

Law for Professionals

Alain Brunet
Franck César

Contract Management

Contractual Performance,
Renegotiation, and Claims:
How to Safeguard and
Increase Profit Margins

 Springer

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Renegotiation, and Claims: How to
Safeguard and Increase Profit Margins



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International Foreword to the Second Edition

Immanuel Kant, in his 1784 essay, *Perpetual Peace through International Cooperation*, wrote “the idea of the original contract without which no right over a people can be conceived.”¹ As I write the “international” foreword to the second edition of *Contract Management: Contractual Performance, Renegotiation, and Claims—How to Safeguard and Increase Profit Margins*, by Alain Brunet and Franck César, I think of all the international contractual disputes that could have been avoided if only those involved in the negotiations had read this book!

The authors bring a theoretical perspective from the world of behavioral economics to bear on practical applications, using examples from real-world civil engineering. Their discussion, for example, of the Channel Tunnel contract brings up the paradox of completeness as a resource, discussing cost overruns, time delays, and the resultant international embarrassment. Yet the final result of the project created an invaluable link that now seems inevitable and eternal. *The End of Time*, the theme song of the 2013–2018 television series, *The Tunnel*, sung by Charlotte Gainsbourg, used alternating lines in English and French to describe the partnership at the heart of any contract: “Set aside all fear/*Restons enlacés, pour l'éternité.*”²

The role of time in contact management is a key subject. The authors quote Jonas Söderlund, the Swedish organizational theorist, who notes that designers have a tendency to search for the perfect solution and not always the solution suitable for the system. That has certainly been my experience when serving as Commissioner of the New York City Department of Design and Construction (DDC), my city’s primary capital construction project manager. The agency built many of the public facilities and elements of civic infrastructure that New Yorkers use every day, from firehouses, libraries, police precincts, and senior centers, to water mains, sewers, pedestrian bridges, and public plazas. Many of the projects seemed simple at the outset, before the multiple hard-copy contracts were signed. But in many large cities, and in many smaller communities, even simple things become complex. Alain

¹Kant, Immanuel, *Perpetual Peace through International Cooperation*, 1784; Section 1: Inheritance, Exchange, Purchase, or Donation <https://www.mtholyoke.edu/acad/intrel/kant/kant1.htm>.

²Gainsbourg, Charlotte, *The End of Time* (translation from the French: “Let’s stay entwined, for eternity”) <https://tvtropes.org/pmwiki/pmwiki.php/Series/TheTunnel>.

Brunet and Franck César note that complexity is hard to define, but most people know it when they see it.

Managing much-needed projects and producing results in real time—on schedule and on budget—increasingly relies on digital tools not in the toolbox of project managers a decade ago. The authors note that for complex projects, traditional tools cannot deal with events on the horizon or even those in the medium term. When the contract is first being negotiated, there are many sources of ambiguity, which often lead to design changes and complex negotiations over change orders. The book describes how these changes can be the result of a lack of time or consideration, the subsequent introduction of new ideas or program elements, or changes in the project environment involving the insertion of new codes and regulatory standards.

In my experience, such design changes and the ambiguities identified on site can also result from changes in leadership, with new civic partners—appointed or elected—often having different expectations or constituent obligations. The authors reference the “Butterfly Effect” described by MIT meteorologist and mathematician Edward Norton Lorenz, whose chaos theory addresses how unexpected consequences result from small actions far away from the original inception. In the *Ethics of Ambiguity*, Simone de Beauvoir touches on values emanating from choices that require the realization of concrete ends, of particular projects. She writes, “But the present is not a potential past; it is the moment of choice and action; we cannot avoid living it through a project; and there is no project which is purely contemplative since one always projects himself toward something, toward the future. . .”³

The uncertain future—*Ten Years After*—is the current research subject of the Center for Buildings, Infrastructure, and Public Space⁴ at Columbia University’s Fu Foundation School of Engineering and Applied Sciences, which I direct. The impact of the coronavirus on the AEC Industry has caused us all to rethink our definitions of *force majeure*, to enhance our definitions of safety, and, in general, to look afresh at the different ways that technology can be applied to project management and the contracts that define and determine our interaction.

As Alain Brunet and Franck César point out, even an internationally recognized standard-form contract could be interpreted differently by the various parties entering into negotiation. The new edition of their book is essential reading for all of us passionate about how we can reduce ambiguity, avoid words that have multiple meanings, and, in so doing, emphatically assure a better future.

Columbia University
New York, NY, USA

Feniosky Peña-Mora

³de Beauvoir, Simone, *The Ethics of Ambiguity*, ©1948, translated from the French by Bernard Frechtman, The Citadel Press, Seventh paperback printing, 1975, p. 76.

