



# Pillsbury | Global Sourcing

Realities of Outsourcing:

5<sup>th</sup> in a Series  
of Webinar Presentations

The Outsourcing Contract –  
Too Big? Too Complex? Is There a Better Model?

January 11, 2007



Pillsbury  
Winthrop  
Shaw  
Pittman<sub>LLP</sub>

All Rights Reserved © 2007

Robert Zahler, Partner  
2300 N Street, N.W.  
Washington, DC 20037  
tel: +1.202.663.8130  
[robert.zahler@pillsburylaw.com](mailto:robert.zahler@pillsburylaw.com)



- Requirements; the contract contains provisions that
  - ▶ establish the relationship
  - ▶ manage the relationship
  - ▶ pay for the relationship
  - ▶ terminate the relationship
- Analogies; an outsourcing contract is like
  - ▶ the sale of an operating division (the company's internal HR functions)
  - ▶ with a long-term services contract for the work previously performed by the "sold" HR division
- Precedents; models of prior contractual forms
  - ▶ federal government facilities management contract
  - ▶ merger and acquisition agreement
  - ▶ systems development or systems integration relationship
  - ▶ software licensing contract



- Desired result: produce an “outsourcing” contract
- Outsourcing defined: The delegation to a third party of responsibility for performing a significant business function
- The **original** commercial paradigm: The outsource supplier will do:
  - ▶ what the customer currently does
  - ▶ at the same or a better level of performance
  - ▶ for the same or a lower price
- The major corollary:
  - ▶ Do not tell me **how** to perform,
  - ▶ Tell me **what** you want performed, and
  - ▶ At **what level** you want that performance delivered



## ■ Requirements for *original* model to be successful

- ▶ supplier needs customer's people and assets (hardware, software and contracts) to perform
- ▶ supplier investments that produce economies of scale
- ▶ works best for centralized, repeatable functions that benefit most from economy of scale investments

## ■ Benefits of the model (to the supplier)

- ▶ little need to know what you do → transferred personnel know
- ▶ little need to know how you do it → transferred personnel know
- ▶ but, need to know at what level you do it and what it costs you → to develop supplier price

## ■ Impact to the customer

- ▶ little or no retained capabilities to accomplish outsourced activities



- Focuses on issues that do not produce value
  - ▶ historical costs
  - ▶ existing service levels
  - ▶ yesterday's scope of services
- Lack of transparency about the cost drivers
  - ▶ where do the cost savings come from?
- Results in “unsolved” issues
  - ▶ pricing for embedded hardware and software
  - ▶ extent of process transformation and technology refresh
  - ▶ characteristic of changes for which the supplier is entitled to additional compensation
- Produces complex transactions, lengthy deal cycles and adversarial negotiations

As the marketplace has matured,  
a variety of outsourcing relationships have developed



# Cornucopia of outsourcing relationships

## IT Outsourcing

Mainframe

Servers and Distributed Computing

Desktop Support

Local Area Networks

Wide Area Networks

Applications Development and Maintenance

Help Desk

## Business Process

Human Resources (HRO)

Finance and Accounting (FAO)

Procurement

Equipment Maintenance

Facilities Management

Applications Development and Maintenance

Call Centers

## Platform Delivery (née ASP)

Billing

Customer Information and Customer Care

Claims Processing

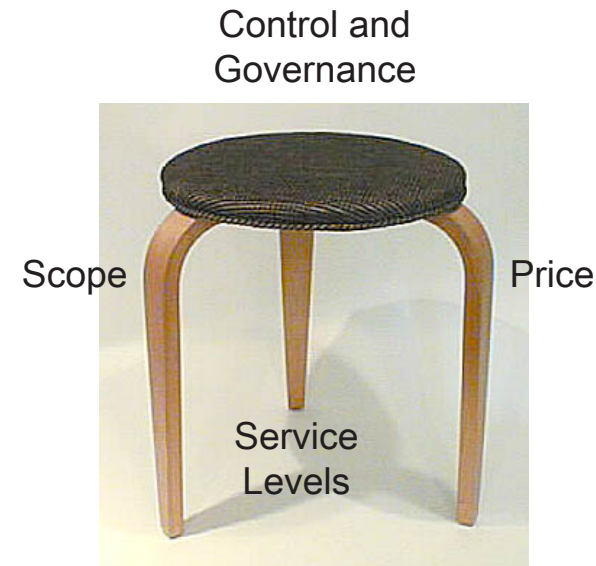
Credit Card Processing

Hosted ERP System

Mortgage Servicing

Computer Reservation System (CRS)

