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Outsourcing Success in 2012



Agenda Morning Session

8:50 am Welcome and Introduction

9:00 – 9:45 am Software as a Service (SaaS) Agreements

9:45 – 10:30 am ERP Implementation Contracts

10:30 – 10:45 am Break

10:45–11:30 am New Approaches to Dispute Resolution in

Outsourcing Contracts

11:30 – 12:15 pm Contracts for Outsourcing Manufacturing

12:15 – 1:15 pm Networking Lunch

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Effective Contracting for Software as a Service



Effective Contracting for Software as a Service Contracts

What is Software as a Service (SaaS)?

What challenges do companies face with SaaS contracting?

What terms should a good SaaS contract have?

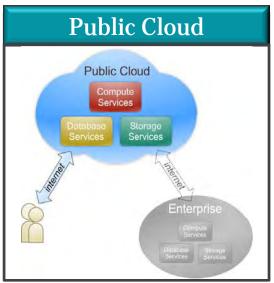
What residual risk should we expect to have in a SaaS contract and how do we mitigate that risk?

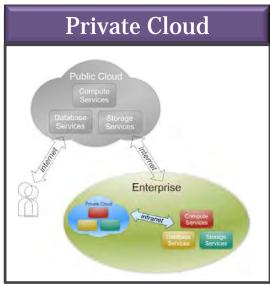
What is Software as a Service (SaaS)?

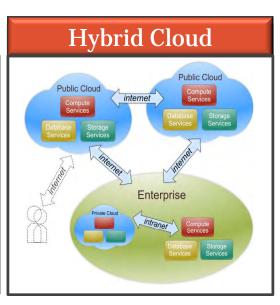
- A cloud computing service, broadly defined as
 - A model for enabling convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction. (NIS&T)
- Other cloud services: infrastructure and platform
- Many common features to outsourcing, but virtualization of the cloud (i.e., no dedicated servers or storage elements) raises many issues (e.g., location, security, continuity commitments)

Deployment Models for SaaS Offerings

 Amount of virtualization SaaS Offerings depends on the nature of deployment model:







- Different degrees of restrictions on location and different dedication/segregation of hardware and software
- Each model contains very different contract terms and legal risks for the customer

WHAT CHALLENGES DO COMPANIES FACE WITH SaaS CONTRACTING?



Challenges of SaaS Contracting:

- Rapid adoption of SaaS has outpaced customer standards and practices for measuring and managing risks
- Achieving full value requires balancing desire for cost savings and functionality with enterprise risk and strategy
- Label of offering alone (public vs. private) doesn't tell the whole story
 - E.g., variability in private cloud offerings
 - Due diligence is essential:
 - Read service descriptions for locations, backup, redundancy, encryption, security, transition process, options for customer control
 - Read contract terms for insight into offering structure, even if you don't use their contract form

Challenges of SaaS Contracting:

- Ease of contracting in the cloud can present oversight challenges
 - Ease of online contracting
 - Supplier resistance to modifying contracts
- Opportunities of cost savings and flexibility may lead to quick business decisions
- Customers may be unwittingly making bad tradeoffs between cost savings and flexibility vs. risk

WHAT TERMS SHOULD A GOOD SaaS CONTRACT HAVE?

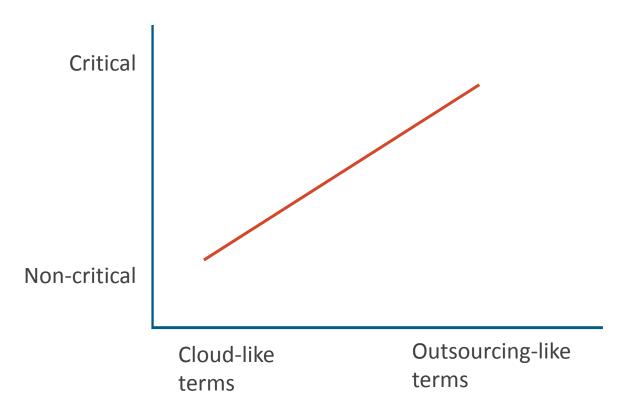
Standard Public Cloud ("Utility") SaaS Contracts in many cases

- Offer no or few commitments to services, service quality, long-term pricing, service delivery locations or technical solution
- Make customer responsible for security, data protection and compliance with laws
- Disclaim or limit almost all liability
- Incorporate on-line forms that are subject to unilateral change
- Give the supplier unilateral right to suspend service or terminate contract

Matching Protections to Risk Profile of SaaS Offering

- Public cloud SaaS services may be ok for non-critical functions without sensitive data, but raise a number of compliance risks where critical functions or sensitive data are involved:
 - Data privacy and security
 - Legal compliance requirements
 - Business continuity
 - Disruptive changes in services
 - Adaptability to changing business environment
- Majority of use of cloud is for non-core functions, but use for core functions is growing substantially

Saas Contracting Strategy



 Balance traditional outsourcing contract protections with supplier flexibility essential to realizing benefits of cloud computing

Key SaaS Contract Issues

- 1. Service Commitments
- 2. Service Quality Protections
- 3. Customer Control Rights
- 4. Compliance Obligations
- 5. Data and Security Protections
- 6. Intellectual Property Rights
- 7. Service Continuity Protections
- 8. Termination Assistance

1. Service Commitments

Customer Need	Pure Utility Cloud Contract	Outsourcing Contract	SaaS Contract
Commitment to contract terms	Terms may be changed by provider in its discretion	Terms changed only by mutual agreement	Terms changed only by mutual agreement
Commitment to Services	High-level definition of standard services, often "AS IS"	Detailed and customized service definition	A detailed but not customized definition
Minimum Term Commitment	Little or no minimum term	Long term commitment early termination charges	May have a short minimum term or long notice period

2. Service Quality Protections

Customer Need	Pure Utility Cloud Contract	Outsourcing Contract	SaaS Contract
Testing and Acceptance	No testing and acceptance	Testing built into transition and all deliverables	Testing of key transition milestones and deliverables.
Commitment to service levels	No service levels, no service level credits and/or unrealistic hurdles to obtaining credits	Detailed and customer-specific service levels with meaningful credits	Service levels built for supplier technology not customer needs, but with meaningful credits

3. Customer Control Rights

Customer Need	Pure Utility Cloud Contract	Outsourcing Contract	SaaS Contract
Determine architecture	No right to approve supplier's architecture	Customer approves architecture	No right approve supplier's architecture
Control changes by provider	Provider may make changes without notice or consent	All changes to services require customer approval	Provider must give notice and customer may terminate if changes have an adverse effect

4. Compliance Obligations

Customer Need	Pure Utility Cloud Contract	Outsourcing Contract	SaaS Contract
Assistance in complying with laws	Standardized offering, often limited based on use of subcontractors	Compliance with all laws applicable to supplier's services to customer	Some ability to configure to meet compliance requirements, but often limited solutions
Audit rights	Typically not available, especially not for subcontractors	Extensive operational and financial audit rights	Some rights available, but may not include physical access
Other incentives for compliance	Extremely limited liability for breaches or failures of any type	Liability for direct damages up to a cap subject to exclusions	More standard (ITO like) liability for direct damages up to a cap subject to exclusions

5. Data and Security Protections

Customer Need	Pure Utility Cloud Contract	Outsourcing Contract	SaaS Contract
Know where data will be	Data may be processed and stored anywhere	Approval required for all data storage locations	Location of data fixed in contract, possibly by country, but beware of 'deemed exports'
Know who will process data	No right to approve and frequent use of subcontractors	Approval of all subcontractors	Agreed limitations on the subcontractors that access data, but may be virtual
Information security	Standardized offering with use of cloud provider controls	Security provided to meet customer's detailed requirements	Security as a Service
Proper disposal and destruction of data	No guarantee all data will be found and erased or returned	Data will be returned or destroyed	Data will be returned or destroyed

6. Intellectual Property Protections

Customer	Pure Utility Cloud	Outsourcing	SaaS Contract
Need	Contract	Contract	
Own IP	Customer owns data provided, but no other provision; possible leakage	Customer owns all IP created by supplier in the course of performing the services	Customer owns data processed or created on cloud service; limited instances of customizations owned by customer and likely license-back requirements

7. Service Continuity Protections

Customer Need	Pure Utility Cloud Contract	Outsourcing Contract	SaaS Contract
Personnel Continuity	No commitment to personnel continuity	Commitments for continuity of key personnel and turnover protections	May have some commitment to continuity of a few key personnel
Non- interruption	Rules of use allowing interruption of services. No business continuity commitment	No right to interrupt services. Detailed business continuity plan	Limited right to limit individual users to protect integrity of system. Business continuity commitments

8. Termination Assistance

Customer Need	Pure Utility Cloud Contract	Outsourcing Contract	SaaS Contract
Termination assistance	Return of data if terminated for convenience	Extension of services and extensive assistance in transition	Extension of services and reasonable assistance in transition
Post- Termination Rights to Technology	None	Post-termination license, rights subject to exceptions, right to acquire dedicated hardware, and right to make offers to dedicated supplier personnel	None

WHAT RESIDUAL RISK SHOULD WE EXPECT IN SaaS CONTRACTS AND HOW CAN WE MITIGATE THAT RISK?



Residual Risks

- Lockstep changes in SaaS offering
 - Manage risk by advance notice of planned changes and opportunity to comment
- Change in subcontractors
 - Manage risk by requiring notice of subcontractors and require that they execute data protection agreements
- No post-termination license rights
 - Manage risk by requiring transition period that is sufficient to obtain replacement system and transfer data.
 - More internal contingency planning for alternatives

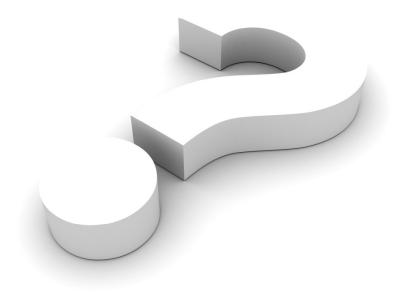
Residual Contract Risks

- No right to hire supplier personnel
 - Manage risk by maintaining internal expert(s) for function, and sufficient transition period
- Supplier retains access control rights (e.g., risk that access rights of departing employees may continue)
 - Diligently manage access controls that are administered by service provider
- Provider processes may be new and not well-defined
 - Diligently manage performance and compliance
- Risk that cloud contract are entered into without appropriate oversight
 - Establish clear internal rules for cloud contracting

QUESTIONS?

