

Client Alert

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A Better Way Out? Exit Services in Outsourcing

By Alistair Maughan

As with any business relationship, the end of an outsourcing can be a difficult time. Happy, trouble-free exits are rare. Emotions often run high, there may be pending legal claims in relation to the termination circumstances that triggered the exit, and employees may be worried about their future jobs.

The problem of achieving a smooth exit that works for both customer and service provider plagues many outsourcings, both large and small. Too often, outsourcing parties let these issues distract them from what's really important: continuity and effective transition.

There is a better way. There are a handful of simple approaches that can be followed in any outsourcing arrangement in order to avoid the most common mistakes in the exit phase. As with many outsourcing issues, the keys to success are planning, transparency, and using past experiences to avoid future mistakes.

In the outsourcing sector globally, it is becoming increasingly important for both customers and service providers to focus on how to ensure continuity of services and a seamless exit and transition. As the average duration of outsourcing relationships continues to shrink and the complexity of the outsourcing services provided increases, the frequency and difficulty of exit also increases. If anything, the growth in frequency of multisourcing strategies – and the corresponding need for one-to-many exit handovers – has exacerbated the problems.

For a customer, the priority should be to maintain continuity of service during an exit. For a service provider, the priority should be to ensure that its resources can be effectively transitioned to the next deployment with minimal downtime.

We have co-written a [Practice Guide on Exit Services in Outsourcing](#) with a number of independent law firms in Europe (the Outsourcing Law Group) with which we cooperate on outsourcing projects. This Practice Guide draws on the vast experience of the Outsourcing Law Group team of assisting clients in this most sensitive time of an outsourcing project.

The Outsourcing Law Group Practice Guide explains some of the core principles that are important to establish a better set of arrangements in relation to outsourcing exits. The Guide examines the most common issues that arise when dealing with exits in outsourcing relationships. The Guide focuses on three essential exit stages – Decision to Exit, Planning of Exit, and Post-Exit – and proposes a six step New Approach to improving the exit experience. The Guide also considers the tricky topic of how parties involved in an outsourcing relationship ought to address the issue of payment for exit services.

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COMMON ISSUES AND SOLUTIONS

One of the main underlying issues of outsourcing is that, during the term of the outsourcing contract, neither customer nor service provider pays enough attention to the issue of exit terms or to creating a foundation for a seamless exit and continuation of services.

No one wants to think about exit issues during the pre-contract “dating phase” of an outsourcing relationship or in the happy post-signing honeymoon period. And then, by the time the services have been ramped up and steady-state achieved, exit is either viewed as too distant an issue to address, or something contentious that would upset the happy balance between customer and incumbent service provider – or, conceivably, something that belongs in the “too difficult” box for both parties.

And so the issue gets ignored until the customer is working out what its future strategy will be, and only then realizes that (a) it has only a very loose idea of how to transition services to another provider; (b) the incumbent service provider has the best access to key data that would allow a level playing field for competitors to bid to replace it; and (c) the incumbent service provider owns key assets and there is no blueprint or plan for how service continuity will be maintained if the customer’s best value for money solution lies elsewhere.

The most common issues in an exit situation are:

- Failing to plan properly, and assuming that the exit process will either magically occur or will be agreed upon at the time when it’s needed (when, by definition, the parties’ relationship is likely to be at its worst)
- A customer expecting something for nothing in the exit situation and believing that the key services required to effect an exit transition have already been paid for during the term
- The parties failing to build a firewall around exit discussions and bringing to the table the same antagonism that exists in relation to termination, or using exit as a weapon in an ongoing dispute over termination.

