October 2006

SLAUGHTER AND MAY

Long-term commercial contracts

Keeping the relationship on track

Rob Sumroy, Partner

Commercial arrangements that provide for continuing rights and obligations of each party over a substantial term are quite different to contracts relating to specific transactions at a particular point in time (such as business or share purchase agreements). Long-term commercial contracts (LTCCs) are agreements where one company (the supplier) provides products or services to another company (the customer) and include:

> Contractual joint venture arrangements where the parties collaborate on a contractual basis without forming a separate entity.

> Design, development, delivery and support agreements in the IT, construction or utilities sectors.

> Agreements for the development, marketing, distribution and administration of "white labelled" insurance policies or other financial services products. Under these agreements, the supplier provides the customer with a product which the customer then markets using its own branding. End consumers of these services generally believe that the service is being provided by the customer.

> Strategic sourcing contracts, such as outsourcing, offshoring and multi-sourcing.

Entering into an LTCC is a major undertaking. Lawyers advising on such arrangements must be aware of the risks that can arise and inform their clients of such risks. In addition, lawyers have a crucial role to play in ensuring that these risks are minimised by managing the way such arrangements are approached in the first place and guiding the way clients respond to the difficulties that may arise along the way. This article looks at:

> The key characteristics of LTCCs.

> The reasons why LTCCs fail.

> The lawyer's role at each stage of the process: partner selection, contract negotiation and after signing.

> The options available when things go wrong.

Key characteristics

Although LTCCs can be distinguished from each other in many ways, they also share certain key characteristics. For example:

> They are collaborative in nature. As most LTCCs provide the foundation for a project and for the successful development of a relationship, they must be balanced as regards the allocation of risk between the parties and the sharing of any benefits that the project might bring. A contract which is too favourable to the customer might accurately reflect the parties' bargaining position at the start of a relationship, but is ultimately likely to fail.

> They serve as operational manuals. LTCCs need to document in as much detail as possible the description and scope of the services or other deliverables, as well as how those services will be implemented operationally. Often in LTCCs, the legal terms and conditions are short form and fairly standard in the market. In contrast, the schedules to the LTCC setting out the nature and scope of the services and the operational processes for delivery and implementation are tailored to each arrangement and can run into hundreds of pages.

Case study: how it can all go wrong

Background

A major UK-based financial services multinational (the company) decides to outsource its IT function. The contract is worth £50 million per annum for an initial term of eight years. The outsourcing forms part of a general strategy for cost reduction.

Developing the business case

The business case on which the decision to outsource is based focuses primarily on the main objective of reducing cost. It is drafted by the company's financial team and agreed with the board of directors. There is little consideration of the type of functionality or level of service that is required from the supplier. Neither the broader IT team nor the actual users of the current IT systems are consulted, and so the necessity for retaining some IT capability within the company (retained IT function) and the priorities and concerns of users remain untested.

The tender process

The procurement and legal teams, with the help of external lawyers, draft a request for tender. Although the document clearly sets out the company's objective to seek to lower its costs, the tender documents only give the briefest of details on the current IT systems and almost no information on the company's expectations in relation to IT delivery or IT transformation over the period of the contract. The responses to the request for tender are analysed primarily by the legal team using a weighted score card approach.

Partner selection

The supplier shortlist is selected primarily on the basis of their score card performance. The contract is finally awarded to the supplier who offered the lowest price in its best and final offer, which is made on the basis that the customer's IT infrastructure will be transformed to a wholly standard, non-bespoke supplier solution. Although the supplier is well known in the market, its credentials in the financial services market are as yet untested.