Paul Roy Partner, Mayer Brown LLP +1 312 701 7370 proy@mayerbrown.com

Sara Arons
Senior Counsel, Dow Chemical Company
+1 989 636 0648
saarons@dow.com



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Negotiating ERP Implementation Agreements

Brad Peterson

Partner

312 701 8568
bpeterson@mayerbrown.com

Greg Manter

Partner

312 710 8648

gmanter@mayerbrown.com



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Goals

- Describe our best ideas in negotiating ERP implementation agreements
- Provoke thought on how similar critical project agreements can be structured



Business Drivers

Goals

Grow revenue

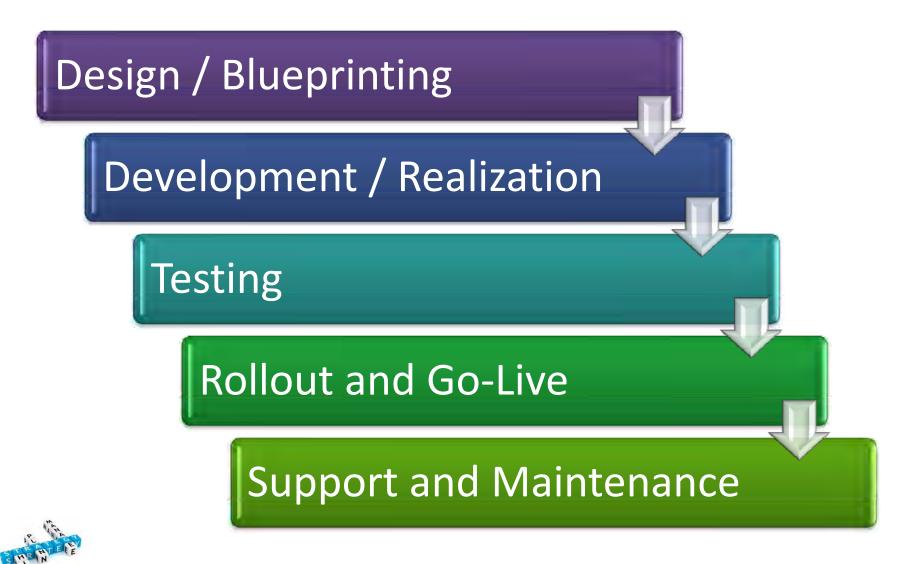
Strategy

- Supplier of choice
- Act as a one company

Plans

- Streamline processes
- Implement ERP system

ERP Implementation Process



Key Goals



Key Risks



How to Mitigate Key Risks and Achieve Key Goals

Schedule A Definitions Schedule B Services Description Stage 1 – Global Blueprint and Localization Activities Schedule B.1 Schedule B.2 Stage 2 – Realization Activities Stage 3 – Final Preparation Schedule B.3 Schedule B.4 Stage 4 – Go Live Activities Schedule B.5 **Cross Stage Activities** Schedule C Deliverables Schedule D Solution Scope Schedule D.1 **ERP Modules Detailed Process Scope** Schedule D.2 Schedule D.3 **Solution Requirements RICEFW Estimating Model** Schedule D.4 Schedule D.5 Interfaces to Customer Applications Affected by ERP Schedule E In-Scope Geographies Schedule F Milestones Schedule G Pricing Methodology Schedule H Staff Loading Charts Schedule I Key Personnel Schedule J Governance Model Schedule K High-Level Project Plan Schedule L Travel Policy Schedule M Facilities

Schedule N Form of Invoice

Schedule O Form of Status Report

Problem: Desire to skip right to implementation

- Business team wants to "get it done"
- No interest in designing a contract that "goes in the drawer"
- Risk of "vendor lock-in"

• Solution:

- Design statement of work as a project plan with legally binding commitments, so that it's a part of the planning phase
- Start with a robust template to minimize time required
- Involve people who have experienced the traditional approach
- Sell value of rigorous commitments and high-value contracting

Problem: Incentives to increase cost and duration

- Implementers profit more from bigger projects
- End users prefer more functionality and customization to accommodate past practices, rather than new processes

Solution: Align incentives with shared risk/reward

- Scope includes Major Scope Assumptions
- Customer has control over what is implemented
- Budget is set early and does not change unless a Major Scope Assumption changes
- Bonuses for early and under-budget performance
- Holdbacks, credits and rate reductions for late or over-budget performance

Problem: Complexity

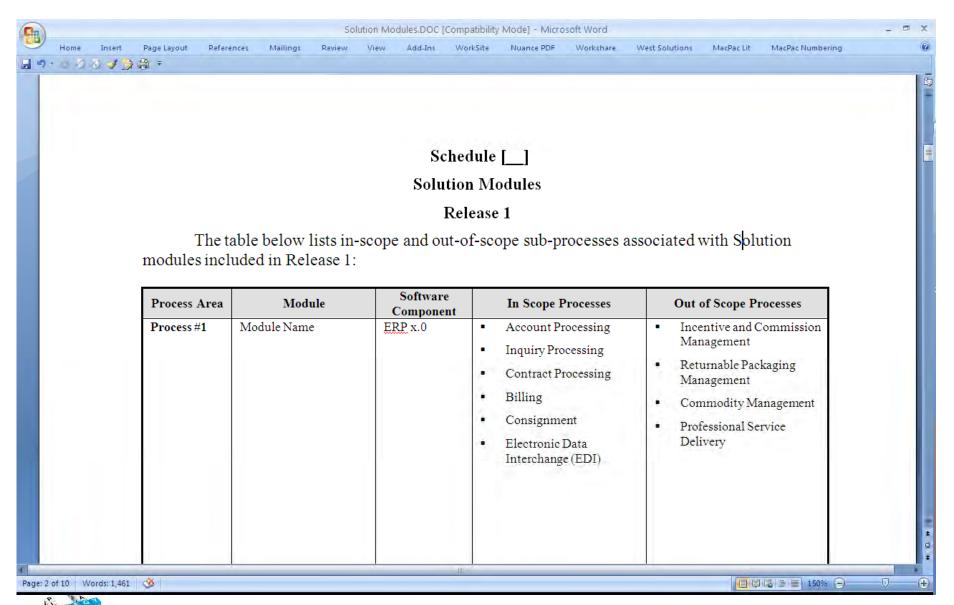
- Stages are interdependent and share common elements
- User, financial, operational, technical and legal perspectives
- Success requires joint effort

Solution: Modularization

- Solution
- Activities
- Deliverables
- Responsibilities
- Staffing
- Pricing

Solution

- High-Level Modules or Components
 - For example: Supply Chain Management
- Sub-Processes that are in-scope (if known)
 - For example: Forecasting and Life Cycle Management
- Functional Requirements
 - Customer-required customizations
 - Reports, interfaces, conversions, extensions, forms and workflows
- Link to Initial Business Purpose of the Solution Fundamental Principles



