

Morgan Lewis

RENEGOTIATING SERVICES DEALS

OUTSOURCING AND TECHNOLOGY

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Agenda

Business Issues and Drivers in Renegotiations

1. Client Perspective
2. Vendor Perspective

Renegotiation Code of Conduct

Renegotiation Process

Specific Contract Terms – Impact on Renegotiation

**BUSINESS ISSUES AND
DRIVERS**

CLIENT PERSPECTIVE

Common Renegotiation Drivers

- Approaching Expiration
- Requirements to change contract economics
- Change in Customer's business
 - *Significant growth or reductions due to acquisitions or divestitures*
- Material deviation from original scope of services
- Changes in methodologies / technologies
- Desire to access new or different solutions

Common Renegotiation Drivers - Services

- Change in Customer's management
- Change in sourcing strategy
- Desire to bring core services back in-house
- Enhance feasibility (reduce termination/resourcing restrictions)
- Poor performance by vendor (real or perceived)
 - *Customer not satisfied*
- Disagreement on contract interpretation
- Unrealized expectations

Common Renegotiation Drivers - Economics

- Reduce prices to perceived market levels
- Implement different pricing models
 - Shift from fixed to variable pricing
 - Eliminate or reduce minimum commitments
- Address unexpected “additional” charges
- Recognize recovery of service provider cost savings resulting from transformation/standardization

**BUSINESS ISSUES AND
DRIVERS**

VENDOR PERSPECTIVE

Vendor Objectives

- Retain profit
- Increase scope / move up food chain / move into other towers
- Increase customer involvement and awareness
- Improve communications and escalation paths
- Clear the air

Vendor Objectives

- Typically at point of renegotiation, vendor will identify a financial period within which it will prefer to sign extension and book (proportion) of the new financial commitment
- This should be a consideration as part of the establishment of the renegotiation timeline
- The vendor's target financial period may provide leverage for both parties (depending on circumstances)

Vendor Objectives

- Differing objectives – account vs the corporate
- Be careful to talk as one voice
- Clients may look to exploit any divergence of objectives
- e.g. chasing new business in a different tower vs maintaining business within existing account tower

RENEGOTIATION - CODE OF CONDUCT

Renegotiation Code of Conduct

- Customer's imperative:
 - ***No detrimental effect on service operations and quality***
 - ***Maintaining constructive relationship even during potentially challenging negotiations***
- Vendor will likely share these objectives

Renegotiation Code of Conduct

- Separate teams will facilitate achieving objectives
 - New Business / RFP Team vs Account Team
 - Communication across teams and some dual badging essential and inevitable
 - Might take a little time to achieve optimum balance

Renegotiation Code of Conduct

- Have a clear and transparent process
 - As the client:
 - *Create a structured and relatively formal process, even if this is a sole-source renegotiation*
 - As the vendor:
 - *Be careful with your communications and being, or appearing to be, intransigent given position of strength as incumbent*
- Both parties have objectives; understanding them on both sides will be essential

Renegotiation Code of Conduct

- As part of the forward process, agree on rules of engagement:
 - *Teams*
 - *Timelines*
 - *Which contract areas, and provisions, will or will not be amended*
 - *Specified objectives*
 - *Escalation path if the rules of engagement are broken or potentially going to be broken*
- Consider an MoU / LoI at outset setting out the above:
 - *Will create a point of reference for rest of process*

Renegotiation Code of Conduct

- What if there is an ongoing (alleged) breach issue?
 - How can parties engage constructively without either detrimentally affecting their contract position, or giving up rights they might have in respect of an alleged breach?
 - Consider establishing a moratorium
 - Effectively, a standstill period during which the parties can negotiate without affecting rights and obligations
 - Establish separate, “without prejudice” workstream which can handle contentious issues
 - The legal teams must find a way to facilitate the constructive engagement of the parties despite any background issues

Renegotiation Code of Conduct

- What if there the client wants to RFP the renegotiation?
 - Formal process crucial and (should be) a given
 - Client must understand what provisions it can leverage to receive and share account-related data with other suppliers e.g. pre-termination information provisions
 - Clients often make mistaken assumptions about what data they can share – be careful

Renegotiation Code of Conduct

- Con't
 - Incumbent vendor will want to ensure that provision of data is limited to what the contract requires and allows
 - Even more critical for incumbent vendor to understand what the client is trying to achieve: will drive its responses, and incumbent is also in a position to “close down” the RFP
 - Can incumbent charge for pre-exit activities, and then exit activities? Look out for this; often times can require significant support and related costs / charges – incumbent should reserve its position on these items until it understands what is required

RENEGOTIATION PROCESS

Due Diligence – Business Issues

- History
 - Pre-Contract History
 - Business Drivers - Issues to be Solved
- Original Negotiation
 - Starting Positions of Both Parties
 - Most Important / Difficult Business Issues
 - Final Agreed Positions
- Operations
 - Business/Operations Successes
 - Business/Operations Failures
 - Changes / Improvements Over Time

