

**Special Edition**

**Top Terms**



**Contract Negotiations As A  
Source Of Value**



**April / May Issue**

## Results of the IACCM annual survey of The Most Negotiated Terms<sup>1</sup>

Business-to-business contracts are ‘instruments for social cooperation’<sup>2</sup>, according to Ian Macneil, the recently deceased author and leading legal academic. “Contracts arise because the parties recognize that there is more to be gained by some level of cooperation than by separation.”

However, when it comes to the terms on which contract negotiators spend most time, this spirit of cooperation remains notable for its absence. IACCM’s 9<sup>th</sup> Annual Report on the Most Frequently Negotiated Terms indicates that risk allocation and avoidance continue to dominate interactions during the negotiation of formal business-to-business agreements. The effect of the recession was in fact to increase the degree of separation between contracting parties, further threatening the economic value to be achieved from their relationship.

Macneil anticipated a growing number of today’s academics and thought-leaders by his appreciation that many contracts can ‘be governed efficiently only if


the parties adopt a consciously cooperative attitude’. It would appear obvious that the nature of a contract – and the time invested in its creation and management – must depend on the nature and economic potential of the relationship.<sup>3</sup> The problem appears to be that too many contracting and legal professionals either fail or feel unable to make this distinction and do not alter their negotiation priorities to reflect the potential value or the extent to which its realization depends on cooperation.

As a result, contracts (and the professionals charged with their creation) are frequently seen as obstacles to value creation and are viewed by many as an unfortunate prerequisite to doing business, rather than as a fundamental asset to successful relationships.

## Did We Learn From The Recession?

In general, the recession was marked by a more adversarial attitude in which contracts often proved themselves of limited value. Many powerful organizations simply ignored inconvenient terms and insisted on their renegotiation. Others made unilateral, non-negotiable changes, in particular in areas such as payment terms (interestingly, the fact that suppliers felt forced to accept such changes led buyers to see ‘increased collaboration’, whereas the suppliers felt that collaboration had taken a hefty negative blow).

The recession did cause some shifts in the areas of emphasis in negotiations – but those areas were certainly not about increased partnership.



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Table 1: Terms where internal and external concern increased during 2009

Price / Charge / Price Changes
Payment
Limitation of Liability
Invoices / Late Payment
Indemnification
Service Withdrawal or Termination (cause / convenience)
Service Levels and Warranties
Business Continuity / Disaster Recovery
Confidential Information / Data Protection
Liquidated Damages

Over 50% of negotiators felt that openness to risk discussion and balance in risk sharing reduced in 2009. The top terms where IACCM members observed substantial increases in both internal and external focus are shown in Table 1.

While the recession caused some narrowing of the gap in frequency of negotiation for specific terms, there was no movement in the top five. Indeed, our Top Ten continues to be dominated by the risk-related provisions that are primarily about self-protection. Limitation of liability is once again number one – despite Macneil’s observation (written some 40 years ago) that ‘damages and losses are not precisely quantifiable (in business contracts) and it is pointless to try.’ It would appear that it

is this very lack of the ability to be precise that generates so much of the negotiation – and of course causes that aura of ‘pointlessness’ that for so many business people surrounds much of the contracting process.

### The Focus of Contracting Practices Today

Much of our negotiation appears driven by classical legal theory that is based more on transactions than it is on relationships. Classical law assumes selfishness and that economic interest is ‘best served by looking after yourself, at the expense of other parties’. This assumption encourages an attitude that approaches negotiation deal by deal, rather than seeking or observing patterns or examining the potential manage

ment of risk across relationship portfolios.

Economists have moved beyond this point, with their understanding that people and organizations are in fact able to grasp the benefits of cooperation and team behavior. The law is struggling to catch up and still appears to believe that the best way to manage risk is to allocate it to someone else and the greatest incentive to perform is via threats of dire punishment for failure.

