

Subsequent-generation outsourcing

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Many of the first-generation outsourcing contracts entered into in the 1990s have now expired or are coming to an end. The outsourcing contracts which have replaced these deals, and the newer-generation, first-time deals are typically of a shorter duration than before.

As a consequence, lawyers are increasingly advising on second and subsequent-generation outsourcing transactions, and on the issues the parties to the deal need to consider to ensure a smooth transition between outgoing and incoming suppliers. While most of the issues relevant to first-time outsourcings will apply to subsequent-generation deals, a number of important additional considerations also need to be addressed.

This note focuses on the issues which are specific to subsequent-generation outsourcing deals, and to any re-tendering exercise or service transfer arrangements from an outgoing to an incoming supplier. For further information on outsourcing generally, and the issues involved, see *Practice notes, Outsourcing: detailed overview, Outsourcing: tax and Employment issues on outsourcing*.

Preliminary considerations: customer options

When an outsourcing contract is due to come to an end, the customer will have a number of options, including extending the existing arrangements with the incumbent supplier; insourcing (where the outsourced services are taken back in-house by the customer); and re-tendering the services, or parts of them.

Increasingly, customers are opting for a combination of these alternatives.

Extension of existing arrangements with incumbent supplier

Extension or renewal of the existing relationship with the incumbent supplier will normally be the most straightforward and lowest risk option. Clearly, any decision to continue with the incumbent supplier will depend on a range of factors, not least the state of the customer's relationship with the incumbent, the level of satisfaction within the customer's organisation with the services being provided, and the incumbent's performance generally, under the existing contract.

Where an extension or renewal of the arrangements with the incumbent is being considered, it is unlikely that the customer will want to extend the arrangements on the terms of the then-current deal. Normally, the customer will seek to renegotiate the existing deal in order to take account of any changes in the customer's business strategies and requirements; to ensure that the customer gets the benefit of any industry trends and developments since the time the original contract was let; and to ensure that the pricing, service levels, supplier accountability, and other key commercial, operational and legal terms compare favourably with then-current market trends.

To ensure that the customer is renegotiating from a position of strength, the timing of these renegotiations are key. If

left too late, the customer is unlikely to have any genuine sourcing alternative, and will find itself with little or no leverage in the renegotiations. As a rule of thumb, and on the basis that a renegotiation will typically take between three to six months and a full re-tendering exercise between 12 and 18 months, starting renegotiations any later than 18 to 24 months before expiry of the current deal is likely to mean that the customer's negotiating leverage is significantly reduced. If, on the other hand, renegotiations are started early, the customer should still be in a position to adopt an alternative sourcing solution if renegotiations with the incumbent are unsuccessful.

Re-tendering the services

If a decision is taken not to bring the services back in-house and not to extend or renew the existing contract, the customer will need to consider the basis on which the services are to be re-tendered. In particular, the customer will need to consider whether the services are to be re-tendered as is, or whether some re-structuring and re-engineering of the services will be required. Increasingly, as part of the re-tendering exercise, customers will elect to split previously bundled services into separate service components. Some of these components may be brought back in-house by the customer, some may be offshored, while others still may be tendered among multiple specialist suppliers.

Service unbundling: single and multi-source arrangements

The decision whether to unbundle services as part of the re-tender exercise is complex, involving a large number of commercial, operational and financial considerations. These will, of course, be further complicated if elements are to be provided from offshore locations, or otherwise involve multiple jurisdictions. *(For more information on these two elements, see Practice notes, Offshore outsourcing and Multi-jurisdictional outsourcing)*

The unbundling of single-source arrangements is, however, increasingly common in the larger-scale outsourcing deals which are up for renewal, and is particularly common in some of the large-scale IT outsourcing contracts signed in the late 1990s. Many of these have been, or are in the process of being, replaced by so-called "smart-sourcing" or "right-sourcing" arrangements, under which customers will outsource discrete elements of the services bundle to a number of different suppliers. One of the key attractions of a multi-sourcing approach is the flexibility it gives customers over its choice of supplier, and the ability to appoint "best-of-breed" suppliers for each of the various service components.