Activities - Stages



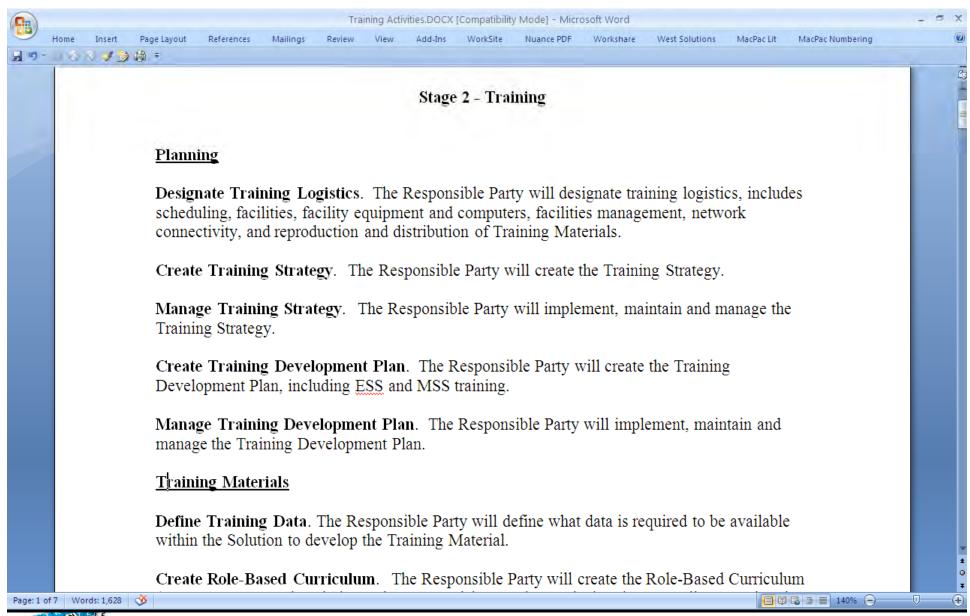
Cross-Stage Activities

Project Management Change Management Quality Assurance

Security

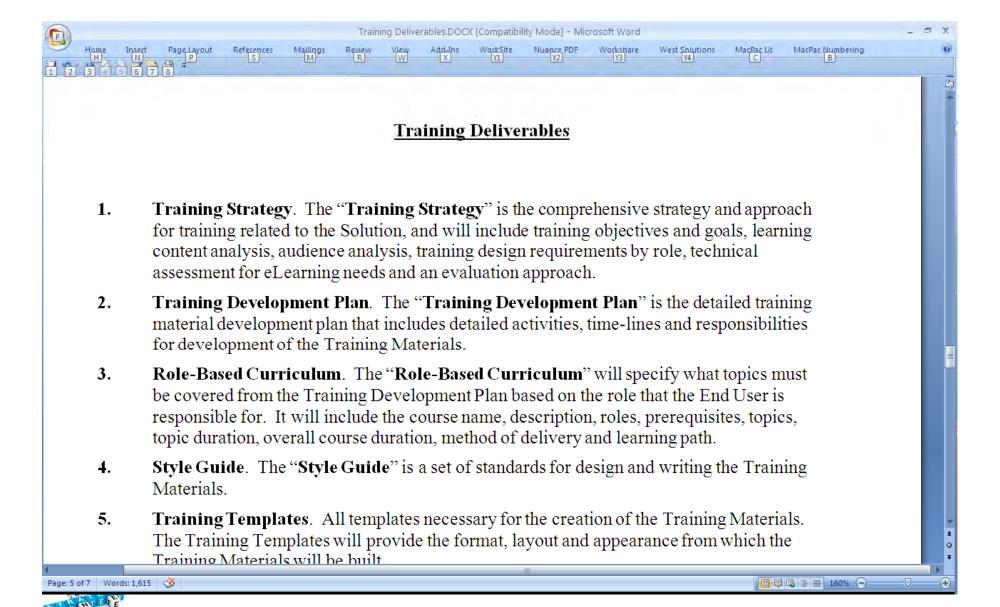
Data Cleansing and Conversion





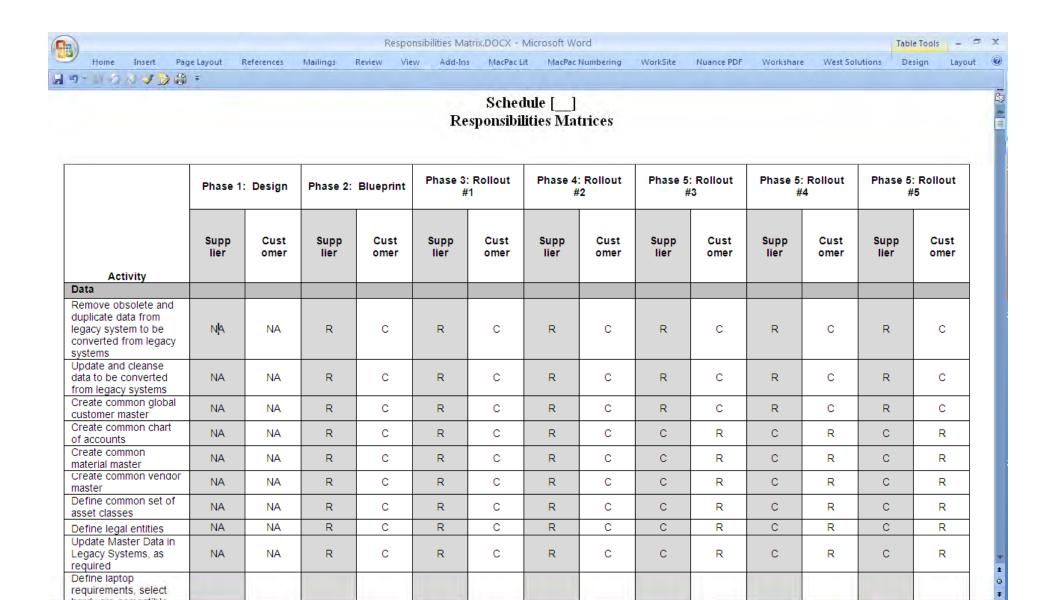
Deliverables

- Acceptance Criteria
 - Format and substance requirements
 - Substance is often the output of a prior stage
- Acceptance Procedures
 - Conformity to acceptance criteria
 - Time allowed for your review
 - "Deemed Acceptance"
 - Require implementer to fix errors



Responsibilities Matrix

- Determines who is responsible for each responsibility
- "Responsible," "Collaborating" and "Informed"
- Include only responsibilities needed by implementer
- Customer Responsibility, or simply "Out of Scope"?





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Staffing

- Key Personnel
- Executive Commitment from Supplier
- Anticipated and/or committed staffing levels
 - In shared risk model, Supplier staffing is estimated and Supplier bears responsibility to complete the project at fixed/capped fee
 - Fixed/capped fee may be dependent on minimum customer staffing commitment
- Work locations and anticipated travel
- Supplier commitment to backfill customer-committed roles where necessary at designated rates

Pricing

- Monthly billing for Productive Hours by personnel approved in Staffing Matrix, subject to holdback
- Payment on acceptance of Deliverables
 - Fixed fees
 - Holdback less Milestone Credits
- Rates reduced when over a budget that changes only when a Major Scope Assumption changes
- Bonuses for under-budget completion, Deliverable quality, scope integrity and achieving other goals

Summary

- Traditional services contracting is a poor fit for ERP projects.
- A modular approach allows a multi-function team to produce a rigorous statement of work.
- The right deal structure aligns incentives on quality, cost and duration, positioning the project for success

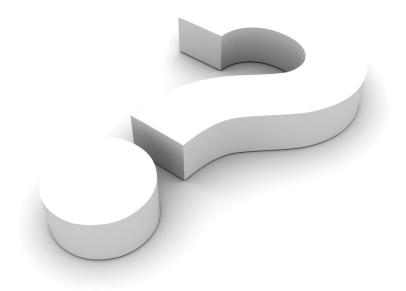
QUESTIONS?

Brad Peterson *Partner*

+1 312 701 8568 bpeterson@mayerbrown.com

Greg Manter Partner

+1 312 710 8648 gmanter@mayerbrown.com



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Effective Dispute Resolution Strategies for Outsourcing Relationships — Lessons Learned

Daniel A. Masur

Partner
+1 202 263 3226
dmasur@mayerbrown.com

Robert J. Kriss

Partner
+1 312 701 7165

rkriss@mayerbrown.com



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Agenda

- Key Causes of Contract Disagreements
- Why Traditional Dispute Resolution Approaches Don't Work
- Informal Dispute Resolution Challenges
- Establishing an Effective Intermediate Dispute Resolution Process
- The Importance of an Early Warning System
- Forming the Team
- Confirm the Terms of the Agreement
- Create a Favorable Record

The Challenge of Dispute Resolution



Key Causes of Contract Disagreements

Structural issues — e.g.. ambiguities and mismatched expectations regarding the demarcation of in-scope vs. out-of-scope services and fixed price vs. incrementally billable services

Underperformance — e.g., lack of accountability for service level or other performance failures, failure to achieve expected savings or profits

Deal points requiring later negotiation — e.g., the pricing of new services or incrementally billable services

Changes in objectives, customer needs, market alternatives, technology, etc.

Causes can be minimized with clear drafting, but contract disagreements arise in every deal

Why Traditional Dispute Resolution Approaches Don't Work

The assumption that the time, expense and relationship damage associated with litigation or arbitration will compel parties to amicably resolve disputes is flawed

In practice, the reluctance of parties to invoke these draconian remedies often results in an avalanche of festering disputes or forces one or both to accept unfair or unfavorable resolutions

What Happens When Disputes Cannot Be Resolved?

- Issues accumulate and fester
- Deadlines, business objectives and financial goals are missed
- Upward communications become guarded, self-serving, inaccurate and/or incomplete
- Governance teams don't trust each other
- Communications become defensive, adversarial and/or emotional
- People see their careers threatened and focus on allocating blame to others
- One or both parties feel compelled to accept unfair or unfavorable resolutions to avoid adverse business impact



The Challenge of Informal Dispute Resolution:

 Avoid impact on the customer's business, while minimizing resulting impact on the provider and/or relationship

 Require the provider to proceed with the project, new service or other request if directed to do so

 Define an accelerated informal process, that is fully integrated with the governance process

 If not successfully resolved within a specified period, require the customer to begin paying a defined portion of the disputed amount

Once resolved, true-up the charges based on the outcome



Establish an Effective Intermediate Dispute Resolution Process

An accelerated determination by a neutral third party can offer a quick, fair and reasonably inexpensive way to resolve routine contract disputes



Define the disputes to be submitted to the neutral third party e.g., disputes involving less than \$250,000, exclude disputes involving intellectual property rights, etc.



Provide for a standing appointment or a streamlined process for selection of the neutral third party

Establish an Effective Intermediate Dispute Resolution Process

Establish a streamlined process with accelerated deadlines for the presentation and resolution of the dispute



Limit discovery and/or the presentation of arguments, live witnesses/witness statements and documentary evidence



Consider "baseball arbitration" as a means to incentivize parties to evaluate their positions realistically and offer reasonable compromises at an early stage

Establish an Effective Intermediate Dispute Resolution Process

Provide for the neutral third party's determination to be final and binding unless appealed to a court or full-blown arbitration within a defined period



Provide for the award of legal fees and costs to the prevailing party if the losing party loses again on appeal

POST-CONTRACT DISPUTE RESOLUTION:

Making a written record to support your position

The Importance of an Early Warning System

- Conduct and statements are evidence
- Relevant to interpreting meaning of contract
- Relevant to proving breach
- Therefore the earlier the dispute is identified, the better the chances that the customer can develop a consistent position and create a favorable record



Forming the Team

- Select leader with proper skill set
- Select in-house and/or outside counsel
- Send e-mail to team stating ground rules
 - All substantive communications to supplier must be approved by team leader
 - All substantive communications from supplier should be reported to team leader
 - Label substantive internal communications privileged
 - Copy legal counsel on all internal communications
 - All e-mails should be objective and accurate. Assume they will become public

Confirm the Terms of the Agreement

- Start with written contract but don't stop there
- Ask team about amendments or e-mails that might have changed terms
- Ask team about conduct inconsistent with terms



Create a Favorable Record

- Send e-mails to supplier establishing your position before commencing dispute resolution mechanism, including:
 - The relevant terms of the agreement
 - Your version of relevant conduct and statements
 - Your proposal for resolution
 - Create documents that an arbitrator or jury would understand (no jargon, clear chronology, sufficient background for context)



Create a Favorable Record

- Reply as needed to supplier's response
 - What is not refuted may be deemed admitted
 - Refute any assertion of supplier that you disagree with
 - Support your position with specifics
 - If supplier responds with vague assertions, reject assertions and note that vague assertions are either contrary to specific facts or not supported by any facts
 - Objective is to create an e-mail string that a neutral third party would find supports your position

Supplier is missing transition milestones.

