of scope. The account manager refused until he had a signed purchase order

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from the client. He wasn't going to fall for the old trick of doing something without a PO only to find out later that the client's accounts department would refuse to pay. When the director heard about this, his worse fears were confirmed. Partnering was just sales rhetoric; suppliers don't really implement it in practice. As his defensive move, he was going to make sure they complied with everything to the letter in the contract — it was the only way to manage suppliers.

Disputes soon percolated, raised by both parties regarding what the other wasn't doing in accordance with the contract. However, due to the original "partnering" approach, not much effort went into the contract, and it was full of ambiguities, conflict, and silent areas (where the contract said nothing). It was, in fact, "contract lite." Since the contract wasn't of much help, it came down to who believed who said what during negotiations (for which minutes weren't kept). Debates over who said what and mutual blaming kept going for a year until the supplier sold its business to another organization and the client and the new provider negotiated a "real" contract.

The most critical dispute management skill is the ability to stay out of disputes, not as an avoidance technique, but rather as a careful cultivator that ensures "mushrooms" have no chance to grow. This is skill in prevention, not in fighting.

PREVENTION TECHNIQUES

Prevention Technique #1: Clear Specifications

A recent study in Australia[1] has shown that nearly 60% of 55 organizations studied had a major contract renegotiation, on average, two years from signing. Most disputes arose out of ambiguous specifications regarding scope (55%), price (42%), and key performance indicators (27%).

These are all very significant concerns and likely due to the client organizations underinvesting in the process of getting to contract, as the previous case illustrates. For this reason, both parties need to have a core competence in writing specifications and/or service-level agreements (SLAs).

Writing a specification that will be interpreted the same way by different people, not only within a single organization but also between parties, is a skill that takes years to acquire. Most specification writers believe they do a good job — and certainly their intentions are good — but often what they meant was not what they said. And in a dispute, it does not matter what they meant, only what was in the contract. A typical independent review of a specification might find material ambiguities in nearly every sentence. Unfortunately, most organizations do not conduct such reviews and only find out later, after the contract has been put into operation, that the specification should have been much, much clearer.

The key to a good specification review is that it is done by someone who thinks differently than the person who wrote it. For example, if the specification/SLA was written by an engineer, have it reviewed by an accountant. If anything requires an explanation, it needs a better specification. If the reviewer can offer multiple interpretations of a particular item, it needs a better specification. If the reviewer has to make any assumptions to understand it, it needs a better specification.

Prevention Technique #2: Clear Communications Protocols

It is not just the documents, however, that require clarity. It is also who can talk to whom about what. Your organization's internal policies and procedures regarding communications, approvals, signoffs, and the like, have no bearing in a dispute unless they were incorporated into the contract and made an obligation of the other party.

If you think about how many people might have a discussion, some form of correspondence, or even just contact with anyone in the other party, there could be quite a few people acting with presumed authority and inadvertently committing your organization or conducting estoppel (variation by conduct). A fair amount of disputes arise this way: an internally unauthorized individual says or does something he or she perhaps should not have, and both parties are left with the fallout.

If you have clear internal processes, authorities, forms, and the like, incorporate them into the contract and make them binding on both parties. If you do not have such things, then there is no time like the present to get them in place.

Prevention Technique #3: Proactive Issue Management

It is not unusual, in a contract of reasonable size and complexity, to have up to 300 unresolved issues at any given time. Look at unresolved issues as the mushroom spores — if you don't kill them early, they can grow pretty fast into disputes if the environment is right.

Before declaring something a dispute, consider managing it as an issue, at least to begin with. Just calling a problem an "issue" rather than a "dispute" has a big impact. After all, wouldn't you rather go to an "issue brainstorming workshop" than a "dispute negotiation"?

Figures 1 and 2 provide an example of a specification for issue management.

[1] In publication.

1 **Issue management**

1.1 (**Authorized representatives**) The parties recognize that raising issues is to be encouraged to foster a proactive and productive working relationship. Issues can be raised by any individual fulfilling the roles specified in the tables in clause 2.1.2 ("Responsibilities") with regard to any matter via the Issue Sheet form (Figure 2: Issue Sheet).

1.2 (**Administration**) The Client shall maintain the issues log and register all issues raised by either party, the log which shall be made available to Contractor upon demand.