Negotiations

The negotiations are primarily driven by the legal team who, under pressure from the company's executive management team, complete them in a short timeframe. The company was successful in the negotiations as it achieved its principal aim of ensuring good cost reductions (subject to some further post-signing validation of pricing assumptions which was required because of the expedited negotiation period) and, in addition, it managed to secure broad contract termination rights for default. Given the time pressures during negotiation, however, a number of items were left for agreement at a later date, including details of management reporting, the criteria for accepting completion of the transition (the handover of the

> They must be flexible. Major LTCCs span several years: the average contractual term of an outsourcing arrangement is between five and seven years. As a result, the parties' requirements will change over time and, to accommodate this, LTCCs need to have robust procedures for agreeing and processing change (change control), allowing both the customer and the supplier to alter the LTCC by agreement without the need for a full renegotiation each time.

Why things go wrong

Long-term commercial arrangements go wrong for many different reasons. Sometimes a breakdown in the relationship is unavoidable because it arises as a result of changes in circumstances which were not foreseen at the time of the deal. For example, a change in management on the customer side brings a new set of priorities which ultimately call into question the value of the LTCC, or changes in the way deals are structured in the market may mean that the arrangement no longer represents good value for the customer. From the supplier's perspective, developments in technology may mean that the supplier no longer wishes to invest in the services provided to the customer.

Just as often, however, relationships become strained as a result of mistakes that are attributable to the parties' actions before, during and immediately after the LTCC negotiations (*see box "Case study: how it can all go wrong"*). For example, a relationship may fail because, during this period, the parties did not spend enough time analysing the impact of the commercial deal on the customer's business and, as a result, did not realise that it is unworkable in practice. Things can also start to go wrong if the customer's demands and the supplier's promises on delivery targets were overambitious and unrealistic. Often, important aspects of the project are not dealt with in sufficient detail or, as a result of time pressure, are left to be agreed at some point after the LTCC has been signed. In addition, the customer's deal team provision of the service from the customer to the supplier) and transformation projects and the parties' respective responsibilities on termination or expiry of the agreement.

After signing

Given the aggressive deadlines and long working hours up to signing, the principal team members involved in the negotiation take a well-earned holiday. As a result, certain important post-signing deadlines are missed. In addition, it comes to light that the company's IT budget for the year does not take account of the presence of the (albeit reduced) retained IT function; the finance team had equated the outsourcing budget with the IT budget. Accordingly, the company's board has to allocate an additional sum to cover those costs, which directly affects the projected cost savings of the outsourcing.

Migration

The project of transitioning the company to the supplier runs broadly as planned but the transformation plan runs into difficulties. The parties disagree over the acceptance criteria that are relevant to assess whether certain aspects of the transformation plan are completed to the required standard.

Cracks start to appear

As part of the post-signing verification process it becomes apparent that there are a number of errors in the pricing assumptions that the supplier made before signing. The effect is that the supplier's costs of delivering the services have increased. The supplier seeks to pass on these costs, with the agreed margin, to the company.

In addition, a number of the matters that the parties had said they would agree after signing remain unresolved. In particular, the parties cannot agree the frequency and format of management reporting, with the supplier arguing that certain of the company's requirements, being specific to the financial services market, are out of scope of the supplier's standard service offering.

Compensation or co-operation?

The company turns to its legal team to see what can be done to ensure that the supplier delivers its service on time and within the specifications of the contract. The legal team points out that, as the transformation plan is late in being delivered, the company has the right to receive significant liquidated damages. If the delay continues, this could give rise to a right to terminate the agreement as a whole.

The company is not satisfied with the legal team's response. The fact that it is entitled to compensation or even to terminate the contract does not resolve the main concern, which is for the transformation plan to be implemented so that the new services can start bringing cost savings. The company returns to its legal team to ask what needs to be done in order to achieve this.

will often focus on the financial aspects of the deal, such as cost reduction or balance sheet realignment, without undertaking sufficient due diligence on the calibre of the supplier or the likelihood that the supplier would be able to achieve the customer's current, minimum business requirements. Legal advisers are in a unique position to ensure that their clients avoid common pitfalls at each stage in the process.

Partner selection

It seems all too obvious to state that the early stages of a long-term commercial project are crucial to its success. After all, it is at this point that the customer must consider:

> What are its project needs, both now and in the future.