⁴<https://cbips.engineering.columbia.edu>.

Foreword to the Second Edition

Contract management is first and foremost a mindset, but as job offers from companies of all sizes show, it is also a professional skill that is increasingly in demand. This is why the new edition of Alain Brunet and Franck César's go-to reference—always quick to pick up on significant developments in the corporate world—is so timely, arriving at a point when we can capitalize on the experience acquired in the management of contractual relationships over recent decades in order to systematize and optimize it.

My own experience relates to three large companies whose technological operations intensify their contractual complexity, both in terms of drafting and implementation. With hindsight, I can see that the contract management mindset and know-how give legal common sense a fair chance, as long as the objective of the contract's profitability is shared by all those involved in its negotiation and its adaptation to changing circumstances. This requirement makes the fortuitous association of the words *contract* and *management* and their productive interaction, all the more interesting. Provided, of course, that you adhere to the comprehensive three-sentence Management Course by Harold Geneen, the iconic head of the International Telephone and Telegraph (ITT) Group in the 1970s: "You read a book from beginning to end. You run a business the opposite way. You start with the end, and then you do everything you must to reach it." The metaphor of the book is to be taken literally, the contract never being behind us during its implementation, but well ahead, a kind of sacred text for both parties, who will strive to maintain the assurance of a balanced relationship when changes are required.

A piece of advice for contract manager candidates: in addition to demonstrating a multidisciplinary approach and good interpersonal skills, your CVs will need to emphasize your sporting prowess, as you will have to behave like hurdlers. The required margin and operating profit will be in your sights, but there will be hurdles to overcome—as is to be expected in the life of the contract—which you can conquer one after another, even toppling them all!

Of course, the days when contracts gathered dust in a drawer as soon as they were signed, only being brought out in the event of litigation, are long gone, because such disputes are too costly for companies in terms of time, money, image, and stock market value. Experience has taught me that a poor initial cost estimate is almost impossible to rectify once an industrial contract is implemented, because the parties

lose their primary common reference point: the mutual profitability they expected when the contract was signed. Even more seriously, the loss of trust between the contracting parties that stems from contentious proceedings prevents any negotiated return to the equilibrium at the heart of the contractual relationship, i.e., the mutual interest of the parties. Another observation from experience: often, more time is spent negotiating the necessary amendments internally than with the other party, which fully justifies the role of the contract manager as a link between these two negotiations. Although the contract manager role is now well established in companies, as shown in the first six chapters of Alain Brunet and Franck César's guide, the environment it faces today is both exciting and disruptive. This can be considered as a challenge to be met, as presented in abundant detail in Chap. 7. It is, of course, the role played by digital technology in developing contract management—in the form of collaborative tools, design methods, the partial automation of the contractual relationship, or decision-making aids to assess the probability of success in the handling of a case—that will call into question what the authors coyly call “the traditional legal approach.” What strikes me about this plethora of digital tools, aside from its unbridled creativity, is its galloping sophistication, which may lead to the contract's irreplaceable value, namely the (vigilant) trust between the parties and the common goal of profitability, being forgotten or diluted by technology. Trust is established between two individuals when each person can predict the actions of the other, and it is the same between two companies. The usefulness, and therefore the legitimacy, of contract managers lies in their ability to determine the tools that will make the contractual relationship more readily understandable for the contracting parties.

AFCM French Contract Management Association
Paris, France
August 2019

Coralie Bouscasse

Foreword to the First Edition

Risk-taking goes hand in hand with an entrepreneurial spirit: the entrepreneur's very *raison d'être* is typically to anticipate and manage risk.

In an uncertain context where margins have been reduced to a bare minimum, contractual problems will require rapid reaction and change.

The Channel Tunnel is a prime example if ever there was one.

When we consider that the consultation process, launched by the respective governments for one of the largest structures ever built, lasted a mere 5 months, there is no need to be a fortune-teller to predict what happened during performance: an economic disaster for some and a genuine strategic opportunity for others.

Although contracts clearly remain part of a company's strategic arsenal, they require a post-signature operational implementation that can no longer be overlooked.

It is to the credit of this publication (largely inspired by Anglo-Saxon practices) and of its authors, Alain Brunet and Franck César, both undisputed experts and practitioners, that they have shed light on this issue at such an opportune moment.

Although the rules of law are often (wrongly) seen as obstacles to entrepreneurial freedom, the authors convincingly demonstrate that contracts can prove to be formidable performance tools once practitioners understand how to use them.

Contrary to the notion that "a contract is made to be broken and to help lawyers serve some sort of purpose. . .,"⁵ the authors show that in a volatile context, particularly in the international field, companies are gradually becoming aware of the importance of intervening very early on, during the drafting of the contract, to prevent disputes, or during the contract's performance phase in order to mitigate the effects of such disputes. The risk of dispute becomes particularly acute when we consider that most international contracts are managed by specialists who devise renegotiation strategies designed to achieve a result in the best interests of the party they represent.