1.3 (**Procedures**) The following issue management procedures will be conducted:
a. the person raising the issue shall submit the Issue Sheet form to the Client's contract manager;
b. the Client shall log the issue and complete all necessary items with the issuer;
c. the individual/s assigned to resolve the issue will do so by the required time noted in the Issue Sheet; and
d. the Client shall report the progress of issues in the appropriate meetings listed in clause 3.2 ("Meetings table").

1.4 (**Escalation**) Should any issue not be resolved by the due date, or the resolution not be able to be agreed, the:
a. parties may agree a revised due date; or
b. issue may be reclassified as a dispute, in the Client's absolute discretion, and follow the processes in clause 5.2 ("Dispute management").

Figure 1 — Example specification: issue management process.

Instructions: Shaded areas to be completed by Client.

<table>
<tr><th colspan="3">Issue Sheet</th></tr>
<tr><td>Issue Sheet ID:</td><td>Raised by:</td><td>Date submitted: ____/____/____
Date closed: ____/____/____</td></tr>
<tr><td>Issue title:</td><td>Priority:
❑ High
❑ Medium
❑ Low</td><td rowspan="2">Governing documents affected:
❑ Schedule 1 Interpretation and Definitions
❑ Schedule 2 Conditions of Contract
❑ Schedule 3 SLA
❑ Schedule 4 Financial Arrangement
❑ Schedule 5 Governance Charter
❑ Other Schedule: _____
❑ Procedure: _____
❑ Other: _____</td></tr>
<tr><td>Assigned to:
❑ Client, or
❑ Contractor
Name:_____
Title: _____</td><td>Priority rationale (reason for the priority ranking):</td></tr>
<tr><td colspan="3">Description of Issue:</td></tr>
<tr><td colspan="3">Proposed resolution:</td></tr>
<tr><td colspan="3">Implication of not resolving Issue:</td></tr>
<tr><td colspan="2">Related Issues:</td><td>Information/background attachments:</td></tr>
<tr><td colspan="2">Investigation/further work required:</td><td>Investigation assigned to:
❑ Client, or
❑ Contractor
Name:_____
Title: _____</td></tr>
<tr><td colspan="3">Description of resolution:</td></tr>
<tr><td colspan="3">Issue resolution approved by:
Client: _____, Date: ____/____/___
Contractor: _____, Date: ____/____/___
(name, signature)</td></tr>
<tr><td colspan="3">Comments:</td></tr>
</table>

This form shall be governed by the terms and conditions of the Contract.
Nothing in this form varies the rights and obligations of the parties unless specifically identified.

Figure 2 — Example issue sheet.

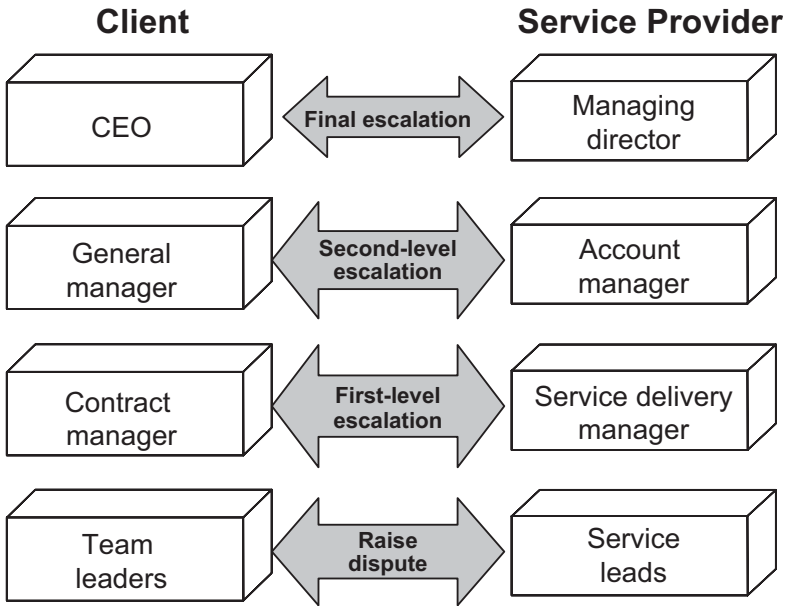

Figure 3 — Internal escalation chart.