> What is the best strategy in order to achieve these needs as cheaply and efficiently as possible.

> Which supplier is best suited to deliver these requirements.

Business case

There is a general lack of awareness among customers of the importance of properly understanding the proposed business case. The reason for this is simply that the business case is not sufficiently discussed and analysed with the relevant people in an organisation before being put to the market. For example, what seems a good concept to the business or finance teams is not necessarily greeted with such enthusiasm by the end-users of the service or the

How to avoid papering over the cracks

During the negotiations for a long-term commercial contract (LTCC) the parties often find that they are unable to agree all the details of the LTCC. Sometimes this occurs because the issues are too sensitive to be discussed at an early stage in the contractual relationship or because certain factors are not yet known. In order to avoid these uncertainties from ruining the relationship, the parties often insert provisions in the LTCC which oblige the parties to use "best" or "reasonable" endeavours to agree these issues after signing.

Agreements to agree

An agreement to agree, to negotiate or to use reasonable or best endeavours to agree is not legally enforceable because it is too uncertain (*May & Butcher v R [1934] 2 KB 17*; *Walford v Miles [1992] 2 AC 128*). However, it is possible for parties to create a contract if they intend to be bound, even though there are further terms still to be agreed. The overriding principle is that there must be certainty. In order to be certain, a contract must be capable of definite meaning without the addition of further terms.

There are two main situations in which sufficient certainty will exist to make the agreement enforceable as a contract:

> Where criteria are specified in the contract which are to be used to resolve the uncertainty. For example, in *Brown v Gould* an agreement which specified that the rent to be paid for a lease was "to be fixed having regard to the market value of the premises" was enforceable (*[1972] Ch 53*). This imprecise formulation was sufficient for the High Court as a criterion was provided, despite its imprecision.

> Where a mechanism is specified in the agreement which may be used to resolve the uncertain matters (*Sudbrook Trading Estates Ltd v Eggleton [1983] AC 444*). The mechanism might be, for example, that a mutually agreed expert would set a commodity's price after a certain initial

operational teams required to implement the service, neither of whom are commonly consulted in developing key deal proposals or the relevant tendering documents. This means that when the customer approaches the market in order to select a supplier it is basing its decisions on untested assumptions. In addition, when selecting a supplier, customers are all too often driven by cost considerations or by market reputations, rather than establishing whether or not a particular supplier is suited to their individual needs, operationally or culturally.

Supplier's position

Suppliers are very aware of the customer's cost considerations and may feel pressured into offering unrealistic prices and delivery targets in order to secure the contract. This in turn can have a negative impact on the likely success of a deal. This is particularly true in cases where, for example, the supplier's "best and final offer" (BAFO) on price becomes, in the minds of the customer's executive team, the maximum cap on price for the deal. This approach fails to take into account, however, that the BAFO is generally given at an early stage of partner selection (usually at the point that the customer moves to exclusive negotiations with one potential supplier) and long before the supplier has been able to complete full due diligence on the customer's needs and circumstances. The customer's insistence on a price at or below the BAFO price will inevitably lead to a narrowing of the scope of the services or a reduction in quality. This decision is usually taken by the customer without sufficient internal consultation with users, operational teams or other important deal stakeholders, who may value quality of service above cost reduction (*see box "Case study: how it can all go wrong"*).

The lawyer's role

With both time and budgetary pressures very common in this early deal phase, it is unusual for legal advisers to be invited to play a significant role in partner selection. However, at this early stage in the transaction, lawyers should at the very least be posing the following questions in order to ensure that their clients are fully prepared:

> Who has been consulted on the proposed business case and the construction of the tender documents? Have the needs of the business users of the proposed service been considered? Have the operational teams, whose

period under the contract. This principle will not apply where the agreement to agree is for an essential term of the agreement, as the court cannot make for the parties the agreement which they have not made for themselves (Willis Management (Isle of Man) Ltd and *Willis UK Ltd v Cable & Wireless PLC and Pender Insurance Ltd [2005] EWCA Civ 806, www.practicallaw.com/3-201-3179*).

