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# Building Successful Outsourcing Relationships

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The success of any outsourcing program hinges on the relationship between the company and vendor. But all too often companies that outsource functions previously performed in-house treat their former capability as a costly burden they can't forget about soon enough—or at least not until the vendor misses a crucial deadline.

The better approach is to view an outsourcing relationship as a joint venture, where the company helps ensure success by arming the vendor with the proper tools and information to get the job done correctly. Among the most important tools is a clear, precise, and highly detailed contract that not only specifies the financial terms, but also allocates risks, lays out expectations, and anticipates potential problems. Some of the key issues that you and your vendor should address in a contract include:

## IP Protection

Whenever outsourcing involves sharing or developing proprietary software or other intellectual property, there is potential for dispute or outright theft, which is why you need to determine the extent to which local law protects IP before entering into an outsourcing arrangement. Popular outsourcing locations such as China, Russia, and Mexico have some of the weakest intellectual property laws, so make sure your outsourcing agreement has a well-drafted, bullet-proof intellectual property provision. It should clearly establish ownership of pre-existing IP as well as IP that is developed or improved during the course of the

outsourcing relationship. The provision should also restrict the vendor from disclosing any proprietary software or other information. Use the following checklist to help draft such an IP provision:

- Define the intellectual property to be protected.
- After determining what legal protections the laws of the host country provide, include an affirmative representation and warranty of the vendor to adhere to those laws. (Do not, however, limit yourself to the protections afforded by local law; be as broad as applicable law will allow.)
- Define the parties that will be subject to a non-disclosure agreement.
- Specify exactly which activities are prohibited under the non-disclosure agreement.
- Include strong penalties for breach of the IP provisions.
- Specify which country's laws govern the agreement.

## Data Protection

For those interested in outsourcing HR functions or customer service capabilities, the protection of customer or employee data, particularly when it comes to transferring personally identifiable information internationally, has emerged as a major challenge due to a growing number of cross-border restrictions. Therefore, make sure your outsourcing

agreement requires the vendor to adhere to the data protection laws of the host country. If the host country does not have sophisticated data protection laws, consider requiring the vendor to adhere to the laws of another, more developed jurisdiction, such as the European Union. Finally, the most widely accepted basis for permitting the transfer of information, regardless of jurisdiction, is if the originating company has obtained the data subject's consent. Therefore, obtain written consent from the data subject prior to transferring information to a third-party vendor.

### Subcontracting

One matter that often gets overlooked when drafting outsourcing agreements is subcontracting rights. While it's not unusual for vendors to turn to subcontractors to assist with a project, it's also not unusual for the vendor to subcontract one or more functions without notifying you. To protect yourself, always be sure that your agreement includes a section on subcontracting rights that carefully spells out when and where the vendor can subcontract. Be sure to include the following provisions:

- Make sure the vendor can only subcontract with your written consent.
- Retain the right to review the terms of a subcontracting arrangement before it is entered into.
- Require the vendor to remain contractually liable for the functions that are subcontracted.
- Require that, at the very least, the subcontractor's level of service, systems, and control must be on par with that of the vendor.
- Retain the right to establish specific parameters or prerequisites for any subcontractor, such as those you might create if you were to hire the subcontractor yourself.
- Require the subcontractor to be subject to the terms and conditions of the IP provisions of the outsourcing agreement.
- Require that the subcontractor hold you harmless and indemnify you for any acts or omissions of the subcontractor.

Finally, while most companies contract the right to periodically oversee the vendor into the terms of the outsourcing agreement, most never consider requiring oversight of a subcontractor as a condition to subcontracting. However, oversight of the subcontractor should be a condition to subcontracting and should be drafted into the outsourcing agreement if you want to best protect your interests.

### Dispute Resolution

Litigation of disputes with a vendor can prove to be your most costly expense when outsourcing. Take, for example, a large US pharmaceutical company which has a dispute with its offshore vendor in Prague. The company decides to bring a lawsuit against the vendor near its Austin, Texas corporate headquarters. However, the company soon learns that under Czech law, all disputes involving Czech companies must be litigated in The Czech Republic absent express agreement otherwise by the contracting parties. Suddenly, the company is forced to find Czech counsel to handle the lawsuit and budget an expensive overseas litigation.

To avoid this type of situation, ensure that your outsourcing agreement properly addresses how disputes will be resolved. This is particularly important when dealing with offshore contracts in jurisdictions such as Russia, China, and the Philippines, where legal systems are not yet fully mature. But wherever the vendor is based, the outsourcing agreement must properly address how disputes will be resolved, which laws should govern the contract, and where disputes will be adjudicated. Consider requiring disputes be arbitrated by a reputable arbitral forum, thereby avoiding courts. The major international commercial arbitration organizations with years of experience include the International Chamber of Commerce in Paris, the London Court of International Arbitration and the American Arbitration Association.

### Indemnification

Unfortunately, not all vendors are always as keen to comply with local law as you. In order to ensure that you aren't left paying for your vendor's liability as a result of negligent or willful conduct, include an

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indemnity provision in your outsourcing agreement. Such a provision should achieve two purposes. First, it should clearly establish that you are not liable for the acts or omissions of the vendor. Second, it should provide for a broad indemnity provision to insulate your company in case an aggrieved third-party decides to include you in any civil or criminal actions.

### Exit Strategy

One reason why outsourcing has become so popular is that it enables a company to respond quickly to changing market needs. However, a change in the geopolitical climate or change in the company's focus or profitability could necessitate the need to terminate an outsourcing relationship. Moreover, a well-established vendor could suddenly fold or otherwise become unable to perform, forcing you to change vendors at a moment's notice. Be sure, therefore, to develop an adequate exit strategy that takes into account how long it will take you to transition the outsourced business functions back to your home office or to another local vendor. Give yourself the right to terminate the outsourcing agreement early in case things go awry. Also, require the vendor to cooperate with you (and the new vendor) during the transition phase leading up to and following termination of the outsourcing agreement. Finally, consider giving yourself the option to acquire key resources of the vendor to ensure a smooth transition process and retention of key assets.

### Statement of Work

While an outsourcing agreement stipulates the contractual terms such as those outlined above, you should also include a comprehensive statement of work, which specifies the exact tasks to be performed and provides the technical details necessary for the vendor to perform those tasks successfully. Generally an appendix to the outsourcing agreement, the statement of work is usually several hundred pages long, and serves as a blueprint for the vendor to follow. Basically, the statement of work says what exactly it is you want and the manner in which you expect the products or services to be rendered.

Any company considering outsourcing one or more functions should also review exactly what your in-house capability currently provides, as well as what level of service you receive and how success is measured before any outsourcing relationship commences. Too often companies tell vendors that they want the same level of service they currently have, but lack specifics as to what that entails.

### Stay Involved

Clearly a carefully crafted agreement and detailed statement of work can go a long way in reducing potential problems. But the dialogue with your vendor should not end there. You must stay involved, keep lines of communication open, and never lose sight of the common goal that binds you and your vendor together. One way to achieve this is maintain at least one senior-level manager in-house to serve as a liaison between you and the vendor and closely monitor the work being done. Smart oversight by a knowledgeable, experienced manager who speaks the same technical language as the vendor and knows first-hand what it takes to deliver on a particular project can help keep your outsourcing relationship on track.



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