- The contract documents typically consist of
  - ▶ terms and conditions -- the main body of the contract
  - ▶ services schedule -- a description of the scope of supply
  - ▶ service level schedule -- a set of performance standards
  - ▶ pricing schedule -- mechanisms to calculate the charges
  - ▶ inventory schedules
    - ◆ lists of equipment, software, contracts, people, etc.
- Scope
  - ▶ proper scope definition is critical to an effective long-term relationship
- Service Levels
  - ▶ customize metrics that measure what's important – end to end
    - ◆ measure outputs, not inputs
    - ◆ don't develop too many metrics
    - ◆ don't rely too heavily on benchmarking
- Price
  - ▶ transparency – clear and simple algorithms
- Control and governance
  - ▶ the “middle layer” -- integration and service management





- The contract can be seen as adding value because
  - ▶ it limits the risk of each party – the lawyer’s view
  - ▶ it provides a roadmap for how each party should conduct themselves – the business person’s view
  - ▶ it documents the common expectations of the parties – the “meeting of the minds”
- Your viewpoint on the value of the contract drives
  - ▶ what is included in the contract
  - ▶ how the agreements will be documented
- The outsourcing contract is different
  - ▶ it does not document a “one-time” transaction that is best left in the desk drawer
  - ▶ it is intended to be used daily (and this is the key point) by non-lawyers
- As a result, the contract needs to be ***drafted*** for use by the people who will, in fact, use it



- The critical path for completing the contract almost always consists of the following activities
  - ▶ agreement of a scope of work
  - ▶ agreement on a set of service levels
  - ▶ supplier's final due diligence given the agreed-to scope of work and service levels
  - ▶ final price negotiations
- The critical path hardly ever runs through negotiation of the terms and conditions
- The typical procurement process of
  - ▶ identifying potential suppliers
  - ▶ obtaining and evaluating supplier proposals
  - ▶ awarding the work

does a poor job of identifying in sufficient detail the information necessary to document the critical path activities

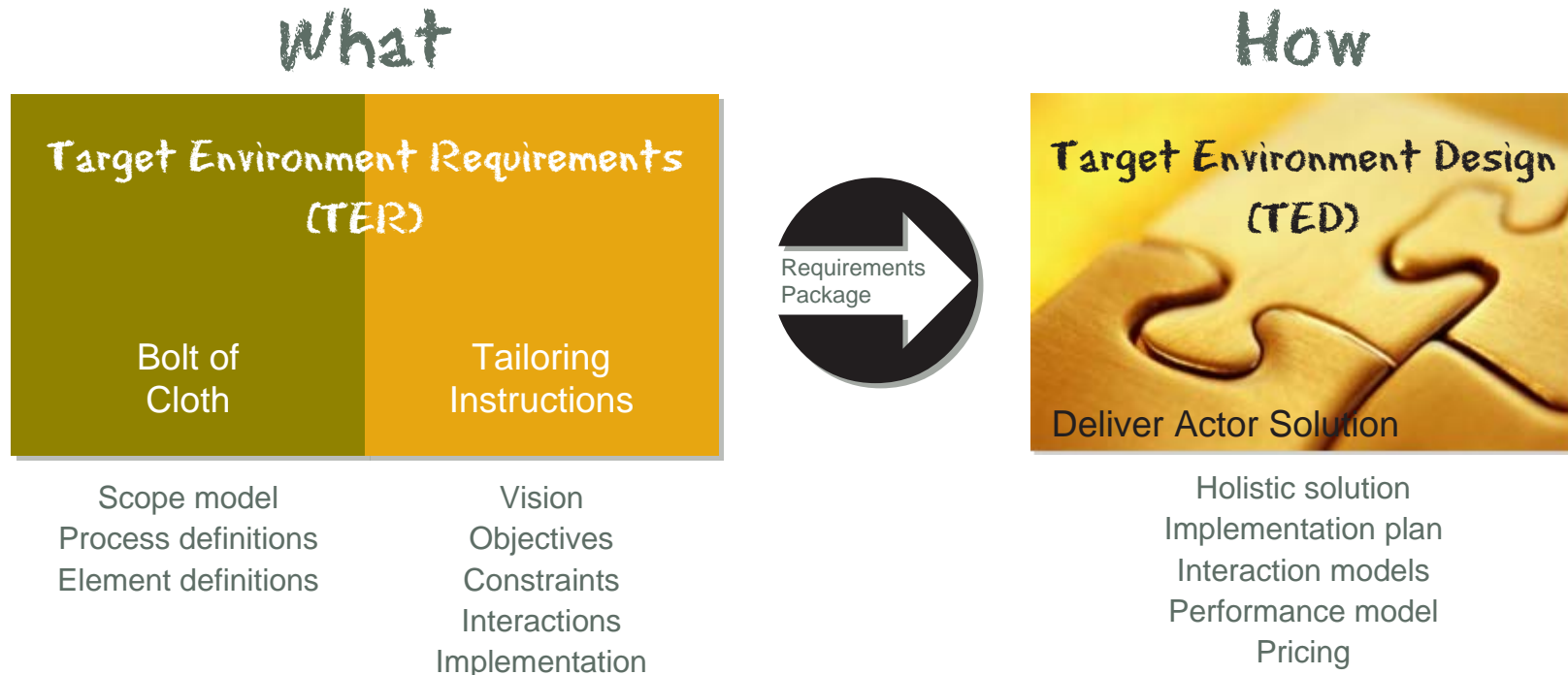
- Complaints about complexity almost always refer to the scope of service provisions or the pricing algorithms
- Traditionally, scope of service provisions have taken the form of:
  - ▶ engagement-specific responsibility matrices
  - ▶ hand-tailored, custom-developed narrative descriptions
  - ▶ neither is a good model
- Pricing provisions are often
  - ▶ too summary without sufficient insight into cost drivers or the ability for the price to vary as consumption changes or the services provided change
  - ▶ too ornate and complex
  - ▶ poorly drafted
    - ◆ a pricing schedule should be understandable to someone unassociated with the transaction with a minimum of explanation