An agreement will not necessarily be uncertain merely because some factual situation remains undetermined, provided that no further negotiation is necessary once the facts are ascertained. In Welsh Development Agency v Export Finance Co Ltd a finance agreement which depended on the merchantability of the goods to be sold was valid despite the merchantability of the goods being unascertained at the time of contract ([1992] BCLC 148).

Drafting for certainty

When drafting an LTCC in which further terms are still to be agreed, lawyers should ensure that the LTCC sets out a clear and objective mechanism for reaching agreement, making clear what will happen if agreement is not reached by a specified time. For example, where agreement cannot be reached, the parties may refer to an expert or arbitrator who would be selected to determine the issue in accordance with objective criteria laid down in the LTCC. Alternatively, the LTCC may provide for one party to serve notice on the other determining the issue in accordance with objective criteria or allow either party to suspend or terminate the LTCC where no agreement can be reached. Which of these options is appropriate will depend on the nature of the matter to be agreed. In each case the parties should be aware of the importance of carefully selecting the mechanism or criteria to ensure it will work in their interests. For example, the inclusion of a long-stop date may help with providing certainty but it may impact negatively on the party seeking to reach agreement before the long-stop date unless the LTCC makes it clear that an earlier date is to apply if certain objective criteria are satisfied.

responsibility it will be jointly with the supplier to implement the deal, been consulted in the partner selection strategy?

> Has there been sufficient analysis of the business case to ensure that it would achieve the desired results? Have consultants been engaged to advise on the benefits of the business case? What is the market precedent for such a project?

> Has sufficient information been provided to proposed suppliers in the tender process in order for them to understand what is expected from them?

> Is there too much focus on the responses to the tender invitation at the cost of carrying out proper due diligence on each proposed supplier? How will the customer establish that the supplier is able to deliver a service which is sufficiently tailored to its needs?

> How are the tender responses being evaluated? Over-reliance on mathematical and automatic response analysis tools can deliver incomplete and often inaccurate pictures of the responses. Where weightings are used in the response analysis process, they must be reasonable and realistic, and should not give inappropriate weight to one deal stakeholder (for example, finance and cost reduction, or legal and risk allocation) over any other (for example, deal delivery, implementation and operational fit).

During negotiations

The LTCC needs to provide a firm foundation for a successful relationship. Unlike a contract for the acquisition or disposal of a business, which documents a moment in time, a long-term arrangement needs to serve as a high-level operational manual which will be referred to during the term of the relationship. If the relationship is to survive, the LTCC must be well balanced as regards the rights and responsibilities of the various parties. It will also require sufficient detail and flexibility to guide the project through its different stages. In order for the LTCC to achieve these goals, a highly focused and collaborative approach to negotiations is required. However, this is rarely achieved in practice.

Terminating the agreement

A party wishing to terminate a long-term commercial contract (LTCC) will need to ensure that it has the right to do so. Depending on the circumstances the party may have the right to terminate the LTCC at common law for repudiatory breach (*see feature article "Great escapes: terminating a contract for breach", www.practicallaw.com/6-202-3921*). However, given the difficulties of establishing such a breach, it is more likely that a customer seeking to end the relationship will look to rely on the termination provisions set out in the LTCC. Commonly, an LTCC will allow for termination for the following reasons:

> Voluntary termination. A clause allowing the customer to terminate early on written notice is likely to be subject to an early termination charge unless the supplier has low start-up costs. This is a consequence of suppliers "front loading" their costs to create customer cost profiles that are attractive in the early years, resulting in the suppliers' anticipated returns flowing only in the later years of the LTCC. An early termination charge would represent some form of compensation for lost costs which the supplier will be prevented from recovering as a result of the LTCC not proceeding to term. The notice period should also form the subject of some discussion. In LTCCs with terms over seven years, a 12-month notice period is not uncommon. Given the costs and time involved, it is unlikely that a customer would choose to rely on this clause without due consideration. However, given the difficulty of relying on other grounds for termination, it is an important right to be negotiated into the LTCC.

