



903: Out of Sight, Out of Mind? Structuring Outsourcing Agreements in India & Asia-Pacific

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Faculty Biographies

David L. Dick

David L. Dick was associate general counsel of Deloitte Consulting. He recruited, trained, and comanaged a global legal department of 15 attorneys and had global responsibility for corporate and internal legal matters. Mr. Dick led the legal aspects of Deloitte Consulting's globalization and its planned spin-off from Deloitte & Touche.

Previously, Mr. Dick was general counsel of Kroll Associates, actively participating in strategic decisions, corporate governance, and sensitive business operations. He was a senior counsel in the corporate law department of Merrill Lynch, providing the full-range of corporate legal services to the firm's publicly-held parent company. Prior to his role at Merrill Lynch, he was in private law practice in Washington, DC, working primarily on international trade and other administrative law matters.

He is a member of ACC and the Georgetown University Law Center Corporate Counsel Institute advisory board.

Mr. Dick has a BA from the University of Toronto, Trinity College, JD from Vanderbilt University School of Law, and LLM in international and comparative law from Georgetown University Law Center, where he received honors for the top academic record in the Master of Laws program.

David Jackson

David Jackson is general counsel for AIG Technologies, Inc. in Livingston, New Jersey. Mr. Jackson supports the structuring, negotiating, and drafting of complex technology transactions, including technology outsourcing agreements, software and technology licensing, development, and distribution agreements, electronic banking, e-commerce, and other Internet-related agreements, and technology acquisition and consulting agreements for AIG Technologies.

Mr. Jackson also has extensive experience in the outside counsel role, having worked as an associate in Shaw Pittman's New York technology and outsourcing practice and also as an associate with Goodwin Procter LLP in Boston, where he was an associate in the intellectual property counseling and transactions group. Prior to his legal career, Mr. Jackson performed accounting and financial work for various organizations, including five years with Arthur Andersen LLP.

Mr. Jackson received a BA from Birmingham-Southern College and is a graduate of New York Law School.

Nicholas R. Sayeedi

Nicholas R. Sayeedi is vice president and associate general counsel of EchoStar Communications Corporation. EchoStar is a Fortune 500 public company and owner of the Dish Network, a satellite television distribution system with more than ten million subscribers. In addition to comanaging the EchoStar legal department, Mr. Sayeedi oversees EchoStar's international, broadband, software licensing, marketing, employment, and IT legal work, and serves as corporate secretary for all of the

company's international offices. He formerly served as EchoStar's lead securities and M&A attorney.

Prior to joining EchoStar, Mr. Sayeedi was an associate in the corporate and securities department of a large international law firm.

Mr. Sayeedi is current chair of the ACC International Legal Affairs Committee.

He received his JD from the University of California, where he served as note and article editor of the law review.

Eugene M. Weitz

Eugene M. Weitz is a member of Lucent Technologies law department supporting Lucent's Worldwide Services (LWS) division. As corporate counsel for LWS, Mr. Weitz is directly responsible for providing legal services to their managed services group which is a leading outsourcer of network services across the globe.

Prior to joining Lucent, Mr. Weitz was a member of the law department of Atos Origin SA, a European leader in IT outsourcing and professional consulting. While with Atos Origin, he served as regional general counsel responsible for all Atos Origin legal matters in North America, Asia Pacific, and the Middle East. His outsourcing and professional services experience dates back to working with Atos Origin's predecessor organizations, Origin B.V. and the U.S. information technology services subsidiary of Royal Philips Electronics N.V.

He is a member of the New York and Connecticut Bar and holds memberships with ACC and the Computer Law Association.

Mr. Weitz received a BA from Lafayette College and his JD from Widener University School of Law.




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Pacific**

David Dick
David Jackson
Nick Sayeedi
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Agenda

- Overview of Outsourcing
- The Outsourcing Process
- Commercial & Legal Terms
- Management and Governance
- Human Resources Issues
- Risk Mitigation
- Take Aways

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Overview of Outsourcing and Offshoring

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The Outsourcing Model

- Outsourcing - The delegation of discrete company business operations to external service provider(s).
- The logic of outsourcing is that a company should focus on its core competencies and delegate non-core tasks to a third party who can provide the same or better service for the same or lower price.

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The Outsourcing Model

- Principal elements of outsourcing transactions may include:
 - Asset sale - The transfer of people, equipment, licenses and/or other assets to the service provider.
 - Long-term strategic relationship between the company and the supplier for providing services to the company through the use of those transferred assets and other assets.