The risk of non-performance is all the more pronounced since the creation and closing of the contract call for long-term processes. The authors use this dynamic view to constantly remind us that it is individuals, with their limitations and

⁵Marcelle Bourgault, *Les Héritiers de la visionnière* (authors' translation).

preferences, who are in charge of implementing the contract. They define *contractual engineering* by drawing on the work of experimental psychology, a discipline that has finally succeeded in making its mark in the field of behavioral finance.⁶

Alain Brunet and Franck César have succeeded in pooling their experiences. They have also—and I am particularly pleased to point this out—drawn on the sense of belonging fostered by the alumni community of the *Institut de Haute Finance* (IHFI), which created the Turgot Prize, whose exceptional influence also owes much to the support of Professor Philippe Dessertine, Director of the IHFI.

Driven by the desire to contribute to “economic education,” in the truest sense, and to offer executives of both large and small companies, as well as operational managers, the key tools to guide their actions, they transmit both contractual know-how and a contractual mindset, which will help to make a lasting change to the mapping of company risks.

An essential “bedside book” for professionals as well as teachers and their students.

Turgot Prize
Paris, France

Jean-Louis Chambon

Cercle Turgot
Paris, France
October 2013

⁶The Grand Jury of the Prix Turgot (awarded for the best book on financial economics) was also a forerunner in this respect, crowning Mickaël Mangot in 2005 for his work on investor psychology and financial markets, *Psychologie de l'investisseur et des marchés financiers* (Dunod, 2005).

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Paris, France

May 2021

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How many people today have heard of Herbert Casson? Casson, a Canadian consulting engineer, is the author of a 1915 book entitled *The Axioms of Business*, although the nod to Euclid only thinly disguises its goals.

Admittedly, its publication did not exactly revolutionize management science and its theoretical flaws are plain to see, but the first of the 16 axioms of this summit of modernity is too tempting to resist: “Business requires two or more individuals”.¹

The present book is dedicated to examining this truism. We aim to clarify the bilateral relationship between project owner and contractor before turning to very simple, but hopefully very practical, tools.

To support this reflection, we draw on two fields related to contract law and the study of relationships between companies: the first, essentially pragmatic and oriented toward the project and its organizational aspects, is project management. The second is rooted in the most recent findings of contract theory, experimental psychology, and sociology.

Most management decisions have legal or contractual consequences. It therefore seems logical to consider the role of the contract when analyzing a firm’s decision-making processes. The firm’s actors do not necessarily perceive the sources of legal uncertainty in their daily activities, and largely attribute this feeling of uncertainty, which is reflected in the neologism “judicialization”, to a more global development that they believe to be beyond their control. It is not uncommon for complex projects to lead to an arbitral award. Although the relative ease of international enforcement is one of the reasons why unsuccessful litigants concede, aside from the fact that they behave like gentlemen and accept “the glorious uncertainty of litigation”,² investors, and especially shareholders, find this uncertainty difficult to accept. As we know,

¹Édouard Herriot’s preface to the French edition of *The Axioms of Business* offers high praise for Casson, “A fully modern man, free of metaphysical fog, without historical clouds before his eyes.” (Cited by Nikitin 2003, pp. 67–75, authors’ translation).

²Loquin (2003), pp. 747–760 (authors’ translation).

they are notoriously averse to unpleasant surprises, but they are nonetheless convinced that the contract has a key role to play in improving the company's performance.

Authors and practitioners regularly question the reasons for the frequently inexplicable discrepancies between their expectations and the actual results generated by the dominant management model. This is despite the development of increasingly sophisticated methods (at the risk of oversimplification, the main stages of this process could be summarized as follows: the 1970s were devoted to project management software, the 1980s to design-to-cost and expert systems, and the 1990s to human resources and risk management). The problem, behavioral economists tell us, is that our choices are far from optimal and our cognitive model is based on rational assumptions that are untenable in a context of uncertainty: a cause must generate effects, productivity is an input, and the project is defined once and for all... In reality, individuals do not know how to adapt their mental schemas and are subject to the optimism bias.

According to Pierre Charreton, "We are no longer in the age of sustainable products, sustainable relationships, and sustainable partnerships, although the term remains very much in fashion. Opportunism is now the order of the day."³ The strong discretionary power of the project owner explains, if not legitimizes, the pre-eminence of the fixed-price contract, a melting pot of complex and often conflicting situations that push risk onto the contractor.