This tendency for the law to be such a dominant feature in defining contractual obligations is not the only factor that undermines the effectiveness of contracting and negotiations. It is further amplified by the methods used in many Procurement organizations. The myopic view that all relationships can be reduced to individual commodity transactions ignores the dependency on relationship quality and governance. Turning again to Macneil, he observes: “Somewhere along the line of increasing duration and complexity, (the contract) escapes the traditional legal model ... It is replaced by very different adjustment processes of an ongoing administrative kind” (for example, think of governance, performance and change management). “This includes internal and external dispute resolution structures ...”<sup>4</sup>

The contracts community – or at least the top negotiators who have responded to our survey – are well aware of this conundrum. Over 80% acknowledge that today’s practices do not result in the best outcome. Their ‘agenda of the future’ closely mirrors the thoughts of Ian Macneil, written in 1969, when he set out ‘The Five Basic Elements Of Contract’:

1. Cooperation
2. Economic exchange
3. Planning for the future
4. Potential external sanctions
5. Social control and manipulation

As Table 2 illustrates, negotiators would like to focus on the areas of cooperation, economic exchange and planning for the future – for example, what are we trying to achieve together? They recognize the need for clarity in the economic exchange - the costs, the benefits, the responsibilities and how these will be adjusted when change is needed. They recognize the importance of on-going communication and reporting against clear and specified goals and that then – only then – the need to establish the consequences of failure (the ‘external sanctions’).

**Table 2: Terms which would be more productive in supporting successful relationships**

Scope and Goals
Change Management
Communications and Reporting
Responsibilities of the Parties
Service Levels and Warranties
Price / Charge / Price Changes
Limitation of Liability
Delivery / Acceptance
Dispute Resolution
Indemnification

### **A Fundamentally Wrong Assumption**

Macneil’s work also pinpointed another key reason why traditional legal theory simply does not work in today’s business environment. He commented on the point that “Classical law views cooperation as being ‘of little interest’ and external to the contract. In part, this is because it assumes a common base of presumed rules by the parties.” Such an assumption is not only risky in the 21<sup>st</sup> century global market, but it is downright wrong. We know for instance that the parties frequently have very different presumptions about ‘the rules’ that govern their relationship – legal, ethical, business and social. Hence once more we can see the

critical importance of changing the fundamentals of our debate, both during negotiation and indeed throughout the relationship. “The distinguishing feature of contractual obligations (in business) is that they are not imposed by the law but undertaken by the parties’, (Smith, 1993).

The purpose of contracting should be to determine and then maintain the alignment of the parties and their respective capabilities to deliver the expected economic gains. This demands a framework that assumes and encourages cooperation and continuing dialogue. “The word solidarity – or trust – is not inappropriate to describe this web of interdependence and expected future cooperation. The most important aspect of solidarity is the extent

to which it produces similarity of selfish interests, whereby what increases or decreases for one does so also for the other.” (Mcneil)

As Table 3 shows, the focus for today’s negotiators clearly fails to achieve this balance of increase and decrease. It is dominated by the ‘potential external sanctions’ that are in fourth place on Macneil’s table of priorities. The dominance of risk-averse terms tends to emphasize the things that separate the parties and reflect their selfish interests. Some would argue this is realism; and in a casual encounter where the item of exchange is a one-time commodity, such concerns would be valid. But here we are discussing relationships that are often intended to survive for many years and require a far more sophisticated behavioral framework. Our focus today is failing to deliver this framework and thereby is also failing the business that we seek to protect.

### So Why No Change?

Negotiators mostly believe that change is necessary and desirable – almost 75% state this to be the case.<sup>5</sup> They are relatively clear about the areas for increased focus (as shown in Table 2 above). But they are unable to make the change primarily because of

**Table 3: The terms that are negotiated with greatest frequency**

Limitation of Liability
Indemnification
Price / Charge / Price Changes
Intellectual Property
Confidential Information / Data Protection
Payment
Service Levels and Warranties
Delivery / Acceptance
Liquidated Damages
Warranty

primarily because of ‘resistance by the other side’. Of course, since both sides are represented in our study, one must be rather skeptical about this statement. However, there is certainly truth in the fact that most negotiators are representatives of broad stakeholder groups; in that sense, they are not really decision makers, but rather positional advocates. Their room for maneuver is generally quite limited – and this is reflected in their other primary reason for failure to change – internal stakeholder resistance and rules.

In the end, this lack of perceived empowerment is unfortunately accompanied by a lack of will or motivation to push for change.