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The Outsourcing Model

- Major categories of outsourcing:
 - Information Technology Outsourcing - Examples include transactions involving data centers, the development and maintenance of software applications, desktop support and telecommunications network management.
 - Business Process Outsourcing - Examples include transactions involving human resources, finance, administration, manufacturing and call centers.

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The Outsourcing Model

- Outsourcing is really about FINANCIAL RESULTS
 - Objectives of large and small outsourcing.
 - Financial savings including decreasing corporate overhead and expenses
 - Improve service levels
 - Focus on the core business
 - Scale services to fluctuating demand

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The Outsourcing Model

- Outsourcing with a US headquartered vendor with subsidiaries in Asia Pacific
- Outsourcing with a non-US headquartered vendor with subsidiaries in Asia Pacific
- Outsourcing with local service providers
- Who gets the outsourced product? (company vs. customer)
- Where is the product delivered? (one vs. multiple jurisdictions)
- The challenges of communicating in Asia Pacific

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The Outsourcing Process

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Objectives

- Customer Expectations/Goals:
 - Supportive relationship with service provider
 - Understand how the outsource relates to the customer's organization
 - Relationship management that advocates for the customer
 - Commitment to customer's success
 - Predictable service and costs
 - Meaningful service level commitments
 - Simple but variable pricing
 - Flexible terms and conditions
 - Avoidance of new regulatory issues

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Objectives

- Internal politics
- External political considerations

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Objectives

- Organization and communication
 - Proceed carefully
 - Reflect back on goals
 - Start slow, with flexibility to expand as confidence grows
 - This transaction is VERY DIFFERENT
 - Outsourcing services are NOT commodity services
 - The unique financial fundamentals requires a different way of thinking
 - Exiting or reversing any outsourcing decision is difficult, expensive and time consuming
 - Enforcing the agreement outside the US is more difficult

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Objectives

- Establish teams – HR; Finance/Accounting/Tax; Legal; Risk Management; IT
- Identify the company's objectives including preferred geographic locations
- Conduct comprehensive due diligence
- Obtain service provider solutions to the objectives and requirements through a RFP
- Develop a term sheet and negotiate
- Produce the final agreement

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Objectives

- Set a realistic schedule
 - Understand the tasks, then set the schedule
 - Do not compromise the process to save time — this is a false economy
 - Allot time for governmental approvals

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Objectives

- Leverage
 - Customer's natural leverage is front-loaded (sales cycle)
 - Once the deal is signed, natural leverage shifts to the service provider
 - Use your natural up-front leverage wisely to build leverage into the agreement for the duration of the term

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Objectives

- On day 1 after cutover, you may have:
 - No employees
 - No equipment
 - No direct control
 - No experience
- All you have is a contract and the contract management team!

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Process

- RFI
- Comprehensive due diligence
- RFP
- Term Sheet negotiations
- Contract

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RFI

- Focus on YOUR objectives, NOT the objectives of the outsourcing:
 - What are the drivers?
 - Consider all perspectives
 - Identify tensions
 - Examine other issues such as Communications, Language barriers, Timetable, Availability of services and personnel, Security (physical and network), Taxes, Import/Export issues (e.g., encryption), Frequency of document updates (e.g., application development).

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RFI

- Write down your objectives
- Gain consensus
- Modify as needed
- Use them!
 - Tell them to the bidders
 - Use them as a reality check throughout the process

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Comprehensive Due Diligence

- Why conduct comprehensive due diligence?
 - Due diligence is a two way street that establishes expectations regarding the detailed negotiation, the vendor, the company and the services to be provided
 - The goal of due diligence is to minimize the size and scope of unknown risks
 - Should conduct due diligence on the other party, the outsourcing site, and the country/region of the site
 - Due diligence should begin after the RFI stage and continue through term sheet and contract negotiations

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Comprehensive Due Diligence

- Due diligence of the other party should include:
 - Experience, business reputation – CHECK REFERENCES AND VISIT FACILITY(IES)
 - Financial condition (audited financial statements)
 - Complaints and litigation
 - Regulatory/Internal controls
 - Adequacy of management information systems
 - Business resumption/ continuity/ recovery plans
 - Use of subcontractors
 - Insurance coverage
 - Experience with import/export issues (e.g., encryption)

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Comprehensive Due Diligence

- Due diligence of the outsourcing facility should include:
 - Communications and IT Infrastructure
 - Language
 - Training of personnel (especially for call centers)
 - Communication with home office personnel
 - Availability and quality of services and personnel
 - Security (physical and network) and data protection
 - Transportation