A company's assessment of a business deal tends to be based above all on financial return and there is a strong temptation to focus solely on the goal of profit. When two parties negotiate, their requirements regarding various aspects of the contract convey relational signals that reveal the spirit in which the agreement is reached. Regular negotiations and contractual adjustments offer them many opportunities to break this dynamic, but also, conversely, many opportunities to signal their willingness to cooperate. The dynamics of framing provide us with an integrative model: there are different phases in a contractual relationship and the contract plays a different role in each of these phases.

It is also reasonable to question whether employees receive sufficient legal support, particularly in the field of contract law. It is clearly surprising that the engineers acting on behalf of their companies on a daily basis have only a very vague notion of their ability to commit their entire organization, even if awareness has evolved considerably since the early 1990s, when the lawyer Roger Percerou⁴ noted that the term "mandate" merely evoked a "money order" for some (or the response of the CFO who claimed with aplomb that he had never entered into a contract on behalf of his group).

Once "contractual engineering" has been implemented, with its combination of contractual mechanisms and behavior, the actors acquire a certain autonomy and the

³Charreton (2011), pp. 117–125 (authors' translation).

⁴The following article by Roger Percerou may well be of interest to readers, Percerou (1990), pp. 8–35.

method can be of great help to practitioners, who will be supported by contract managers—professionals who have become experts in the field.

There is no doubt that after more than 30 years of uninterrupted development, behavioral economics is on the way to becoming the dominant paradigm, especially following the 2002 Nobel Prize in Economics,⁵ which was awarded to Daniel Kahneman. Following in the footsteps of French researcher Maurice Allais, Kahneman (a researcher in experimental psychology) and Amos Tversky⁶ designed a series of experiments that showed that the choices we make are not necessarily in our best interests. While it is well established in the field of market finance that players sometimes act irrationally (some critics have noted that it didn't take a Nobel Prize to bring this point to light!), we would agree that much work remains to be done in the area of contracts.

Where appropriate, and to enrich our arguments, we include quotations from the works cited, translating foreign-language texts so that readers are able to benefit directly from the insights provided.

Throughout the book, the reader will find “in practice” boxes highlighting specific points relating to the practical arena. These include illustrative anecdotes, descriptions of experiments, or practitioners' reactions to practical situations.

The overall challenge is knowing how to interpret behaviors that form strategic or psychological obstacles, in order to overcome them and cooperate successfully with the other party.

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⁵Or more precisely, “The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel”.

⁶Amos Tversky died in 1996. His collaboration with Daniel Kahneman was exemplary in every respect.

Contractual Performance, a Strategic Challenge

2

In the business world,¹ contracts govern, structure, and influence the way that companies and organizations operate, and they play an essential role in creating sustainable competitive advantages.

In a globalized economy, entering into a contract with a third party, which often has a different culture, legal system, and business practices, can bring both opportunities and threats.

Awareness of the potential impact of contract risks, not only on the legal security of the company, but also on its sustainability, its image, and its business continuity, is relatively recent.

This awareness has developed strongly over the last 20 years, both in private companies and in organizations in the public or parapublic sector, alongside an increasing interest in risk management, which has become a central preoccupation for senior management.

But controlling contract risks is not only a question of compliance.

Although the concept of contractual performance has yet to gain a solid foothold, the increase in competitive intensity has highlighted the positive role of contract management as a key element in a company's overall performance.

From this perspective, companies cannot ignore the challenges and benefits of an active vision of contract management, which is:

- a conscious activity undertaken by the company in its contractual sphere; and
- oriented towards one goal: the improvement of economic and operational performance.

¹For Éric Brousseau, the notion of a Walrasian “market secretary”, who would centralize all offers and requests, is pure fiction. It was not until the early 1970s that economists “sought to better account for what markets are actually made up of: contracts” (Brousseau 2000, authors’ translation).

2.1 Contract Management: A Business Lever

Faced with the ever-increasing complexity of the economic and legal environment, safeguarding the interests of the company (or of the organization in the broadest sense: public companies, local authorities, associations, etc.) in its commercial relationships with its contractors is of strategic importance.

In a context of globalized trade where companies are increasingly focusing on their core businesses, the number, complexity, and criticality of the contracts that link companies to external partners (customer contracts, partnership contracts, subcontracting, technology transfer agreements, etc.) have increased significantly (as have their negotiation and monitoring costs!).

2.2 Strategic Contracts That Carry Critical Risks

In the digital age, the customer is “everywhere”: customer strategies are “omnichannel”, distribution channels are multiplying (web, mobile, physical distribution), interactions with the customer are frequent, and sometimes at all stages of the value chain.

Customers want to remain in control of their purchasing activities, whether this relates to monitoring the progress of their orders or to personalizing their products, and will impose the highest e-commerce standards on suppliers (order modifications, delivery times, returns management, cancellation conditions, etc.).

