A Better Way Out?

“Parting is such sweet sorrow” -William Shakespeare

As with any business relationship, the end of an outsourcing can be a difficult time. Happy, trouble-free exits are rare. Emotions often run high, there may be pending legal claims in relation to the termination circumstances that triggered the exit, and employees may be worried about their future jobs.

Too often, outsourcing parties let these issues distract them from what’s really important. For a customer, the priority should be to maintain continuity of service during exit. For a service provider, the priority should be to ensure that its resources can be effectively transitioned to the next deployment with minimal downtime.

In the outsourcing sector globally, it is becoming increasingly important for both customers and service providers to focus on how to ensure continuity of services and a seamless exit and transition. As the average duration of outsourcing relationships continues to shrink and the complexity of the outsourcing services provided increases, the frequency and difficulty of exit also increases.

Regulation of exit services has been a permanent part of outsourcing contracts for many years and has developed from a single clause in the main contract to a separate schedule setting out the services and information to be delivered by the service provider in relation to exit both over the term of the contract and upon an exit event actually occurring. But this has not stopped many outsourcing relationships from falling into the same traps that have existed for years.

Despite the increased focus on regulation of exit services, disagreements and uncertainty about the rights and obligations of customers and service providers in exit situations do not seem to have significantly decreased. If anything, the growth in frequency of multisourcing strategies – and the corresponding need for one-to-many exit handovers – has exacerbated the problems.

This Practice Guide asserts that there is a better way. There are a handful of simple approaches that can be followed in any outsourcing arrangement in order to avoid the most common mistakes in the exit phase. As with many outsourcing issues, the keys to success are planning, transparency, and using past experiences to avoid future mistakes.

This Practice Guide explains some of the core principles that are important to establish a better set of arrangements in relation to outsourcing exits. The Guide examines the most common issues that arise when dealing with exits in outsourcing relationships.

We also focus on three essential exit stages – Decision to Exit, Planning of Exit, and Post-Exit – and on the always tricky topic of how parties to an outsourcing relationship ought to address the issue of payment for exit services.

Even the greatest exit plan will not resolve every potential issue that may arise at the end of an outsourcing relationship. But it is possible to use the planning process to establish the right culture within which an exit will occur, to determine key resource constraints, and to identify how exit transition issues will be addressed in a way that recognises the concerns of all parties.

“Plans are nothing; planning is everything.”

– Dwight D. Eisenhower

Most Common Exit Problems

- Outline exit plan never finalised
- Mis-match between the exit plan and new service provider’s transition plan
- Customer tries to get free services (from service provider’s perspective)
- Service provider overprices the exit services (from customer’s perspective)
- Service provider refuses to release key data or provide relevant access to infrastructure citing – IPR, data privacy, or confidentiality concerns
- Insufficient documentation available to the new service provider
- Cherry-picking of key employees
Outsourcing is often compared to marriage: both require compromise and understanding of the other party’s needs and desires, and both work best when the two parties work to overcome difficulties for the sake of the long term. But there’s one big difference: people get married expecting it to be permanent, not limited to a fixed term. No one gets married for the next five years with the option to renew on an annual basis with twelve months’ notice on either side.

By contrast, outsourcing relationships are almost always set for a limited term (although a handful of “evergreen” contracts in the closed-book life & pensions outsourcing sector prove that every rule has an exception). From day one, the parties state that there will be an end-point, so why not plan for it?

1 Common Issues and Solutions

The problem of achieving a smooth exit that works for both customer and service provider plagues many outsourcing relationships, both large and small. One of the main underlying issues is that, during the term of the outsourcing contract, neither customer nor service provider pays enough attention to the issue of exit terms, or to creating a foundation for a seamless exit and continuation of services.

No one wants to think about exit issues during the pre-contract “dating phase” of an outsourcing relationship or in the happy post-signing honeymoon period. And then, by the time the services have been ramped up and steady-state achieved, exit is either viewed as too distant an issue to address or something contentious that would upset the happy balance between customer and incumbent service provider – or, conceivably, something that belongs in the “too difficult” box for both parties.

And so the issue gets ignored until the customer is working out what its future strategy will be, and only then realises that (a) it has only a very loose idea of how to transition services to another provider; (b) the incumbent service provider has the best access to key data that would allow a level playing field for competitors to bid to replace it; and (c) the incumbent service provider owns key assets and there is no blueprint or plan for how service continuity will be maintained if the customer’s best value for money solution lies elsewhere.

The most common issues in an exit situation are:

- Failing to plan properly and assuming that the exit process will either magically occur or will be agreed upon at the time it’s needed (when, by definition, the parties’ relationship is likely to be at its worst)
- A customer expecting something for nothing in the exit situation and believing that the key services required to effect an exit transition have already been paid for during the term
- The parties failing to build a firewall around exit discussions and bringing to the table the same antagonism that exists in relation to termination, or using exit as a weapon in an on-going dispute over termination.