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Comprehensive Due Diligence

- Due diligence of the country/ies in which the outsourcing takes place should include:
 - Political climate
 - Crystal ball issues: Inflation, currency fluctuation and the potential for drastic increases in wages and infrastructure.
 - Hiring qualified outside counsel to help understand legal issues:
 - Tax laws and accounting treatment
 - Labor laws
 - Ability to enforce SLAs and other contract provisions
 - IP protection
 - Necessary governmental approvals
 - Understanding currency risks

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RFP

- Use your requirements and objectives to develop a comprehensive RFP that considers local country needs
- Establish basis for an “apples to apples” comparison
 - Be precise, but not prescriptive
 - Be comprehensive, but concise
 - Focus on key objectives
 - Ask for a firm bid
- Maintain competitive process for as long as possible, BUT
- Cannot efficiently continue process with several service providers

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Term Sheet Negotiations

- If utilized, the negotiated term sheet will embody the deal and will be the basis of the agreement
- Term sheet allows negotiation of the terms of the deal without bogging down in “legalese”
- DO NOT differentiate between legal and business issues -- this is a false distinction in these transactions
- Include ALL contractual provisions – address specific issues here, rather than waiting until the statement of work and service level discussions occur
- Continue to evaluate and improve the service provider’s proposed charges, technical solution and legal terms

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Contract

- Use the term sheet as the basis for drafting and negotiating the agreement
- Be able and prepared to walk away from the deal on the table if it:
 - Is not in alignment with the term sheet
 - Does not meet your objectives and requirements

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Scope of Services

- Exercise caution: this is a critical part of the contract, as it directly impacts the financial outsourcing model
- Focus should be on clearly describing what is and is not included
- Describe services in broad terms
- Services “evolve” based upon changes in technology and business
- Scope ties to pricing; thus, it must be clear whether or not an extra charge can be added for any service element provided
- Be flexible and allow for new services; use statements of work
- Change control

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Performance Standards

- General performance measures
- Service Levels
 - How to develop Service Levels
 - Documented vs. actual Service Levels
 - Process for adjustment and evaluation over time
 - Continuous improvement standards
 - Credit bearing vs. non-credit bearing Service Levels
- Asia Pacific examples
 - Communications –response times
 - Language barriers – customer satisfaction
 - Availability of services and personnel
 - Frequency of document updates (e.g., application development)

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Performance Standards

- Service Level credits for Non-Performance
 - Clearly understandable calculation formula
 - Based on priorities
 - Goal is to ensure performance rather than to punish
 - Incentive for better performance
 - Taking credits – right to earn back.

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Price Development

- Determine the company's and vendor's financial objectives
- Identify activities to be retained and those to be outsourced
- Determine which assets will be retained and which will be outsourced
- Identify the dollars associated with the in-scope activities (and any assets) that will be transferred
- Develop and agree upon a financial "base case" based on this financial information
- Develop pricing algorithms and prices
- Beware hidden costs and who will pay for them (e.g., governmental fees, licensing, employee termination)

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Price Development

- Pricing models
 - Resource based
 - Price times quantity (P x Q)
 - Utility Pricing
 - Inflation/Cost of Living Index
- Currency fluctuation (who bears the risk?)
- Payment issues
- Tax issues (e.g., withholding)
- Impact of Corporate Restructuring and M & A

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Term

- Typically range from 3-10 years
 - Multiple “lifetimes” in the IT industry
- Supplier’s justification for a long term
 - Large, up-front costs to market and establish relationship
 - Time needed to accomplish necessary changes to:
 - Make significant investments in “new” technology
 - Implement productivity improvements
 - Achieve “cultural” change



Term

- Impact of an extended term
- Impact of a short term
- The need for:
 - The perfect contract
 - Complex, burdensome specificity, and broad, over-generalized principles
 - Large “cost savings”
 - Termination for convenience
 - Options to expand or reduce capacity
 - Options to purchase outsourcing operation



Termination

- Termination for cause, convenience, change of control, legislative change, deteriorating financial condition
- Termination assistance
 - Transition assistance
 - Equipment
 - Licenses and leases
 - Intellectual property rights
 - Hiring service provider staff

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Termination: Exit Strategy

- The goal is to maintain flexibility to transition or restructure all or part of the services during the term at reasonable transition costs
- Partial or full termination for material breach
- Termination for convenience
 - It may be the only effective way out of a deal
 - Service provider will need, at minimum, a fee that accounts for its investment in the deal
 - The agreement might contain a methodology for determining the fee