■ The traditional statement of work is



■ Two steps should be taken to improve the format

- Remove transaction-specific information about how a solution will be delivered (the how) from the provisions assigning responsibility for processes (the what)

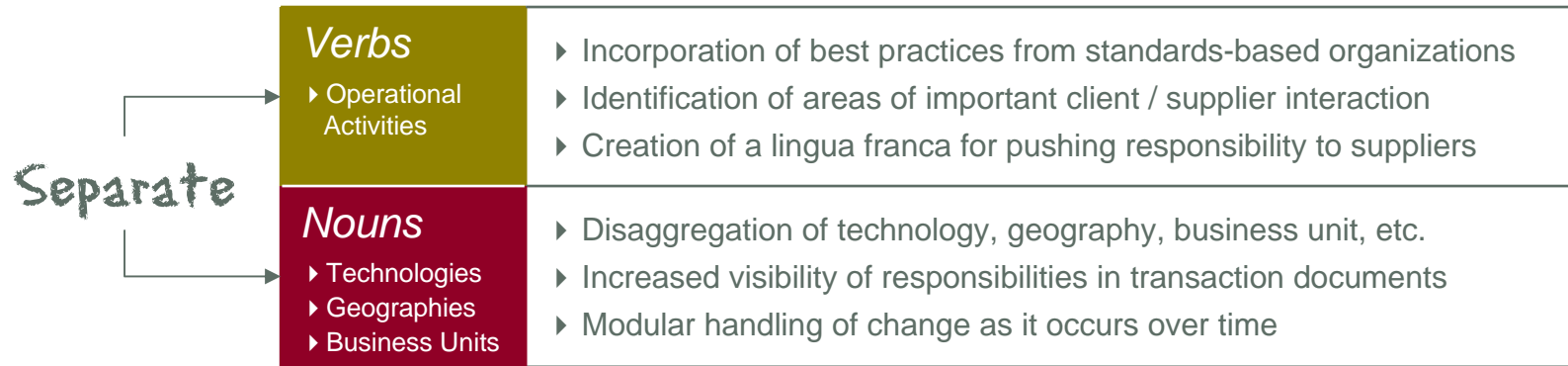


- Document how the solution will be provided in a separate commercial solution exhibit