There is a better way. Many of the issues involved in an exit can be avoided if the parties follow a few simple rules:

- Plan for the exit in advance when entering into a business relationship, and spend time discussing and regulating any future exit terms
- Understand each other’s drivers and needs for a successful exit: the process is not just about continuity of service for the customer
- Keep exit under review during the contract life, and don’t let draft exit plans grow stale or out-of-date
- Work out in advance a fair way to pay for an exit
- Create a structure for exit. One size will not fit all, and you can’t legislate for everything, but if you can try to create a level playing field for cooperation, openness, and dialogue, you will have made the parties’ collective lives easier when exit finally occurs
- The incumbent’s exit plan is only half the story. Establish a process by which to create alignment between the incumbent’s exit plan and the new service provider’s incoming transition plan
- Think about exit in terms of the obligations pre-exit (including what may be needed to consider whether to exit or not), managing an exit, and then post-exit obligations. How will all of the key resources (e.g., people, data, process maps, software, intellectual property, and data) be treated at each stage?

Underlying Problems

Many deals are won by new providers, and the causes of incumbent displacement are often unrelated to provider dissatisfaction

Increasingly common for exit/transition to occur on one-to-many basis – where client implements multi-sourcing

Often, transition is offered on a no-cost basis or transition is priced significantly below competition

Taking the easiest possible approach to transition and price, assuming that the incumbent provider fully cooperates and provides all necessary documentation and access.

This approach is rarely mirrored by the termination services agreed between customer and the incumbent provider

“History repeats itself, first as tragedy, second as farce.” - Karl Marx
2 Decision to Exit

Outsourcing relationships certainly fit into Benjamin Franklin’s oft-repeated description of the U.S. Constitution. All outsourcing relationships will end at some point, either through natural expiry, change in customer strategy, M&A activity, or, possibly, breach leading to termination.

But exit has bad connotations. It’s seen as something that happens when things go wrong. Sure, exit can occur when the parties’ relationship has broken down, but that’s only one of many reasons. In practice and in our experience, more outsourcing relationships reach the exit phase for non-fault reasons than for contract breach-based termination.

2.1 Key Customer Concerns

The decision to terminate or exit is most often driven by the customer. Common reasons for termination are: (a) a need for a change of scope; (b) a need for new technology; (c) internal policies or laws requiring a tender process to be carried out after certain prescribed periods of time; or, of course, (d) dissatisfaction with the current service provider or material default of the contract.

It’s not uncommon nowadays for a new corporate CEO or CIO to want to change direction dramatically, and outsourcing is one of the management levers that boards of directors often seek to use in order to effect material change within a business. Termination “for convenience” clauses may be less common in the current generation of shorter-term contracts, but they are by no means unknown.

Regardless of the reason for the decision to terminate, the key customer concerns in the decision phase should be to ensure continuity of services. This means not only continuity at the same (contracted) level after the notice of termination or in the lead up to the expiry of the contract, but also continuity during any period of transition if the customer decides to hand the services over to another provider (or even to bring the services back in-house). A key part of this concern includes preventing knowledge leakage from the service provider because its employees are transferred to other work situations.

It is equally important to the customer that relevant information and knowledge about the services can be shared with the replacement provider or bidders in a tendering process as part of due diligence. Data access will help to ensure that any future contract is financially and technologically sustainable. Getting hold of the right data to enable a fair competition is also crucial for a customer to be able to determine where the best future value-for-money solution lies.

Each of these key issues is addressed in the sections below.

2.2 Key Service Provider Concerns

Exit services are undoubtedly important for the service provider to deliver. It can be destructive for reputation and therefore business if it becomes a widespread belief among the customer community that a certain service provider is unable to deliver a seamless exit to a replacement provider.

A service provider, however, will be motivated to focus on current and new customers, and will usually seek to utilise its resources in the best possible way to keep current and new customers satisfied rather than maintain the best resources to provide services to a customer that has decided to source its services elsewhere. A service provider needs to be able to plan for the re-allocation of resources and focus on servicing its other customers.

Further, in the competitive global outsourcing market, a service provider will be reluctant to share any information which it considers to be a trade secret or confidential, including sharing intellectual property rights (IPR) with competitors.

It is also important to a service provider to ensure that it will be paid for continued services and any exit services provided in the exit phase. The prospect of revenue and measurable earnings acts as an incentive to deliver the exit services and ensure a seamless transition.

It’s often thought that silence is the best policy of a service provider when it comes to exit plans: for example, if the contract doesn’t say anything, everything will have to be negotiated and there will be a price for that. But, thinking more strategically and less about holding a customer for ransom, in order to be able to assist the customer, plan the allocation of resources, protect the necessary trade secrets, and share the necessary information to enable a replacement provider to take over the services, it is actually in the longer term interests of the service provider to have a thorough and detailed exit schedule to provide clarity in relation to the rights and obligations in the exit situation. It doesn’t necessarily mean that exit is less of a revenue earning opportunity; it just means that exit is an opportunity for planning and future planning is as important to the service provider as it is to the customer.
Governance and Exit Services Ombudsman

To address the emotional distress of the exit situation, one beneficial step that the parties can take is to appoint an independent “ombudsman” to oversee fair play and protection of both parties’ core interests.