Due Diligence – Business Issues

- Financial
 - Billing Issues – Procedures and Substance
 - Expense Issues
 - Profitability Issues
- Current Issues/Drivers
- Market
 - Benchmarking Service Levels/Charges
 - New Competitors

Due Diligence – Relationship Issues

- Original Negotiation
 - Executive Sponsors / Negotiation Teams
 - Buy-in of organizations
- Operations
 - Executive Sponsors
 - Relationship Managers / Operation Teams
 - Understanding of Contract (Differences from “typical”)
- Cultural Issues
 - Client expectations – Business drivers
 - Style and Structure differences

Due Diligence – Relationship Issues

- **Governance**
 - Meetings – Regularity and Productive?
 - Participation – Right Persons from Both Sides Issues
- **Change Management**
 - Willingness to Change
 - Procedural Issues (Documentation, Follow-through)
- **Dispute Resolution**
 - Governance Level Appropriate
 - Speed
 - Executive Support - Participation

Due Diligence – Contract Issues

- Documentation
 - Agreement
 - Exhibits
 - Amendments
 - Services Documentation / E-mails / Understandings
- Legal Personnel
 - Original Negotiation
 - Operations / Amendment Issues
 - Current Team
- Change Management
- Claims / Disputes

Amendment – New Agreement

- **Ease of Negotiation**
 - Relationship issues - avoid re-negotiating previous issues
 - Efficiency – concentrate on new deal issues
- **Market Changes**
 - Technology Changes Require New Form
 - Change of Service Scope
 - Client / Service Provider Form Agreements
- **New Vendors**
 - RFP Process

Prior Claims

- Due Diligence
 - Documentation
 - Status of Governance, Change, and/or Dispute Resolution
 - Settlement proposals
- Separate Agreement?
- Releases
 - Unknown claims

Contract Provisions

- Amendment vs. Restatement
 - Extent of changes
- Term
 - Longer terms
 - Easier termination
- Scope
 - Additional Definition
 - Process for Scope Additions / Changes
 - Financial Terms

Contract Provisions

- Pricing
 - Experience – documentation
 - Flexibility for time and volume
 - Expense experience / specifications
- Change Management and Governance
 - Participants
 - Process Improvements
 - Surveys and Feedback

SPECIFIC CONTRACT TERMS

IMPACT ON RENEGOTIATION

Renegotiation of the Existing Outsourcing Contract

- When renegotiating an outsourcing contract, the precise language of the contract becomes extremely important.
- Each party reviews the contract for support to bolster its position. Is there any contractual basis for requesting renegotiation or avoiding renegotiation?
- The use of the contract to restructure the outsourcing relationship is therefore important not only during renegotiation, but regarding to understanding initial structuring and negotiation of the contract.
- The key contract terms that to be reviewed include:
 - *Term*
 - *Defining Scope of Services*
 - *Pricing Terms*
 - *Measuring Performance*
 - *Termination Rights*
 - *Unwinding the Relationship*
 - *Other Key Provisions*

Term

- Initial Term
 - *Is the expiration date approaching? If yes, may provide leverage. If no, may have to find other leverage points.*
 - *Upfront investments made by Vendor amortized over initial term – Impact on Termination fees.*
- Extension Options
 - Unilateral Rights to Extend
 - *Does Customer have the unilateral right to extend at a price determinable by the contract (i.e., without renegotiation)? If yes, does Customer want those terms? If yes, can avoid renegotiation.*
 - Evergreen Contracts
 - *If either party has the right to refuse an extension, that right can be used to force renegotiation*
 - Need Agreement to Extend
 - *If no unilateral right to extend, then extension will require agreement of both parties. This type of provision provides Customer leverage to offset Vendor's leverage provided by the costs of insourcing and re-sourcing*

Defining Scope

- Many renegotiations driven by dispute over fees – Customer feeling overcharged, Vendor feeling that it is not making sufficient profit.
- Scope definition - Specific Definition (Vendor's desire) vs. General Definition (Customer's desire)
- Detailed SOW
- Sweep-in Clauses
 - *Services Currently Performed by In-Scope/Displaced Employees*
 - *Services Not Described in SOW but Required for Proper Performance of the Services*
 - *Changes to the Services that are not Material or Can Be Performed Using Existing Resources*
- Continuous improvement – technology and process evolution – without price increase
- New Services and Projects – Mandatory Change
- Acquisitions; Internal Growth of Business
- Divestitures; Downturn in Business