To adapt to these new requirements and to offer new services and greater responsiveness, companies need to broaden their supply chain, which now extends beyond the boundaries of the company to connect (thanks to the internet and the Internet of Things (IoT)) to the outside world (suppliers, logistics providers, marketplaces, etc.).

In Practice

Internet of Things security

The Internet of Things (IoT) is often referred to as the “Internet of Threats” to highlight its low level of protection against cyber threats such as ransomware and other types of malware. The security of IoT systems will be one of the major challenges to address in the coming years. Security can be extraordinarily complex due to the number of physical devices (sensors, peripherals, etc.) found on industrial sites and their massive deployment via cross-platforms and clouds that continually connect in real time. The potentially large area of attack makes threat modeling a necessity. While blockchain (which we will discuss in the last

chapter) is supposedly unhackable, this is not the case for the applications that use it.² ◀

These new, open ecosystem, industrial strategies encourage companies to conclude multiple and often novel forms of partnerships (white labels, marketplaces, etc.), characterized by increased interactions between contractors, a stronger overlap between their respective service offerings, and, ultimately, by greater dependence and increased risks, particularly for the image of each partner.

However, these developments are not specific to the B2C world: in traditional B2B sectors, the Industry 4.0 revolution is manifested by increasingly interconnected value chains, as in the automotive or aeronautics industries, where the notion of a “supply chain” is now tending to replace the traditional segmentation between automakers, original equipment manufacturers (OEMs), and Tier 1 suppliers.

Integration is no longer merely vertical and the service delivery chain is no longer linear (customer → supplier → subcontractor), but is based on a network organization, with multiple interaction loops at each stage of service delivery, and on a tangle of underlying contractual relationships.

Nevertheless, contract risks are often among the least controlled business risks, particularly in view of their changing nature throughout the life of the contract.

To reduce legal risk—if we consider that lawyers have the ability to act on “legal standards” in general, whether they are laws, regulations, or a compliance program³—we need to reduce uncertainty (echoing the irrepressible sense of dread that grips lawyers at the precipice of a “legal vacuum”).

Sound management of contract risk involves understanding the optimal point between the economically justifiable level of risk and the effort required to control the effects of an acceptable degree of uncertainty.

Finding the right balance between the entrepreneurial risk-taking necessary to develop the company, the contract’s required flexibility and adaptability to change (business, technological, regulatory, etc.), and the control of performance risks becomes one of the major challenges for contract management.

Some groups have understood this, and are seeking to “de-legalize” their approach to contracts, in particular by drawing on “proactive law” contributions (which we will return to later), the primary purpose of which is to enable the parties

²Indeed, given that “virtually everything can now be connected to the Internet, we have to recognize its corollary statement: everything that can be connected to the Internet can be hacked” (quoted by Weber and Studer 2016, pp. 715–728). A recent survey (2018) conducted by Deloitte of 1,100 IT and line-of-business executives in US companies shows that cybersecurity is the most important issue for 23% of them, so much so that one in five respondents decided not to launch artificial intelligence investment initiatives.

³For Pierre Charreton, the notion of legal risk inherent in a legal world that is “in a state of levitation”, decoupled from entrepreneurial risk, stems from an abuse of language that is “very often maintained by lawyers themselves, perhaps out of existential concerns” (Charreton 2011, pp. 117–125, authors’ translation).

to achieve their partnership objectives. Winning in court is no longer the primary objective. The challenge is to maximize value creation while controlling risks.

The issue is no longer limited to protecting oneself against uncertainties or legal events that will probably never happen, but is about contributing to positive results for the business, measured in terms of costs, deadlines (setting up the contract, administration, etc.), and economic gains (control of risks and management of opportunities).

2.2.1 New Industrial and Competitive Approaches

Companies' business models are no longer based solely on their intrinsic competitive advantages (product quality, technological expertise, etc.), but also on their ability to forge strategic partnerships with third-party companies.

2.2.2 Customers, Partners, Subcontractors: More Open-Ended Models

New business models have thus been developed with the aim of building sustainable competitive advantages by collaborating with actors who can be both partners and competitors, depending on the context of the intervention.

Commercial, technological, and industrial partnerships are numerous and have now taken their rightful place in managers' strategic arsenal, whether in the form of extended supply chains that aim for "pull-flow production" with one or more global players, close partnerships with strategic suppliers, or clusters based on industry expertise.

What is at stake? To be part of a more global, evolving, and competitive environment, driven by the highly segmented needs of versatile customers. . .

In this context, the company's objective is no longer simply to further internalize technical capacities, but to develop negotiation and contractual engineering skills that will help it to position itself at the heart of a complex ecosystem comprising a multiplicity of distinct players—in terms of expertise, size, and country of origin.