Ineffective Approach

Customer adds
 resources without
 sending supplier
 documentation
 defining the problem,
 providing an
 opportunity to cure,
 stating the potential
 cost of mitigation if
 problem is not solved
 and describing reason
 for adding each
 resource

Potential Outcome

 After milestone is met, supplier claims additional resources were not necessary

Better Approach

 Send documentation before adding resources

Scope Issues: included services or new services?

Ineffective Approach

 Uncontrolled internal and external inquiries by several departments concerning cost of implementation and extent of acceptance in the industry

Potential Outcome

Customer's
 inquiries are used
 by supplier to
 demonstrate that
 customer, itself,
 believed it was
 requesting a new
 service

Better Approach

 Controlled development of rationale for included service and carefully crafted request for implementation at no additional cost

Material Breach

Ineffective Approach

 Customer terminates agreement for cause based upon alleged material breaches without sending documentation explaining impact of breach

Potential Outcome

Court finds
 breach was not
 material and that
 termination was
 wrongful

Better Approach

Send
 documentation to
 supplier
 explaining
 materiality and
 evaluate response
 of supplier before
 terminating for
 material breach

Supplier delay in implementing new system allegedly due to customer changes in requirements

Ineffective Approach

- Customer terminates contract without sending communications to supplier documenting supplier's failure to perform
- Supplier-prepared status reports blame customer

Potential Outcome

Court finds
 customer breached
 the agreement by
 wrongful
 termination

Better Approach

- Create new change control policy, if necessary
- Require notice from supplier of customer conduct allegedly preventing supplier from meeting milestones

Positioning For Success

- Sending detailed communications is not an unfriendly act
- Creating evidence reduces litigation cost and increases chances of success
- Clear communication will result in greater certainty of outcome and promote settlement

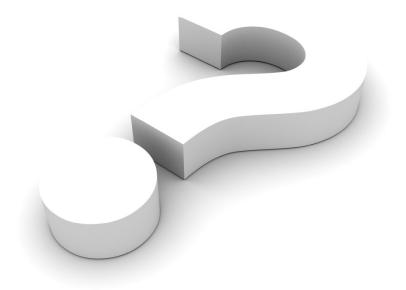


QUESTIONS?

Daniel A. Masur
Partner
+1 202 263 3226
dmasur@mayerbrown.com

Robert J. Kriss

Partner
+1 312 701 7165
rkriss@mayerbrown.com



MAYER · BROWN

Contracts for Outsourcing Manufacturing

Geofrey L Master

Partner
+852 2843 4320

geofrey.master@mayerbrownjsm.com

Linda Rhodes
Partner
+1 202 263 3382
Irhodes@mayerbrown.com



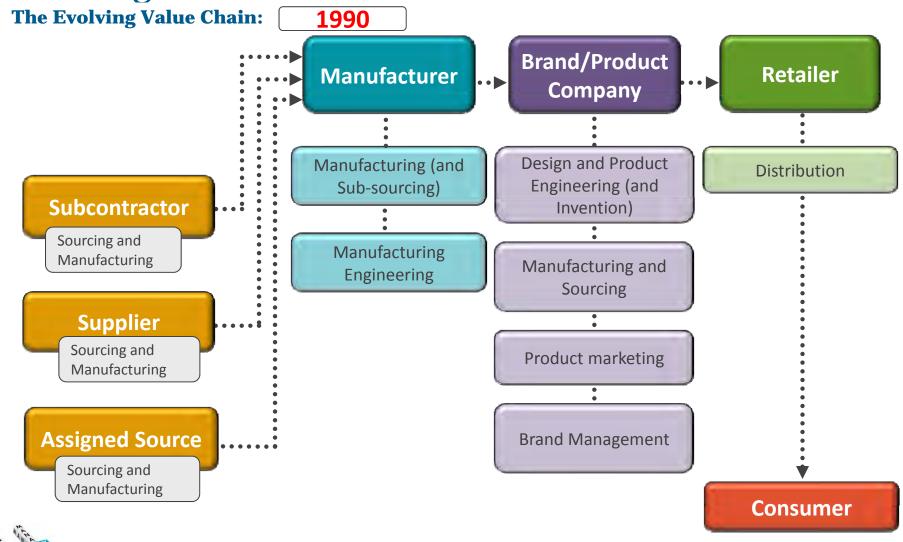
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Agenda

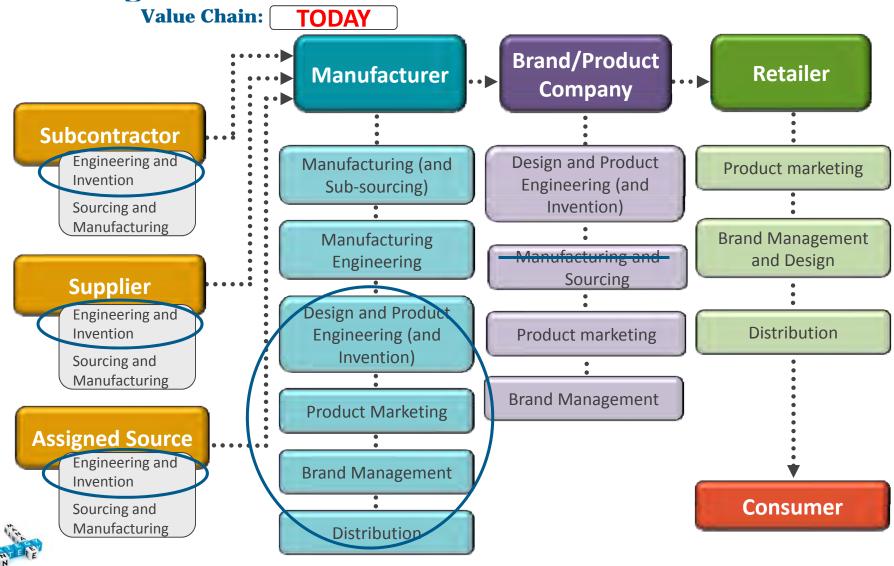
- Overview of Outsourcing Manufacturing and the Evolving Product Value Chain – Trends
- Key Contract Provisions to Manage Critical Elements
- Value Enhancement Techniques In Sourcing Relationships
- Special Case: Contract Manufacturing Arrangements



Overview of Outsourcing Manufacturing and the Evolving Product Value Chain



Overview of Outsourcing Manufacturing and the Evolving Product Value Chain



Overview of Outsourcing Manufacturing and the Evolving Product Value Chain - Trends



Expanded role of manufacturer - increasingly ancillary services (e.g., product development) are being undertaken by manufacturers

- Convergence product/services: manufacturers providing more and more (product development, brand management, logistics)
- Greater need for contracts, greater complexity, longer negotiations, more basis for disputes
- China policy less OEM, more Chinese products/brands



Expanded manufacturing geographies - for best cost, product companies must engage with manufacturers in an increasingly wide range of geographies, which has led to

- Internal geography bound sourcing organizations being under stress
 - Re-emergence of the sourcing services organization
- Expansion of manufacturer footprint
- "Reshoring" production

Overview of Outsourcing Manufacturing and the Evolving Product Value Chain - Trends



IP issues with manufacturers are growing

 IP issues and competition (manufacturer as competitor) issues are emerging as a result of manufacturer developed products, joint collaboration to develop new products, opportunism



Breakdown of product development discipline

- Availability of manufacturer capital for product development has lowered internal approval thresholds
- Lack of discipline in defining rights, roles and responsibilities

Key Contract Provisions to Manage Critical Elements Introductory Overview — the Manufacturing Contract

- Manufacturing contracts
 - Yes, and should comprehensively address all activities/ responsibilities between product company and manufacturer:
 - Critical engagement risks including risks literally external to the contract (e.g., manufacturer solvency) must be identified and addressed
 - Opportunities to enhance cost savings in manufacturing contracts through information sharing, commitment and waste elimination
 - Practical realities manufacturers and many supply chain organizations:
 - Manufacturing contract is only part of the overall context of the supply chain relationship
 - Not always familiar and comfortable with contracting practice, tradition (or legal support)

Key Contract Provisions to Manage Critical Elements Introductory Overview — the Manufacturing Contract

- Separate agreements/towers for development, asset management and manufacturing (preserve ability to deconstruct relationship)
- Successful relationships call for appropriate, solid contracts and proactive relationship management



Key Contract Provisions to Manage Critical Elements

Issue 1

Performance/
delivery (product and service)

- Quality management
- Delivery performance

Issue 2

IP Capture and management

Issue 3

Production equipment/tooling management

Issue 4

Cost control and price management

Issue 5

Indemnities/
Warranties

Key Contract Provisions to Manage Critical Elements Issue 1: Performance/Delivery

Quality management

Full life cycle approach (conception, development, production, in-the-field)

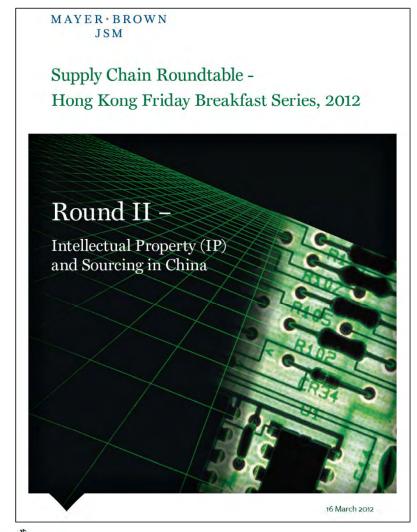
- Define the requirements and develop appropriate metrics
- Need for appropriate remedies, including for "in-field" quality issues