# Separate the processes from the elements

- Operational responsibility should be defined in two parts



- **Decomposing** the description of **responsibility** into its constituent components
  - ▶ **Increases readability** by customer management and subject matter experts
  - ▶ **Eliminates the cover-to-cover reading** necessary to fully understand a process
  - ▶ Helps **ensure full coverage** of each process



## *Which issues are the most disputed?*

- With respect to the general terms and conditions, extensive negotiation most often arises with respect to the following provisions:
  - ▶ “sweep” clauses relating to scope of services
    - ◆ what the people previously did
    - ◆ what is reflected in the base case
    - ◆ services inherent in those services otherwise described
    - ◆ service evolution and new services
  - ▶ controls over
    - ◆ where the services are to be provided
    - ◆ by whom the services are to be provided
  - ▶ customer “savings” clause
  - ▶ intellectual property
  - ▶ warranties, representations and indemnities
  - ▶ audit rights and compliance with laws
  - ▶ limits of liability and “carve outs”
  - ▶ termination rights

- Yes, in fundamental and important ways that have hardly ever been recognized
- Many (not all) BPO transactions are **not** based on the original outsourcing paradigm; distinction between doing
  - ▶ what the customer did, and
  - ▶ delivering a specified service described in a statement of work
- The cost drivers for BPO relationships are fundamentally different than the cost drivers for ITO
  - ▶ oftentimes, assets are not sold and significant numbers of people are not transferred
  - ▶ the importance of properly document transition and transformation activities
  - ▶ addressing what happens if those activities do not occur as planned or on time
- The need to focus on the “knowledge capture” activity



- Yes, but ***not*** in fundamental ways
- There is a need to address a set of issues relating to
  - ▶ data protection and data privacy
  - ▶ intellectual property
  - ▶ employee turnover and inflation
  - ▶ disaster recovery and business continuity
  - ▶ choice of law and dispute resolution
  - ▶ (and maybe) tax issues
- Like BPO, knowledge capture is important
- Pricing too often defaults to a charge “per head”
  - ▶ a poor pricing metric
  - ▶ converting to some business metric is not as easy as assumed



# Appendix:

## **Pillsbury** | Global Sourcing

Standard “Short Form” General Terms and Conditions  
for Single-transaction ITO or BPO Deals

Table of Contents

# Pillsbury | Global Sourcing



Pillsbury  
Winthrop  
Shaw  
Pittman<sup>LLP</sup>

All Rights Reserved © 2007

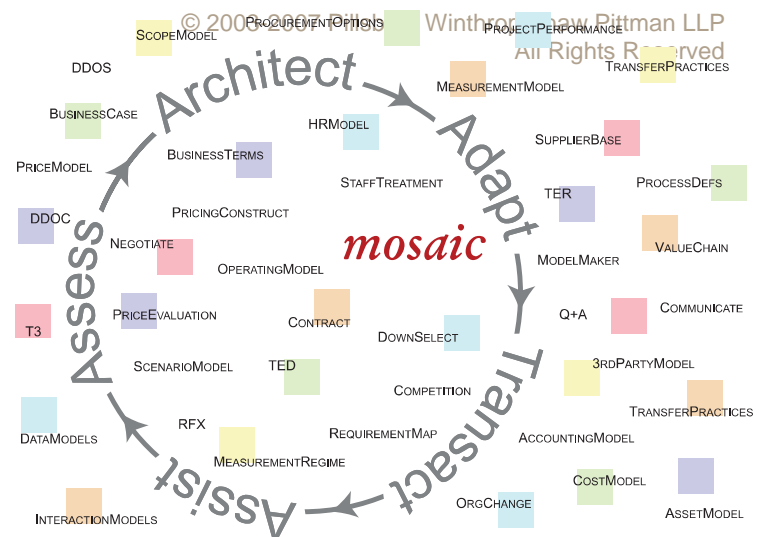


*Questions and Answers*

# Outsourced Services Agreement (ITO & BPO)

Standard “Short Form” General Terms and Conditions  
for Single-transaction ITO and BPO Deals

V1.0



**\*\*Note: This Agreement was prepared for use in transactions between a US-based Customer and US-based Supplier (and potentially including non-US Affiliates of both Parties). If either of the principal Parties is a non-US entity, or if the Agreement will involve the off-shore provision of Services, additional provisions will be necessary, as will the revision of certain provisions – e.g., those dealing with privacy, data security, intellectual property rights and dispute resolution.\*\***



