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How to Integrate Disruptive Technologies in Existing Supplier Contracts

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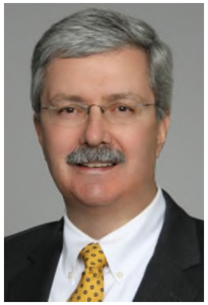
The Age of Disruption

HOW EMERGING TECHNOLOGIES AND CYBERSECURITY ARE TRANSFORMING SOURCING

Speakers



Daniel A. Masur
Partner

Dan Masur is the partner-in-charge of our Washington, D.C. office and is recognized as one of the leading lawyers in the outsourcing field by *Chambers Global, Chambers USA* and *Legal 500.* He has represented national and international clients in a broad range of on-shore, near-shore, and offshore information technology and business process sourcing transactions involving global and niche sourcing providers, offshore captives and various hybrid structures.

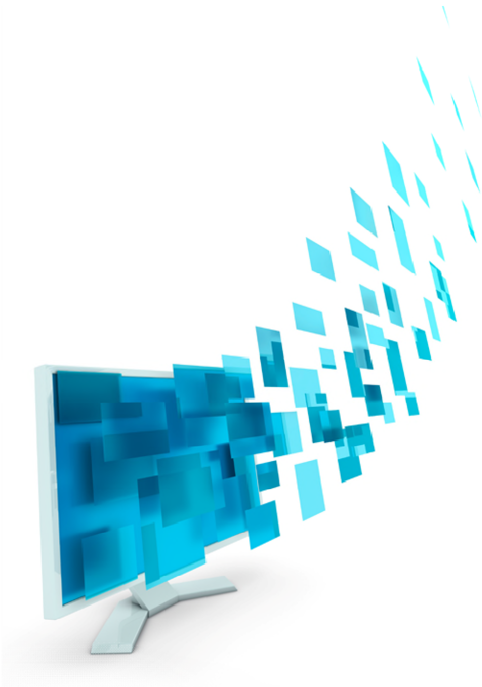
Linda L. Rhodes
Partner

Linda Rhodes is a partner in the Mayer Brown's Washington DC office and focuses her practice on complex commercial transactions, including business and technology solutions (e.g., information technology outsourcing, and business process outsourcing), cloud computing and other digital solutions, mergers, acquisitions, divestitures and transition services, joint ventures and corporate governance.

DEFINING THE OPPORTUNITY:

Defining the Opportunity

- Incorporating new technologies / solutions / services – e.g., cloud, everything-as-a-service, autonomics/robotics – to reduce applicable charges, improve performance and/or add new or enhanced capabilities.
- Modifying an existing relationship to incorporate mobility, data analytics and/or other components of the company's digital strategy by altering the form of service provisioning.



Defining the Opportunity *(cont'd)*

- Directing some or all of the services to digital service providers offering more attractive pricing, stronger capabilities, new product or service offerings, etc.
- Moving to a different outcome or business construct, such as buying an integrated unit of consumption that is meaningful to the client's business, not just discrete devices or other IT components used to perform the function.

STRATEGIC AND TACTICAL CONSIDERATIONS:

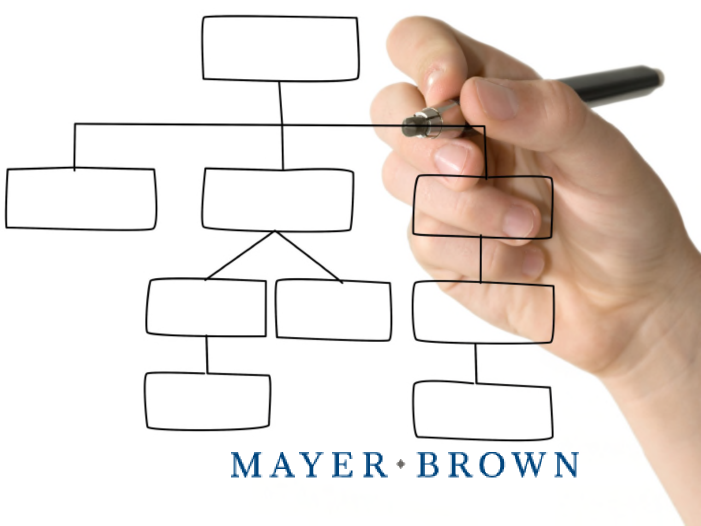
Process

Defining the optimum process, including:

- Timing (not just tied to renewal)
  - Driven by business objectives and requirements
- The role of the incumbent provider
  - Driven by customer/vendor relationship, demonstrated capabilities in digital arena, willingness to embrace change and willingness to deliver competitive solution without direct competition
- Cost-benefit analysis
  - Can be more complicated than traditional transaction
  - Often involves more than just cost savings
  - Benefits may include improvement in time to deploy, end user productivity, speed to market, cost of inventory, marketing effectiveness, customer renewal rates, etc.

