Customer Liability on Termination For Convenience – Part II

In the Part I posting, I discussed payments due to service providers for termination for convenience when no employees of the customer have been transferred to the service provider as part of the outsourcing transaction. This Part II will address some additional issues and costs due to the service provider for a termination for convenience when employees of the customer have been transferred to the service provider and are providing the services under the outsourcing agreement (the “Services”).

Determining Affected Employees

The first step is to determine the identity and number of the service provider’s employees affected by such termination. Since termination for convenience is rarely ever permitted in the initial year of the term of the outsourcing agreement, you cannot simply assume that those employees that were transferred to the service provider are the same ones that must be dealt with on a termination for convenience.

While there are several possible ways to determine the employees affected by a termination for convenience, one of the most common methods is for the parties to determine those employees of the service provider that are dedicated to providing the Services (the “Dedicated Employees”).

In most cases, Dedicated Employees will be former employees of the customer. However, in some cases, they may be employees that were never employed by the customer. Irrespective of their origin, however, Dedicated Employees do not generally spend 100% of their time in connection with the Services. As a result, some realistic percentage of their time spent in connection with the Services should be settled upon. In my experience, both customers and service providers are comfortable if that number is at least between 80% to 85%. Hence, for the purposes of this posting, Dedicated Employees will be those who spend at least 85% of their time working in connection with the Services.

Payments to Terminated Designated Employees

Just as with dedicated assets that are no longer needed as a result of a termination for convenience, the parties should look at the service provider’s need to retain any of the Dedicated Employees. And, again, similar to the asset analysis, the outsourcing agreement should provide that the role of each Dedicated Employee be analyzed by the service provider to determine whether the service provider could use that employee elsewhere in its business thus reducing the actual number of Dedicated Employees that would be (i) terminated, (ii) transferred back to the customer, or (iii) transferred to another service provider (“Terminated Employees”).

Once the ultimate number and identification of specific Terminated Employees is determined, the service provider and the customer will need to work out the appropriate severance and other payments that are payable by the customer to each of Terminated Employees. (Such ‘other payments’ might include a lump sum payment to the employee to compensate him/her for decreased benefits and pension benefits at the customer or the other service provider.)

Another complication that can arise is compensation to those Dedicated Employees that are offered a position back at the customer or at another service provider and decline to take the position. Whereas this position will likely be considered a failure of such employees to mitigate their damages and reduce (or possibly eliminate) their severance payment as it relates to salaries, they may well be entitled to pension and other benefits.

While I recognize that there are unlikely to be many Dedicated Employees in this category, the outsourcing agreement needs to address which party will be responsible for these payments to such employees. And although the customer may wish to make this the financial responsibility of the service provider, as a practical matter, it was the customer's termination for convenience that triggered this financial responsibility and it is my experience that service providers are unwilling to accept any such financial responsibility as the amounts due are solely as a result of the termination for convenience by the customer.

You Get What You Pay For

Almost everyone is familiar with this old adage, However, when dealing with termination for convenience in outsourcing arrangements, the phrase could more likely read '**You Pay For What You Get'**. Specifically, while some customers require all outsourcing agreements to permit termination for convenience (especially governments for political reasons), customers must understand that such a remedy is unlikely to result in any cost savings. Indeed, termination for convenience is more likely to cost far more than letting the agreement run its course. This is true irrespective of whether the customer intends to repatriate the Services or move them to another service provider.