2.2.3 "Coopetition" Strategies

The notion of "coopetition",⁴ a neologism derived from the contraction of the terms cooperation and competition, has emerged to describe the ad hoc collaboration mechanisms between players who may be competitors in historical markets.

Coopetition was used by Yahoo! and Microsoft in 2010. Despite being competitors in the search engine market (Yahoo! and Bing), the two companies

⁴On this topic, see <https://www.youtube.com/watch?v=FhQBtOUF9oI>.

agreed to strengthen their joint competition against Google, which at that point dominated two-thirds of the global online advertising market.

Some competing pharmaceutical groups also pool R&D resources to develop new products (such as Plavix, the result of an alliance between Sanofi and Bristol-Myers Squibb) or the Alstom and Bombardier groups, which, although direct competitors in the rail transport sector, are partners in various consortia, for example in France for the supply of trains to the Paris transport operator RATP.

Long regarded as defensive or solely focused on reducing costs, coopetition strategies are increasingly seen as an offensive strategy: pursuing innovations that no company would have been able to implement in isolation or creating offers aimed at capturing new market share, thus distancing other competitors.

Although seemingly counter-intuitive and even paradoxical, these strategies—which are not without their challenges (particularly contractual and legal)—aim to create market disruptions and develop new capacities through cooperation, which each partner will then use individually to strengthen its own position.

2.2.4 Business Process Outsourcing

In parallel with these coopetition dynamics, companies have been refocusing on their core businesses in recent years, considering that delegating certain aspects of their value chain to third parties not only guarantees the efficiency of outsourced functions, but also drives flexibility and agility in their core businesses.

In the IT sector, for example, many large groups have outsourced the bulk of their infrastructure management or application development activities to large software engineering companies, often based in India or Eastern Europe.

The beneficiaries of these outsourcing movements experience massive changes of scale, as in the case of Accenture (450,000 people in 2018), whose workforce in India and the Philippines alone now exceeds the company's total workforce less than 10 years earlier (200,000 people in 2010).

With the economic boom in certain countries with low labor costs, entire functions are now largely outsourced, not only so-called “support” functions (IT, general services, accounting, etc.) but also operational functions (manufacturing, logistics, etc.).

Business intelligence provider Visiongain estimates that the pharmaceutical sector's “contract manufacturing outsourcing” market will be worth US\$93 billion in 2022, with most “active pharmaceutical ingredient” (API) production now being outsourced (particularly to Asia).

For large laboratories, given the industrial, regulatory, and image risks and the impact on public health, all supplier relationship management practices must be reviewed: in particular, contracts must offer a flexible framework to meet the need for traceability, quality monitoring, and transparency.

However, this upsurge in outsourcing is not exclusive to industrial players and is gradually spreading to the service sector, particularly the banking and financial

sector, which outsources many critical activities, such as cash transportation, payment methods, and middle or back-office services.

In this context, when groups outsource functions that are essential to the production of the product or service provided to the client, the contract becomes the major lever for controlling operational risks, including the risk of dependency on third party companies, a consequence of the loss of know-how of internal teams.⁵

2.2.5 The Contract, at the Center of the Partnership Relationship

These developments have naturally established the ability to lay contractual foundations and to establish, negotiate, and manage complex contractual commitments beyond classic customer/supplier relationships as a key skill for organizations.

Whether it is a commercial contract with a customer, a procurement contract with a supplier, or a partnership or outsourcing contract, the contract has thus taken on an increasingly central position.

Taking the lead and dominating the competition now depend just as much on a winning partnership strategy as on traditional internal know-how.

The purpose of the contract, and the underlying contractual engineering, is no longer simply to transfer ownership of a good, a service, or a risk, but is also to drive strategic differentiation and risk security.

This new reality is summed up in a concise and enlightening way by the following quotation, attributed to an American CEO, “If you are not in control of your contracts, you are not in control of your business.”

However, although companies’ contract management has generally become more institutionalized and complex, new areas of risk have emerged, linked to a contractual corpus that is sometimes poorly controlled, even within the largest organizations.⁶

2.2.6 Contract Risks Are Often Inadequately Controlled

The increase in the number and criticality of contracts has gone hand in hand with an increase in their complexity.

⁵ An analysis of the “hidden costs” of outsourcing operations shows that the greatest effort should be put into the contract itself (Barthélemy 2001, pp. 60–69). See also Michael J. Earl, “The Risks of Outsourcing IT”, *MIT Sloan Management Review*, 1996, <https://sloanreview.mit.edu/article/the-risks-of-outsourcing-it> and <https://www.supplychainquarterly.com/articles/746-the-10-hidden-costs-of-outsourcing>.