Delivery performance

- Full life cycle approach focus on logistics (when and where)
- Define the requirements and develop appropriate metrics
- The costs of over-setting/under-setting metrics

Key Contract Provisions to Manage Critical Elements

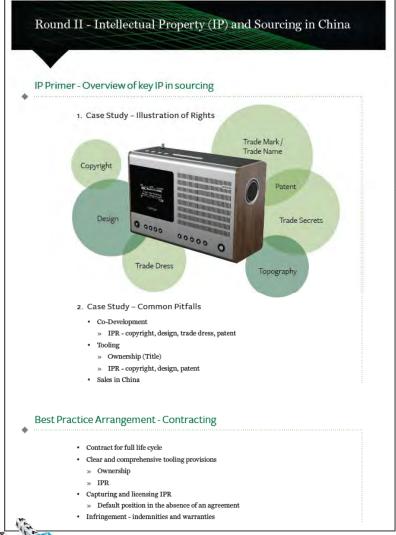
Issue 2: IP Capture and Management





Key Contract Provisions to Manage Critical Elements







Key Contract Provisions to Manage Critical Elements Issue 3: Production Equipment/Tooling Management

- Life cycle approach:
 - Inception:
 - Clear and transparent agreement, including financing and title
 - License of IP for creation of tooling
 - Operation:
 - Repair/replacement tooling warranty
 - License of IP for (customer production only)
 - End of life management:
 - Sale, destruction or storage
 - Transition assistance (e.g., move to successor manufacturer)



Key Contract Provisions to Manage Critical Elements Issue 4: Cost control and Price Management

- Traditional
 - greater transparency than traditional services
 - often cost plus basis, with limits, protected by confidentiality provisions
- Adjustment/change provisions
 - commodity/component pricing changes
 - product specification changes should be tied to product price change

Key Contract Provisions to Manage Critical Elements Issue 5: Indemnities/Warranties

Product Related

- non-delivery
- third party IP infringement
- personal injury/property damage
- product recall

Compliance

- Laws/regulations
- Ethical, Social and Environmental
 Compliance, Fair Labor Association –
 Apple/Foxconn



Value Enhancement Techniques in Sourcing Relationships

- Due diligence pre-relationship and continuing
- Active, effective governance/contract administration
 - Training/educating sourcing organization to bring the contract and governance process alive is essential to making contract tools work and
- Use of past manufacturer experience (transaction history) and productivity tools to find ways to cut costs for pass through savings
 - Value enhancement is not just beating on the manufacturer
- Utilize effective and credible enforcement mechanisms, including choice of law

Value Enhancement Techniques in Sourcing Relationships

- Value-Added Tools
 - Commodity price mechanisms
 - Currency fluctuation mechanisms
 - Inventory management and service level programs
- Productivity activities/provisions
 - Product productivity value added engineering
 - Process productivity Kaizen
 - Hybrid consigned/customer contract mechanisms

Special Case: Contract Manufacturing Arrangements

MB has the combined sourcing and tax experience to structure transactions in a tax efficient manner to achieve the client's objectives.

Special case of "contract manufacturing"

•Manufacturing and supply services of sourcing, manufacturing, packaging and labeling of products ("Services") in a way to meet specific tax objective of deferring US income on manufacturing profit from offshore manufacture

Basic scenario

- Multinational product company having an offshore operating company selling into US market
- Obtaining Services abroad from a third party offshore manufacturer
- Objective deferral of US tax on offshore manufacturing profit

Special Case: Contract Manufacturing Arrangements

Structure

The multinational product company, through an offshore affiliate, engages an offshore contract manufacturer to perform the Services. Offshore affiliate makes a "substantial contribution" to the manufacture of the products.
 Offshore affiliate transfers title to US affiliate prior to entry into US waters

Contracting structure and approach

- Generally, many of the previous principles apply as described except that the contract manufacturing arrangement is structured as a "services" arrangement and the offshore affiliates makes a substantial contribution to the manufacture of the products
- Outsourcing principles and tax requirements need to be coordinated

Special Case: Contract Manufacturing Arrangements

Areas of alignment between tax and outsourcing

- Cost savings cost transparency
- Quality standards/controls
- Raw Materials Sourcing/Vendor selection

Areas of tension between tax and outsourcing

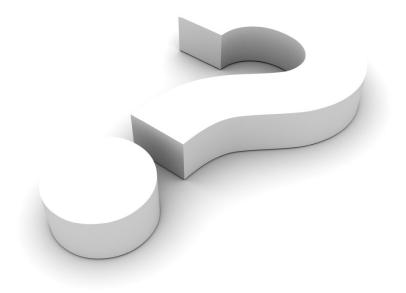
- Indemnities/Allocation of risk offshore affiliate bears a level of risk typically greater than the risk assumed under a traditional supply chain agreement
- Transfer of title

QUESTIONS?

Geofrey L Master

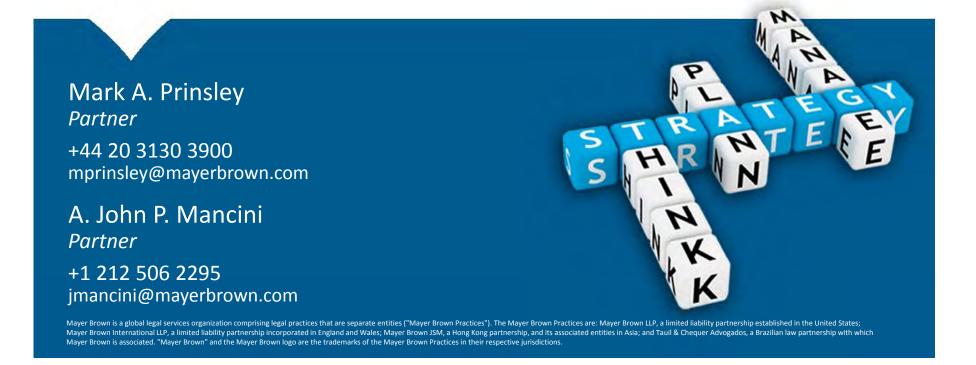
Partner
+852 2843 4320
geofrey.master@mayerbrownjsm.com

Linda Rhodes
Partner
+1 202 263 3382
Irhodes@mayerbrown.com



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Key Intellectual Property Issues in Outsourcing Transactions



Key Issues

- Allocation of risk of third party IP claims between the Supplier and the Customer.
- Use of IP and Know How on termination.
- High Risk Areas:
 - opensource;
 - standards;
 - framework licences.

Identification of Key Risk Areas

Patents

Copyright

Know How/Trade Secrets

Allocation of Risk

	Responsibility	
	SUPPLIER	CUSTOMER
Legacy processes of the Customer		
Legacy processes of the Supplier		
New processes used by the Supplier	?	

A Practical Example – Payroll Services Agreement

Indemnity

• Subject always to the Client's proper observance of its obligations under this clause, [Supplier] shall indemnify the Client against claims, demands, actions, costs, expenses (including but not limited to legal costs and disbursements on a solicitor and client basis), losses and damages arising from, or incurred by reason of any infringement or alleged infringement (including, but not limited to, the defence of such alleged infringement) in the United Kingdom of any Intellectual Property Right in connection with the Software or the Services.

A Practical Example – The Carve Outs

- [The Indemnity] shall not apply insofar as any such claim or demand or action is in respect of:
 - any use by or on behalf of the Client of the Software or the Services in a manner not reasonably to be inferred from the specification or requirements of the Client or not complying with the Supplier's instruction or in combination with any item not supplied by the Supplier where such use directly gives rise to the claim, demand or action; or
 - any modification carried out by or on behalf of the Client by a third party to any item supplied by the Supplier under this Agreement if such modification is not authorised by the Supplier in writing and where such modification directly gives rise to the claim, demand or action.

Offshore Outsourcing

And the Risk of the Customer Being Sued In Its Home Jurisdiction

- A bit of legal archaeology
 - Is a dispute relating to infringement of IP rights in one State to be justiciable in another State?



May The Force Be With You (if you own IP Rights!)

- Implications of Supreme
 Court decision in LucasFilms
 v. Ainsworth in the UK
- Decline of US "Local Action" rule
- Impact of Brussels
 Regulation for European
 nearshore operations

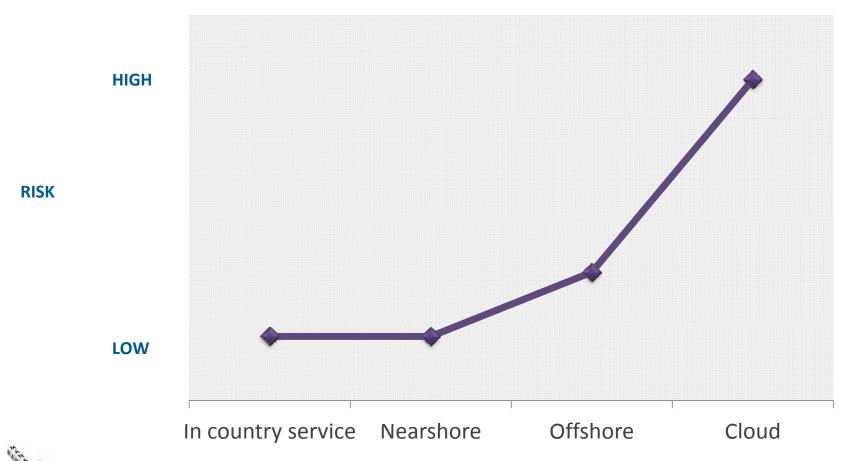


Potential Exposure for the Customer

- Authorising infringement?
- Joint liability?
- Dealing in infringing products/services?
- Exposure to proceedings for infringement of "foreign" intellectual property rights?
- Indemnity is no substitute for adequate insurance/risk management.