Prevention Technique #4: Internal Escalation First

Too many contracts do not specify an internal interparty escalation process prior to getting third parties involved. Without an agreed-upon escalation mechanism, disputes can too quickly be dispatched to third parties. While most contracts will state that the parties have a duty to try to resolve a dispute prior to seeking an alternative dispute resolution (ADR — see Technique #5), such contracts do not go far enough in specifying that process.

The first step is to outline who can raise disputes and the escalation (see Figure 3). Even if you do not like what the executives have resolved, whatever the resolution is it will be far better and considerably less expensive than going to court. The next step is to specify the process, which follows a similar process to that of issue sheets.

Prevention Technique #5: Alternative Dispute Resolution

There are three types of ADR, which parties regularly use and often require prior to a party being able to go to court:

1. Arbitration
2. Mediation
3. Independent expert

The history of these is quite interesting. Arbitration was originally created as an alternative to court to save both parties time and money. However, these days no one goes to arbitration without their team of lawyers, so it does not save much money. So mediation became the next form. Yet again, most organizations bring their lawyers to mediation as well, again substantially increasing the cost. Moreover, neither the arbitrators nor mediators are likely to have a detailed understanding of either party's business, as they are usually legal or accounting professionals. Thus, much of the time is spent educating the arbitrator/mediator about the businesses and the issue, without even getting to the point of argument.

As a result, the independent expert alternative is becoming more popular. This is where the parties try to agree on an expert in the area (for example, an expert in facilities management) who acts as a "marriage counselor" and tends to base decisions on industry norms and personal experience. A key part of this process is that neither party brings their lawyers. The goal is not to win, but rather to reach an objective compromise — a win-win situation.

RECOVERING FROM DISPUTES

Most people, after believing that the other party "won" a dispute, immediately prepare for the next one — setting up better defenses or even seeking revenge: "They got me the last time, but I'll get them back." Another truck of fertilizer has just been delivered!

If you cannot imagine ever saying you are sorry to the other party, you may not be able to recover from a dispute. If the parties still have to work together, baby steps are required. This involves trying to do simple, noncontroversial things together in an attempt to rebuild respect and, one day, trust.

However, it is often inevitable that an individual in one or both parties cannot overcome the feelings of being betrayed, believe that the other party is treacherous, or seek

revenge. In most cases, these individuals will need to be removed and replaced from their particular role on the contract. This is in the interests of expediency in reforming a working relationship, not to punish that individual.

If either party cannot put a dispute behind them, both will inevitably become expert mushroom growers.

ABOUT THE AUTHOR

Sara Cullen is a Senior Consultant with Cutter Consortium's Sourcing & Vendor Relationships and Enterprise Risk Management & Governance practices. She is currently the Managing Director of The Cullen Group, a specialist organization offering consulting, training, and methodologies regarding commercial agreements. Dr. Cullen was a former national partner at Deloitte in Australia, where she ran the outsourcing consulting division, and she received her PhD from Melbourne University in the field of outsourcing. She has consulted to 110 private- and public-sector organizations, spanning 51 countries, in more than 130 outsourcing projects with contract values up to $1.5 billion per year.

Dr. Cullen is a widely published author. Her publications include Intelligent IT Outsourcing, Outsourcing: Exploding the Myths, Contract Management Better Practice Guide, Best Practices in ITO, Lessons Learnt in Outsourcing, Service Provider Management, Outsourcing Guidelines, and Outsourcing: What Auditors Need to Know, *in addition to research with various universities since 1994, including the London School of Economics, Melbourne, Oxford, and Warwick. She has been featured in such publications as the* Australian Financial Review, Business Review Weekly, Computerworld, Directions in Government, European Journal of Information Systems, Information Economics Journal, Journal of Strategic Information Systems, Information Technology Report, Insurance Directions, Oxford Handbook, MIS, *and* MISQ Executive. *Her expertise is globally recognized, and she performs peer reviews regarding outsourcing research for the* Harvard Business Review, California Management Review, *and the* European Conference on Information Systems.

Dr. Cullen has lectured at many universities, including Melbourne, Monash, Swinburne, Queensland University of Technology, and the Royal Melbourne University of Technology. Dr. Cullen earned a BS in accounting from St. Cloud State University (US); she was awarded a Masters of Management (Technology) from Melbourne Business School; and earned her PhD from the University of Melbourne. She is also a Chartered Accountant in the US. She can be reached at scullen@cutter.com.