

Facilities Management Contracts: A Few Things to Know

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Whether it is an airport, industrial facility, power station, hospital, commercial tower, residential project or any other asset, for a project to retain its value, be attractive to its users and function as intended, it must be operated and maintained properly. This is normally done through the appointment of a facility manager under a facility management contract.

Regardless of the type of facility, it is important to ensure that the facilities management contract contains certain key provisions to ensure that the facility management contract properly fulfils its required purpose.

Scope of services and the consequences of breaches

The primary rule for any facility management contract is that the precise scope of the facilities management services to be performed by the service provider are clearly set out in the facilities management contract (typically in a schedule), together with the relevant Key Performance Indicators (or KPIs) which the service provider is required to achieve.

Such KPIs should be SMART – Specific, Measurable, Achievable, Relevant and Time based. They need to be clearly defined as well as capable of being assessed objectively.

The service provider is usually required to submit to the employer a 'work plan' which demonstrates how the service provider will discharge facilities management services and satisfy (if not exceed) the KPIs. The work plan should be a 'living document' and should therefore be subject to periodic review and refinement.

The KPIs should address the fundamental requirements of the facilities management services and often focus on such things as availability, response times as well as the overall quality of service. However, the precise scope of these requirements needs to be tailored on a case by case basis.

To ensure single point responsibility, it is important that the service provider warrants that it has carried out all reasonable investigations and inspections of the asset and that the asset is capable of being managed to the standards prescribed by the facilities management contract. This will eradicate the risk of the service provider seeking to blame the building contractor for any deficiencies in the facilities management services.

From a practical perspective, where the asset is a new building, it may be a good idea to have the service provider inspect the asset prior to Take Over and to attend any tests on completion under the construction contract. You may also consider including in the building contract an obligation on the building contractor to provide the service provider with training for the operation and maintenance of the asset. This will need to be addressed at the earliest stages of a project so that it is possible for the construction contract to include clauses to address these issues.

Penalties

In order to incentivise the service provider to comply with the KPIs, it is usual for financial penalties to be levied if the relevant requirements are not attained while bonuses may be available if KPIs are exceeded (particularly if this will confer a financial benefit upon the employer).

Careful thought should be given to any penalty regime, especially from a practical perspective and bearing in mind the specific characteristics of the project. For example, a service interruption which occurs during non peak hours may have far less of an impact than would have been the case had the interruption occurred during peak hours, so the penalty regime should reflect this.

Additionally, care must be taken when determining the amount of any penalties (which the employer should be able to recover without any need to establish any loss). A balance must be struck between imposing financial penalties which are significant enough to incentivize the service provider to properly discharge its obligations under the facilities management contract but which are not unduly onerous. Indeed, levying severe penalties can be counterproductive as they can damage commercial relationships and may damage the service provider's cashflow and therefore its ability to adequately provide the facilities management services.

To facilitate the recovery of penalty payments, it would be usual for an employer to insist on having a clear right to set off penalties from subsequent payments to be made to the service provider. The employer may also wish to have the ability to make a call on any performance bond provided by the service provider (particularly if the outstanding penalty exceeds a certain threshold).

Termination rights

While most commercial agreements provide for rights of termination in the event of 'material' breaches of contract, what constitutes a material breach can be unclear. In the context of facilities management contracts, this uncertainty can be circumvented by stating that a ground for termination is triggered in the event of specified breaches of the KPI regime.

For example, a right of termination may be invoked if the financial penalties levied for failure to satisfy the KPIs exceed a stated threshold as this is indicative of consistent poor performance or if a 'fundamental' breach occurs (i.e. if there is a complete outage for a significant but defined period of time).

Aside from termination of the facilities management contract pursuant to the KPI regime, facilities management contracts should also contain customary grounds for termination (including in the event of insolvency and breaches of any anti corruption laws), while the employer may also wish to have the flexibility to terminate the facilities management contract at its convenience.

Termination for convenience should be considered as the term of facilities management contracts can be relatively long (i.e. 5 years would not be unusual) while commercial circumstances can quickly change. In practice, the employer's right to terminate a facilities management contract at its convenience may be limited to set times, for example on the third anniversary of the date of the facilities management contract.

Whether or not the service provider will be prepared to agree to a right of termination for convenience will be largely determined by the party's respective bargaining power as well as the compensation payments to which the service provider will be entitled if the right to terminate for convenience is used. The issue of loss of profit is likely to feature highly in any such negotiations.

Monitoring performance

Regardless of how well a KPI regime is drafted, the KPI regime will have little practical significance unless the service provider's performance can be effectively monitored and evaluated.

It is therefore vital that the service provider submits regular reports (typically on a monthly basis) to the employer regarding the status of the facilities management services. These reports should include details of (and the reasons for) such things as outages, accidents and complaints.

The monthly reports should be complemented by the employer having clearly defined inspection and audit rights (including of the service providers records, which survive termination).

Scheduled maintenance

Wear and tear is fact of life and it is therefore important that any facilities management contract makes adequate provision for scheduled maintenance to take place. This is typically performed pursuant to a maintenance plan which has been pre-agreed by the employer (including in terms of scope and cost).

The KPI mechanism needs to take into account the scheduled maintenance plan (which should cause as little disruption as possible) and contains appropriate carve-outs. However, care must be taken to ensure that breaches by the services provider are not incorrectly characterized as scheduled maintenance, thus wrongly absolving the service provider from liability.

The facilities management contract should also make it clear whether the employer or the service provider is responsible for procuring spare parts. This is particularly important when any stockpile of spare parts provided by the building contractor has dissipated and spare parts need to be independently procured. It is often felt that the service provider is best placed to accept this responsibility in which case the service provider's remuneration needs to address this issue.

Interface with third parties

Given that facilities management contracts usually concern operating assets and facilities, it is pivotal that the drafting of the facilities management contract makes it clear that the service provider must not delay, interfere with or disrupt the day to day operations of the asset. How the interaction between the service provider and other contractors on site is managed needs to be considered and documented.

If any such clause is to be meaningful, it is important that the service provider is fully aware of the day to day use and operation of the asset and this usually means that the employer is required to disclose relevant third party contacts to the service provider. If the employer is to disclose any third party contracts, the employer should be mindful of any confidentiality provisions as well as the need to delete any commercially sensitive information.

Handback procedures

Employers usually periodically re-tender facilities management contracts, including to ensure that it is obtaining the most competitive rates in the market. It is therefore important that the duration of the term is considered and that the facilities management contract contains a clear handover procedure, which will become operational if the employer decides to change service provider.

The handover procedure should include a programme for the service provider's transition out of

managing the asset. The outgoing service provider may be required to provide its successor with appropriate training as well as a license to use any intellectual property rights to perform the facilities management services going forward.

There should also be an inspection of the asset prior to the expiry or termination of the facilities management contract and the service provider should be required to remedy any defects in the asset which are attributable to the service provider's breach. The employer should have the right to engage a third party to remedy any such defects (at the cost of the service provider) if the service provider fails to adequately correct such defects.

Other provisions

Although the provisions discussed above form the cornerstone of an effective facilities management contracts, it is important that other fundamental clauses are properly addressed bearing in mind the commercial deal and tailored provisions to comply with the relevant laws of the jurisdiction. These include such things as insurance, force majeure, performance security, payment, subcontracting and clauses addressing the respective liability of the parties.