> Termination for specified causes. The customer will want to ensure that certain failures on the part of the supplier will give rise to a right of termination. The existence of a clause setting out this particular right will help to avoid any debate as to whether the breach in question amounts to a repudiatory breach at common law or was a material breach (see below). Common grounds for termination include the failure to implement a major development or transformation milestone, or the occurrence of a persistent or material breach or service failure.

> Termination for any cause. Although the parties may be tempted to include in the LTCC the right to terminate for any breach of any term of the LTCC, the courts may not necessarily uphold the strict literal interpretation of this type of clause. In *Rice v Great Yarmouth* the contract gave Great Yarmouth Council (the Council) a right to terminate where the other party (the contractor) committed a breach of any of its obligations under the contract (*[2000] All ER (D) 902*). The Court of Appeal held that the Council could only terminate if there had been a repudiatory breach, or an accumulation of breaches that could properly be described as repudiatory. In reaching this decision, the Court of Appeal considered it relevant that the contract was intended to be long-term (a four-year term was contemplated), it involved significant financial investment by the contractor and the contract contained numerous obligations on both parties of varying significance.

> Termination for material breach. It is usual to provide for a right to terminate in the event of a material breach which is wholly or partly

The negotiation stage of a long-term commercial project can be a long and drawn-out affair. Over-populated and centralised meetings will continue for days, often with little progress being made on the key commercial points. There is generally too much focus on legal points which have no real impact on the deal fundamentals without proper consideration of key issues such as risk allocation, project implementation, and processes for dealing with change.

Where the LTCC does not recognise that the benefits and risks must be balanced between the parties there is a risk that it will fail, to the detriment of both parties. For example, an LTCC which gives the customer the security of a fixed price as well as the flexibility of a variable scope of work may be very attractive for the customer but is likely to place too much of a burden on the supplier, which may soon find that its costs in supplying the service will not be matched by reasonable revenues. This is turn may cause the supplier to try and cut costs in other areas which will result in it providing services of a low standard which will ultimately have a negative impact on the customer.

remediable but has not yet been remedied. A breach which is irremediable will usually constitute a repudiatory breach and so will give rise to a common law right to terminate. There is wide scope for dispute over whether any particular breach is material and/or remediable but the two appear to be linked. Broadly, the factors that will be taken into account in order to determine whether or not a breach is material are mostly commercial. In *Dalkia Utilities Services plc v Celtech International Limited* the factors included the seriousness of the breach, the reasons for the breach and the contractual intention of the parties (*[2006] EWHC 63 (Comm), www.practicallaw.com/6-202-0418*). The single most important factor was the overall commercial context: this outweighed considerations of the impact of the termination on the parties. However, the impact of the breach on the "innocent" party was still a concern, though the impact of termination on the "guilty" party was not.

> Termination for insolvency events or change of control. The parties will want to allow for a right to terminate where there has been a significant change in the actual or practical identity or status (from a legal or commercial context) of the other party. For example, termination for insolvency-related events or where there is a change of control of the other party.

Wrongful termination

Before terminating a contract, a party must carefully consider whether it has the right to do so. If a contract is wrongfully terminated the other party may accept that wrongful termination and sue for damages (*Peregine Systems Limited v Steria Limited* (*[2005] EWCA Civ 239, www.practicallaw.com/7-200-6624*).

Consequences of termination

Long-term service agreements are difficult to terminate because, very often, the services are so essential to the customer that an orderly period of transition is required so that no disruption to the customer's business is caused. This is particularly challenging where termination has followed a dispute between the parties. In order to protect the customer, comprehensive exit provisions must be drafted into the LTCC. These will include obligations on the supplier to continue to provide the services for a period of time (typically between six and 12 months, depending on the nature of the terminated services) without any degradation in service performance. In addition, the supplier will be obliged to provide information about the service to the customer who will be seeking to find alternative suppliers. Most importantly, the parties should, where at all possible, agree an exit plan ensuring the smooth transition of the service to the alternative supplier. It may not be practical for the parties to draft a detailed exit plan before signing the contract as they may find it difficult to envisage what type of exit plan will be required, and the actual exit strategy may depend on the particular circumstances of termination.

