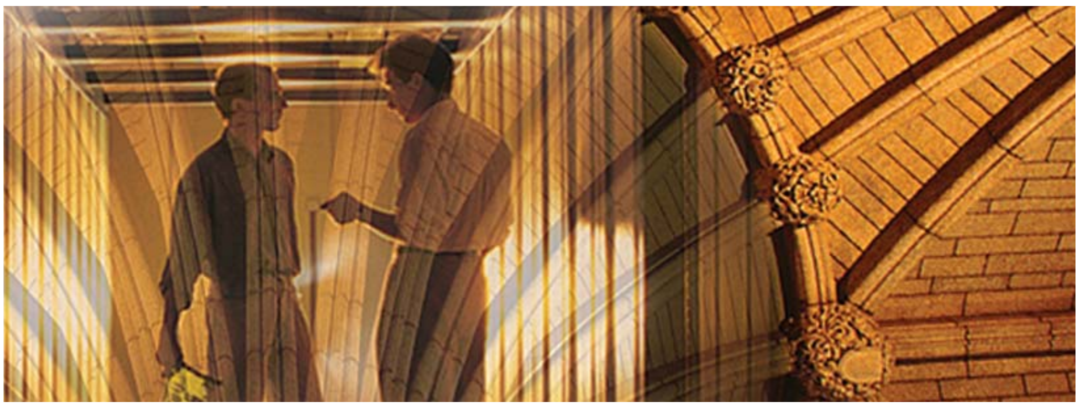
Flexible Contracting:
Preserving the Ability to Engage in Multi-Process Outsourcing Transactions



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Structuring any outsourcing transaction requires careful planning. In today's environment, outsourcing customers would be well-advised to ensure that their outsourcing transactions are structured to preserve the ability to engage in multi-process outsourcing (MPO) transactions. To preserve such ability, customers should incorporate terms and conditions into their outsourcing contracts that enable ongoing flexibility in their relationships with their outsourcing suppliers.

MPO Transactions

MPO transactions involve outsourcing two or more distinct processes or functions to one or more suppliers. These types of transactions are likely to increase in the coming years for a number of reasons. Customers are continuing to consider outsourcing as an effective means to achieve increased cost savings, to obtain access to best practices, expertise, innovation and capability enhancements, to standardize functions across their enterprises, and to improve performance, and they are pursuing these objectives across multiple processes or functions (e.g., human resources, finance and accounting, customer care, and procurement functions). Suppliers are becoming increasingly competent in a variety of business processes and there is a movement of consolidation in the supplier marketplace. Suppliers that traditionally focused on information technology (IT) are building or buying other business process offerings. Suppliers in the non-IT business processing space are looking to combine with other business process suppliers and/or with the traditional IT suppliers.

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MPO transactions are inherently complex due to the interrelationship and potential friction points between outsourced processes or functions and between suppliers. The complexities of MPO transactions present customers with issues not ordinarily encountered in outsourcing transactions involving only one function or one supplier. Among these, one of the most important issues is the need to incorporate provisions in outsourcing contracts that enable ongoing flexibility.

Flexibility and MPO Transactions

"Flexibility" is somewhat of a catch-phrase among outsourcing commentators. The term refers, in part, to the extent to which an outsourcing contract accommodates change. Flexibility is important within the context of MPO transactions because a customer may want to outsource multiple processes or functions to multiple suppliers simultaneously, or may want to outsource multiple processes or functions over time in a series of transactions to a single supplier or to multiple suppliers. Additionally, customers may want to establish a "stable" of suppliers to encourage competition for work that is outsourced over time. A customer may want to reallocate among itself, its existing suppliers, and new suppliers those processes and functions previously outsourced. They may also want to re-evaluate their outsourcing transactions in light of changing business needs.

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To accommodate such changes, customers need provisions in their outsourcing contracts that permit them to shuffle and re-shuffle their suppliers and the services provided by their suppliers. This includes provisions that facilitate:

- Outsourcing additional work to existing or new suppliers;
- Using multiple suppliers;
- Transferring functions or processes back to customers or to different suppliers; and
- Maintaining competitive pressure on incumbent suppliers.

Many such provisions are typically found in outsourcing contracts. However, they assume greater importance within the context of MPO transactions because these provisions provide the flexibility to effect the kinds of structural changes that customers often want to make to their outsourcing relationships in connection with MPO transactions.