It’s even possible for a service provider to appoint an internal ombudsman within its own organisation, tasked with ensuring a best practice seamless exit. This must be a senior manager who has not and will not be involved in the day-to-day operation of the contract and exit services.

The purpose of the ombudsman role is to allow each party to escalate disputes related to the exit services to allow the ombudsman to hear the parties and, within an agreed number of days, propose a compromise to support the overall goal of an efficient and seamless exit, and support parties in settling the dispute on the basis of the suggested compromise. For protection, there may be circumstances (e.g., disproportionate cost) where the parties will not be obliged to follow a suggested compromise.

2.3 Service Continuity

Increasingly, we see outsourcing contracts that, firstly, set out an agreed general principle underlying the exit phase that both parties should strive to achieve continuity and, secondly, drill down into specific mechanisms to achieve continuity.

But the key to success is not just to address continuity at the general and specific levels – it’s also to consider both parties’ need for continuity. The customer’s need is obvious: it is the recipient of services and, unless there has been some dramatic shift, that need endures. A gap in service provision could have disastrous consequences for its business.

If it’s not generally regulated in the contract, the customer and service provider should contractually agree that no key resources (to be defined and listed by name or role in the contract) should be removed or replaced after the exit has been announced, unless the customer gives an explicit consent to such a removal or replacement. Such resources can also be provided by subcontractors to the service provider. This agreement gives reassurance to the customer that services will continue as contracted; key resources are available for knowledge transfer to a replacement service provider; and delivery of the exit services will continue when the transition begins. During the transition, when the replacement service provider successfully takes over and begins delivering services, a ramp-down of the resources, including key resources, can also begin.

Often the transition to a replacement service provider is a step-by-step process where different services are transferred one at a time (in contrast to a “big bang” scenario). In either case, a final end date is usually agreed upon, after which the replacement service provider is required to provide all contracted services. The exiting service provider will plan the removal of resources, disposal of equipment not transferred, and the close-down of activities to be finalised at this agreed upon end date. The exiting service provider will expect not to be contractually obligated to provide any services after this date, unless otherwise expressly agreed upon.

Some outsourcing contracts stipulate that the exit services must continue until transition to the new service provider is completed irrespective of any agreed upon end date. However, if the services are not provided by the replacement service provider due to defects or a delay in transition, the customer should also negotiate the right to have the services fall back to the exiting service provider or have the services continued by the exiting service provider after the agreed upon end date of transition. Such right should be unconditional and cannot depend on potential acceptance from the service provider to continue to deliver services if the situation occurs. The service provider can negotiate protection against additional costs and risk of breach of contract in other ways than requiring the right to consent to continue.

Such “emergency” continuation of services should be for a short period of time, either as a fixed period (e.g., three months) or on-going one month’s notice, to maintain flexibility in the on-going transition. This short period should limit costs and keep pressure on the parties to finalise the transition. The customer may require the option to extend the three month period until the services are fully transferred and delivered at the same level by the replacement service provider. Some service providers will insist (with some justification – they need to plan their resourcing as much as a customer needs certainty in service delivery) that this cannot go on forever and a final long-stop date for the emergency continuation of services may be agreed upon.

The customer will sometimes have to accept that the exiting service provider cannot retain all of the same resources to deliver the services during the exit phase, particularly during an emergency continuation of services. There will be additional costs for and problems in incentivising staff, maintaining resources, and keeping equipment and underlying support and licensing agreements alive during any continuation phase.

It is, however, in both parties’ interests to have these options regulated to enable the service provider to plan to continue services, if necessary, and for the customer to ensure the continuity of services necessary to support its business. As Section 5 below points out, payment of costs additional to the service price ought to be seen as a small price to pay compared to a fractured transition to a replacement service provider.

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It is essential that the purpose of the assistance and provider’s facilities, resources, and infrastructure. This will manage expectations and enable the customer to inform a replacement service provider in detail of what is to be expected from the exiting service provider, and allows the replacement service provider to plan and price the transition more accurately.

A detailed listing requires assistance from the technical solutions team during the negotiations and the schedule needs to be updated and maintained over the term of the contract to ensure that the listing remains relevant to services as they adapt over time.

As a part of these discussions, it should also be agreed upon that the service provider will deliver certain due diligence materials at pre-agreed upon points, e.g., shortly after contract signing and once a year during the term. The customer shall be allowed to disclose such materials to potential new service providers/bidders as a part of a tendering process as long as a non-disclosure agreement is signed. This is important to ensure that the materials are always available to the customer and of sufficient quality to enable the customer to start an exit quickly, if necessary, for example, due to the service provider’s default.

