

# Proactive Remedies – a New Approach to Solutions in Outsourcing Contracts

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# Overview

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- ▼ The challenge
- ▼ Current approaches – some proactive remedies are used
- ▼ What the marketplace is telling us
  - ▼ Some results for the Bird & Bird/Quantum Plus research
- ▼ New remedies to promote successful outsourcing



# The Challenge

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- ▼ The remedies that are included in outsourcing contracts tend not to be used by practitioners during the lifecycle of the outsourcing
- ▼ Negotiation is the preferred technique for resolving problems
- ▼ Most remedies included in outsourcing contracts are ineffective, counterproductive or impractical
- ▼ There is a need for contract draftspersons to develop new remedies that assist practitioners



# Current Approach – some proactive remedies are already used

- ▼ **Termination for near insolvency** – universally included/sensible
- ▼ **Termination for change of control of service provider** - commonly included where customer has a strong negotiating position
- ▼ **Third Party Step-in:** increasingly included – cumbersome, probably impractical, divisive
- ▼ **Financial Distress** – introduced in UK by Office of Government Commerce: problematic – see next slide



# Financial Distress – The OGC Approach

- ▼ Introduced by UK Office of Government Commerce in 2003 in response to Global Crossing, chapter 11 and EDS share price fall
- ▼ 3 levels of distress/consequences:
  - ▼ Level 1 – notification/planning obligations
  - ▼ Level 2 – escrow account established to protect sub-contractor payments
  - ▼ Level 3 – escrow account ring fenced to protect Customer's re-compete expenses and damages claim
- ▼ Level 3 remedies counterproductive – could be a serious danger to IT Service Providers



# What the marketplace is telling us

**Bird & Bird/Quantum Plus** research – key findings:

- ▼ Importance of senior stakeholder involvement
- ▼ Key role of governance
- ▼ Importance of continuity of personnel
- ▼ Key role of governance
- ▼ Limited role of contract
  - ▼ most remedies included in outsourcing contracts are ineffective, counterproductive or impractical
  - ▼ Service credits have little real effect
- ▼ Reporting arrangements need attention

See [www.twobirds.com](http://www.twobirds.com)



# Need for Solutions that Go Beyond the Contractual

- ▼ PA Consulting: "Getting out of the cost box", July 2004
  - ▼ 85% of CIOs agree that the perception of IT has improved across the business, their ability to realize long-term value from IT is weak
  - ▼ 65% of respondents reported having successfully reduced or controlled IT costs, often by renegotiating suppliers' contracts
  - ▼ 64% of respondents strongly agree that IT projects are linked to business need, but their ability to create business value from these IT projects is less convincing
- ▼ Helen Haapio – contract is not just a "deal": contracts are tools for:
  - ▼ Managing business, projects and commitments
  - ▼ Creating, allocating and protecting value
  - ▼ Communication, coordination, motivation and control
  - ▼ Sharing, minimizing and managing risk
  - ▼ Problem prevention, dispute avoidance and resolution



# Solutions Need to address the Sociology of the Outsourcing Relationship

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- ▼ Outsourcing (particularly long-term partnering projects) go beyond achieving the "deal"
- ▼ Outsourcings need to address and provide solutions in a changing business environment
  - ▼ Contract "fundamentalism" (as in religious fundamentalism) rarely works successfully for very long in an outsourcing relationship
- ▼ The contract needs to provide a road map and to promote a positive working relationship between service provider and customer over an extended period



# New remedies to promote successful outsourcings (1)

- ▼ Balanced scorecard: provides an early warning mechanism to identify when problems are arising
  - ▼ Regular re-assessment
  - ▼ Third party/objective approach
  - ▼ Results communicated to senior stakeholders
- ▼ Scorecard should assess broad parameters of the outsourcing relationship:
  - ▼ Service level achievement
  - ▼ Customer satisfaction
  - ▼ Service provider profitability
  - ▼ Staff turnover – customer and service provider
  - ▼ Stake-holder commitment



# New remedies to promote successful outsourcings (2)

- ▼ Senior Stakeholder Governance: provides a “hand on the tiller” to keep outsourcing “on track”:
  - ▼ Needs to meet regularly - quarterly
  - ▼ Needs to be focussed on actions, rather than just review
  - ▼ Senior stakeholders need have “buy-in” to the outsourcing
- ▼ Balanced Scorecard to be reported to Senior Stakeholder Group on regular basis:
  - ▼ Senior Stakeholder Group to be empowered to decide on rectification activities
  - ▼ Serious concerns over loss of control:
    - ▼ Customer side – risk transfer issues
    - ▼ Service provider – loss of autonomy



# New remedies to promote successful outsourcings (3)

- ▼ Senior Stakeholder Group to mandate joint working party approach for serious problem resolution:
  - ▼ Structured negotiation
  - ▼ Joint working party (JWP) mandated to identify solutions by senior stakeholders
  - ▼ JWP Identifies solutions which are presented to senior stakeholders for implementation decision
  - ▼ Senior stakeholders decide on the rectification approach
  - ▼ JWP focuses on solutions, not liabilities
  - ▼ JWP has responsibility for implementing solutions



# New remedies to promote successful outsourcings (4)

- ▼ Sharp financial remedies
  - ▼ High, but focused financial remedies
  - ▼ Get attention of senior management on both sides
  - ▼ Traditional service credits largely ineffective at incentivising change
- ▼ Partial Termination
  - ▼ Needs to be a managed service exit
  - ▼ Allows for outsourcing to continue
  - ▼ Likely to be more relevant in a multi-vendor environment



# The way forward

- ▼ Contract draftspersons need to talk more to practitioners to find out more about what works and what does not
- ▼ Contracts should be a useful “roadmap” for practitioners
  - ▼ Or should they just be statements of risk allocation and liability?
- ▼ Remedies in outsourcing contracts for lifecycle situations should promote outsourcing success
- ▼ Remedies in outsourcing contracts for lifecycle situations should be proactive, rather than reactive



# Thank you...

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