Multi-sourcing does, however, raise a number of challenges, particularly where the services being multi-sourced are interconnected. In this scenario, the customer will need to ensure that the outsourcing contract with each supplier contains appropriate "interface" provisions, requiring each of the suppliers to co-operate with each other and to work together to ensure a seamless delivery of the various service components. In the multi-source environment, the customer will want to ensure that as many of the contract processes as possible are standardised, including governance, change control, and dispute resolution. The contracts will also need to include appropriate terms requiring each of the suppliers to participate, if necessary, in the governance, change control, and dispute resolution processes under the customer's arrangements with connected suppliers.

The contracts will also need to address the level of co-operation and assistance to be provided by each supplier, and include provisions enabling the customer to disclose each supplier's confidential information to the other connected suppliers (some of whom may be competitors) where necessary to facilitate delivery of the other service components. From the suppliers' standpoint, the contracts should clearly document the terms on which any such disclosure can be made, and should include limits on the type of information which may be disclosed - many suppliers, for example, will insist on a prohibition on the disclosure of its proprietary methodologies and tools. Suppliers will also wish to ensure that any disclosure of information is subject to strict confidentiality undertakings which limit the purposes for which any information disclosed may be used, and the steps recipients must take to protect the confidentiality of any disclosed information.

A further difficulty with multi-sourcing solutions for interconnected services is that, unless a special contracting structure is adopted, the customer will have no single point of responsibility for end-to-end delivery of the services. One way of addressing this issue is to engage one of the suppliers (often the supplier responsible for providing the principal services component) in a prime contractor capacity, requiring it to take responsibility for the performance of each of the other suppliers. While this has the advantage of giving the customer a single point of responsibility for failure of any part of the services, in practice it can be difficult to get one of the suppliers to perform this prime contractor role (particularly if the other suppliers are competitors). Any supplier who agrees to take on this role is likely to build a significant premium into its charges.

Incumbent's involvement in the re-tendering process

The incumbent's co-operation and assistance during the re-tender process (and regardless of whether a single or multi-source approach is chosen) will be a key factor in the success, or otherwise, of the

re-tendering exercise. An initial, and important, consideration for the customer will be whether or not to encourage the incumbent supplier to pitch for the services. This will inevitably depend on the customer's relationship with the incumbent supplier, and how well the incumbent has performed under the existing contract.

One of the key advantages of the incumbent bidding for the services is that it will give the customer a meaningful understanding of what it is likely to take to provide the services (in terms of personnel and assets, for example) and the cost of doing so, against which the tenders from other bidders can be benchmarked and appraised.

This approach does, however, have potential drawbacks. In particular, the incumbent will, in all likelihood, be in a better position than other prospective suppliers to bid for the services - it understands how the customer's business works and how the services are currently being delivered, and the incumbent's personnel are being used to deliver the services. In these circumstances, unless the customer takes steps to create a level playing field between the incumbent and prospective suppliers, and to persuade prospective bidders that the re-tendering exercise is genuine (and not just a benchmarking or market-testing exercise on the customer's part), it is unlikely that those other prospective suppliers will find bidding for the services an attractive option and, consequently, will lack the incentive to invest the time and resource in putting together a meaningful bid.

A number of steps can be taken to help create this level playing field. First, the customer should consider whether it is necessary or appropriate to require the incumbent to create a Chinese wall within its organisation to separate the incumbent's operational and delivery teams from its bid team. While there are limitations on the customer's ability to police compliance with this requirement, the prospect of the incumbent being removed from the bid process, together with the negative impact that non-compliance would inevitably have on the

incumbent's reputation in the market, means that Chinese wall arrangements can be an effective way of helping create a more level playing field between the incumbent and the other prospective bidders.

Second, steps should be taken to ensure that, to the maximum extent possible, each bidder has access to the same information as the incumbent (taking into account any Chinese wall arrangements which have been put in place within the incumbent's organisation). This issue can be addressed as part of the review of the contract with the incumbent supplier referred to in *Reviewing the outsourcing agreement with the existing supplier* below.

Finally in this respect, prospective bidders are much more likely to view the re-tendering exercise as genuine, and not just an opportunity for the customer to benchmark or market-test the incumbent's current offering, if it is apparent that the customer is taking the re-tendering process seriously. This will mean the customer investing considerable time in preparing a detailed invitation to tender, taking appropriate steps to ensure a level playing field between all bidders, and investing the time and resources needed, during all phases of the re-tendering process, to give all bidders a genuine opportunity to submit a competitive bid.