Pricing Terms

- How is the Customer charged under the contract?
- Variable pricing structure with meaningful ARCs/RRCs to handle material fluctuations in volumes
 - *Renegotiation triggers*
 - *Can the baselines be renegotiated?*
- Deemed terminations for convenience
- Minimum fees
- Inflation / currency risks (on-shore and off-shore)
- Tax allocation (domestic and foreign, current and future)
- Right to withhold disputed charges
- Gain sharing from technology and process evolution
 - *Does the contract provide guaranteed savings? Have they been implemented/applied?*
 - *Other shared benefits or risks?*
- Customer right to audit Vendor charges

Measuring Performance

- Service Levels - Objective Measure
 - *Defining objective standards of performance (speed, availability, reliability, accuracy, etc.)*
 - *Are the right things being measured?*
 - *Service Level Credits – sufficient amount of fees at risk?*
 - *Has the Vendor met its service level obligations?*
 - *Under what circumstances was Vendor excused from service level failures and are they appropriate?*
 - *Is there a termination right associated with Vendor's failure to meet its service level obligations?*
 - *Periodic Adjustments?*
 - *Self-Executing Continuous Improvement – Reporting and proposal requirements*
 - *Does the Customer have the right to add service levels? To make adjustments to the service level methodology metrics?*

Measuring Performance

- Customer Satisfaction - Subjective Measure
 - *Customer and Vendor shall conduct mutually agreed upon satisfaction surveys*
 - *Details of who prepares the survey, who conducts the survey, who is surveyed and who bears the costs*
 - *What happens if results are not satisfactory?*
 - *Vendor obligated to improve customer satisfaction?*
 - *Customer and Vendor required to enter into good faith negotiations with a view to address the dissatisfaction? What if renegotiations are not successful?*
 - *Does the contract contain this type of provision?*
 - *Has the Vendor complied?*
 - *What were the results?*
 - *Did the Vendor comply with its response obligations?*

Measuring Performance: Benchmarking

- If Customer feels it is getting overcharged compared to the market, benchmarking provision provide right to conduct a measurement and comparison benchmarking process to compare the fees and service levels to what's prevailing in the market.
- What happens if the benchmarking process indicates that Vendor's pricing/performance for the benchmarked service is inferior to the comparative peer group?
- Automatic adjustment formulaes?
- Are the Customer and Vendor required to enter into good faith negotiations with a view to decreasing the fees and increasing the service levels within the range established by the peer group? What if renegotiations are not successful?
- If the contract contains a benchmarking provision, has one been performed?

Termination Rights

- Effective leverage comes from the client developing viable alternatives that are financially, technically, and tactically feasible and desirable, and being ready, willing and able to execute
- The single most powerful tool for creating leverage is the ability to get up and walk away from the table without a deal
- Is termination with the incumbent an option?
 - At expiration?
 - For convenience?
 - *What is the cost? If not unduly burdensome, can provide leverage in renegotiation.*
 - *Can you terminate in part or only the entire relationship?*
 - For cause? Is renegotiation an option in the presence of a default?
 - Termination for cause rarely clean. However, plausible claim of right to terminate for cause can provide negotiation leverage.

Termination Rights

- Is insourcing or resourcing an option of Customer? In whole or in part?
- Exclusivity covenant?
 - *Right to use third parties*
 - *Termination transition*
 - *Cooperation*
 - *Confidentiality restrictions and requirements*
- Minimum fees?
 - *Can effectively remove the option of Customer to insource or resource*
- Deemed termination for convenience?
- Price renegotiation trigger?
- If you don't renew or if you can terminate, insource or resource, what are the transition risks and mitigation options?

Unwinding the Relationship

- Termination Assistance – For Any Termination
 - *Time Period*
 - *Costs*
 - *No degradation in on-going Services*
 - *Is Vendor required to cooperate with third parties engaged by Customer?*
- Confidentiality Restrictions
 - *Are third parties engaged by Customer permitted to have access to confidential information of Vendor?*
 - *Are the third parties required to enter into a confidentiality agreement with Vendor?*

Unwinding the Relationship

- Customer's right to the services and assets necessary for it to continue the operation of its business are very important when renegotiating the outsourcing contract
- Rights to Hire Vendor Personnel; possible transfers under EU Laws
- Customer ownership, license and access rights to:
 - *Customer Data*
 - *Equipment*
 - *Software*
 - *Third Party Service Agreements*
 - *Vendor Proprietary IP*
 - *Vendor Third Party IP*
 - *New Developments*
 - *Procedures Manual/Other Work Product*

Other Key Provisions

- Damages
 - *Each party must assess its potential liability to the other party*
 - *Limitations on liability and exceptions*
- Dispute Resolution
 - *What is the dispute resolution process under the contract and has it been followed?*
 - *With respect to future steps in the process (e.g., litigation in a particular jurisdiction), do they provide renegotiation leverage. For example, litigation and public disclosures vs. confidentiality of arbitration.*
- Continued Performance
 - *Does the contract expressly provide for obligation of continued performance during dispute?*
- Review of Ancillary Agreements and Documents
 - *Have there been amendments to the contract through change control documents or other documents?*
 - *How would any ancillary agreement be affected by renegotiation?*

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- Outsourcing Across the Globe: Focus on Russia – Webinar
 - March 20 | 9:00 - 10:00 AM ET / 2:00 - 3:00 PM GMT / 5:00 - 6:00 PM MSK
 - More information to come!

