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COSTLY LESSONS IN OUTSOURCING MEGADEALS – A LITIGATOR’S PERSPECTIVE

By Andrew Legg, Rani Mina and Miles Robinson

Outsourcing continues to be regarded as an important means of achieving substantial cost savings quickly. 2010 saw a year on year increase in the number of outsourcing megadeals (including ten deals worth in excess of US\$1 billion) with the public sector continuing to dominate spending.

It also remains important for customers to consider carefully whether it might prove cheaper to keep the work in-house. Boeing’s 787 Dreamliner, reported to be three years late and billions of dollars over budget, is a case in point: most of the delay is blamed on the company’s decision to outsource 30% of the design and manufacture of the airliner. The need to avoid false economies is particularly acute for the public sector, which is likely to rely even more heavily on outsourcing as departments work to drive efficiency.

A deep understanding of the complications in outsourcing, particularly on this scale, and the reasons why stressed outsourcing relationships often lead to serious disputes, is vital for both customers and suppliers. Many of the problems find their roots in the original drivers for the deal, with customers seeking to realise anticipated cost savings as quickly as possible and suppliers trying to ensure that the contract remains profitable over the term. Contracts that are negotiated and drafted under immense pressure to meet tight commercial deadlines often turn out to be ambiguous or to lack sufficient detail, such as where parties have

agreed heads of terms or “agree to agree” on certain points after signature. Problems also come about where the contract says nothing about what emerges to be a key point or does not allow for developments in the market (a particular problem with IT outsourcing).

These issues lead to arguments about scope creep, with the customer insisting that certain services are included within the contract price and the supplier taking the view that the customer must pay for what it considers to be additional services. Such disputes tend to be high value, reflecting the value of the underlying contract, and highly significant, given the potential impact on the customer’s business and reflecting the transformational nature of the project.

Disputes with suppliers who provide business critical services and are embedded in a customer’s business, are even more difficult to resolve. Supply and service level threats are a common negotiating tactic, which can leave the customer little choice but to capitulate to the supplier’s immediate demands, although there tend to be strong commercial incentives for both parties to reach a longer term settlement by renegotiating the original contract. Termination of the relationship and litigating in the public eye are unattractive options in most cases and both parties will have in mind the need to continue working together, often over a number of years to come.



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In the end, there are costly lessons to be learnt from customers who push too hard and suppliers who oversell when negotiating the deal; the cost of delivering the services is inevitably higher than projected and agreeing

to an unrealistic timetable only serves to generate disputes, delay and additional costs once it becomes clear that changes to the contract are needed.