⁶ A survey conducted by Ernst and Young in 2006 with a sample of 140 financial executives indicated that 52% of respondents considered that their contract risk management was under control, 22% “did not know” their degree of vulnerability, and 26% saw this as a likely “opportunity for improvement”.

What Is Contract Risk?

Contract risk is often defined as “the possibility of financial loss either due to a buyer reneging on the contract or a failure by the organization to adequately manage the contractual benefits or obligations”. (Source: [lexology.com](https://www.lexology.com))

It is standard practice to consider contract risk as distinct from legal risk. Drawing on one of the examples cited by Christophe Collard and Christophe Roquilly, an operational definition could be:

- contract risk is specifically related to “imprecision, gaps, or other inadequacies in contractual documentation, which result in the contract failing to fully and clearly reflect the parties’ intentions or to sufficiently protect (the contracting party’s) interests by avoiding the risk that it will be held liable”;
- legal risk, on the other hand, covers “non-compliance with the legal, regulatory, or case law provisions governing the exercise of the company’s activities”.

From the inception of the contract, each signatory party agrees to accept a degree of exposure to a number of risks that it deems acceptable:

- financial: hope of making a gain, likelihood of making a loss, etc.;
- technical: beyond the delivery of the product or service, each party judges both its own capacity (and the capacity of the other party) to perform its contractual obligations and the risk and impact in the event of each party’s failure to meet its own obligations; and
- legal (legal security, compliance with regulations, etc.).

Contract risk therefore lies at the crossroads of these different dimensions. It is a type of entrepreneurial risk that each of the parties agrees to accept when signing the contract, with respect to:

- its interpretation of the obligations entered into by each of the parties at time t ; and
- the likely evolution of the contractual relationship over the term of the contract.

We would like to highlight three major points here:

- contract risk is not stable or linear over the duration of the contract; it evolves as soon as the contract has been signed, and its development will be influenced by all of the operational events that mark the life of the project;

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- contract risk, which is a type of “performance risk”, is affected by the ability of the contracting parties to perform their contractual obligations. It has a strong temporal and operational dimension (which, as we will see, calls for the implementation of specific governance processes to manage the contractual commitments); and
- contract risk is cross-functional: it is not the sole responsibility of the legal department, in that it reflects the company’s strategy (and in particular its partnership strategy) and its degree of risk appetite or aversion.

2.2.7 More Inherently Complex Contracts

Beyond the differences between legal systems,⁷ a number of factors add to the complexity of contracts, including their very structure, which tends to increase their unit cost (cost of contract).

Complexity corresponds to what is impossible, or in any case difficult, to understand, analyze, manage, control, anticipate, and forecast.⁸ This complexity is primarily cognitive and informational given the multiple contractual documents, including technical appendices as voluminous as they are specialized, which require a very broad range of skills in order to fully understand all the associated contract risks.

Contractual patterns are also built around numerous partners from various professions, working on interrelated work packages. Contract risk therefore also arises from the numerous and complex interfaces between these partners, remembering that a delay generated by one of them can cause a delay for all the other players involved in the interface.

The result of this complexity is longer lead times and higher costs.

According to a study carried out by the International Association for Commercial and Contract Management (the IACCM), the time taken to review and validate contracts (the cycle time) has increased by 14% since 2010. Similarly, according to another IACCM study (conducted among 700 organizations and dating from 2017), the average cost of creating a contract (drafting, negotiation, approval) may have

⁷These differences, and the increasing interactions between the various systems, are evoked by French jurist Mireille Delmas-Marty as follows: “Despite the discontinuities created by the autonomy of the various legal systems, the novelty is that the increasing number of interdependent situations is making isolation impossible and encouraging such interactions. Regardless of the field considered, neither the governments of ‘independent’ states, nor the legislators of ‘sovereign’ parliaments, nor the judges of ‘supreme’ courts can totally ignore the existence of other national, regional, and international legal systems: national law is, in a way, surrounded from all sides.” (Delmas-Marty 2006, authors’ translation).

⁸Franck Marle, *Modèles d’information et méthodes pour aider à la décision en management de projet*. Doctoral thesis at École Centrale Paris, 2002.

risen by more than 38% in the space of 6 years, in particular because of the number of stakeholders involved in drafting the contract, regulatory inflation, or new challenges (cybersecurity, personal data, etc.).

Companies have taken on board this trend toward more complex contracts and are trying to control it, in particular by mapping the interfaces between actors (by defining as precisely as possible the actions to be performed by each one) and by preparing visual representations (responsibility matrices, RACI, tree structures, etc.).