In these circumstances care must be taken to ensure that proper mechanisms for agreeing the exit plan are drafted into the contract (see box "How to avoid papering over the cracks").

Agreeing to agree

Sometimes complex but critical deal issues are not addressed in sufficient detail during the negotiations and lawyers are tasked with finding a way of allowing the LTCC to be signed immediately, with the outstanding issues to be agreed at a later date. This results in vague legal drafting along the lines of: "the parties will use their reasonable endeavours to agree within [x] days after signing", or "the parties will, acting reasonably, discuss in good faith in order to agree…". This approach is of particular concern, as under English law such agreements to agree are unenforceable. It also fails to recognise that if matters are difficult to agree before signing, they will be twice as hard to agree after signing when the impetus for agreement has been removed (*see box "How to avoid papering over the cracks"*).

Operational involvement

In many cases the operational teams responsible for implementing the deal are not sufficiently involved in the negotiations, and so are unable to point out any weaknesses in the proposed project or in the processes that are mapped out in the LTCC. Often the respective legal teams are instructed to draft and negotiate large sections of the LTCC in isolation without input from the operational team. While lawyers have a key role in ensuring that the LTCC is legally enforceable and reflects the deal agreed by the parties, when it comes to operational matters such as change control schedules, service level structures, contract management structures and dispute escalation and resolution processes, if the structures created by the lawyers bear no resemblance to the processes that will in fact be implemented by the operational teams once the LTCC is signed, then the LTCC will be ignored from the moment of signing, finding itself locked away in the bottom drawer of someone's desk.

Managing the process

Lawyers should put their negotiating and project management skills to good use and help clients avoid these problems. The following points should be considered when assisting clients during the negotiation phase:

> Are the right people attending the right meetings? Does the negotiation team have the right mix of skills, experience and authority to agree the different parts of the LTCC? Are the respective operational teams being consulted and involved sufficiently?

> Would the process be more efficient if different teams were given responsibility for agreeing different parts of the document? Rather than one large meeting addressing the LTCC as a whole, might it be better for separate meetings to run in parallel with the relevant experts in attendance? Where matters arise that cannot be agreed in the individual meetings, they can then be escalated to the "core" commercial negotiations. In this way, the need for senior executive input into the negotiations is minimised, and one can avoid the protracted negotiations that can so often cause damaging ill-feeling between the parties even before the LTCC is signed.

> Are there too many agreements to agree, and other attempts to paper over the cracks of key issues (*see "Agreeing to agree" above*)? Are the risks of leaving such important details to be agreed after signing properly understood by the client (*see box "How to avoid papering over the cracks"*). Is the outstanding issue so central to the deal that the parties should consider a delay in signing until the issue is resolved?

> Does the LTCC represent a fair balance of risk and reward between the parties? Although lawyers may relish obtaining the best possible deal for their clients, they should consider whether, given the collaborative nature of most long-term commercial projects, an LTCC which places too much risk on one party is likely in practice to fail well short of full term, which is unlikely to be in the best interests of either party. Where the focus of the project is transformational (for example to improve services, or to transform parts of the customer's business) rather than just to cut costs, it may be worth considering whether it is more effective to motivate a supplier by sharing the gains made in certain predetermined areas, rather than merely penalising (for example, through claiming service credits) for poor performance. These "gain share" models can be complex and difficult to craft in a way that will truly deliver value to customers and suppliers. However, by directing its lawyers' time to achieving true "win/win" relationships which provide benefits for both parties, a client will be maximising the value of that legal input.