There is a better way. Many of the issues involved in an exit can be avoided if the parties follow a few simple rules:

- Plan for the exit in advance when entering into a business relationship and spend time discussing and regulating any future exit terms
- Understand each other’s drivers and needs for a successful exit: the process is not just about continuity of service for the customer
- Keep exit under review during the contract life; don’t let draft exit plans grow stale or out-of-date
- Work out in advance a fair way to pay for an exit
- Create a structure for exit. One size will not fit all, and you can’t legislate for everything, but if you can try to create a level playing field for cooperation, openness and dialogue, you will have made the parties’ collective lives easier when exit finally occurs

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- The incumbent's exit plan is only half the story. Establish a process by which to create alignment between the incumbent's exit plan and the new service provider's incoming transition plan
- Think about exit in terms of the obligations pre-exit (including what may be needed to consider whether to exit or not), managing an exit, and post-exit obligations. How will all of the key resources (e.g., people, data, process maps, software, intellectual property, and data) be treated at each stage?

EXIT PLANNING

The most common defect of outsourcing exit processes is that planning doesn't start early enough.

Even the greatest exit plan will not resolve every potential issue that may arise at the end of an outsourcing relationship. But it is possible to use the planning process to establish the right culture within which an exit will occur, to determine key resource constraints, and to identify how exit transition issues will be addressed in a way that recognizes the concerns of all parties.

It is essential that detailed planning of an exit should not begin after an exit is decided upon; it should begin immediately after the contract is signed or even as a part of the tendering process. It is common today in many outsourcing contracts to require the service provider to deliver an exit plan shortly after the signing of a contract, and to require that plan to be continually updated when there are significant changes made to the services provided.

It is, however, equally common that an exit plan is not delivered, or is delivered as a high level plan which is not useful and, very often, the plan delivered is not updated and maintained during the term of the contract. Customers tend to accept this situation until exit becomes a live issue within the customer's organization – by which time, it's frequently too late to revise or create a plan.

Regardless of whether the eventual exit is planned due to expiry, or unplanned due to material default, it can become a costly problem for both the service provider and the customer if an exit plan has not been provided, is insufficient, or is obsolete due to changes in the services. The customer will have the cost and the burden of the problems; however, if the service provider is in material breach, a substantial portion of the cost may eventually be covered through claims for damages caused by the service provider.

The overall purpose of the exit plan is to enable the customer and the replacement service provider to provide services of a similar nature and scope to the services in the contract, at the same service levels as prior to termination or expiry of the contract. Further, the plan should ensure a seamless transition minimizing disruption or degradation in the services during the exit phase, including provisions to ensure that no data is lost or corrupted. And all of these provisions in the plan need to be carried out in the shortest practical timeframe.

A NEW APPROACH TO EXIT PLANNING

While it's not possible to wave a magic wand and make all exit issues disappear, it is possible for customers to take a more proactive approach to exit planning.

Based upon our experience in exit situations, effective planning can be broken down into specific segments. It would be illusory to believe that any single plan could remove all exit risk, but the planning process does at least

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cause the parties to focus on the key risk areas; and that focus may effectively reduce the threat to continuity of service.

Our Practice Guide addresses six areas where parties to an outsourcing relationship can make small but significant changes in the exit planning process.

Improve the Payment Model. The cost structure related to exit services should be based on the principle that some exit-related services and deliverables will not be separately payable but, instead, will be included in the base charges. Apart from such expressly stipulated services or deliverables, all other requirements should be separately payable and subject to a quotation and approval process.

Focus on Achieving Alignment between an Exit Plan and a Transition Plan. The incumbent provider's exit plan is only half the battle. The exit plan must align with the new provider's transition plan. Both plans should be shared and openly discussed. The aim of all parties should be to identify possible gaps and work out how such gaps can be closed.

Regular Certification of Exit Readiness. On a yearly basis, the service provider should be required to certify to the customer in writing that the current version of the exit plan fully reflects any changes in the services; and that an exit from the service provider and transfer of the ability to perform services to the customer and/or competent replacement provider can be efficiently conducted via the exit plan, subject to the exit plan being updated where required with information to be obtained from the customer and/or replacement provider.

Risk Management. Risk management best practice often lapses when faced with an exit situation. The service provider should provide and maintain a specific exit-related risk register. The register should cover any non-trivial risk that may adversely affect the ability of the service provider and customer jointly to execute the exit plan. Risks may be operational, technical, commercial, or legal. The customer and service provider should jointly own the agreed mitigation initiatives, which should including a time schedule and, if relevant, a price proposal.