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Legal

- Representations and warranties
- Limitation of liabilities
 - Carve-outs
- Indemnification
- Insurance
- Taxes (withholding)
- Government/Regulatory
- Import/Export

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Legal

- Employment related issues
 - Co-employment considerations
- Enforcement of Rights
 - US law governs!
 - Consider speed, reliability of local courts
 - Can use American courts, but the American subsidiaries may not be asset rich
 - Consider arbitration (arbitration judgment easier to enforce in most Asia Pacific countries)

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Legal

- Critical to understand IP laws and how they are enforced in country
 - Is the destination country a party to international IP agreements?
 - WTO TRIPS Agreement
 - Berne Convention
 - Practical considerations regarding enforcement
- Data privacy
 - Country specific restrictions on personal and HR data
 - HIPAA compliance
 - Other industry-specific regulations
- Security (physical and network)
- Import/Export issues (e.g., encryption)
- Frequency of document updates (e.g., application development)

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Management and Governance

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Control and Governance

- Oversight program – Will management be watching in far away places?
- Internal administration
 - Training
 - Language Proficiency
 - Call Center Scripts
 - Annual “Health Check” – visit the vendor’s facility(ies)
- Document service provider performance
- Technical and financial audits
- Controlled subcontracting – particularly important in off-shoring

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Control and Governance

- Implement a robust measurement, reporting and meeting timetable
- Do not unnecessarily limit your audit rights – include financial and security audits (Sarbanes-Oxley)
- Audit as often as needed
- Do not fail to consider taking all service level credits earned
 - You can always give back the money in exchange for something else

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Compliance with Law

- Potentially applicable laws:
 - Employment-related
 - Data security
 - Industry-specific
 - Outsourcing country specific
 - Privacy
 - Other Local laws including contract law

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Privacy and Data Security

- Which party is responsible for monitoring which privacy and data security laws?
- Consider the laws of each country in which the information originates, is stored, processed, or delivered
- Joint marketing/service provider vs. processing / servicing exemptions
 - Disclosure in initial privacy notice
 - Contractual restrictions on confidentiality and use of information

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Human Resources

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Tools

- “Selection” process
- Terms and conditions for transferred staff
 - Transfers not typical in offshore outsourcings (except for oversight). Usually reduction in force.
- Severance & retention compensation
- Communications

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Compliance and Risks

- Apportioning employment-law risks
- Supplier Human Resources practices
- WARN Act
- Impact on remaining staff

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American Immigration Issues

- Compliance with U.S. immigration laws is implicated in:
 - Initial knowledge transfer activities
 - Ongoing service delivery management and “customer presence”
- Visa options for temporary entrance by offshore personnel:
 - H-1B (professional job, specialty occupation)
 - L-1 (multinational employees, transferred from foreign affiliate)
 - J-1 (corporate trainees receiving on-the-job training)
 - B-1 business visitor visa/visa waiver (short visits only)

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American Immigration Issues

- Each visa category is under scrutiny and the H-1B visa quota has been constricted; demand now outpaces supply.
- Essential steps in contracting:
 - Who is responsible for immigration compliance?
 - Identify potential project delays in obtaining visa clearances
 - Handle visa applications with care -- credibility is important

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European Law

- Acquired Rights Directive (Council Directive 2001/23/EC) (and "TUPE")
- Works Council Directive Directive (Council Directives 94/45/EC and 97/74/EC)
- Data Protection Directive (Directive 95/46/EC)
- (By March 2005) Information and Consultation Framework Directive (Council Directive 2002/14/EC)

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Acquired Rights Directive

- Most outsourcing transactions (and business sales/acquisitions) covered
- No contracting out of the ARD
- Preserves employee's employment
 - Transfer on existing terms and conditions
 - Occupational pension scheme exemptions

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Acquired Rights Directive

- Creates duty to inform and (usually) consult employee representatives
- Impacts transaction timeframes
- Inform (and consult) before a binding decision
 - Before non-binding letters of intent (e.g., in France)
- Penalties for getting it wrong
 - Civil in the UK
 - Criminal in France, Belgium, Germany, etc.