Process *(cont'd)*

- Change management considerations
  - Requires honesty regarding your organization's willingness to:
    - embrace change
    - relinquish control
    - accept a vanilla one-to-many solution
    - forego customization
- Creating and maintaining negotiating leverage
  - Creating deadlines and a sense of urgency
  - Maintaining the specter of competition



Impediments

Identifying and addressing impediments, including:

- Transition charges
  - Moving to a digital solution will require transition work, including designing the new solution, developing a detailed transition plan, determining the road map for the migration and migrating the services.
  - Implementing new tools, including reporting tools and processes, may be necessary.
  - Disaster recovery planning for your new digital solution may be required.
  - The cost associated with these efforts will need to be factored into your business case.

Impediments *(cont'd)*

- Termination charges
  - Moving to a digital solution may result in a termination of all or part of the existing agreement for convenience or trigger minimum commitments, resulting in continued payment of minimum charges or termination charges.
  - Working in the context of your existing contract, you may have leverage to negotiate around certain termination charges, but certain termination charges, such as stranded costs, may not be negotiable.
- Availability of internal talent
  - New digital technologies may require internal customer staff with different skill sets.
- Mindset/resistance to change

Impediments *(cont'd)*

- Stranded costs, including
  - Moving to a digital solution may result in stranded equipment. Customer's equipment is most likely refreshed in cycles, and customer will have equipment that is not at end of life at the time of migration to the cloud solution.
  - If customer owns the equipment, it has sunk costs. If the provider owns the equipment, then the provider will have stranded costs and want to pass those costs onto customer through termination charges.
  - Similarly, there may be third-party maintenance and other contracts to be terminated with termination costs.
  - Customer may have leased space that is no longer needed for the technology solution. Use of the stranded space should factor into customer's overall planning.

CASE STUDY:
INTEGRATING CLOUD SERVICES IN TRADITIONAL IT INFRASTRUCTURE ENGAGEMENT

Role of the Existing Managed Service Provider

- Traditional managed service providers – Different approaches to cloud
  - Offer cloud-based services (e.g., IBM/Softlayer)
  - Willing to incorporate third-party cloud provider as subcontractor
  - Willing to add cloud provider only as managed third party with separate contract
- Value offered by traditional managed service provider
  - Separate cloud contract managed directly by client vs. integrating the cloud provider into the existing arrangement as a subcontractor or managed third party
  - At its most basic, cloud is another means of performing the same functions then being performed by the existing provider
  - What value does the managed service provider offer and is it worth the cost
  - If you respond "yes", then consider …

Role of the Existing Managed Service Provider *(cont'd)*

- Advantages of integrated provider and/or provider-subcontractor models
  - Leverage existing contractual commitments/terms
  - Existing provider responsible for management of entire solution
  - Integrated performance standards and service levels
  - Streamlined governance process – one throat to choke
  - Existing provider identifies and fills gaps and bears gap risks
  - Avoid or minimize transition/termination charges and stranded costs
- Disadvantages of integrated provider and/or subcontractor models
  - Suboptimal cloud capabilities – Softlayer vs. AWS or Microsoft
  - Price impact of MSP markup on cloud provider pricing

Retrofitting of Existing Contract, Defining Deviations

- Leverage existing contract terms, but recognize required deviations
  - Digital services terms are often substantially different from traditional outsourcing terms.
  - Leveraging your existing provider and existing contract by placing the burden on the provider to request “deviations” for the digital solution.
  - Contract deviations **only apply** to the digital portion of the solution.
  - Integrating digital capabilities into your deal does not mean the provider gets to renegotiate the entirety of the deal.
  - Consider whether you need to include contingencies to the “deviations” to accommodate the digital solution.

Retrofitting of Existing Contract, Defining Deviations cont'd

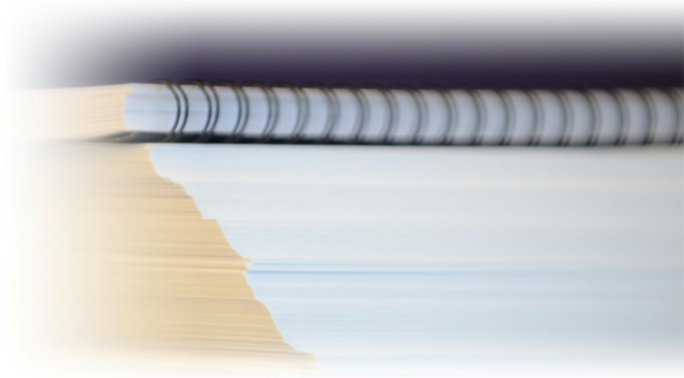
Issue	Traditional OS	Cloud Provider	Contingency
Control rights	Service Locations per Supplement; no change without customer consent	No approval of Service Locations	Restrictions on location of customer data continue to apply
Approval rights	Approval of subcontractors	No approval of subcontractors	Flow-through of contract terms required; provider remains responsible
Audit rights	Right to audit facilities, records	No right to audit facilities, records	Deliver annual controls audit report on cloud environment
Post-termination rights	Post-termination rights unless otherwise agreed via the supplement	No post-termination rights	Continuation of services during disengagement period required