Tools for assessing risk of direct IP claims against the Customer for Actions of the Supplier

Assess Method of Service Delivery



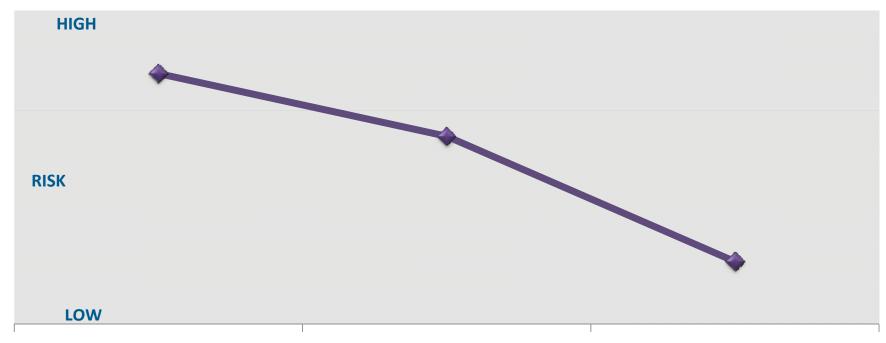
Tools for assessing risk of direct IP claims against the Customer for Actions of the Supplier

Assess Processes Being Used



Tools for assessing risk of direct IP claims against the Customer for Actions of the Supplier

Assess Allocation of Patent Infringement Risk in Services Agreement



Granted Patents in specified Granted Patents worldwide territories

Any Patents whenever coming with force during term

US LEGAL RIGHTS TO INDEMNIFICATION

Express/Contractual Indemnity

- Parties should allocate risk of infringement by contract.
 - The uncertainties surrounding the precise reach of the implied warranty accompanying the sale of goods under section 312(3) and that fact that it is unclear whether state law claims are viable, parties should contractually create clearly defined rights to contribution or indemnity.
- Courts enforce clear indemnification provisions.
- U.C.C. gap-fillers do not apply where purchase contracts indicate that the parties have agreed upon a particular allocation of risk of infringement.

Where A Party Has Not Contracted For Indemnity, It May Turn To:

- Uniform Commercial Code Section 2-312(3)
 - All sales of goods are accompanied by the warranty of noninfringement created by Article 2, section 312(3) of the Uniform Commercial Code.

Other State Statutes

 Many states also have statutes that provide for contribution among joint tortfeasors.

State Common Law

 In many states, recovery of attorney's fees and other costs of litigation is available when wrongful act or breach of contract forces party to defend against third parties.

Other State Statutes

- Many states have enacted statutes requiring that an award of compensatory damages be set-off against any amount paid by tortfeasors who settle with the plaintiff.
 - However, most of these statutes allow contribution only against parties already sued by the owner of the IP.
- Some states also prohibit deceptive or unfair trade practices, which might afford a direct means for infringers to sue those who have caused or contributed to infringement.
 - However, most only authorize suit in very narrow circumstances (e.g., Texas Deceptive Trade Practices Act does not apply to purchaser whose net worth exceeds \$25 million).

State Common Law

- Many states allow common law actions to recover attorney's fees and other costs of litigation when a wrongful act or breach of contract forces a party to litigate against third parties, thereby incurring expenses in protecting its interests.
- Contribution in favor of the infringer might also be available under negligence, misrepresentation theories, or other theories.
- Thus, state common law claims may be a means for direct infringers to shift their liability to those contributing to or inducing their infringement.

U.C.C. § 2-312(3) Warranty Against Infringement—What It Says

"Unless otherwise agreed, a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications." U.C.C. § 2-312(3).

U.C.C. $\S 2-312(3) - Risks$

Main Risks

- Must Infringe As Delivered
 - Section 2-312(3) only requires that goods "be delivered free of infringement claims" (emphasis added).
- Specifications
 - Section 2-312(3) provides that a buyer who furnishes specifications to the seller must hold the seller harmless against any claim arising out of the seller's compliance with those specifications.
- Rightful Claim
 - The section 2-312(3) warranty is only breached where the buyer or seller is forced to defend against a "rightful claim."

U.C.C. § 2-312(3) — Risks — Must Infringe As Delivered

- Section 2-312(3) only requires that goods "be delivered free of infringement claims" (emphasis added).
- Thus, in most cases, the buyer will not be protected against claims arising out of its use or resale of the goods.
 - See, e.g., Phoenix Solutions, Inc. v. Sony Electronics, Inc., 637 F. Supp. 2d 683, 699 (N.D. Cal. 2009) ("[A] buyer should not use a seller's component in a system that results in infringement liability to a patentee, and then simply pass the liability to the seller of the single component.").

U.C.C. § 2-312(3) – Risks - Specifications

- Section 2-312(3) provides that a buyer who furnishes specifications to the seller must hold the seller harmless against any claim arising out of the seller's compliance with those specifications. Thus, in some cases, a buyer's provision of specifications will preclude its right to indemnity.
- Moreover, if the seller is sued for infringement, and the infringement claims arise out of the seller's compliance with the buyer's specifications, the buyer could be liable to the seller for indemnity. See *Bonneau Co. v. AG Industries, Inc.,* 116 F.3d 155, 158-159, (5th Cir. 1997) (ruling that all defense costs in the infringement litigation against the seller were to be borne by the buyer).
- However, the mere provision of specifications by the buyer does not always preclude the buyer's claim for breach of warranty against infringement or entitle the seller to indemnity from the buyer. See *Jack Frost Laboratories, Inc. v. Physicians & Nurses Mfg. Corp.*, 1995 WL 293328 (S.D. N.Y. 1995) (denying seller indemnification, even though the buyer had specified the size and color of the packaging for the purchased product and had requested that the packages be microwavable, because the third-party patent infringement claim did not arise from those specifications, but rather from the packages' composition).

U.C.C. § 2-312(3) – Risks – Must Be Rightful Claim

- Infringement claims must be "rightful claims."
- One commentator has opined: "A rightful claim is one where the buyer or seller reasonably believes that a third party's infringement charge would probably be upheld by the courts." Dudine, Warranties Against Infringement Under the Uniform Commercial Code, 36 N.Y.S.B.F. 214, 219 (1964).
- Case law indicates that settlement does not necessarily preclude a finding of a "rightful" claim and therefore, indemnity, but may do so if the indemnitor can prove that the settlement amount was unreasonable.
 - See, e.g., Pacific Sunwear of California, Inc. v. Olaes Enters., Inc., 167 Cal.App.4th 466, 84 Cal.Rptr.3d 182 (Ct. App. 2008) (finding that the fact that the claim blossomed into full-blown litigation in federal district court created at least a triable question as to whether the claim was "rightful");
 - Demarco, Inc. v. Johns-Manville Corp., 2006-Ohio-3587 (Ohio Ct. App. July 13, 2006) (After making a voluntary settlement, indemnitee may be required to show "he was legally liable and could have been compelled to satisfy the claim.").

Additional Risk That Applies To The State Law Remedies: Preemption

Preemption concerns are clearly not present so long as the third-party's activities fit within the definitions of contributing to or inducing infringement

However, allowing a state right of contribution or indemnity against a party that did not violate any federal law may risk preemption

This risk reinforces the importance of contractually created clearly defined rights to indemnity in a purchase agreement

Use of Supplier IP/Know How on Termination

Access to supplier background **IP/Know How** Transitional periods Fees Restrictions on disclosure to competing service providers

High Risk Areas

Opensource

- Exclusivity
- Patent infringement risk

Standards

Framework Licences

Suppliers have their own framework licences with major software providers etc

Katz call center patents

QUESTIONS?

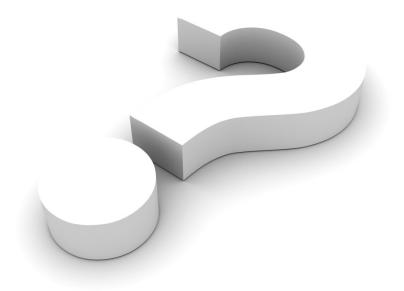
Mark A. Prinsley
Partner
+44 20 3130 3900
mprinsley@mayerbrown.com

A. John P. Mancini

Partner

+1 212 506 2295

jmancini@mayerbrown.com



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Negotiating Data Privacy & Security Provisions in Outsourcing Agreements

Rebecca S. Eisner

Partner

+1 312 701 8577

reisner@mayerbrown.com

Guido Zeppenfeld

+49 69 79 41 2241 gzeppenfeld@mayerbrown.com



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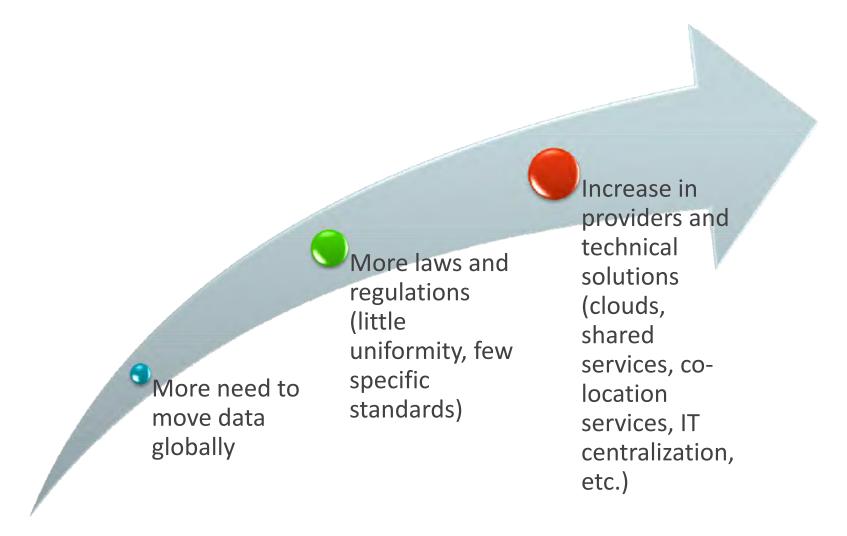
Agenda

