

Prevention is better than cure when providers fail

Melita Thomas looks at how to minimise the fallout from a service provider going into administration or insolvency.

Melita Thomas is a partner with Remit Consulting, which advises real-estate businesses on strategy, business process and outsourcing, information systems and finance. Tel: 07919 448018, email: melita.thomas@remitconsulting.com or visit www.remitconsulting.com.

With the collapse of household names greeting us every time we open the newspapers, now may be a good time to consider what risks you may be facing should your service provider go into administration or become insolvent¹.

When you enter a contract, this is probably the last thing on your mind; you will have avoided dealing with companies that you think may be on shaky ground, but things have changed so rapidly in the last six months that even well-known names are being looked at in a new light. So if you have to grant a new contract you may want to enhance your measures to avoid risk.

For a moment, just imagine how bad this could get. Let us say that two years ago you outsourced a team which is providing daily services to your company and, one day, news comes through that the administrators have been called in. Your immediate questions are:

- Is anybody still working on your contract? Are they still being paid and how do you find out? Have they been offered jobs elsewhere?
- How long will it be before your customers notice a drop in service quality?
- How do you get to see your latest contract data and at what stage your projects are?
- Are the team's offices still open or have its creditors caused immediate difficulties at an operational level?
- Is it your fault for missing the warning signs? What could you have done anyway?

This article covers two aspects of such a scenario: first, "prevention" – how you should construct new contracts to protect your position in these types of situation – and second, "cure", or at least damage limitation, should such a situation occur.

STRUCTURING CONTRACTS

When you structure the initial contract you should pay regard to the exit strategy – this may be a deliberate, planned strategy for the end of the contract or an emergency strategy. We will be looking at developing an exit strategy in a later article, but in brief, the contract should cover the following.

Data

The contract should include a strategy for how your data will be returned and in what format. This is

an instance where having your contractor use your facilities or property management system and help desk to record and manage all of the data could be advantageous, as all you need to do is switch off its access. In many cases, however, the supplier may be using its own specialist systems. You need to have the data extracted and returned either to you or to a new contractor. It is important that you attach some longer-term financial incentive to doing this, as it is likely to be low down your supplier's list of priorities.

Physical

The exit strategy needs to consider how the transfer of physical items such as keys and passes will be dealt with.

Work in progress

Another issue is what will happen to works in progress. Should the contract require an immediate handover of activities to your new service providers, or should you look at a phased withdrawal?

It is important to ensure that throughout the contract you have visibility of budgeting and forward planning so that there are no surprises for you or your customers at the end of the contract.

In the unlikely event that you know your supplier's prospects are not good at the time of negotiations, you could consider whether advance staff salaries should be held in an escrow account – say two to three months' worth.

The contract should also require regular external auditing of the service provider and include a clause permitting termination if the service provider fails to meet financial tests in the future.

Contractual remedies

You need to make sure you have understood the small print. For example, are there any penalty clauses for termination? If termination is for failure to deliver the agreed services or other breaches, what other remedies or redress might be available to you?

The contract should oblige the service provider to keep you informed of any legal action arising from its management, as you do not wish to receive unexpected visits from court officials. It should also clearly state that in the event of an administration or insolvency you have the immediate right to terminate the contract and put in place alternative arrangements.

Finally, you need to be clear whether the contract itself can be novated to another contractor and whether you can require the service provider to novate any contracts with sub-suppliers to you directly.

REFERENCE

¹ There are differences in what may occur in either situation, which you should discuss with your legal advisers.

MANAGING THE FALLOUT

In addition to these contractual elements, you need to have a clear disaster-recovery plan in place should your service provider collapse. This plan, which should have been worked out well in advance, should cover three stages.

Stage 1 – Preparation

An initial risk assessment should have analysed the likelihood of your service provider failing. This risk assessment should be updated at least annually in a normal market and as frequently as every three months in the current climate. It should consider the service provider's financial position, access to credit, robustness of the management team, trading history and the quality of other customers – if they fail and cannot pay their bills, this may drag down the service provider.

You then need to look at the areas your contract covers and identify the individual risks in each. For example, a contract covering rent collection may damage your income stream if the service provider's collapse occurs around a quarter day, but may be less dangerous if it occurs midway through the rent cycle. The failure of a service provider who is responsible for carrying out health and safety checks may expose you to litigation if work is not carried out. You should tabulate each area of the contract and the risk that you would be exposed to in each.

In addition, you should identify and draft an initial budget for the costs of dealing with a crisis. This will be refined after stage two.

Stage 2 – Action plan

Having identified your risk areas, you need to put a plan in place to cover each of them (see box).

This disaster-recovery plan should also consider the longer term – for example, should you go back to the under-bidder and place a contract, or will you need to retender? Could one of your other suppliers take it on? There is no reason why you cannot agree a contingency plan with another supplier in advance of any problems. Can you pass the contract lock, stock and barrel to another contractor, or would it be better to divide it into smaller parcels and have a range of suppliers?

Stage 3 – Review and maintenance

It is no use having a plan which gathers dust in a drawer, so you need to:

- communicate to the relevant people the existence of the plan and have a regular review of both the initial risks and the action plan for responding to them;
- ensure you monitor the service provider's financial position;
- keep the plan current and visible – it is not helpful to have an out-of-date plan in the bottom of a filing cabinet in the basement;
- ensure that if you have named individuals in the action plan, these names are updated as staff leave or change roles; and

- keep the budget updated, as staff costs and the costs of setting up new contracts may change.

BE PREPARED

It is to be hoped that these turbulent times will pass and that business failure will be consigned to a distant memory. However, no business can call itself properly managed if it does not have clear, comprehensive and costed contingency plans. **FM**

DISASTER RECOVERY PLAN

Staff

What type of cover will you need and how quickly? Can the task be brought in-house or do you need to be aware of a reliable source of temporary staff? What will the HR and union issues be?

You need to discuss with your HR department what the implications will be at the end of a contract under TUPE (the Transfer of Undertakings (Protection of Employment) Regulations 2006).

You may need temporary staff – where will you find them, and how much will you have to pay them?

Will you need to set up a temporary help desk? How could you staff that? What processes and procedures need to be in place for the help desk to operate?

Data

Where is the relevant data and how can you access it? How can you check its accuracy? You must make sure that the service provider's access to your systems is terminated.

A simple but key issue is contact data. If you are a facilities management company leasing out premises, you need names and phone numbers for building occupiers. This needs to be the right contact – the office manager, or the tenant's property manager, not just the switchboard. You may have to contact them to tell them the building cannot be entered or that there are safety risks.

You should also hold contact data on any sub-suppliers so they can be contacted immediately and potentially have contracts novated to allow for continuity of service.

Physical risks

For the premises to be secure, you need to know where the keys are and who has the fire alarm codes. Are there security risks from the disgruntled staff of the failed service provider? You will need to nominate staff to go to sites and collect keys and passes.

Detailed processes and procedures need to be in place for the key activities of securing premises and charging occupiers.

If you are an occupier, could you institute workplace changes to allow people to work at home, or could you take alternative, serviced office space for a short period?

Finance

Where is your money, or that of your tenants? How are the bank accounts accessed? Could monies properly belonging to you or your tenants be mixed up in the service provider's frozen assets? You must seek legal advice immediately on making any appropriate claims in bankruptcy proceedings.

You also need to update the initial budget drawn up during the preparation stage and identify individuals who will have responsibility for managing the various processes within this plan.