These detailed listings will trigger discussions about what may be considered trade secrets and IPR of the service provider which will not be shared or can only be shared under non-disclosure agreements, or should only be available under a commercial license provided by the service provider to the customer or replacement service provider. Taking the time to discuss and list these elements upon entering into the contract – and not having the discussions during the exit itself – is time well spent and acts to give both parties clarity with regard to rights and obligations when an exit occurs.

A customer could consider having separately specified service credits to be payable by the service provider to the extent that the due diligence materials are not delivered on the due dates and if the service provider does not deliver the materials and assistance listed when an exit is on-going.
3 Exit Planning

“Vote early, vote often” - Al Capone

The most common defect of outsourcing exit processes is that planning doesn’t start early enough. To paraphrase the proverbial preferred election strategy of Al Capone and successive Chicago politicians over the years, the best approach is: start early, repeat often.

3.1 Focus on Exit Planning from the Beginning of the Contract Term

It is essential that detailed planning of an exit should not begin after an exit is decided upon; it should begin immediately after the contract is signed or even as a part of the tendering process. It is common today in many outsourcing contracts to require the service provider to deliver an exit plan shortly after the signing of a contract, and to require that plan to be continually updated when there are significant changes made to the services provided.

It is, however, equally common that an exit plan is not delivered, or is delivered as a high level plan which is not useful and, very often, the plan delivered is not updated and maintained during the term of the contract. Customers tend to accept this situation until exit becomes a live issue within the customer’s organisation – by which time, it’s frequently too late to revise or create a plan.

There are many tasks and focus areas when an outsourcing contract has been signed and is beginning to be implemented in both the customer’s and the service provider’s respective organisations, so an exit plan is not a first priority for either party. When services are on-going, it can be unpleasant for the customer to discuss exit planning with the service provider, and the service provider has no reason to bring up the topic of exit since its main interest is in maintaining the provision of services for as long as possible.

However, regardless of whether the eventual exit is planned due to expiry, or unplanned due to material default, it can become a costly problem for both the service provider and the customer if an exit plan has not been provided, is insufficient, or is obsolete due to changes in the services. The customer will have the cost and the burden of the problems; however, if the service provider is in material breach, a substantial portion of the cost may eventually be covered through claims for damages caused by the service provider.

The overall purpose of the exit plan is to enable the customer and the replacement service provider to provide services of a similar nature and scope as the services in the contract, at the same service levels as prior to termination or expiry of the contract. Further, the plan should ensure a seamless transition minimising disruption or degradation in the services during the exit phase, including provisions to ensure that no data is lost or corrupted. And all of these provisions in the plan need to be carried out in the shortest practical timeframe.

The first draft of the exit plan should follow and reflect the steps of transition and ensure that fall-back to the customer or the exiting service provider is possible. When the transition is finalised, the exit plan should enable the customer to evaluate the time and effort to be invested in an exit, planned or unplanned, at any point in time during the term of the contract. It just makes logical sense to think about the exit plan as a reverse or mirror image of the transition plan.

Alternatively, some customers require service providers that are delivering services to customers to submit an exit plan as part of the tendering process, with the expectation that the exit plan will match the transition plan. When the transition plan is complete, the exit plan can then be updated accordingly, and revised on an on-going basis throughout the term of the contract.

The goal of both parties ought to be to increase certainty and transparency, and to ensure that a full alignment of the exit plan with a new service providers’ transition plan can swiftly take place when exit becomes a reality upon termination or expiry of the contract. Such alignment of the two plans will be performed by the exiting service provider. However, to do so it will need the active participation of the customer and the new service provider to provide the relevant information and ensure an alignment on key issues such as relevant milestones for completion of obligations and performance of deliverables in the exit services to support and enable the transition services. This participation needs to be detailed in the provisions for exit services.

Such aligned transition plan will then form the basis for the new service provider’s exit plan to be delivered upon or just after signing of the contract, and updated accordingly during the term of the contract. Upon the next exit, the process outlined above will then reoccur.

This process should be made clear to both the service provider and customer and it requires effort from all parties to carry through, whether as part of entering into the contract or after the signing, but also (and maybe even more so) during the term of the contract. It is important to the service provider that the cost of the process is part of the on-going fees, and both the customer and service provider should agree to have the exit plan meeting in the governance model, ensuring follow-up on this topic. However, it is imperative that the customer pay close attention to this part of the contract, since the service provider has no natural incentive to focus on an exit.

3.2 Incentives for the Service Provider to Have and Withhold Focus on Exit Planning

An incentive for the service provider to prioritise its exit plan could be to require that the service provider’s top management must certify “exit readiness” once a year by providing the customer with
Who Owns the Exit Process?

The issue of exit governance is important but infrequently addressed. It’s common for a customer to take the position that either the exiting or the replacement service provider is ultimately responsible for managing the exit process.

But is this right? The exiting and replacement service providers can only really control their own scopes of work, and neither has much leverage to manage the other. It can be like shutting two squabbling kids in a room and telling them to sort it out.

So the best party to take a holistic view of the end-to-end exit process and manage the transition is really the customer itself.

