

10 Recommended Terms & Conditions For Exiting A Parts Management Services Contract By Ron Giuntini

As in all contracts, "stuff" happens. One of the areas that "stuff happens" is when the supplier does not achieve performance levels assured to the customer, and as a result, the customer decides to terminate the contract "for cause."

Spending time upfront when crafting a contract to include Terms & Conditions (T&Cs) that deal with contract termination can save an equipment operator much grief if a program goes "south." Contract termination is not a pleasant event, but pre-packaging the rules for de-coupling can mitigate the risks of severe disruptions in the availability of parts during the transition period.

Below are 10 elements that should be included in a parts management service contract's T&Cs to effectively manage its "exit" from a contract. The focus of this article is on contracts in which a supplier plans and controls the parts issued to an equipment operator's maintainers. Note: This article will not discuss cases in which bankruptcy drives the termination of the contract.

1. Performance metrics that trigger cause for termination

By establishing a few "simple" performance metrics and their acceptable ranges, emotional subjective "he-said, she-said" issues can be minimized. For example: A performance metric is established in which a monthly moving average of 95% of the customer's maintainer parts requirements are to be fulfilled within 24 hours. If actual performance falls below 85% for any two months over a 12-month period, the customer has the right to terminate the contract. Note that collecting accurate performance data is critical in avoiding further problems of "he-said, she-said."

2. Service termination phase-out period

This period is important because it provides the opportunity to control, in a planned manner, the phase-out of the current service supplier and the phase-in of the new service supplier; note that as a result of the poor experience of contract termination, the customer may choose to in-source the work. The period should cover, at a minimum, 3-6 months. Unfortunately, there can be much stress during the period between the 3 parties involved: the customer, the terminated-supplier and new-supplier. The terminated-supplier wants to "cut its loses" as quickly as possible, the customer wants to assure that there is no disruption in its operations and the new-supplier wants to assure that all their "t's are crossed and i's are dotted" in their contract in order not to make the same mistakes as that of the terminated-supplier

3. Buy-back exit-transition-kit and price for non-repairable parts

These kits should include all part numbers, classified as non-repairable, and the quantities that are believed to be sufficient to support a period between when the current-supplier exits and the new supplier is inducted. The price should be composed of the most current acquisition costs (continuously updated) for all the part numbers with an integration (supply chain management of planning, acquisition, physical distribution, engineering, accounting, customer relations and program management) allocation % added to the kit cost. For example if the most current unit costs for all the part numbers and quantities is \$1,000 and the integration allocation % is 40%, then the unit price would be \$1,400. This is a "touchy" area; if the kit price is too expensive because the supplier has "gold plated" the price in order to "punish" the customer for exiting the contract, then the customer may "walk" from buying the parts or develop a high level of resentment by the customer that they were "taken advantage of" in being "forced" to

pay "too much"

4. Buy-back exit-transition-kit and price for repairable parts

As in the #2, the kit configuration should be similar, but for repairables, the part condition must also be defined; identifying which items would be in a new, used-as-removed, repaired, or overhauled/remanufactured condition. The value and reliability of the part is driven by this condition definition

5. Obtaining reliability Intellectual Property (IP) data of parts failure

Due to the customer not having the need to collect demand history for parts, because they have outsourced that activity to the supplier, and most likely not having had collected the data for other reasons, it is critical that the data from the terminated-supplier be obtained in order for a new-supplier to use the data as inputs to their operational planning and control processes. The T&Cs must identify how data sets are stored in the application system software being utilized by the terminated-supplier will be transferred to the customer. If the data set format is not defined in the contract, the customer may have data that it cannot use. This will make it very difficult for the customer to decouple from their current supplier

6. Reimbursement for seeking a new parts management service provider

All contracts should have a termination reserve fund to compensate the customer for the costs it must incur to seek a new supplier; similar to a rental agreement in which one month's rent is held in an escrow account in case the renter damages the landlord's property. A rule of thumb is to reserve at least 2 months of the expected contract value to be straight-lined funded over a 24 month period; so if you have a 60 month contract at \$12,000/month, a reserve of 2 months, or \$24,000, would be reserved over a 24 month period, or \$1,000 would be reserved per month in an escrow account

7. Access to computerized planning and control systems

The terminated supplier should be required to install their application planning and control software on a "host" and provide the use of the software in a "Software As A Service" (SAAS) environment; the customer is charged per period for its use. The first three months would be at a fixed marginal charge, which would be paid from the contract termination reserve fund; further use would be paid on a fixed monthly basis Without this capability, major disruption in operations could occur, or many people would have to be added to the maintenance organization to "grunt" through the process

8. Access to current parts suppliers

A list of suppliers that have been providing parts to the terminated supplier must be provided to the customer or the new supplier. This IP is critical for the customer to move forward with its transition. The terminated supplier should continually update this listing during the contract. It is recommended that an independent third-party audit the supplier to validate that they are keeping their parts supplier listing currently updated

9. Transfer of updated technical documentation: maintenance parts repair manuals and illustrated parts catalog

If the contract calls for the service supplier to maintain the technical documentation for maintaining the equipment, either hard-copy or electronically, the documentation must be transferred to the customer at termination time. This is important especially for equipment that is "technology refreshed" on a frequent basis. Without the proper equipment configuration, the planning of parts becomes very difficult; the customer can order parts that are no longer applicable to the current configuration of their equipment

10. Transfer of open parts supply orders from the terminated supplier to the customer or the new supplier for selective items not in the termination kit

This element is extremely important for long-lead time parts that are to be used in a planned maintenance event. These are usually expensive items with only one supplier

Though contract termination is something that should not be greatly dwelt upon when forging a relationship between a supplier and its customer, the proper crafting of termination T&Cs will enable the customer to believe that they can mitigate their business risks if the relationship fails.