Our investigations suggest that most negotiators do indeed wish to do things better and differently, but they see too many obstacles. For example, what is the business case that could drive executive support? How could you measure the benefit that would flow from greater cooperation and more collaborative management of risk and change? As one General Counsel explained: “The benefits of cooperation would probably be significant nine times out of ten. But unfortunately I don’t know how to measure them. The one time out of ten when things went wrong, all hell would break loose. And that is why contracts people and lawyers are reluctant to change.”

In part, we cannot measure because we do not in general study contracts as a portfolio. For example, until IACCM introduced this study of the most negotiated terms, no one had thought to measure it. Similarly, very few organizations regularly capture data on the frequency, source and consequence of change; or similar data related to claims and disputes. There is even reluctance in many to monitor cycle times. Yet information of this sort would generate a greater drive for improvement and would help executives understand how the policies and procedures of today frequently stand in the way of good trading relationships.

## The Road Ahead

Individual companies can make a difference and those with substantial negotiating power do sometimes break the mould. However, at present these examples are anecdotal rather than fundamental.

IACCM recognizes its responsibility to do more than simply advocate change. As a professional association, we must show leadership. Our research and advocacy of best practices is one example of that. In particular, the work we have done to benchmark the companies ‘Most

Admired’ in negotiation and contract management has resulted in a welcome boost in awareness and understanding of good practice and the benefits of developing contracting competency.<sup>6</sup>

At a more practical level, IACCM is undertaking work to develop standard forms of agreement. For example, in the technology sector we are at an advanced stage of producing balanced model terms that could change the face of negotiation and eliminate the traditional ‘battle of the forms’. Our goal is not to prevent negotiation, but rather to ensure that it focuses on the things that really matter and assists parties in reaching trade-offs based on areas and items of value.

We are also involved in initiatives that could change some of the ground rules for contracting. An example is the UNCITRAL initiative (backed by the Organization of American States) to take the courts out of on-line dispute resolution. This proposal would result in the creation of a global arbitration service and has the potential to be just one element of a growing range of global contracting principles and practices for cross-border trade.

Education and awareness is also fundamental to change.

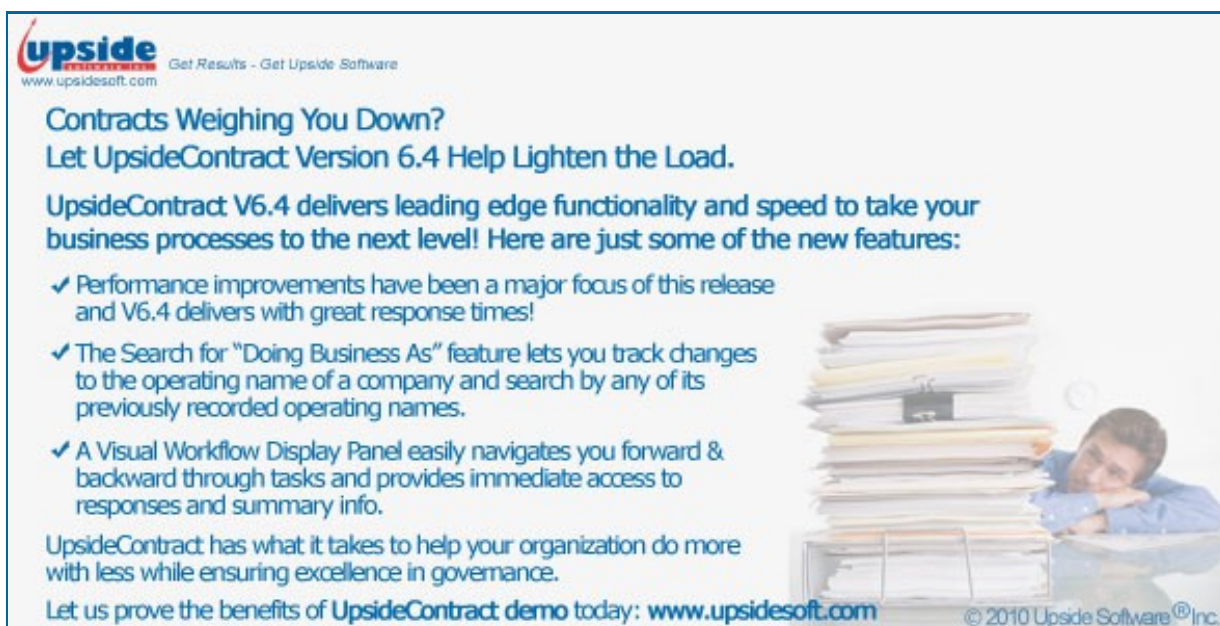
The Association’s focus on development of a global ‘body of knowledge’ and consistent worldwide training for those involved in contract management is key to improved performance. As with any ‘community of practice’, massive benefits flow from consistent terminology, methods and techniques – not only by facilitating communication and trust, but also by enabling measurement and continuous improvement. Today, there are several thousand professionals undertaking IACCM on-line training; later this year, we will publish the world’s first book containing a universal ‘body of knowledge’ for contract management.

