

A Guide To Managing Outsourcing Relationships

Law360, New York (February 9, 2017, 5:16 PM EST) --Companies are increasingly outsourcing information technology and other services, creating new challenges for managing relationships that are vitally important to their businesses. The parties typically take great care and spend significant sums of money negotiating and preparing detailed outsourcing contracts. But that is where the legal focus often ends. As a result, carefully negotiated and documented rights may not be enforced and the actual relationship that develops between the customer and service provider may look nothing like what was envisioned when the contract was executed. When disputes arise, it may be difficult to determine the actual terms of the parties' current agreement. It may be necessary to interview dozens of witnesses and sort through hundreds, if not thousands, of emails to figure out what has happened and who is responsible for what.



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Having been involved in sorting out many dysfunctional outsourcing relationships over the past 16 years, we have observed a number of recurring problem areas and have identified a number of ways that trouble could have been avoided. These suggested governance practices are surprisingly easy to implement and, if thoughtfully implemented, should not antagonize any service provider that is acting in good faith. Managing an outsourcing relationship with an eye on the contract and keeping in mind how conduct and communications could be interpreted by a judge or jury need not drive a wedge between customer and service provider. On the contrary, the practices suggested below are intended to create clarity. Clarity reduces the number of disputes, lowers the cost of resolving them and produces outcomes that are fair to both parties. Consider the following practices to keep outsourcing relationships on track.

1. If not addressed in the contract, send a notice to the service provider identifying the only customer employees authorized to speak or act on behalf of the customer.

If you identify at the outset of the relationship a small number of representatives authorized to speak or act on behalf of the customer ("designated customer representative"), you will be able to control messaging, adhere to the contract and avoid situations where the communications or conduct of less informed junior personnel create ambiguity and uncertainty. Also, when disputes arise, instead of spending substantial time and money reviewing email communications of dozens of employees, you can focus on the emails of one or two people whose communications have legal relevance.

2. Do not ignore breaches of contract by the service provider.

All customer employees interacting with the service provider should be instructed to notify the

designated customer representative if they think the service provider may have breached the contract. The designated customer representative should discuss the matter with legal counsel to decide whether to send a breach notice. If you do not provide written notice of material breaches as they occur, you may lose your rights under the contract. For example, a customer may want to terminate a contract for cause based upon a series of breaches over a period of time. However, it would be difficult to terminate a contract for material breach based upon breaches that were not the subject of notices when they occurred. A judge, jury or arbitrator might well conclude that if a breach was not important enough to merit a written request to cure it shortly after the breach occurred, the particular breach should not later be considered alone or with other breaches as a sufficient basis to terminate the agreement. Also, the failure to object to breaches may result in a finding of waiver or be a basis for interpreting the contract in a manner unfavorable to the customer where the contract language is susceptible to different interpretations. The conduct of the parties in performing the contract is relevant to interpreting the meaning of the contract when the contract language is ambiguous. The tone of the breach notice need not be harsh or threatening. It should point out where performance has fallen short of the contract requirements and ask the service provider to improve the performance within the time permitted for cure under the contract or a longer period if the contract period is too short under the circumstances.

3. Make sure written communications between customer and service provider are accurate.

All customer employees should be instructed that if the service provider makes a false or misleading statement, they should send an email to the service provider correcting the misstatement. Failure to rebut incorrect statements may result in the service provider taking the position in a later dispute that the customer agreed with the service provider's statements. Indeed, the failure to correct misstatements can cause a service provider to genuinely believe its statements are correct and create ill will if the customer later attempts to dispute those statements. Keeping the written record between the parties as accurate as possible is fair to both parties and should protect, not disrupt, their relationship. It is particularly important that PowerPoint presentations, minutes of meetings, and emails that discuss the quality of services, the responsibilities of the parties, and conduct that allegedly is creating problems for the relationship be as accurate as possible.

4. Do not perform or agree to perform tasks or pay additional fees to service providers for supposed new services without consulting legal counsel.

Determining whether certain tasks are the responsibility of the service provider or the customer and whether certain services are covered by the contract fees or are new services requiring the payment of additional fees can be difficult. Contract language may be ambiguous, and even well-drafted language cannot anticipate all scenarios. As a result, the conduct of the parties in performing the contract may be considered in determining their understanding of its terms. Therefore, it is good practice for the designated customer representative and legal counsel to brief customer employees who will interact with service provider employees as to the respective responsibilities of each party under the contract in easy-to-understand terms and to direct customer employees to bring to the attention of the designated customer representative, before they perform the task or agree to the fee in question, any situation where they are unsure about who is responsible for performing the work or the fee for the work. In a related matter, all customer employees should be instructed not to approve procedural manuals or agree to any interpretation of the agreement without consulting the designated customer representative. A procedural manual prepared and approved after the execution of the contract can substantially modify the parties' respective responsibilities under the contract.

5. Promptly report any sign of trouble with the service provider to the designated customer representative.

It is important to inform the designated customer representative at the first sign of trouble so that he/she can consult legal counsel and develop a strategy to resolve the dispute, and the team can avoid making statements or taking actions that may weaken the customer's position.

6. Do not assign customer personnel to perform work that should be completed by the service provider without sending a notice of breach and providing an opportunity for the service provider to fix the problem.

When a service provider is failing to meet performance expectations (e.g., missing milestones for transitioning from a legacy system to a new system), customers are tempted to assign additional personnel to get the job done. However, if a customer takes self-help action without warning the service provider in writing that the customer intends to do so and intends to charge the service provider for the additional cost unless the service provider improves, the result likely will be that the customer will be stuck with the bill. The service provider may argue that the problems were caused by the customer, or there was no problem since there was no breach notice, and in any event, it is unfair to impose additional cost on the service provider when the customer provided no opportunity for the service provider to fix the problem itself for much lower cost. Accordingly, the better approach is to provide the service provider with written notice of a breach and an opportunity to improve performance. The notice should state that if the supplier does not improve performance by a specified date, the customer will take steps to address the problem and will charge the service provider (or reduce payment to the service provider) to reimburse the customer for its efforts. Providing an estimate of the cost (more than x) in the notice is helpful in supporting the customer's case for reimbursement if the dispute must be litigated. Providing a cost estimate reinforces the reasonableness of the customer's position. The customer gave the service provider full notice of the consequences if the service provider continued to fail to perform.

7. When collaborating with the service provider on a project, make sure that the written record accurately describes the responsibilities of each party so that the project more likely will be successful, or if it fails, blame and cost can be fairly assessed.

Customer employees should be instructed to inform the designated customer representative whenever the customer and service provider are working together on a task. The designated customer representative, in turn, should consult legal counsel to determine which party is responsible under the contract for each aspect of the performance. The contract may not be clear as to specific projects so it will be necessary for the parties to clarify their respective responsibilities before beginning work. An email to the service provider should be sent confirming the customer's understanding. For example, if the contract requires the service provider to refresh equipment and the service provider attempts to create a "refreshment team," send an email either declining the invitation or stating the responsibilities of each party (e.g., customer to provide priority list; service provider to perform all other activities).

As you can see, these suggested practices are not difficult to implement. The implementation does not have to be confrontational to be effective. The fundamental objective is clarity — it should be easy to determine what happened, what the terms of the agreement are, and who is responsible for the failure of the performance. That type of clarity should be in the interest of both parties and should maximize the chances that the parties will receive the benefits of their bargain.

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