Some customers will be prepared to step into this role, whereas others will be reluctant, feeling that they lack the resources and skills to do so. As a result, we see a role for specialist transition management outsourcing services. Some customers actively seek to procure such input from external companies in parallel with their re-procurement exercises for the underlying services themselves.

We see this as a positive development: it shows a customer is prepared to take responsibility for service continuity and invest in long-term success. It doesn’t mean that expectations for either the exiting or the replacement service provider are any less, merely that the customer recognises that it is in the best position to direct the process of handover of services.

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a letter from the service provider so that transfer of the services to the customer or a replacement service provider can be efficiently conducted. Further, the customer should consider requiring the service provider to provide and maintain a risk register listing risks that could adversely affect the ability to execute the exit plan. Such register should also suggest mitigation, with the cost to be discussed in the relevant governance forum.

Another possible remedy for the customer, if the service provider does not deliver or update the agreed exit plan, is to have a right in the contract to allow a third party to do the work at the cost of the service provider. This would require access to the service provider’s facilities and information about the services for such third party. Further, service credits and/or bonus schemes are also a possibility.

3.3 A New Approach to Exit Planning

While it’s not possible to wave a magic wand and make all exit issues disappear, it is possible for customers to take a more proactive approach to exit planning.

Based on our experience in exit situations, effective planning can be broken down into specific areas. It would be illusory to believe that any single plan could remove all exit risk, but the planning process does cause the parties to focus on the key risk areas, and that focus may effectively reduce the threat of continuity of service.

In our view, there are six areas where parties to an outsourcing relationship can make small but significant changes to the exit planning process.

Improve the Payment Model. The cost structure related to exit services should be based on the principle that some exit-related services and deliverables will not be separately payable but, instead, will be included in the base charges. Apart from such expressly stipulated services or deliverables, all other requirements should be separately payable and subject to a quotation and approval process. Items that could be considered for inclusion in the base charges include delivery of due diligence material on a yearly basis, drafting, delivering and continually updating the exit plan and a fall back plan, and compilation and delivery of actual deliverables such as documentation, software, customer IPR, release notes, test plans, or operations manuals. We discuss the possible approaches to charges in Section 5 below.

Focus on Achieving Alignment between an Exit Plan and Transition Plan. It’s crucial to realise that the exiting service provider’s exit plan is only half the battle. The exit plan must align with the new provider’s transition plan. Both plans should be shared and openly discussed. The aim of all parties should be to identify possible gaps and work out how such gaps can be closed. Ideally, the customer and replacement service provider will designate how the services will transfer to the replacement service provider; the incumbent service provider will update and align the exit plan to support, integrate with, and enable transition in accordance with the transition plan agreed between the customer and replacement service provider; and such alignment will include relevant milestones for the completion of obligations and performance of deliverables to support the milestones set out in the transition plan.

Regular Certification of Exit Readiness. On a yearly basis, the service provider should be required to certify to the customer in writing that the current version of the exit plan fully reflects any changes in the Services; and that an exit from the service provider and transfer of the ability to perform services
to the customer and/or competent replacement provider can be efficiently conducted via the exit plan, subject to the exit plan being updated where required with information to be obtained from the customer and/or replacement provider.

**Risk Management.** Most customers and service providers are pretty good at risk management in the normal course of operations. But risk management best practices often lapse when faced with an exit situation. Exit should be treated as any normal project. The service provider should provide and maintain a specific exit-related risk register. The register should cover any non-trivial risk that may adversely affect the ability of the service provider and customer jointly to execute the exit plan. Risks may be operational, technical, commercial or legal. The customer and service provider should jointly own the agreed mitigation initiatives, which should including a customer and service provider should jointly own the agreed mitigation initiatives, which should include a time schedule and, if relevant, a price proposal. Both customer and provider should jointly review the risk register and mitigation proposals, and determine initiatives to be taken in relevant governance forum.

**Adjustment of Pricing and Relief of Service Provider Step-by-Step.** Customers need to be more proactive and cut service providers some slack in terms of appropriate relief from service requirements. Equally, providers ought to be more open to a graduated service transition in certain circumstances. There’s no precise template for how this might occur, but transparency as to how services can be transitioned and resources released is key.

An Ombudsman as Part of Governance. The parties should agree in advance on the right governance forums to manage an exit. These may be differently constituted from the normal running, live service forums. Customers should be more prepared to own the exit process (see box on page 7). Additionally, parties ought to consider appointing ombudsmen, either within their own organisations or independently, in order to ensure rapid and effective resolution of exit-related issues (see box on page 4).

**A New Approach to Exit Planning**

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| Improve the Payment Model |
| Focus on Achieving Alignment between Exit Plan and Transition Plan |
| Regular Certification of Exit Readiness |
| Risk Management |
| Adjustment of Pricing and Relief of Service Provider step-by-step |
| An Ombudsman as part of Governance |
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“Help, I need somebody. Help, not just anybody. Help, you know I need someone, help.” - *The Beatles*

### 4 Post-Exit Services

#### 4.1 Post-Exit Assistance from the Service Provider

The customer and service provider should, as a part of the exit schedule and the exit plan, also discuss the possibility that the customer may require services to fall back to the service provider in the event that the replacement service provider fails to transfer the services or cannot deliver the transferred services at the same service levels as the exiting service provider.