Minimizing Stranded Costs

- Seek to avoid or minimize stranded costs by, among other things:
  - Aligning the migration to the cloud with equipment refresh to reduce stranded costs and/or termination charges
  - Aligning migration to the cloud with the expiration of impacted licenses, leases and third-party contracts
  - Repurposing impacted assets
  - Shifting financial responsibility for impacted costs to the existing provider as provider may have more options than customer for repurposing assets

SOW, SLAs

- Statements of Work
  - Remarkably few changes: the services received by customer in large part remain the same, with perhaps additional capabilities
  - Performing same functions using different platform
- Service Levels
  - Integrated service levels: existing provider to assume the risk of gaps, including differences in methodology and exceptions
  - Again, remarkably few changes
  - Treatment of service levels offered by cloud provider
  - Addition of new service levels covering management of cloud provider



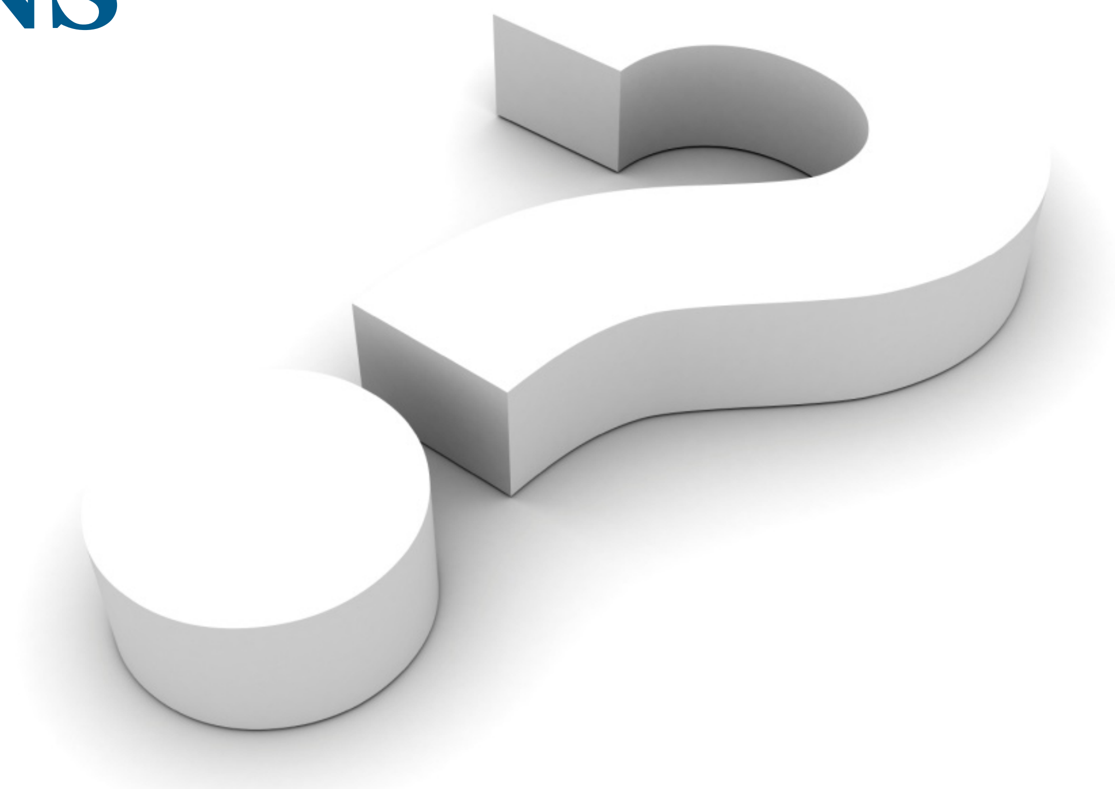
Pricing

- Treatment of cloud provider pricing
  - Treat as pass-through of standard cloud pricing
    - with negotiated discount and
    - without MSP markup
  - Pass-through of periodic price reductions (and service level improvements) offered by cloud provider
  - Treatment of required price commitments
  - Define separate MSP management fee, with ARCs/RRCs

Pricing *(cont'd)*

- Pricing challenges
  - ARC/RRC pricing as the parties ramp down traditional volumes and ramp up cloud volumes
    - Addressing fixed component of existing base charges
    - Treatment of fixed component of management charges for cloud services
  - Treatment of cloud migration costs

QUESTIONS



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