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Works Council Directive

- 1,000 employees with 150 staff in at least two, European countries
- The Works Council's constitution "must stipulate by what method the employees' representatives shall have the right to meet to discuss the information conveyed to them. This information shall relate...to trans-national questions which significantly affect workers' interests"
- Voluntary or imposed framework
- Always check the constitution before any outsourcing transaction
 - Specified information/consultation duties
- Pan-European employee representative forum

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Data Protection Directive

- Restrictions on processing personal data
- Personal data is "any information relating to an identified or identifiable natural person" and includes "factors specific to his physical, physiological, mental, economic, cultural or social identity"
- "Processing" includes "collection, recording, organisation, storage, adaptation or alteration, retrieval, consultation, use, disclosure by transmission, dissemination...erasure or destruction"

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Data Protection Directive

- Legitimate processing
 - Express consent
 - "Legitimate interests"
- Sensitive personal data (racial or ethnic origin, political opinions, religious or philosophical beliefs, trade union membership, data concerning health or sex life)
- Transmission outside Europe
 - "Adequate level of protection" in third country
 - Safe harbor arrangements

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Information and Consultation Framework Directive

- Where 50+ employees in an undertaking or 20+ employees at an establishment
- Information on Activities - economic situation
- Information and consultation on
 - Employment
 - Any "anticipatory measures envisaged"
 - Decisions likely to lead to "substantial changes in work organization or in contractual relations"
- Consultation on latter category must be "with a view to reaching an agreement"

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Risk Mitigation

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Contractual

- Non-exclusivity versus granting exclusivity
- Most favored customer
- Right to withhold disputed amounts
- Partial termination
- On-going reporting requirements

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Operational

- Disruption of infrastructure
- Security
- Redundancy
- Data privacy/safeguards
- Business continuity and disaster recovery
- Customer satisfaction surveys, service levels and service level credits

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Insurance

- What is available? At what price?
- Service Provider must maintain appropriate types and amounts of coverage.
- Company as an additional insured
- All liability limits should be in addition to insurance coverage
- Verify rating of any non-U.S. carrier

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Takeaways

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Before Negotiations...

- Assess whether the company lends itself to outsourcing
- Set realistic goals
- Obtain buy-in from senior management, IT service units and internal customers
- Consider employee buy in and behavior
- Understand key aspects of outsourcing, especially pricing

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Before Negotiations...

- Assemble as much information as possible about your environment (e.g., budgets, performance levels, assets, people)
 - Do not measure too many service levels

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Before Negotiations...

- Assemble the right negotiation team
 - Have at least one person with on-going responsibility for managing the agreement on the negotiation team
- Engage appropriate consultants/resources with necessary expertise – ENGAGE IN THOROUGH DUE DILIGENCE
- Anticipate and understand amount of time and resources needed to negotiate a complex deal
 - Failure to do so almost always advantages the service provider

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During Negotiations...

- Show strong leadership by senior management
- Empower your negotiation team
- Encourage senior management to control the service providers' access to them outside of the negotiation channels
- Follow a disciplined acquisition process
- Openly bid and keep bidding open long enough
- Keep competition open as long as possible

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During Negotiations...

- Customers should consider not granting exclusive rights to the service provider
- Control the process and timelines
- Hold service provider to timelines and deliverables during negotiations

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During Negotiations...

- Address all aspects of the relationship
 - Define scope with precision
 - Do not evaluate and negotiate piecemeal
 - Do not delay due diligence
- Put a contingency plan in place
 - Important to be able to “walk away” and to convince the service provider you mean it
 - Competition helps (including “in-sourcing”)

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During Negotiations...

- Select a service provider with the values, cultural fit and rapport needed to maintain and enhance an effective relationship over time
- Address all substantial issues before the agreement is signed
- Do not allow re-openers

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After Negotiations...

- Assemble and empower the right implementation and management team
 - Have the team that will manage the service provider in place early, with necessary processes and procedures fully developed and ready to go
- Provide appropriate knowledge transfer and ongoing education for hand-off (and to new employees hired to oversee the service provider)

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After Negotiations...

- Anticipate resources needed to implement and oversee service provider post execution and migration
 - Shaw Pittman, a law firm that assisted us with this presentation, recommends budgeting approximately 10% of cost of annual service provider fees for internal resources to oversee service provider – include travel costs and expenses for offshore visits
 - Consider whether the internal organization will have the knowledge and stature to properly manage the service provider

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Factors Contributing to Post Transition Problems

- Lack of alignment between the service provider and customer goals and objectives
 - “Too good” a deal on either side
- Customer inability to maintain surrogates for competition post implementation
- Unwillingness to hold the service provider accountable to the provisions of the agreement

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