Biography



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Peter Watt-Morse, one of the founding partners of the firm's Pittsburgh office, has worked on all forms of commercial and technology transactions for more than 30 years. Peter works on business and intellectual property (IP) matters for a broad range of clients, including software, hardware, networking, and other technology clients, pharmaceutical companies, healthcare providers and payors, and other clients in the life science industry. He also represents banks, investment advisers, and other financial services institutions.

Peter advises companies on business process (BP) and information technology (IT) outsourcing transactions. He also handles technology acquisition, development, licensing, and distribution agreements; strategic alliances and joint ventures; IP creation and strategy; university and governmental technology transfer issues; and general corporate and commercial matters.

Peter is an adjunct professor at the University of Pittsburgh Law School, where he teaches classes related to technology transactions and IP. He frequently speaks and writes about outsourcing, IP, and technology-related topics, including an annual seminar he moderates on Cyber Law. He also has an extensive background in technology use in the practice of law and is past chairman of Morgan Lewis's Technology Steering Committee.



Biography



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Mike Pierides' practice encompasses a wide breadth of commercial and technology transactions. Mike advises on major outsourcings, strategic restructurings following divestments or acquisitions, and technology-specific transactions such as licensing and "as a service" arrangements. He is also active advising on new technologies such as blockchain and artificial intelligence.

His clients include companies across a multitude of sectors, including technology, financial services, aviation and telecommunications. Within the financial services sector, he advises a wide range of clients, including retail banks, investment banks, investment managers, payments providers, and others. Mike has also worked at the intersection of financial services compliance and technology, advising clients on their related systems and compliance procedures.

Mike represents both customers and suppliers, allowing him to bring opposing parties' perspectives to transactions.

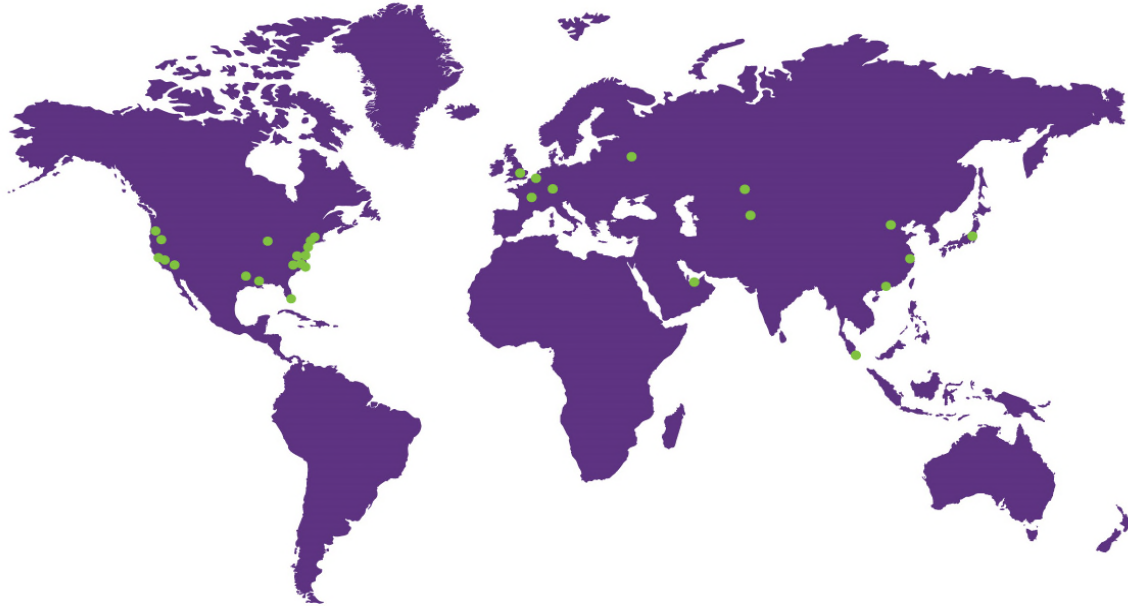
Mike is recognised by *Chambers UK* as an authority on outsourcing and information technology, and is highly regarded for his work on complicated BPO and information technology outsourcing (ITO) transactions. Clients and sources told *Chambers* that Mike "[has] excellent understanding of our sector and the services we provide...", that "he is particularly strong around the negotiating table," and that "he leads from the front rather than merely offering opinion."

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