- Data Privacy and Security Risks (and Costs) On the Rise
- Overview of Recent US Legal Developments and Sources of Data Privacy and Security Requirements
- Overview of Key Data Privacy and Security Issues in Multinational Deals
- Hot Buttons For Customers and Suppliers in Negotiating Data Privacy and Security Provisions
- For Better or For Worse: The Proposed Reform of EU Data Protection Rules

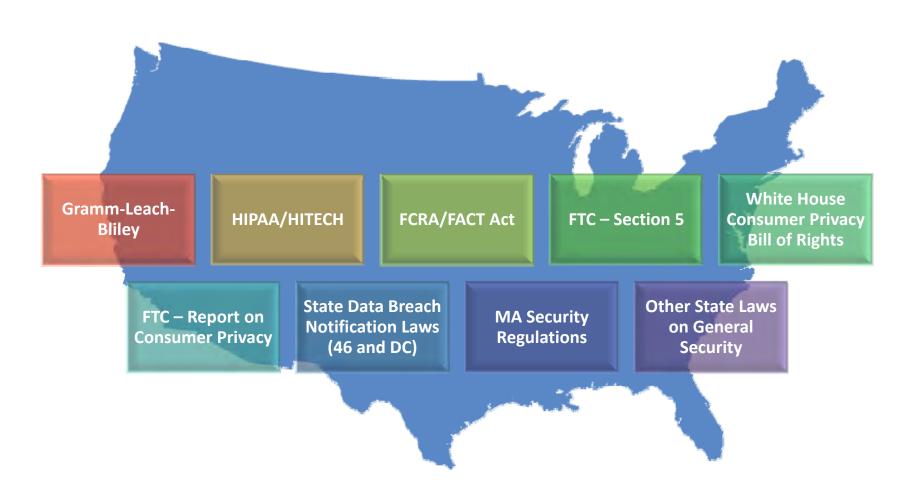
Data Privacy and Security Risks On the Rise: 2010 Annual Study: Global Cost of a Data Breach (Poneman Institute, LLC) – published May 2011

- Data Breach Costs Up US organization cost of data breach = \$7.2 million, \$214 per record; Germany \$4.7 million, \$191 per record
- Highest costs for the following types of breaches: malicious or criminal attacks, lost or stolen devices, third party mistakes, lack of preparedness
- Breaches involving third party mistakes by outsourcers are still a major worry and expense

Data Privacy and Security Risks On the Rise



Legal Sources of Data Privacy and Security Requirements



US Cont. — White House Report — Consumer Data Privacy in a Networked World

- The framework consists of four main elements:
 - A Consumer Privacy Bill of Rights containing seven general privacy principles
 - Individual control; Transparency; Respect for context; Security; Access and accuracy; Focused collection; Accountability
 - An enforceable code of conduct developed through a "multistakeholder process" applying the general principles to particular business contexts;
 - Company adoption of a code will become enforceable under FTC Section 5; and
 - International collaboration.

US Cont. — FTC Report — Consumer Privacy in an Era of Rapid Change

- FTC recommended best practices: privacy through substantive and procedural principles; simplified consumer choice; use of consumer data consistent with the context of the relationship; transparency of data brokers
- FTC areas of enforcement focus: National "Do Not Track"
 System; privacy in mobile services; access to data collected by data brokers; privacy issues with "large platform providers"; enforceable, self-regulatory codes
- http://ftc.gov/opa/2012/03/privacyframework.shtm

US Cont. — FTC Report: Privacy by Design

PRIVACY BY DESIGN

As a baseline principle, "companies should promote consumer privacy throughout their organizations and at every stage of the development of their products and services." This means implementing substantive privacy protections as well as procedural safeguards aimed at integrating the substantive principles into a company's day-to-day business operations. In particular, companies should incorporate substantive privacy protections into data security and accuracy practices, collection limits, and retention and disposal policies.

OVERVIEW OF KEY DATA PRIVACY AND SECURITY ISSUES IN MULTINATIONAL DEALS



Overview of Key Data Privacy and Security Issues in Multinational Deals

- Application of national data privacy laws.
- Enforcement by national data protection authorities
- International transfer of personal data
- Examples of countries with comprehensive data protection laws regarding personal data
 - Hong Kong
 - Japan
 - Argentina
 - Canada
 - Mexico

- Russia
- European EconomicArea (EEA) Countries(EU plus others)
- Israel

Data Privacy and Security Hot Buttons for Customers and Suppliers



Data Privacy and Security Hot Buttons — Compliance

Customer Hot Button	Supplier Hot Button	Reasonable Outcome
Supplier should comply with Customer's privacy laws and obligations	Customer privacy laws don't apply directly to Supplier (except a few)	Supplier should comply with privacy laws directly applicable to suppliers, and Supplier should be responsible for failures to perform obligations that cause Customer to be out of compliance – EU might require this and more
Supplier must implement all changes to Services required by privacy law or regulations	All Changes should go through Change Control (mutual agreement) cost, capability and timing may be issues in implementing new requirements	Supplier should not have a "veto" right over compliance changes — cost, capability and timing are more negotiable (but Supplier should spread the cost of changes required for multiple customers)

Data Privacy and Security Hot Buttons — Compliance

Customer Hot Button	Supplier Hot Button	Reasonable Outcome
Supplier must specify countries in which data will be processed and stored, and from which it will be accessed	Supplier wants the right to move service locations as needed to address rising costs, efficiencies, etc.	For data protection compliance, IP protection and other reasons, locations of data must be approved by Customer (and changes should be subject to Customer approval)
Customer must approve all subcontractors or subprocessors	Supplier wants the flexibility to change subcontractors	Ideally, all subprocessors who will have access to data are known to Customer and are subject to Customer approval, including changes in those subprocessors – EU requires this and more

Data Privacy and Security Hot Buttons — Compliance

Customer Hot Button	Supplier Hot Button	Reasonable Outcome
Customer must have audit rights at all facilities where data is processed and stored, or is remotely accessed	Supplier will not grant access for audits in its shared service facilities	If physical access for audits is not mandated by applicable law, Supplier may provide standard audits or certifications, or audits by a third party, with rights to follow up on audit concerns
Supplier should be Safe Harbor certified AND Customer wants to use EU approved DC to DP clauses or alternative means of confirming an adequate level of data protection for EU data export	Supplier does not want to use EU approved clauses, and says Safe Harbor certification is good enough	EU approved transfer clauses are usually better – Safe Harbor certifications can be for the wrong scope, they expire, and they only cover EU to US initial data transfers

Data Privacy and Security Hot Buttons — Security

Customer Hot Button	Supplier Hot Button	Reasonable Outcome
Customer wants a performance warranty that Supplier will provide security in accordance with "highest and best practices" in the industry	Security is a service — Supplier will perform as much as you pay for	Depends on the service, data and price. For traditional outsourcing, Supplier should follow Customer's security requirements. For standardized services (e.g., some cloud), parties need to complete a gap analysis of Supplier's security offering.
Standards for security will come from multiple sources Customer policies, industry standards and other applicable laws and regulations	Customer should tell Supplier exactly what Supplier should do to meet the Customer's security requirements, preferably in one document	Customer should include its own security policy in the contract, and reference other applicable industry standards (or portions thereof), noting order of precedence in case of conflicts

Data Privacy and Security Hot Buttons — Liability

Customer Hot Button	Supplier Hot Button	Reasonable Outcome
Supplier is responsible for all confidentiality and security breaches	Supplier will use commercially reasonable efforts to implement security measures that are designed to prevent confidentiality and security breaches	Liability should flow from failure to meet or perform to specified standards, not simply because a breach occurred – commercially reasonable efforts and "designed to" remove too much responsibility
Supplier should bear unlimited costs and damages from data breaches	Service is not insurance against all business risks and damages	Costs and damages for personal data breaches are more frequently capped, but subject to exceptions (willful misconduct, gross negligence)



For Better or For Worse: The Proposed Reform of EU Data Protection Rules

- What's going on?
- What will happen next?
- What's the potential impact for customer and supplier in an outsourcing scenario?

Proposed EU DP Reform: What's Going On?

- January 25, 2012: EU Commission issues data protection proposals, including
 - Draft General Data Protection Regulation (the "Draft EU Regulation")
 - Draft Directive on police and judicial activities
- Choice of EU Legislative Instruments
 - EU law to prevail against national laws of member states
 - Regulation vs. Directive
- Why the big push now?
 - Recognition of deficits of 1995 EU Data Protection Directive with a view to harmonization and technical development.
 - Recent EU constiutional changes

Proposed EU DP Reform: What Will Happen Next?

- Commission to seek approval from EU Council and EU Parliament.
- Complex legislative process for adopting the EU Regulation;
 - Controversy and heavy lobbying to be expected
 - Unlikely to be completed prior to the end of 2012
- Actual application likely to be deferred
 - Current proposal: 2 years following adoption
 - **-** 2014/2015?

Proposed EU DP Reform: What's the Potential Impact For Customer and Supplier in an Outsourcing Scenario?

- Uniform data protection rules in all EU member states
 - Specific rules in certain areas might still be possible (eg: employment relationship)
- "One-Stop-Shop" in respect of Data Protection Authorities
- Severe consequences for failure to comply
 - Eg: fines of up to 2% of global turnover for security breach, unauthorised international transfer or failure to appoint a data protection officer
 - Fines of up to EUR 1million against individuals
 - Enhanced remedies available to data subjects and representatives

Proposed EU DP Reform: What's the Potential Impact For Customer and Supplier in an Outsourcing Scenario?