Outsourcing Additional Work to Existing or New Suppliers

To preserve flexibility in structuring MPO transactions, customers should include terms and conditions in their outsourcing contracts that not only permit, but also facilitate the ability to obtain new services from their existing suppliers. For example, outsourcing contracts should include provisions obligating suppliers to submit proposals for new services at the customer's request. Customers may also want to consider requiring the supplier to perform any new services for which the customer accepts a proposal from the supplier. Statements of work, pricing, service level methodologies, and other contract provisions (e.g., warranties and indemnities) should also contemplate the introduction of new services by extending to and covering such work.

Conversely, a single supplier may not offer the best solution for all of a customer's outsourced functions and processes. Customers wanting to preserve the flexibility to engage in MPO transactions should also include terms and conditions in their outsourcing contracts that permit and facilitate the ability to obtain services from new suppliers. Customers should resist agreeing to terms and conditions that create exclusive relationships with their chosen suppliers. For example, if the outsourcing contract contains terms and conditions that make it a "requirements contract" with respect to any or all of the services performed under the contract, the customer must obtain all of its requirements for those services from the supplier. Terms and conditions stating that a supplier is the exclusive provider of any services to the customer have a similar effect. Less obvious but just as restrictive are provisions requiring customers to maintain a "minimum spend" with a supplier, or that grant a supplier rights of "first offer" or of "first refusal" with respect to any services. Provisions such as these can hold customers hostage to a single supplier and that supplier's service capabilities.

To ensure that customers always have access to the best solution mix for their needs, outsourcing contracts should expressly indicate that the contract is not a requirements contract and that the customer shall not be required to obtain its requirements for any of the services performed under the contract from the supplier. Likewise, outsourcing contracts should expressly indicate that the supplier is not the customer's exclusive provider of any of the services performed under the contact and that the customer may obtain any services from different suppliers, including services to supplement, replace, or render unnecessary the services performed under the contract. Finally, provisions requiring customers to maintain a minimum spend with a supplier, or that grant a supplier rights of first offer or of first refusal with respect to any services, should ordinarily be resisted absent an overriding benefit to a customer's business.

Practical Ability to Use Multiple Suppliers

Simply because an outsourcing contract provides a customer the right to use multiple suppliers does not necessarily mean that the customer's chosen suppliers will collectively provide the customer with a workable overall solution. As a practical matter, customers cannot effectively engage in MPO transactions with different suppliers if those suppliers operate independently of each other. Without the practical ability to outsource different functions and processes to different suppliers, contractual rights permitting the use of multiple suppliers are of little value. To ensure that customers can structure MPO transactions using multiple suppliers, customers should include terms and conditions in their outsourcing contracts that enable them to cause their suppliers to operate as a seamless whole.

In order to successfully integrate the often disparate technologies and processes of suppliers' solutions, outsourcing contracts should require each supplier to fully cooperate with the customer and the customer's other suppliers. Such cooperation should include requiring each supplier to timely provide electronic and physical access to the business processes and associated equipment, software, and systems being used to provide its services to enable the customer's other suppliers to perform the work assigned to them,

and to timely provide written requirements, standards, policies, or other documentation for such business processes and associated equipment, software, or systems to permit the customer's other suppliers to integrate their solutions. Furthermore, each supplier should covenant that its services will seamlessly interface with the customer's retained services and those services provided by the customer's other suppliers. Suppliers should also be required to obtain the customer's consent prior to implementing material changes to their services, and customers should retain control over technology architecture, standards, and policies. This allows the customer to effectively coordinate the delivery of services from multiple providers and decline any changes that could or would negatively alter the functionality, performance standards, or technical environment of the customer's retained functions and processes or those services provided by the customer's other suppliers. Service levels should include allowances for dependencies among service lines controlled by different service providers. Finally, outsourcing contracts should include license rights that allow each of the customer's suppliers to access and use intellectual property owned or licensed by the customer's other suppliers if and to the extent necessary for each supplier to perform services on behalf of the customer.

Another means to cause suppliers to work together is through the use of multi-supplier operating agreements. Essentially, these agreements require a customer's suppliers to solve problems between or among them first, and apportion fault and liability later. For example, multi-supplier operating agreements should require suppliers to cooperate and collaborate on root cause analyses. This helps to ensure that a customer's operations will not degrade as a result of disputes between two or more suppliers. Multi-supplier operating agreements should also establish a common set of terms under which the customer and its suppliers shall interact. Key terms include those addressing governance and dispute resolution, audit rights, compliance with laws, data formats, data interfaces, general architecture and standards, business continuity and disaster recovery, joinder, choice of law, and venue. Provisions like those outlined in the previous paragraph, together with multi-supplier operating agreements, provide customers with the tools to cause their chosen suppliers to work together in a seamless manner.