Adjustment of Pricing and Relief of Service Provider. Customers need to be more proactive and cut service providers some slack in terms of appropriate relief from service requirements. Equally, providers ought to be more open to a graduated service transition in certain circumstances. There's no precise template for how this might occur, but transparency as to how services can be transitioned and resources released is key.

An Ombudsman as Part of Governance. The parties should agree in advance who actually controls an exit – and the customer shouldn't be surprised if the right answer is that it's the customer's job. It's vital to set the right governance forums to manage an exit. These forums may be differently constituted from the normal running, live service forums. Customers should be more prepared to own the exit process. Additionally, parties ought to consider appointing ombudsmen, either within their own organizations or independently, in order to ensure rapid and effective resolution of exit-related issues.

PAYMENT

Any gap in service provision could have disastrous consequences for a customer's business. That being the case, as a rational economic operator, a customer ought to be prepared to pay a premium if necessary to ensure

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that those consequences are avoided. So why do many customers seem to want to achieve an exit at no, or minimal, cost?

Exit charges ought to be a part of the overall financial equation for a customer, and one of the factors in its decision-making. That overall financial equation is split into two distinct parts: the initial decision to appoint an incumbent service provider and then the later decision, to possibly change providers. Part of the problem, however, seems to be that many customers often focus on the wrong part of the equation: that is, at the outset, they regard the cost of exit as a “next generation” issue but then, when the time for re-compete comes around, they regard exit costs as something that should be entirely subsumed within the original transaction cost.

The most successful exit processes are ones in which exit charges are transparent both in terms of what level of fees is payable but more particularly in terms of what will be paid – or priced into – what revenue stream.

Crucially, payment and charges should be fair and balanced between the two most commonly held views, either that customers expect an exit to be handled at no extra charge (especially in a for-cause termination) or that service providers expect to be paid at full day rates for all extra termination services.

Exit service disputes between customers and service providers often derive from lack of clarity about who bears the costs of the services to be provided, *i.e.*, whether such costs should be paid by the customer as part of the ongoing payments during the term of the contract, or paid separately as the exit services are being delivered. There are a number of permutations and variations in relation to exit services payment mechanisms, and some have led to more disputes than others.

Often, outsourcing contracts take the position that if a termination is due to a service provider’s material default, the service provider is required to provide the exit services at its own cost. The rationale is that the payments would often form part of a claim for damages anyway, and therefore the service provider may as well bear the cost up-front to save the customer having to make the damages claim. In some jurisdictions, this is considered to be market practice.

We do not generally support this approach of linking the level of exit service payments to the underlying cause of a termination. A seamless transition may be worth paying for if a business is vulnerable to service disruptions and it must be remembered that a service provider will have little incentive to deliver, or to ensure quality, if there is no payment for its services.

CONCLUSION

Our Practice Guide takes the position that the most controversial thing about the exit process should be that it ought to be uncontroversial. Of course, the parties may be wildly in disagreement about the underlying cause of the exit. Often, such disagreements are hard to avoid, with allegations and counter-threats about who is to blame. But the issue too often is that parties can’t separate their contractual antagonism from the need for cool analysis to make sure that the practical exit process runs smoothly.

In practice, there’s no silver bullet that will ensure a perfectly smooth transition in the exit phase. It’s possible to use sensible planning techniques and best practices to anticipate and avoid many of the most common problems, but there’s no magic solution and it’s not possible to legislate for every possible scenario.

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Outsourcing parties can achieve a vastly improved exit scenario by taking simple steps to recognize that, for example, continuity of services for the customer is significantly more important than saving a few dollars, euros or pounds – or that the service provider has as much need to plan its future resourcing as the customer needs certainty in services delivery.

[Download a copy of the Outsourcing Law Group Practice Guide.](#)

Contact:

Alistair Maughan

44 (0)20 7920 4066

amaughan@mofo.com

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