How to add value to an outsourcing transaction

Rob Sumroy, Partner

Lawyers are often criticised for hindering outsourcing transactions. By imposing standard, inflexible contracts with arcane legal language, and which bear little resemblance to the deal struck between the parties, lawyers can reduce a deal offering benefits to both parties into a recipe for disappointment and dispute. The challenge for lawyers is to drive the outsourcing deal, not hinder it, and to add value for the client in the process. By playing a central role in the managing of the transaction team throughout the whole outsourcing lifecycle, from the decision to outsource, through supplier selection, documentation of the deal, service delivery and, ultimately, renewal or exit lawyers gain a unique perspective. This article looks at how, that perspective can assist lawyers in delivering real value to clients.

Decision to Outsource

Modern outsourcing deals are not simply the replacement of an in-house function with a third party supply arrangement (see section 2: “A New Perspective on Outsourcing?”). Often the implementation of deals requires analysis of complex structural and commercial issues and the implementation of a bespoke transaction strategy. From the moment a decision to outsource has been taken, the various stakeholders within the client including executive management, operational management, employees, finance, HR, tax and external consultants will have conflicting and inconsistent expectations and requirements. The lawyer must manage these expectations and advise on the risks and associated rewards of the selected strategy and ultimately draw together these stakeholders as a cohesive client team.

Supplier selection

The outsourcing tender document (often referred to as an RFP (Request for Proposal) or ITT (Invitation to Tender)) is fundamental to the outsourcing process. It describes the client’s requirements, expectations and aspirations for the proposed customer/supplier relationship. It sets out the parameters of acceptable behaviour expected of the supplier. By including a draft set of terms and conditions on which the client is willing to engage a supplier as a core part of the RFP, the client is giving an important message to bidders: the supplier’s response to the legal terms will form an integral part of the selection process. Suppliers will be judged at least partly on their willingness to engage on reasonable commercial and legal terms. Any issues that the supplier has with the proposed terms should be explained in full as part of its response to the RFP, because the acceptability of the supplier’s legal position may prove to be part of what differentiates that supplier from other bidders.

This approach will enable the customer to take the lead on contract preparation, and will avoid the pitfalls associated with contracting on supplier standard terms that do not relate to the particular deal. It will also avoid any shocks or surprises at the contract negotiation stage and save valuable time for the parties to concentrate on resolving key commercial points and completing the technical schedules. However, the draft terms and conditions delivered with the RFP must itself be a sensible first draft, relevant to the proposed transaction and focusing on the client’s key requirements. Simply appending a standard client contract to the RFP, or worse a negotiated contract from a previous unrelated deal, will provoke a negative supplier response and cause tension and delay at negotiation stage.

Memorandum of Understanding

There are usually several points of agreement between the RFP and the supplier’s response to the RFP. By capturing both these points and those on which agreement is yet to be reached, in a memorandum of understanding (often referred to as an “MOU”) or other interim document, the lawyer can help the parties focus on the outstanding legal, technical and commercial issues that remain to be resolved. It is at this stage, once the points of agreement and difference are crystallised, that the lawyer is able to help his client to assess the various options for completing the deal and the level of risk associated with each option.
Documentation of the Deal – the Contract

The outsourcing contract is a living document that will direct and guide the parties throughout each of the stages of engagement: transition, transformation, business as usual (or "steady state") and ultimately renewal or exit. Its role is quite different to that of other transaction documents (for example an asset or share transfer agreement) which in most cases is relevant for only a few months (or perhaps only a few moments) after signing. By contrast, the outsourcing contract is an operations manual that has to anticipate the changes that will take place during the life of the relationship. A contract, by its nature, requires certainty and clarity. But outsourcing relationships are long (contract periods of seven to ten years are not uncommon) and the expectations and needs of both parties will change fundamentally during that time. Changes in market norms, technology, pricing models, business strategies, group structures, economic climate, etc. will all result in the parties having different aspirations and priorities than they had at signing. The challenge for the lawyer is to create a contract that provides certainty and clarity on the one hand, but that is sufficiently flexible to meet changing requirements on the other. The following are examples are examples of ways in which that challenge may be met:

> service measurement and regular review meetings;
> a change control procedure for processing and agreeing changes to the contract and schedules;
> an operational change management process, to manage and track day to day change on an operational level;
> technology refresh obligations and associated cost allocation;
> price variation and rights to benchmark charges/services against appropriate prevailing market norms;
> flexibility to add or remove businesses/companies in connection with customer group restructuring activities;
> rights of partial termination and termination, with appropriate financial compensation for the supplier; and
> practical remedies for dispute, including escalation, service credits, step-in rights and expert determination/mediation to enable the parties to resolve disputes within an ongoing relationship.