In addition to the work on this new book, IACCM has a range of working groups and projects in areas such as complex project contracting, the development of supplier relationship management skills and techniques and improved standards in outsourcing. Overall, there are hundreds of managers and professionals from more than 60 countries who are volunteers in these projects and who are working together to ensure that change and improvement will occur.

A new focus is possible; and it will generate improved results. We are excited by the numbers who are now committed believers in making this journey. ~

**Footnotes:**

- <sup>1</sup> This is IACCM's 9<sup>th</sup> annual study of the terms that are most frequently negotiated in business-to-business transactions. It is based on input that represents many thousands of contract specialists and negotiators within procurement, legal and contract management functions. More than 1,000 organizations contributed to this year's study, which was undertaken in the period December 2009 – March 2010. All major industries and legal jurisdictions are represented in the results and further breakdown analysis to reflect cultural, jurisdictional or industry variations will be published at a later date.
- <sup>2</sup> 'Contracts: Instruments For Social Cooperation' Ian R Macneil, 1968. Published by F B Rothman.
- <sup>3</sup> See in particular the work on transaction cost undertaken by a range of academics, and acknowledged by the recent Nobel Prize in Economics awarded to Oliver E Williamson.
- <sup>4</sup> See page 6 for an example of the continuing evolution of dispute resolution as a key element of trust in trading relationships. Cross-border (and therefore cross-jurisdictional) relationships are increasingly reliant on non-legal mechanisms.
- <sup>5</sup> When asked "If the aim of contract negotiation is to create a framework for successful business outcomes, do you believe that negotiations today focus on the right topics to achieve that aim?", 26% believe that the focus is right.
- <sup>6</sup> IACCM undertook a worldwide study of The Companies Most Admired for Post-Award Contract Management (2008) and The Companies Most Admired for Negotiation (2009). This latter study was accompanied by in-depth best practice analysis and reporting undertaken in partnership with Huthwaite International.



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The advertisement features a photograph of a man in a blue shirt looking stressed, leaning his head against a massive, towering stack of papers that reaches above his head. The background is a light, neutral color.

## OVERVIEW

### The spotlight is upon our community!

In today's networked world, contracting and relationship competency have become core to business performance. The IACCM EMEA Conference offers opportunities to hear from world-leading companies and organisations, and to network with other high-performing practitioners and experts from the world of contracts, sourcing and in-house legal.

To further enrich your experience in 2010, we are delighted to announce that we have developed a partnership with Shared Services & Outsourcing Network (SSON), whereby we have developed 'a conference within a conference'. As a result, you gain massively enhanced networking opportunities, plus the chance to participate in either your specialist IACCM event, or to join the wider, cross-functional SSON audience in their sessions.

As The Economist recently observed, many organisations are not good at defining and managing relationships. Successful relationships demand clarity, collaboration and a readiness to adapt to change. These characteristics are right at the forefront for an organisation like IACCM – which is busy defining the practices and approaches that lead to successful trading relationships. By combining the thought leadership of SSON and IACCM, we bring our delegates the insights and ideas that equip them to drive change and ensure success within their organisation and beyond.

This year's event offers you a dedicated two and a half-day contracts and sourcing conference within a more extensive SSON event. As a result, you will gain the opportunity to engage with 250 IACCM members, while also interacting with 600+ senior representatives from related functions such as Finance, Operations and IT.

Don't miss this chance to learn and contribute to the exciting debate over best practice and next practice for the contracts, commercial and relationship management community!



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