Reviewing the outsourcing agreement with the existing supplier

As noted above, one of the keys to a successful re-tendering exercise will be securing the incumbent's co-operation and assistance during the tender process. In order to achieve this objective, it is important that the customer undertakes a review of its existing contract terms with the incumbent, in advance of any re-tendering exercise. The purpose of this review will be to ensure that the contract contains the provisions needed to allow the customer to take steps to create a level playing field for all bidders; to ensure that the incumbent is required to provide the necessary degree of co-operation and assistance in the preparation of the invitation to tender, and the re-tender process

generally; and to ensure that the incumbent's obligations on termination and the provision of exit assistance have been properly captured and documented.

If (as is frequently the case with first-generation contracts), the contract does not contain provisions allowing each of these objectives to be met, the customer may wish to renegotiate the relevant terms. This will need to be done at a time when the customer has some negotiating leverage with the incumbent, and the incumbent is incentivised to negotiate - commencing negotiations after the incumbent has been told that it will not be invited to bid, for example, is unlikely make for an easy or straightforward renegotiation of the relevant terms. If it is not possible to renegotiate any unsatisfactory terms at this stage, the customer may simply agree with the incumbent to address particular matters in a different way from the approach set out in the contract on a one-off basis, or otherwise seek a derogation from the contract in the particular circumstances.

Areas of the contract which should be reviewed by the customer and which may, if possible, need to be renegotiated include:

Provision of information

This should include an analysis of what information must be provided by the incumbent supplier, by when and in what form. Frequently (and particularly in relation to many first-generation contracts), the incumbent will be under an obligation to supply the information needed only after notice of termination has been served. While this will assist in relation to transition to the replacement supplier, once selected, it will not enable the customer to disclose the information to bidders during the re-tendering process. This may impact on the preparation of the invitation to tender and on the bidders' ability to prepare and submit competitive bids. The contract should, therefore, be amended, if necessary, to ensure that the requisite information is provided in advance of the re-tendering exercise, and that this information can be disclosed by the customer, not only to the chosen replacement supplier, but also to

prospective bidders. In this respect, the confidentiality provisions of the contract should also be checked to ensure that there are no restrictions which will inhibit the customer's ability to run a proper re-tendering process. The customer should also consider whether access to key supplier staff in relation to the provision of information is likely to be required. The incumbent will understandably have concerns about disclosure of its confidential information to potential competitors, and is likely to require limits on the nature of the information which can be disclosed to the bidders (and, as noted above, many suppliers will, as a minimum, refuse to disclose their proprietary service delivery methodologies and tools). The incumbent may also require the bidders to give strict confidentiality undertakings before the information can be disclosed.

Access rights

Similarly, prospective bidders may require access to the assets, premises and third party contracts used by the incumbent to provide the services to enable the bidders to prepare their bid, to price the services, and to assess whether they can meet or exceed the target service levels. These access rights will need to be built into the contract. Again, the incumbent will have concerns about the scope of any such access rights, particularly where the assets or premises are used to provide services to multiple customers. Frequently, the incumbent will require any prospective bidder to whom access rights are to be granted to enter into a directly enforceable agreement with the incumbent, setting out the scope of any access, the terms on which it is granted, and the consequences of any failure by a bidder to comply with those terms and conditions, including an immediate ability to suspend access rights, and indemnity protection against any losses suffered. In addition, the incumbent will need to review the terms of its contracts with third parties to determine whether, and to what extent, the terms of those contracts can be disclosed as part of the tender process.

Co-operation in the re-tendering process

Since much of the information relating to the customer's outsourced business and the outsourced services will now be in the hands of the incumbent, its input and assistance in preparation of the invitation to tender will be critical. Appropriate terms should be included in the contract setting out the incumbent's obligations in relation to preparation of the invitation to tender, and participation in the re-tendering process generally. The level of involvement likely to be required is considered in more detail in *Invitation to tender* below.