## OUTSOURCED SERVICES AGREEMENT

### TABLE OF CONTENTS

<b>GENERAL TERMS AND CONDITIONS</b> .....	1
<b>1. PREAMBLE</b> .....	1
<b>1.1</b> Background and Purpose .....	1
<b>1.2</b> Objectives .....	1
<b>1.3</b> Defined Terms .....	2
<b>2. THE SERVICES</b> .....	2
<b>2.1</b> Obligation to Provide the Services, Generally .....	2
<b>2.2</b> Scope of the Services .....	2
<b>2.3</b> Users of the Services .....	3
<b>2.4</b> Services Not Exclusive .....	3
<b>2.5</b> Relationship of the Parties .....	3
<b>2.6</b> Cooperation and Coordination with Other Parties .....	3
<b>2.7</b> Evolution of the Services .....	3
<b>2.8</b> New Services .....	4
<b>3. PERFORMANCE</b> .....	4
<b>3.1</b> Generally .....	4
<b>3.2</b> Place of Performance .....	4
<b>3.3</b> Time of Performance .....	4
<b>3.4</b> Manner of Performance .....	5
<b>3.5</b> Responsibility for Furnishing Resources .....	5
<b>3.6</b> Quality Assurance .....	6
<b>3.7</b> Compliance with Laws and Customer Policies .....	6
<b>4. SUPPLIER PERSONNEL AND SUBCONTRACTING</b> .....	6
<b>4.1</b> General Requirements for Supplier Personnel .....	6
<b>4.2</b> Key Supplier Positions .....	7
<b>4.3</b> Approval and Removal of Supplier Personnel .....	8
<b>4.4</b> Subcontracting .....	8
<b>5. CHARGES</b> .....	9
<b>6. CUSTOMER RESPONSIBILITIES</b> .....	9
<b>6.1</b> General .....	9
<b>6.2</b> Customer Facilities and Resources .....	9
<b>6.3</b> Required Consents .....	10
<b>6.4</b> Savings Clause .....	11

# Pillsbury | Global Sourcing

6.5	Affected Customer Personnel .....	11
7.	ADDITIONAL RESOURCES SUPPLIED OR ACQUIRED DURING THE TERM.....	11
7.1	Customer’s Rights in Additional Resources .....	11
7.2	Customer Approval of the Terms of Certain Resource Acquisitions .....	12
8.	TRANSITION .....	12
8.1	Conduct of the Transition .....	12
8.2	Completion of Transition Projects .....	12
9.	DATA SECURITY AND PROTECTION .....	13
9.1	Customer Data, Generally.....	13
9.2	Data Security .....	13
10.	INTELLECTUAL PROPERTY RIGHTS.....	13
10.1	Customer Material .....	13
10.2	Developed Material.....	14
10.3	Supplier Material .....	14
10.4	Third Party Material.....	14
10.5	Intellectual Property Rights Agreements with Supplier Personnel.....	15
10.6	Other Obligations and Rights Regarding Developed Material .....	15
11.	TERM AND TERMINATION .....	15
11.1	Initial Term and Renewal .....	15
11.2	Termination, Generally .....	15
11.3	Termination By Customer .....	16
11.4	Termination By Supplier .....	17
11.5	Disengagement Assistance .....	17
12.	GOVERNANCE AND MANAGEMENT .....	17
13.	AUDITS AND RECORDS.....	18
13.1	Audit Rights.....	18
13.2	Audit Follow-up.....	18
13.3	Records Retention.....	19
13.4	Supplier Audits .....	19
14.	REPRESENTATIONS, WARRANTIES AND COVENANTS OF SUPPLIER .....	19
14.1	Work Standards.....	19
14.2	Maintenance.....	19
14.3	Efficiency and Cost-Effectiveness .....	20