After signing

The period immediately following signing or completion of an LTCC is often key to the relationship. During this period, there will be a number of critical contractual obligations to be met, including commencing operations, implementing migration and transformation plans, setting up of cross-party delivery teams, design and implementation of new technologies, obtaining regulatory or rights-holders' consents, agreeing those items that the parties agreed to deal with post-completion, post-signing due diligence and price validation. The timeframes for these deliverables will generally be fairly aggressive and it is common for a number of key obligations to fall in the first few weeks or even days after signing. Despite the obvious need for focus and effort, it is common for the days following signing to be characterised by almost complete inactivity. The post-deal euphoria gives way to inactivity as the respective parties reward their negotiating teams with well-earned holidays, and others return to resume their "day jobs". This will cause problems when the parties do eventually begin to consider implementing the service: what was once a six-month period to implement a key project stage has shrunk to five months.

Part of the reason for the sudden loss of a sense of urgency during this period is the fact that the project loses the input of the senior negotiating team who, despite having the most detailed understanding of the contract, are often no longer tasked with delivering the project. Instead, the operational teams, whose job it is to deliver the deal, are introduced to an LTCC with which they are almost completely unfamiliar.

Ultimately, this level of inactivity and unfamiliarity leads to delays, miscommunication and mistrust. The fine commercial balance achieved at signing is almost instantly lost as operational teams, unfamiliar with each other and the LTCC, ignore the LTCC and the processes set out in it in an effort to deliver what they believe (often mistakenly) to be the deal their negotiation teams have struck.

Actions for lawyers

At these times of post-signing hiatus, as the cracks begin to show in the relationship, it is common for the lawyers to be approached for advice on rights and potential remedies. Rather than reaching for the LTCC to assess dispute scenarios (although this may of course be necessary in parallel), lawyers have a key role in switching the focus of the parties from negotiation and signing to operational delivery of the deal. In order to avoid a slow and difficult start to the relationship, lawyers for both customer and supplier should consider the following:

> Agree a list of post-signing action points, and details of who is responsible for each action.

> Ensure that each party has appointed a member of its negotiating team to be the relationship manager with responsibility for the smooth implementation of the project. This has the added advantage of ensuring that there are people on both sides of the relationship with sufficient understanding of how the deal is supposed to work in practice.

> Introduce relevant parts of the LTCC to the teams responsible for its operational implementation. A lengthy legal summary of the whole LTCC is unlikely to be of much value. Instead, making the LTCC relevant to the operational teams can be achieved by running a series of introductory sessions which highlight the main elements of the LTCC, and at which queries, comments and concerns can be addressed. There is a good argument for running these sessions jointly between the parties as an initial trigger to the operational collaboration that delivery will require. The output of this session could be recorded in a frequently asked questions manual which can be circulated among the operational teams.

When things go wrong

Given the difficulties that early termination of an LTCC presents, it is the lawyer's role to assess whether such a course of action is really necessary. It will therefore be very important to understand what the causes and extent of any reported problems are. In general, there will be three options available:

Carry on as before

Sometimes tensions build up in a relationship as a result of a number of minor issues which are not properly dealt with. It may be, for example, that the timeframes in the LTCC are unnecessarily aggressive, which causes the supplier to default despite the fact that the service provided is perfectly adequate for the customer's purposes. Or it may be that the deal economics unintentionally favour one party over the other (for example, as a result of currency fluctuations following the pegging of currency exchange rates for cross-border payment of services). Or there may be small problems in the software solution which the supplier is not addressing sufficiently quickly or at all.

In these circumstances it may be in the parties' best interests to try and address the issues and to allow the relationship and the deal to continue as before. This may be done most effectively by using the escalation procedures in the LTCC and by agreeing any necessary amendments to the LTCC by way of side letter or addendum. Most importantly, however, the clients should be encouraged to ensure that these issues do not arise again, by instituting regular reviews and meetings.