The long-term and evolutionary nature of outsourcing arrangements will require a close working relationship between the parties. The lawyers for each side need to be aware of, and sympathetic to, this co-operative relationship between their respective clients. In particular, taking a confrontational stance towards the other side will delay or derail the negotiations, and may fundamentally affect the working relationship between the parties once the contract is signed. Although every negotiation has its points of conflict, only the big issues should require escalation for resolution. The lawyer’s role is to focus the client’s minds onto these big picture issues, rather than getting stuck on detail that does not represent a material level of risk or value for the client. This frees up legal resources for documenting the important elements of the deal, including the key schedules, without which the contract will fail to achieve its aims.

Documentation of the Deal – the Schedules

A substantial part of the detail in an outsourcing transaction is contained in the schedules to the contract. These schedules will address fundamental issues such as scope and description of the services, service levels, service credits and other remedies, transition and transformation timelines, charges and payment, price variation and benchmarking, change control, exit management, etc. It is of little value to the client if the lawyer negotiates a sound commercial deal on the terms and conditions but the schedules are incomplete, unclear or inadequate. Therefore, although the schedules are often prepared by the operational or commercial teams together with external consultants, the lawyer has a crucial role to play in ensuring that the detail is correct and complete, that it accurately describes the deal, that the language creates legally enforceable obligations and that there are no inconsistencies between the schedules and the terms and conditions in the main body of the contract.

The process of schedule creation, review and completion is both time-consuming and resource intensive. It should be commenced early, and sufficient time and resource needs to be allocated for schedule creation, and for both legal and executive review. The lawyer can play a significant role in the management of that process, as well as the management of expectations within the parties as to the timeframes within which the schedules can be completed.
Service Delivery
The lawyer’s role does not end at contract signing. If the lawyer has been successful in creating a contract that incorporates tools for flexibility and change, then he must now train the parties to the contract to make full use of those tools. The proliferation of operational and commercial schedules and appendices inevitably makes outsourcing contacts long documents (it is not uncommon for them to exceed a thousand pages). The dual challenges for the lawyer are firstly to help the client understand the contract and know how to use it, and second to remain sufficiently aware of how the contract is being used to be able to advise the client on an ongoing basis. This can be achieved through the creation of key summary documents and user training on specific areas, and regular meetings between the lawyers and the various parties to share know-how on the contract implementation and the supplier/client relationship.

Renewal or Exit
The customer’s business must continue unaffected by any decision to terminate the outsourcing relationship. However, expiry of the contract, whether as a result of an early termination, as part of a re-negotiation with supplier or at the end of the term, will have the potential to impact the customer at least as significantly as did the initial outsource. Employees will be affected by the operation of TUPE (see further “[ ]”), and consideration will be required of which third party contracts, equipment, property and other assets will transfer from the supplier back to the customer or to the customer’s new supplier. Transition between suppliers is a disruptive process that may take many months. The customer will expect full support from the supplier, but as the relationship is coming to an end the supplier has less incentive to provide that assistance other than at full cost to the customer.

The challenge for the lawyer is to ensure that the parties adequately provide for these matters in the original contract, and do not leave them to be agreed when the relationship is coming to an end. It is also a key part of the lawyer’s role to advise his client through the process of exit, including the development and implementation of the exit plan, in tandem with bringing the services back in house or re-outsourcing to the new supplier.

Conclusion
A party to an outsourcing transaction will be looking to its legal advisors to add value to the outsourcing relationship in the following ways:

> Achieving a better deal within the time constraints of the procurement process.
> Achieving a more efficient deal - whether manifested in a deal being reached within quicker timeframes or with lower costs.
> Managing the various interest groups, internally within the party, and steering the combination of those groups as a unified team.
> Obtaining full buy-in for the outsourcing contract as an operational manual for the relationship, including through the creation of contract summaries and the delivery of training.
> Supporting the operation of the outsourcing contract through service delivery, change management, dispute management, re-negotiation and exit.