# Pillsbury | Global Sourcing

14.4	Deliverables .....	20
14.5	Non-Infringement .....	20
14.6	Viruses & Disabling Code .....	21
14.7	DISCLAIMER .....	21
15.	CONFIDENTIALITY .....	21
15.1	“Confidential Information” Defined .....	21
15.2	Obligations of Confidentiality .....	22
15.3	No Implied Rights.....	23
15.4	Compelled Disclosure.....	23
15.5	Public Disclosures.....	23
15.6	Return or Destruction.....	23
15.7	Duration of Confidentiality Obligations .....	23
16.	INSURANCE.....	24
17.	INDEMNIFICATION .....	24
17.1	Indemnification By Supplier.....	24
17.2	Infringement Claims .....	25
17.3	Indemnification Procedures .....	26
18.	LIABILITY.....	26
18.1	Limitation of Liability and Exclusions .....	26
18.2	Force Majeure .....	28
19.	DISPUTE RESOLUTION .....	28
19.1	Informal Dispute Resolution.....	29
19.2	Governing Law .....	29
19.3	Jurisdiction and Venue.....	29
19.4	Continued Performance .....	29
20.	MISCELLANEOUS .....	29
20.1	Waiver.....	29
20.2	Remedies Cumulative .....	30
20.3	Assignment .....	30
20.4	Notices .....	30
20.5	Interpretation.....	31
20.6	Order of Precedence.....	31
20.7	Severability .....	31
20.8	Counterparts.....	31
20.9	Third Party Beneficiaries .....	32
20.10	Contract Amendments and Modifications .....	32
20.11	Survival.....	32

20.12	Entire Agreement.....	32
<b>GLOSSARY</b>	.....	33
<b>INDEX OF DEFINED TERMS</b>	.....	38

**SCHEDULES** *{Note: This is a straw-man list of the Schedules to the Agreement – it will need to be customized}*

Schedule A	Services and Solution(s) [Wrapper document: introduction and contents listing/description]	
A1	Scope and Description of Services [ValueChain Scope Model(s) with definitions of Processes & Elements, or traditional Statement of Work]	
A2	Disaster Recovery and Business Continuity	
A3	Solution Requirements	
A4	Solution Description	
A5	Operations Facility Locations	
A6	Transition	
A7	Transformation	
A8	In-flight and Backlog Projects	
A9	Approved Subcontractors	
A10	Disengagement Assistance	
Schedule B	Performance Measurement [Wrapper document: introduction, contents listing/description and SLA framework]	
B1	Service Level Table [by Geography or Service Cluster]	
B2	Service Level Table [by Geography or Service Cluster]	
B3	Service Level Table [by Geography or Service Cluster]	
B4	...	
B[x]	Balanced Scorecard	
Schedule C	Compensation [Wrapper document: introduction and contents listing/description]	
C1	Charges for Recurring Services [Pricing constructs and general terms of pricing, invoicing, and payment]	

# Pillsbury | Global Sourcing

	C1-1	Fixed Service Charges <a href="#">[Including Transition Charges, if applicable]</a>
	C1-2	Variable Service Charges
	C1-3	Benchmarking
	C1-4	Extraordinary Events
	C2	Charges for Project Services <a href="#">[Pricing constructs for Large Projects and general terms of pricing, invoicing and payment]</a>
	C2-1	Rate Card(s) <a href="#">[by geography and/or Service Cluster]</a>
	C3	Charges for New and Replacement Services
	C4	Financial Responsibility for Equipment, Software, Third Party Services and Facilities
	C4-1	Financial Responsibilities Matrix(ces)
	C5	Early Termination Fees
	C6	Invoice Template
	C7	Economic Change Adjustments
	C8	Displaced Customer Baseline Costs
Schedule D		Governance and Management <a href="#">[Wrapper document: introduction, contents listing/description, and description of governance and management framework and processes]</a>
	D1	Org Charts
	D2	Meetings
	D3	Reports
	D4	Procedures Manual <a href="#">[Table of contents and procedure for PM to be prepared and approved by Customer]</a>
	D5	Contract Change Process
	D6	Interaction Models
	D7	Issue and Dispute Escalation Process
Schedule E		Customer Resources <a href="#">[Wrapper document: introduction and contents listing/description]</a>
	E1	Affected Personnel <a href="#">[by Country Location]</a>
	E2	Equipment <a href="#">[by Country Location]</a>
	E3	Software <a href="#">[by Country Location]</a>
	E4	Third-Party Services <a href="#">[by Country Location]</a>

# Pillsbury | Global Sourcing

E5 Facilities [by Country Location]

Schedule F Supplier Insurance [Description of the requirements for the insurance coverage  
Supplier is required to maintain]

[Schedule G Existing Customer-Supplier Agreement(s) Superseded by this Agreement]

## **EXHIBITS**

1. Form of Change Order
2. Form of Bill of Sale [For transferred assets]
3. Form of Local Adoption Agreement [To be omitted from US-only transactions]