Such fall-back is often disputed by a service provider as impossible to execute and not necessary if introduced in the negotiations. The cost of such fall-back should, of course, be discussed. However, the possibility of a period of time when all services are either run in parallel or at least not completely shut down by the exiting service provider is not impossible and should be considered by the parties in the negotiations.

As mentioned under Section 2.3, the transition to a replacement service provider is often a step-by-step process in which different services are transferred one at a time (in contrast to a “big bang” scenario). On the condition that there is a full alignment of the exit plan and the transition plan as described in Section 3.1, the fall-back obligation on the service provider can be set to a limited time after each step of the transition has been performed. So, for example, the exiting service provider will be obligated to have fall-back readiness for 30 days after the completion of a stabilisation period with the new service provider of a transitioned part of the services. After the 30 days, the exiting service provider will be relieved of its obligations to provide the services and will no longer maintain the fall-back readiness.

In a less significant way, the customer should certainly consider requesting a right to require post-exit assistance from the service provider within a certain number of days upon a request, at pre-agreed hourly rates. Such assistance should be provided by named key resources of the service provider that understand the customer’s services and systems. Payment to have such resources on stand-by for a period of time after the exit has been completed should be discussed.

#### 4.2 Deletion and Return

During the contract life, the service provider will have gained considerable knowledge of customer’s business and had access to customer’s data and property.

The customer should ensure that, as part of the exit plan, the service provider must return all of the customer’s property and that all copies of data that are not to be returned and not part of a records retention obligation are deleted or destroyed. This also includes all copies of standard software used on behalf of the customer and the customer’s IPR,
including IPR developed by the service provider on behalf of the customer.

Further, the knowledge gained by the service provider about the customer’s business and systems should be protected by confidentiality obligations which remain in effect after the end of the contract.

Usually these types of provisions are not substantially discussed in negotiations. However, they are important to remember, and a description of an appropriate process for removal and returning of customer property is usually the solution. It is important to ensure that the service provider does not delete any data, IPR or software that belongs to the customer without the customer’s explicit consent.

Further, it is also important to describe the level of documentation or certification of such deletion and destruction to be provided by the service provider to the customer after the exit is completed.

To the extent that any record retention period for certain information in relation to the services provided has been agreed upon, it is also important to ensure that the records are destroyed or returned to the customer in accordance with the same principles at the end of such agreed upon period.

“Take the money and run” - Steve Miller Band

5 Payment

Earlier in this guide, we described how a gap in service provision could have disastrous consequences for a customer’s business. That being the case, as a rational economic operator, a customer ought to be prepared to pay a premium if necessary to ensure that those consequences are avoided. So why do many customers seem to want to achieve an exit at no, or minimal, cost?

Exit charges ought to be a part of the overall financial equation for a customer, and one of the factors in its decision-making. That overall financial equation is split into two distinct parts: the initial decision to appoint an incumbent service provider, and then the later decision possibly to change providers. Part of the problem, however, seems to be that many customers often focus on the wrong part of the equation: that is, at the outset, they regard the cost of an exit as a “next generation” issue but then, when the time for a re-compete occurs, they regard exit costs as something that should be entirely subsumed within the original transaction cost.

The most successful exit processes are ones in which exit charges are transparent both in terms of what level of fees is payable but more particularly in terms of what will be paid – or priced into – what revenue stream.

Crucially, payment and charges should be fair and balanced between the two most commonly held views, either that customers expect an exit to be handled at no extra charge (especially in a for-cause termination) or that service providers expect to be paid at full rack rates for all extra termination services.

Exit service disputes between customers and service providers often derive from lack of clarity about who bears the costs of the services to be provided, i.e., whether such costs should be paid by the customer as part of the on-going payments during the term of the contract or paid separately as the exit services are being delivered. There are a number of permutations and variations in relation to exit services payment mechanisms, and some have led to more disputes than others.

5.1 Payment Up-Front

In the search for transparency and budget certainty, a customer could ask its service provider to include the entire cost of the exit services in the on-going payments during the term of the contract, and deliver the exit services when required without any separate payment at that time. This request recognises that exit will eventually be a necessity, so why not add in the price of exit to business-as-usual charges?

This approach has disadvantages for both customer and service provider. The main risk for both sides is pricing uncertainty: how does either party know whether it’s under- or over-pricing? The level of uncertainty will typically cause a provider to add large amounts of risk premium.