- Enhanced risk for data processors
 - Subject to EU enforcement regime
 - Security breach notification requirements
 - Obligation to appoint a data privacy officer
 - Compliance with data transfer requirements
- Enhanced requirements for controller-processor contracts
 - Confidentiality agreements
 - Sub-contracting
 - Return of data

Proposed EU DP Reform: What's the Potential Impact For Customer and Supplier in an Outsourcing Scenario?

- Enhanced requirements for individual consent of data subjects as basis for data collection or usage.
- Enhanced information and notification obligations.
- "Right to be forgotten"
- New rules for appointment of data privacy officer.

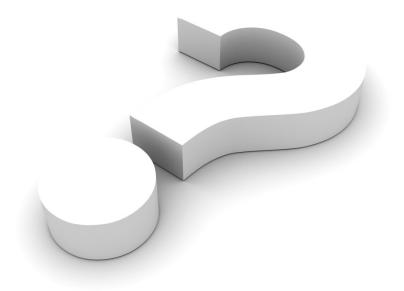
QUESTIONS?

Rebecca S. Eisner *Partner*

+1 312 701 8577 reisner@mayerbrown.com

Guido Zeppenfeld *Partner*

+49 69 79 41 2241 gzeppenfeld@mayerbrown.com



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Facility Management Outsourcing Transactions: Managing Troubled Deals

Kevin A. Rang
Partner
+1 312 701 8798
krang@mayerbrown.com

Craig E. Reimer

Counsel
+1 312 701 7049

creimer@mayerbrown.com



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Agenda

- Reasons Why Deals Get Into Trouble
- Practical Ways to Mitigate Risk
- Understanding Bankruptcy Risks of Financially Distressed Suppliers
- Minimizing Bankruptcy Risks

REASONS WHY FACILITY MANAGEMENT DEALS GET INTO TROUBLE

Reasons why Facility Management Deals Get Into Trouble

Underbid GMP or Fixed Price Deals

- Mistake
- Lack of Diligence
- Win at all cost bids

Poor Account Management by Supplier

- Performance of New Service requests without required approvals
- Failure to properly manage the costs of resources required to meet performance requirements
- Wrong people managing the account

Reasons why Facility Management Deals Get Into Trouble

Catastrophic Supplier Performance Failure

- Bungled upgrade of software at a manufacturing facility that led to the plant being shut down for a week
- Manufacturing plant that had not properly managed pest control resulting in significant amounts of product that had to be discarded

Supplier Financial Troubles

- Companies are still struggling in this economy, especially those in the Real Estate markets
 - Grubb & Ellis bankruptcy

- RFP/Contract Negotiation Stage
- Steady State



- Alignment of Goals of Customer Deal team is critical
 - The day to day objectives of internal functions are different
 - Example:
 - Procurement: Savings is priority
 - Business: Operational stability is priority
 - Need to recognize competing objectives of functions and establish common objectives of deal team
 - All functions need to operate consistent with the agreed objectives, especially when addressing unexpected issues

- Inclusion of Supplier proposed management team in negotiation process.
 - Negotiating is problem solving
 - Get them involved as early as possible
 - Account team replacement opportunity
 - Vendor evaluation factor
 - Significant value in getting the right management team from day one

- Effective Governance Structure and Execution
 - Centralized v. Decentralized Management of Supplier
 - Centralized Management of supplier
 - Core governance team manages and directs supplier system wide (traditional office space deals)
 - Decentralized Management of supplier
 - Centralized core governance team but local direction of supplier (plant manager in plant)
 - Governance structure should have mechanisms that reflect the reality of supplier management by the customer

- Performance Monitoring
 - Supplier's Operational Performance
 - Financial Health of the Transaction
 - Supplier Overall Financial Health



- Service Performance Monitoring
 - Regular communications at local and centralized levels
 - Don't wait until significant items arise to hold meetings
 - Don't cancel meetings for lack of significant issues
 - Document issues that are discussed
 - Proactively monitor the Supplier's performance
 - Early detection of deficiencies may avoid catastrophic failure
 - Consider exercising step-in rights to avoid operational failures
 - Early detection of unapproved New Services
 - Modify or adjust KPIs to address service deficiencies

- Financial Performance Monitoring
 - Applicable to GMP or other
 Pass-Through Priced Deals
 - Begin Month 1
 - Measure against budget or baseline



- Look for signs of unapproved new services
- Important even if the supplier is taking all or most budget overrun risk
 - Supplier losses will be felt by both parties!



- Bankruptcy related issues
 - Overview of key concepts and issues in bankruptcy
 - Automatic Stay
 - Broad statutory stay of litigation and lien enforcement related to the debtor, property of the debtor, and property of the estate
 - Designed to provide the debtor with breathing spell to reorganize and to ensure equal treatment for creditors
 - As name implies it is automatic, requires no notice or further action by debtor or order of court to apply (willful violation of stay may be subject to sanctions and award of attorneys' fees)
 - Practical effect: must terminate before case is commenced; it will be too late to assert right of termination after supplier is in bankruptcy

- Types of Bankruptcy Cases
 - Chapter 7: Governs Liquidation Proceedings
 - A trustee is always appointed to liquidate assets and distribute proceeds to creditors in accordance with statutory priorities
 - Chapter 11: Governs Reorganization Proceedings
 - Goal is negotiation of a plan of reorganization
 - Flexible process designed to preserve "going concern" value
 - The debtor is authorized to remain in possession and control of its assets, unless the bankruptcy court orders otherwise (also known, therefore, as a "debtor-in-possession" or DIP for short), unless the bankruptcy court orders otherwise (i.e. appoints a trustee)

- DIP/trustee has right to assume or reject contracts
 - Requires notice, hearing and approval of Bankruptcy Court
 - Court likely to show great deference to DIP/trustee's exercise of its business judgment in making decision to assume or reject
 - Pending decision, non-debtor party to contract generally must perform; DIP/Trustee is required to timely perform obligations arising post-petition
 - Assumption requires DIP/Trustee to cure all defaults, and give adequate assurance of future performance
 - Defaults based upon insolvency, financial condition or commencement of bankruptcy are treated as unenforceable "ipso facto clauses" and are therefore not entitled to being cured

- DIP/Trustee can also assume and assign contract to third party
 - Anti-assignment provisions in contract generally not enforceable in bankruptcy
 - May be difficult to establish lack of adequate assurance of future performance by prospective assignee
- Rejection relieves debtor from any further performance obligations, but gives non-debtor party a claim for damages
 - Debtor must turn over your property but cannot be forced to provide transitional services following a rejection
 - Rejection damages claim treat as general unsecured,
 prepetition claim in case; such claims will not be paid unless
 and until a plan is confirmed in case and ultimate recovery on
 such claims often ends-up well below 100%

- Steps to take when negotiating the agreement
 - Negotiate most permissive termination rights possible
 - Make clear what steps necessary for "effective" termination of agreement
 - Make clear what supplier's transitional obligations may be posttermination
 - Provide means for calculating damages arising from breach of posttermination obligations
 - The contract should not provide supplier a right to renew or extend the term of the agreement
 - Draft specific right to demand adequate assurance of future performance and right to anticipatory breach

 Draft provisions to provide ability to assert control over payment of sub-contractors

Problem

 Payments made to supplier intended to fund amounts it owes employees and subcontractors are at risk of being used for other purposes if such funds not disbursed prior to commencement of bankruptcy

Solution

 Have agreement provide right to require funds be deposited into segregated account and held in trust for payment of specific expenses due subcontractors or other key parties; provide contractual right to pay supplier's subcontractors directly

 Draft provisions to provide ability to assert control over payment of sub-contractors

Problem

 Cannot compel performance of posttermination transitional obligations in bankruptcy

Solution

 Draft right to communicate directly with sub-contractors following termination event; document interest in sub-contracts and other key business records associated with transitional services

Binding arbitration

Problem

 Bankruptcy generally is not a favorable forum for non-debtor party to resolve disputes with debtor

Solution

- Include binding arbitration provision in agreement
 - Arbitration provisions generally are favored in bankruptcy
 - Arbitration panel determines legal rights; bankruptcy court decides how that decision may be enforced under applicable bankruptcy law
 - Not clear arbitration provision enforceable under rejected contract

- Limits of negotiating protection in agreement
 - Prepetition agreement that seek to limit rights in bankruptcy are generally unenforceable
 - Provision intended to preclude entity from having right to file for bankruptcy considered void because they go against public policy
 - Similarly, provision conferring special rights on non-debtor party (e.g. relief from the automatic stay) are usually unenforceable

- Additional Considerations
 - Evaluate workout/settlement proposals made outside of bankruptcy with view towards potential harm that may be incurred inside of bankruptcy if deal cannot be reached, supplier files for bankruptcy and existing agreement rejected
 - Monitor bankruptcy proceedings
 - Things happen quickly in bankruptcy
 - Be prepared to respond quickly to any changes in performance by supplier
 - Get your bankruptcy counsel involved

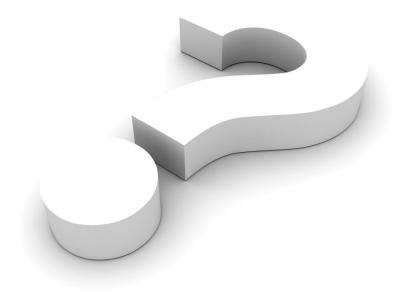
- Make contingency plans
 - Initiate negotiations with an alternative provider that can be brought in on short notice
 - Negotiate and document transitional services agreement with financially distressed supplier in contemplation of or following actual termination of existing agreement



QUESTIONS?

Kevin A. Rang
Partner
+1 312 701 8798
krang@mayerbrown.com

Craig E. Reimer
Counsel
+1 312 701 7049
creimer@mayerbrown.com



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