

## THE CASE FOR INDEFINITE CONTRACTS

### The weaknesses of short term contracts

- 01** Firstly, **contractors dislike them**. They
- ¥ make it hard for contractors to plan any long-term investment
  - ¥ unsettle contractors' staff, and cut across long term plans for their training and development
- 02** Secondly, short term contracts compel clients to arrange for frequent **re-competition**. This process
- ¥ diverts contractors towards the pursuit of short term goals
  - ¥ forces clients to arrange repeatedly to
    - update counts and measurements not needed for any other useful management purpose
    - draft, complete and evaluate tender documents
    - capture and transfer essential client information and records
    - terminate, novate or renew leases
    - create new interfaces with new IT, and deal with all the hazards which go with them
    - bed down new contractors and their managers.

### The weaknesses of long term contracts

- 03** The first weakness is the persistence and frequency over many years of complaints about **cost drift** (upwards) and **quality drift** (downwards). The longer the contract period, the greater the drift. The early euphoria generated by many high value service contracts has received wide publicity, and has been made much of in the national debate about procurement, but the feedback obtained after the honeymoon period (commonly put at 1000 days) often fails to live up to the early promise.
- 04** Secondly, long contract periods are increasingly ill-suited to the **ever-increasing pace of change**. It is for example increasingly common for
- ¥ service priorities to change significantly as a result of demographic, economic and environmental changes
  - ¥ new techniques to come on the market faster
  - ¥ services to be put on new statutory bases, and authorities themselves to be reorganised
  - ¥ contractors to find other fields more attractive, or to get taken over by companies with different priorities.

### The strength of indefinite contracts

- 05** Indefinite contracts have some of the strengths of both long term and short term contracts. Their essential feature is the inclusion of break clauses providing for periodic renegotiations of outcomes, quality levels, service levels and prices to match new circumstances and strategies. Depending on the success of negotiations, they may therefore last only for a single term, or for as long as the service in question is needed.
- 06** There is **no upper limit in UK or EU law** to the length of contract periods. Some PFI arrangements and waste disposal contracts are for periods of over 50 years. Indeed, the EU directives (**110**; 7(9)) (**116**; 7(5)) specifically recognise that contract periods can be indefinite.
- 07** Both parties usually have points which they want to renegotiate before agreeing to renewal; and there is no doubt some stage (as yet untested) at which negotiations create a new contract, which then needs a new contract notice in OJEU. But a renewed contract is not 'new' if the original contract conditions required the parties to do their utmost to negotiate renewed terms acceptable to both. The directives are therefore satisfied if arrangements for negotiation and renewal are spelled out in contract notices or tender documents; or preferably in the (much fuller) information given to respondents to contract notices.

### The machinery

- 08** The more information which can be given about **the machinery for renewal**, the better. It would for example normally be feasible to spell out

- ¥ the intervals at which renewal will be considered
- ¥ the identity of the other stakeholders whose opinions will then be sought
- ¥ what sort of cost comparisons will be attempted, in considering whether prices in real terms need to be varied
- ¥ arrangements for dispute resolution if negotiations get stalled
- ¥ the conditions of termination in the event of non-renewal.

- 09** Methods of dispute resolution are of two main types. These are
- ¥ alternative dispute resolution, with no renewal if in the end there is no consensus. The only constraint is the risk of damages if the other party claims that agreement to renewal was unreasonably withheld
  - ¥ binding arbitration as to the terms of renewal, by an agreed arbiter (as for the London Underground PPPs)
- 10** Both methods preserve for clients some of the bargaining power which they lose if they commit themselves to long term contracts.

### The criteria for renegotiations

- 11** It is hard to be specific about what contract conditions should say, pre contract, about the **criteria on the basis of which the parties should approach renewal**. The difficulty is that the contracts under consideration will be designed, now, for improvement to meet new standards and expectations conceived many years ahead.
- 12** Criteria for renegotiations so far ahead can be stated only in abstract terms. There is however no reason not to do this as definitely as possible. Contract conditions may for example require the parties to do their utmost to renegotiate outcomes, quality levels and service levels so as to
- ¥ comply with changes in statutory duties
  - ¥ meet whatever recommendations and targets may be established by national and international environmental organisations, for example as to carbon dioxide emissions, water consumption and the use of replaceable materials
  - ¥ comply with new codes and recommendations established by any regulatory and professional bodies which have general responsibility for the services covered by the contract
  - ¥ vary service volumes to match demographic changes
  - ¥ vary the volume, level and quality of the service to match variations in the funds available, taking into account other calls on funds, and any guidance or norms as to their apportionment
  - ¥ achieve PIs set for the authority, at least up to the mean level achieved by similar authorities.

### Renegotiating outcomes, quality levels and service levels

- 13** Contractors have strong incentives to supervise and motivate their workforces to do whatever their contracts require. By the same token, authorities must expect contractors to be indifferent in the long run to any points of performance which are **not** recognised by contracts.
- 14** Merely agreeing add-on objectives in discussions or correspondence is unlikely to point contracts in some new direction. The original outcomes, quality levels and service levels need to be modified in renegotiations.

### Renegotiating prices

- 15** Prices will have to be renegotiated regularly because the desired balance between price and quality is certain to shift over long periods. This is because
- ¥ changes in the relative value put on the service in question are inevitable with the passage of time.
  - ¥ both parties may have second thoughts about tender prices. Contractors cannot expect to enjoy top prices for ever, any more than clients can expect to enjoy keen prices for ever. Clients have to accept that contractors' pricing problems tend to become their own problems too. If prices are not raised at least to the level of costs, contractors may feel forced to depress their quality levels to what they think their prices are worth.

- 16** Neither side can expect the other to be convinced by evidence of competitive prices elsewhere. All that can generally be said about competitive prices is that
- ¥ their wide spread is often inexplicable
  - ¥ the more numerous the tenders, the wider their spread
  - ¥ the lowest are usually too low for anybody's good.
- 17** Clients will therefore need to judge from internal evidence from their own contracts. Open book accounting makes this easier.

### Cash incentives

- 18** Mechanisms for progressively reducing prices in real terms (for example value-incentive clauses) are well recognised, but appear to have no place where prices may be renegotiated anyway. Whatever the terms of value-incentive clauses, they would be overridden by second thoughts about prices, and by any desired changes of balance between price and quality.
- 19** Big cash incentives are usually stimulating, but their disadvantages have to be kept in mind. These are that
- ¥ they are superfluous if, as now suggested, contractors are rewarded with renewals
  - ¥ they are hard to reconcile with authorities' budgets. Budget-holders may come to dread bursts of high performance near the end of the financial year
  - ¥ small contractors can become over-dependent on incentives if these are too great in proportion to basic prices.

### SOURCES

- 110** SI 1993/3228 - Public Services Contracts Regulations  
**116** SI 1995/201 - Public Supply Contracts Regulations