Very few service providers will be able to calculate the actual cost of exit when entering into a contract. Partly, this is because the actual services to be delivered and transferred upon the exit date cannot be known at the time of contract execution because services evolve over a contract’s duration, often significantly. Also, while one can set out high-level descriptions of exit services to be performed, the actual scope of many of these service elements cannot be determined until the precise time and nature of exit is actually decided (e.g., the number of hours required to provide knowledge transfer in interviews with the replacement service provider can vary substantially based on the replacement service provider’s experience and existing knowledge). Additionally, a lot depends on how many of the services are actually transferred as a one-to-one solution and how many are rebuilt in a new environment at the replacement service provider’s facilities not necessarily involving the exiting provider’s knowledge.

If a customer can somehow delimit the services and establish a fair price for the exit services that it requires to be added in to the contract charges, what happens then if the contract is extended in duration? The exit services are the same but the customer will pay the added in price over a longer duration. And if the contract ends early, the cost of exit isn’t recouped by the service provider.

If the customer requires (as some do) a fixed price for all exit services when entering into a contract, for the reasons set out above, this can result in either an overpayment or underpayment of the service provider, and neither is to the advantage of the
customers. An overpayment is clearly detrimental to the customer but an underpayment will result in the service provider trying to cut and avoid costs when the actual exit services are to be provided, adversely affecting the transition of services to a replacement service provider and the customer’s business.

5.2 Payment on Time and Materials Basis

On the other hand, most customers typically believe that to agree that the exit services should only be provided and paid on a time and materials basis once exit has been decided upon generates too much uncertainty in terms of budget and cost control. Further, there will be no financial incentive for the service provider to organise and efficiently deliver the exit services, and there is a risk that the customer will be invoiced for exit services work that should have actually been performed during the term of the contract and paid for as part of the on-going fees, e.g., updating documentation such as operational manuals and user guides, which are normally required to be updated on an on-going basis during the term of the contract by the service provider.

To avoid double-charging, the customer will need to meticulously analyse invoices from the service provider and this could also cause disputes.

5.3 Best of Both Solutions

In practice, the best solution is a more nuanced approach which combines the best elements of the two main payment approaches and bases payment upon a detailed description of which services belong in which category.

Some of the exit services will need to be determined and priced when exit is a reality, and some of the exit services can be included in the on-going fees since the work provided will be part of the on-going services (or performed by people whose roles are already fully funded by the on-going service charges) and not distinct undertakings only to be completed when the exit is a reality.

The best approach to regulating payments for exit services is to set out a list in the exit schedule of which fees for services will be separately payable when exit is imminent and planned for, and which services are susceptible to advanced fixed pricing.

Services which could be part of the on-going payments during the contract life are:

- Delivery of due diligence materials on a yearly basis, as described under Section 2.5 above
- Continued performance of the services as described under Section 2.3 above with the proviso, however, that if emergency continuation of services is required, additional documented costs may need to be paid separately
- Drafting, delivering, and continually updating the exit plan, including a fall-back plan
- Compilation and delivery of actual deliverables such as documentation, software, customer IPR, and release notes, test plans and operations manuals: basically, any information which is developed and maintained as part of the services during the term of the contract

Other types of deliverables and services can be considered under such a list, depending on how much cost and budget control the customer requires. However, it is important always to consider what can realistically be priced by the service provider upon entering into the contract, bearing in mind the concerns set out above concerning the service provider’s reasons to cut costs during exit when the customer is dependent on seamless provision of services.

Even the model above may not avoid all payment disputes. However, if the parties make sure that the service provider actually performs the services related to exit during the term of the contract (delivering due diligence materials updating the exit plan, etc.) and has paid for this exit as part of the on-going fees, the parties will have taken a big step in the right direction.

The customer should also consider whether it is prepared to accept lower service levels or other stipulated degradation in service quality by allowing service provider’s personnel to be diverted away from their usual duties and on to exit-specific activities. In return, the customer would not expect to pay for any such exit-specific activities because the costs of those personnel are already covered by the usual service charges.

Disclosure and Evaluation

Evaluation of exit ought to form a much bigger part of outsourcing projects. Customers take time to evaluate different service providers’ track records at transition but rarely address how those same providers have exited prior customer relationships. Have they been “bad leavers”? Service providers prepare case studies, reference sites and materials to tout their service transition skills but usually keep their exit experiences hushed up. It’s as if it’s a forbidden topic that they might have had to transition away from a customer. In reality, it’s a fact of business life: losing a client happens to us all, and it’s probably not your fault.

The outsourcing industry should encourage more openness about exits. Customers should place more emphasis on “good leaver” experiences during pre-contract evaluations; after all, they’re as important to continuity of service as incoming transitions. And if a customer does decide to move to a replacement service provider and exit its incumbent, it should positively encourage that incumbent to write up a joint case study on which that customer should put its name and be prepared to act as a reference site for the incumbent’s next sales prospects.

Customers and service providers should help each other in order to take some of the stigma out of contract exits.
Linking Exit Charges to Cause

Often, outsourcing contracts take the position that if a termination is due to a service provider’s material default, the service provider is required to provide the exit services at its own cost. The rationale is that the payments would often form part of a claim for damages anyway, and therefore the service provider may as well bear the cost up-front to save the customer from having to make the damages claim. In some jurisdictions, this is considered to be market practice.