However, studies have shown that traditional project management approaches often fail to take into account the extent of the interrelationships between actors.⁹

Finally, contracts are often designed to serve profitability and return on equity objectives, which have tended to increase since the 2000s (with a level of around 15% in Europe).¹⁰ This often leads to the inclusion of clauses relating to deadlines and to compensation payments for delays, which can be extremely costly for the defaulting party. This can in turn encourage the parties to strengthen their respective safeguards and to try to insert loopholes (often located in the technical appendices), making the contractual corpus even more complex.

2.2.8 Difficulties Understanding the Completeness of the Commitments Made

Despite this growing complexity, many companies have only a cursory view of the contractual commitments they have entered into, which is clearly problematic in terms of controlling the associated risks.

Although the emergence of Contract Lifecycle Management (CLM) software solutions partially resolves these difficulties (we will come back to this topic later), it is estimated that 80% of companies have difficulty assembling all of their contractual reference documents (contracts and amendments) and, therefore, understanding and analyzing their content.

Necessary information such as due dates, analysis of all current contracts at a supplier or customer level, or the typology of the most risky clauses is often only available on a piecemeal basis, requiring manual, ad hoc analysis, leading to delays and information processing costs.

In addition, efficient contract management requires the ability to quickly prepare “standard” contracts, based on tried and tested clauses and terminology, and to validate any deviations from this standard via proven validation circuits.

However, in reality, contracts often mechanically replicate clauses drawn from the company’s past projects. They may also be based on the habits of the person drafting the contract, or may recycle and “customize” templates, which may not necessarily be appropriate for the project at hand. These modifications are performed

⁹Rodrigues and Bowers (1996), pp. 213–220.

¹⁰Source Datastream/Worldscope.

on a case-by-case basis, sometimes without a formal analysis and validation process to examine deviations from the standard wording.

Finally, too few companies genuinely examine the efficiency of their clauses by benchmarking them against best practices, which is undoubtedly due to the lack of a universally recognized best practices framework for contractual clauses.

However, some notable initiatives include:

- the CommonAccord project developed by James Hazard, which aims to build a library of contractual clauses, accessible in open source and enriched collaboratively by a community of users. This initiative aims to codify, standardize, and automate the drafting of clauses (by removing lawyering), contributing to the move toward “smart-er” contracts;
- the IACCM’s “virtuous” contracting principles (IACCM Contracting Principles) and the related model clauses, accessible to all and expected to be enriched by a large number of users.

Overall, companies frequently lack the capacity to control the exhaustiveness and scope of their exposure to contract risks, both in the upstream (pre-signature) and performance (post-signature) phases.

2.2.9 Difficulties Monitoring the Contract Lifecycle

The contract is a “living” object, sometimes so alive that it can prove fatal in terms of the strategic commitments made.

Companies must therefore be able to analyze the “trend” of the contract:

- over the course of the project to measure changes in its risk exposure; and
- at certain key milestones, in particular to ensure that binding contractual deadlines are met.

However, in practice, few companies are able to globally monitor their contract lifecycles, although it would help them to comply with the contractual milestones for which they are responsible (possibly subject to compensation payments for delays).

The Increasing Complexity of Contractual Patterns: The Example of “Turnkey” Contracts

In a turnkey contract, the contractor undertakes to deliver the complete product to the project owner in working order, from design to acceptance, after verification of its performance guarantees where appropriate.

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These types of contract have specific features that are worthy of mention here, in that they frequently involve a consortium of separate companies that “jointly and severally” enter into contractual commitments with the customer.

In this context, one of the partners often plays a leading role as integrator of an overall system, the components of which are then designed and manufactured by other partner companies in the consortium.

By its very nature, this type of contract implies a tangle of overlapping responsibilities and specific risks for the lead partner, toward both the client and the other members of the consortium.

As shown in the example here relating to an international project for the construction of a subway, the lead partner agrees to accept “global responsibility for all the work packages and sub-systems”, including:

- committing to respect overall performance deadlines;
- ensuring that the services delivered are adequate with respect to the contractual documents;
- committing to take full control of the interfaces between all of the work packages and sub-systems “to form a coherent and effective integral system”; and
- making a financial commitment, since in the event that any of the consortium members make errors that harm the project owner, the lead partner will potentially be liable “in respect of any of the members of the consortium”.

Consequently, although each member of the consortium remains responsible for the technical tasks allocated to it and, in particular, for the operation of its equipment, the lead partner cannot absolve itself of all responsibility in the event that one of the consortium members fails to deliver the required services.

2.3 Controlling Contract Performance: A Major Undertaking

2.3.1 More Offensive Commercial Strategies

Random events may jeopardize all or part of the company’s activity and/or assets. Not all risks are insurable and the implementation of contracts by operational staff legitimizes the need to design appropriate strategies that use the contract as a resource.