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Transferring Functions or Processes

Along with the right to source additional functions or processes to suppliers, customers should seek the right to transfer them back to itself or to a different supplier without terminating the outsourcing contract. The right for customers to "in-source," or transfer functions or processes back to themselves for performance by their personnel, and "re-source," or transfer functions or processes from one supplier to another, are generally important rights for accommodating changes in customers' business needs. When structuring MPO transactions, these rights are particularly important because they allow customers further flexibility in obtaining the best solution for each of the functions and processes that are outsourced. In addition, if a function or process that was outsourced in a previous transaction would be better-performed by the customer or a different supplier, the customer can transfer that function or process to itself or its chosen supplier. Accordingly, outsourcing contracts should expressly provide that customers have the right to in-source or re-source any functions or processes performed by their suppliers in order to preserve flexibility in structuring MPO transactions.

For customers to take advantage of these rights, in-sourcing and re-sourcing events should allow customers access to transition assistance services from the supplier from whom such functions or processes are being in-sourced or re-sourced. These transition assistance services should include, if and to the extent requested by the customer, the original supplier's continued performance of the functions or processes being in-sourced or re-sourced, the original supplier's cooperation with the customer and the customer's designees in the transfer of such functions or processes, and the right to obtain any new services to facilitate the transfer of such functions or processes to the customer or a different supplier. Customers should also include terms and conditions that allow them to acquire or obtain licenses to resources and assume third-party contracts used by the original supplier to perform any in-sourced or re-sourced functions or processes. Finally, customers should reserve the right for themselves and their designees to hire (or re-hire) the supplier personnel performing the in-sourced or re-sourced functions or processes to maintain the customer's operations when such functions or processes are transferred.

Absent the right to receive transition assistance services, acquire or obtain licenses to such resources and assume such third party contracts, and hire or re-hire supplier personnel, customers run the risk that in-sourcing and re-sourcing events could leave them scrambling in order to continue to obtain their requirements for any in-sourced or re-sourced functions or processes without degradation or interruption.

Maintaining Competitive Pressure on an Incumbent Supplier

Customers should also include provisions in their outsourcing contracts that allow them to maintain competitive pressure on their incumbent suppliers. Two of the primary benefits these provisions afford customers are the comfort of knowing that their outsourced solutions remain competitive with other offerings available in the marketplace, and the ability to avoid transferring functions and processes to different suppliers, with the attendant hassles and switching costs that result from such transfers. Considered within the context of MPO transactions, these provisions increase flexibility by encouraging a customer's incumbent suppliers to remain viable alternatives to transferring functions and processes back to the customer, or to different suppliers, and procuring new services from different suppliers.

One of the primary provisions for maintaining competitive pressure are those allowing (but not requiring) customers to obtain new services from their incumbent suppliers. It goes without saying that suppliers want new business from their customers. If a customer is not required to obtain its requirements for new services from its existing suppliers (see discussion above), then, to win new business, suppliers are motivated to perform their current scope of services at or above the requirements for such services and to provide competitive proposals for new services. Another set of terms and conditions that maintain competitive pressure are benchmarking provisions that permit customers to measure the performance of their incumbent suppliers, including the cost, quality and availability of the services they provide. If a supplier's services are found to be lacking in any of these respects, then the outsourcing contract should provide that any relevant terms and conditions will be equitably adjusted at the customer's option in order to remain competitive with prevailing terms offered in the industry. Similarly, customers may want to seek the

right to terminate an existing outsourcing contract if the existing supplier does not agree to provide the services it is then providing under that contract on the terms and conditions being offered by a different supplier. Rights to renegotiate pricing due to extraordinary events (e.g., mergers and acquisitions) affecting the customer's business provide a further tool to maintain competitive pressure on incumbent suppliers. These types of provisions all allow customers to maintain leverage over incumbent suppliers, and enhance the flexibility to structure MPO transactions by encouraging incumbent suppliers to keep their service offerings competitive over the life of the outsourcing contract.

Conclusion

MPO transactions are gaining traction in the marketplace, and call for a new approach to contacting, operating, and governing outsourcing relationships. One of the keys to preserving flexibility in structuring MPO transactions is to include terms and conditions in existing outsourcing contracts that maintain flexibility. Provisions that give customers the flexibility to re-structure their outsourcing relationships enable them to accommodate the changes that accompany MPO transactions, and can be invaluable for ensuring the success of these transactions. Customers that do not preserve flexibility in their outsourcing contracts may not be able to obtain access to the best practices and cost efficiencies that MPO transactions can offer.