We do not generally support this approach of linking the level of exit service payments to the underlying cause of a termination. A seamless transition may be worth paying for if a business is vulnerable to service disruptions and it must be remembered that service providers will have little incentive to deliver, or to ensure quality, if there is no payment for the services.

The core problem of this approach is that it magnifies any disagreement about the underlying circumstances of exit. It multiplies the financial implications of exit – and all at the very time when it’s really in the customer’s best interests to try to defuse the situation and focus on continuity of services.

Logically, customers would be better advised to consider de-coupling termination and exit. Whatever arguments (or even legal claims) there may be about whether termination is permitted or who is to blame, those arguments should be ring-fenced and kept away from the practical, technical, and, governance processes involved in effecting the exit.

Paying for an exit is not the same as waiving all legal claims about the underlying causes of the exit. And remember, if all had gone really well, there would eventually have been an exit (upon natural term expiry) which the customer would have paid for, so why should early termination for cause turn this paid-for event into a freebie?

Both sides ought to segregate their teams that deal with arguments about termination rights from the mechanics of exit. Obscuring this division by linking exit payments to cause simply adds fuel to the fire.

6 Conclusion

The most controversial thing about exit should be that it ought to be uncontroversial. Of course, the parties may be wildly in disagreement about the underlying cause of the exit. Often, such disagreements are hard to avoid, with allegations and counter-threats about who is to blame. But the issue too often is that parties can’t separate their contractual antagonism from the need for cool analysis to make sure that the practical exit process runs smoothly.

In practice, there’s no silver bullet that will ensure a perfectly smooth transition in the exit phase. It’s possible to use sensible planning techniques and best practices to anticipate and avoid many of the most common problems, but there’s no magic solution and it’s not possible to legislate for every possible scenario.

Outsourcing parties can, however, achieve a vastly improved exit scenario by taking simple steps to recognise that, for example, continuity of services for the customer is significantly more important than saving a few dollars, euros or pounds – or that the service provider has as much need to plan its future resourcing as the customer needs certainty in services delivery.

We recommend clearly agreed upon priorities during the exit phase, and that those priorities should be shared and aligned between customer and service provider. Transparency is a key to success, including clarity about what resources are being used and how they may be transitioned away or across to a replacement service provider.

Exit should be about more than an opportunity to punish a service provider, secure a last big pay cheque from a customer, or cause a competitor replacement service provider to fail. In this modern interconnected world, increasingly a service provider that hands over service provisions to a competitor one day, will pretty soon be taking its own hand-over from that same competitor. And in exit services – as we’d like to think in life itself – what goes around comes around.

“Instant Karma’s gonna get you” - John Lennon
Successful outsourcing projects require clear thinking, teamwork and a depth of expertise that comes from experience. Implementing outsourcing across multiple countries requires an extra level of co-operation and alignment from a skilled team of advisors.

The Outsourcing Law Group (OLG) is a group of like-minded law firms that work together to provide best-in-class legal advice on outsourcing projects across Europe.

Local Presence, Globally Aligned Skills

Independently, each OLG firm has a substantial outsourcing practice and is a recognised market leader in its own country. Together, the OLG firms offer unrivalled depth of expertise in outsourcing across key European countries, and best practices from concept to contract and beyond. In reality, the OLG offers something more important than an international legal brand name: cross-border teamwork of real specialists and genuine local skills. By bringing together top-rated experts in outsourcing projects in the key European countries in which it operates, the OLG reduces the frictional costs of implementing outsourcing consistently across national borders.

Big Picture, Cultural Sensitivities

The OLG operates according to consistent international standards, but also understands and operates within local cultural norms. The OLG offers clients the flexibility to overcome language and cultural barriers, and to manage local sensitivities, while still being able to see the bigger picture. The OLG works with its clients to marry the overall commercial objectives of a project with key local legal and cultural factors – with one aim: to ensure project success for our clients. In addition, the OLG won’t let the local variants derail the wider project. OLG lawyers understand where mandatory local laws vary on specific issues, and how best to deal with such variants on international outsourcing projects without disturbing the central goal of implementing a common multinational commercial approach to the negotiated terms with service providers.

Teamwork, Value, and Efficiency

The OLG provides a managed service that is flexible enough to cope with highly centralised customer organisations, but also adept at managing the more complex task of successfully implementing cross-border outsourcing across more decentralised corporate group structures.

The OLG leverages the joint resources of all of its firm and staff projects with the most relevant resources for each aspect of a project. The OLG works as a single law firm, taking a unified approach to each client project under the leadership of one firm, sharing know-how, and providing cohesive advice and seamless service. The OLG has invested in the development of common contract methodologies, joint training of lawyers and alternative approaches to frequently occurring outsourcing issues on pan-European projects.

The OLG’s hallmarks are consistency, outsourcing experience and teamwork.

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