Renegotiate

Given the difficulties that termination will present in long-term supply arrangements, renegotiation may be the only realistic choice for the parties. Renegotiation will be a good option where the relationship between the parties is strong but, for a number of reasons, the LTCC no longer accurately reflects the provision of service that is required. It may be that the customer's technological requirements have now changed as a result of a change in business focus. Or it may be that the economics of the deal require review as the supplier is consistently being hit by service penalties despite the fact that service provision is, in practice, satisfactory for the customer.

The hope is that the process of renegotiation will result in an LTCC which more accurately reflects the position and the parties' respective needs and ambitions. When advising on a renegotiation, a lawyer should consider the following points:

- Ensure that the new LTCC does not lose any of the positive elements of the old deal. It may be that certain aspects of the relationship worked well. To enable a smooth transition to a new deal to occur it is important that the operational teams are not burdened with changes which bring no additional benefit. So if, for example, certain of the operational processes worked well under the old LTCC, an effort should be made to retain them for the new deal.

- The new LTCC should seek to rebalance the relationship between the parties. The ultimate aim must be to try to achieve a balanced win/win position.

- Do take into account the fact that although the renegotiation will result in a new deal, the negotiation is being conducted with a familiar party. A customer should, for example, resist strongly any arguments raised by its supplier for a post-signing period of "validation" or "verification" to assess the accuracy of its own assumptions about the customer's business. This aspect of risk allocation onto the customer is not appropriate where the supplier is an incumbent. The supplier should know by now what level of service it can reasonably provide to the customer using the assets and employees that are available. Any inherent problems with those assets and employees may by now be the fault of the supplier, who may have been managing and maintaining them for a significant part of the original deal.

- Make sure that the new LTCC is kept under regular operational and executive review to ensure that any issues that arise under the new deal are dealt with swiftly.

Walk away

The decision to terminate an LTCC early should not be taken lightly but there will be circumstances where both the deal and the relationship between the parties have reached a point where the only sensible option is to seek early termination. Whether or not a party can terminate the LTCC in the particular circumstances will depend largely on the drafting of the relevant provisions of the LTCC (*see box "Terminating the agreement"*). It is likely that the parties will be considering whether or not to pursue a dispute while at the same time trying to agree on an exit strategy which might take up to 18 months to implement. In addition, the customer will be trying to assess who will provide the service in the long-term and be considering how to re-approach the market.

Lawyers advising clients going through an early termination should consider the following:

- Keep on top of the detail. It will be fundamentally important to your client that you understand and can advise on its rights under the LTCC and how this affects its ability to pursue a dispute strategy, and to ensure that it will get the assets, people and contracts it requires under the exit strategy.

- Given that the parties may be engaged in a dispute, care must be taken to ensure that communications are controlled and documented so as to ensure that privilege is not waived and that any matter discussed on the exit strategy is without prejudice to any potential litigation (*see feature article "Privilege: what can you protect?", www.practicallaw.com/0-102-3897*). This need to formalise communications will create difficulties as far as the negotiations for the exit strategy are concerned but it is very important that lawyers are alive to the risk of disclosing information that would damage their client's position in any related dispute.

> Co-ordinate the different streams. There may need to be two or more management and operational teams engaged with the dispute and the exit strategy. The lawyers will play a key role in ensuring that these two teams work in parallel and that decisions taken by one group will not affect progress in another group.

> Be responsive. The client will be keen for matters to be resolved proactively, as quickly as possible and with an agile and commercial approach.

This article was originally published in PLC magazine in December 2006 and is reproduced with the permission of Practical Law Company Ltd

London
One Bunhill Row
London EC1Y 8YY
United Kingdom
T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

Paris
130 rue du Faubourg Saint-Honoré
75008 Paris
France
T +33 (0)1 44 05 60 00
F +33 (0)1 44 05 60 60

Brussels
Square de Meeûs 40
1000 Brussels
Belgium
T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

Hong Kong
47th Floor
Jardine House
One Connaught Place
Central
Hong Kong
T +852 2521 0551
F +852 2845 2125