Acquisition Advisory Panel
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CONTRACT STRUCTURE AND CRITICAL TERMS

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Fundamental Purpose of IT and Business Process Outsourcing Contracts

- Memorialize all business terms, i.e., the allocation of legal, financial and operational responsibility and risk
- Address all known and foreseeable issues
- Provide a workable framework to manage the relationship, address future change and resolve disputes
- Provide proven contract management tools

Fundamental Purpose of IT and Business Process Outsourcing Contracts

- ITO and BPO contracts must be crafted to provide customers with tools to:
  - Retain leverage and manage change
  - Manage in-scope and new services
  - Monitor and manage service quality
  - Deliver promised cost savings
  - Provide competitive price protection
  - Manage potential liability and risk without impacting price

Critical Differences – Business Process Outsourcing Less Mature than IT Outsourcing

- Service delivery strategies and tools evolving
- Pricing models and methodologies also evolving
- Less history regarding evaluation and pricing of perceived risk
- Fewer competitive benchmarks and Standards
- Unlike ITO, not yet commoditized

Critical Differences – Greater Anxiety and Perceived Risk with Business Process Outsourcing

- Attributable to importance of outsourced functions and perceived lack of maturity
- Subject to greater legal and regulatory requirements and heightened scrutiny than IT
- Governance and control issues are critical
- Greater need for customer/supplier trust, confidence and chemistry
- Greater interest and visibility at senior levels

Eight Keys to Successful Customer-Supplier Relationship

- **ALIGNMENT OF INTERESTS:** The contract must align the interests of the customer and supplier to the extent possible
- **BARTER:** The contract must give the customer rights, such as the right to in-source or use third parties, that are of value to the supplier and can therefore be traded to obtain concessions not foreseen at contract signing

Eight Keys to a Successful Customer-Supplier Relationship

- **OPTIONS:** - The contract must ensure that the customer is never without options in dealing with the supplier. This is critical to a healthy, balanced and successful working relationship.
- “**NO SURPRISES:**” - The contract must require advance customer approval of changes that could increase the planned charges, adversely impact the Services, increase the customer’s total cost of receiving the Services, etc

Eight Keys to a Successful Customer-Supplier Relationship

- **CONTROL:** In the contract, the customer must retain sufficient control to ensure that the function continues to effectively meet your ever changing needs and objectives
- **COMPETITION**: The contract must ensure that competitive leverage is not lost after contract signing
- **VISIBILITY:** To effectively manage the relationship, the customer must have visibility into all aspects of the supplier's performance

Eight Keys to a Successful Customer-Supplier Relationship

- **GOVERNANCE/ESCALATION**: - The contract must provide an effective mechanism to manage the relationship, resolve disputes, escalate problems and retain the attention or senior supplier management
- This is especially important in a multi-vendor environment, given the need to manage the touch points and avoid finger pointing

Manage Change/Retain Leverage

- Right to use third parties or in-source -- existing and new services
- Mandatory use of customer as reference
- Termination for convenience or change of control, without punitive termination charges
- Broad customer rights to terminate for cause
- Partial termination for convenience or cause
- Exit rights/Termination Assistance

Manage Change/Retain Leverage

- Vendor right to terminate only for failure to pay
- Control of architecture and standards
- Approval/removal/incentive compensation of key vendor employees
- Approval/removal of Subcontractors
- Approval of Service Locations
- Broad Audit rights
- Right to withhold disputed charges
- Dispute resolution process

Management of Service and New Services – No "Nickel/Diming"

- Definition of Services –SOW plus:
  - Services performed by displaced customer employees
  - Services, etc. in customer base case
  - Inherent, necessary or customary services
- Definition of New Services --
  - Materially different service/significant change
  - Requested and/or approved by customer
  - Requiring materially different level of effort, resource or expense
  - Not covered by Resource Baseline or pricing methodology

Management of Service Quality

- Service levels and service level credits
- Earnback / bonus
- Right to add, modify and delete
- Periodic reviews of service levels and vendor performance
- Root cause analysis
- Continuous improvement
- Customer satisfaction surveys
- Termination rights tied to performance

Pricing–Management and Protection

- Definition of in-scope and new services
- No post-signing due diligence or price adjustment
- Standard for pricing of new services
- Variable pricing
- Right to reprioritize work of dedicated Vendor Personnel
- Treatment of Projects

Alternative Pricing Structures

- Gainsharing
- Percentage of savings (with guaranteed level of savings)
- Percentage of revenue
- Cost-plus (with risk/reward sharing)
- Value pricing

Pricing–Management and Protection

- Right to in-source or use third parties for in-scope and new services
- Benchmarking
- Specialized benchmarking
- Most favored customer
- Extraordinary events

Governance and Coordination

- Coordination with related disciplines and organizations
- Increasingly important in multi-vendor environment and with offshore providers
- Managing accountability at the seams
- Competitive concerns among suppliers

Initial Term

- Typically 5, 7 or 10 Years
- Business process outsourcings tend to be shorter than IT outsourcings
- Key drivers: supplier investment to be amortized over term, perceived risk, availability of more favorable pricing, renewal rights and termination charges

Exit Rights

- Right to continue Services for up to 12-18 months on same terms, including pricing and service levels
- Right to hire vendor employees
- Right, but not obligation, to purchase substantially dedicated equipment
- Right, but not obligation, to software and third party contracts, unless exception agreed to in advance

Limitations of Liability

- Exclusion of consequential damages
- Liability cap – typically 12 months, but up to 24 months, trailing revenue
- Exceptions to liability cap and consequential damages exclusion, e.g.:
  - Gross negligence, willful misconduct or fraud
  - Indemnification claims
  - Refusal to perform
  - Breaches of representations and warranties

Limitations of Liability

- Items not considered damages (e.g., service level credits, deliverable credits, invoiced charges, withheld charges)
- Acknowledged direct damages (e.g., cover damages, cost of re-procurement, government fines/penalties)
- Right to terminate if liability exceeds 80-90% of cap and supplier refuses to waive and/or refresh cap

QUESTIONS?