Intellectual property rights

It will be necessary to look in detail at the intellectual property provisions in the existing contract. Who owns the intellectual property rights in any materials which are needed to provide or receive the services post termination? Who, for example, owns the intellectual property rights in the procedures manuals? Are there obligations in the contract to keep these up to date (and, if so, has this been done?) and can these manuals be transferred to an incoming supplier for use in the provision of the services? Is there any software or other technology which is proprietary to the incumbent (and which is not commercially available), and in respect of which the customer will require ongoing usage rights? If so, the terms on which any such licence is to be granted will need to be agreed, and the customer will need to consider whether any replacement supplier will require usage rights. Where appropriate terms cannot be agreed, alternative approaches will need to be considered, including the replacement of these proprietary tools and technologies with commercially available alternatives. If this approach is adopted, will the incumbent be entitled to charge for the work involved in doing this?

Exit management and dealing with handover

The parties' respective obligations during the exit phase will typically be addressed in a detailed exit management

plan. While a skeleton form plan will often be included at the time of contract signature, this will need to be updated regularly throughout the life of the contract and, in particular, after notice of termination has been served, to take account of any changes to the services, the service delivery methods, and the customer's business during the life of the agreement. It will, therefore, be necessary for the parties to review the exit management plan in detail to ensure that it has been updated to address handover of the services as these exist at the time of exit. The following issues will need to be considered:

- Are the obligations of the incumbent, the customer and the replacement supplier on exit clear?
- Is it clear what information the incumbent must provide to the replacement supplier as to how the services are currently delivered, including access to technical specifications where appropriate?
- Does the customer have rights to extend the provision of the services by the incumbent beyond the original termination date if the arrangements with the replacement supplier have not been finalised?
- Does the contract address the costs of handover and assistance in relation to transition, including any applicable rates where assistance is chargeable?
- Are the third party contracts, assets and other items which are to transfer to the replacement supplier adequately identified? Is it clear who is to have responsibility for obtaining any third party consents needed to facilitate these transfers?

TUPE and other employment issues

Another important element which will need to be considered is the employment provisions which will apply on or in relation to any exit. Regardless of what is stated in the contract, the employment of employees may pass from the incumbent to the replacement supplier pursuant to the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). However, the contract should,

in any event, deal with or include the following matters:

- The identity of staff who will transfer.
- How employment liabilities are to be addressed.
- The apportionment of employment costs.
- The pension aspects.
- Provisions dealing with any redundancies or reorganisations.
- Limitations in respect of the period leading up to the termination of the contract (such as the hiring of new staff or changing the terms and conditions of employment of existing staff, and restrictions on the removal of staff from the services during the notice period).
- Provisions conferring the benefit of relevant protection on the incoming supplier.

For more details of what may be included in an outsourcing contract in relation to employment matters, see *Standard document, Outsourcing agreement: long form and its accompanying drafting note*.

As many of the contracts now coming to an end will have been negotiated before the TUPE 2006 regulations came into force, they will have been drafted in light of the TUPE 1981 regulations, under which it was, to some extent, less clear whether TUPE applied to an outsourcing arrangement. Accordingly, many of these contracts may contain wording about what is to happen to employees regardless of whether TUPE applies, for example, in relation to the customer or a replacement supplier offering employees of the outgoing supplier contracts of employment on the same terms. The customer will need to review how these matters are addressed in the contract and how those provisions apply in the light of the new TUPE regulations. The customer will also need to establish its general strategy and approach in relation to communications issues with employees, as well as skills and employee transfer issues generally. For more details on em-

ployment matters generally in relation to outsourcing, see *Practice note, Employment issues on outsourcing*. See also *Human resources issues* below.

Warranties and indemnities on exit

The warranties and indemnities given by or to the incumbent supplier on exit will need careful consideration. Will the incumbent provide any indemnities in relation to possible redundancies, pensions matters or other employment liabilities, for example? Any potential liabilities in relation to the warranties and indemnities may need to be factored into the ongoing costs of the service for the replacement supplier if it may potentially be called on to meet these liabilities.

Costs on exit

Some outsourcing contracts provide for the costs of transitional assistance given by the incumbent supplier to be charged on a time-and-materials basis. In practice, whether or not the incumbent can charge for the provision of transitional assistance will depend on the reason for termination, and the level of assistance required. Typically, customers will expect a reasonable level of transitional assistance to be included in the contract charges, especially where the contract runs its course (rather than terminates early), or where it is terminated for the supplier's breach. Where termination assistance is chargeable, the applicable rates should be agreed before transition begins.

Third party contracts

The position in relation to third party contracts which are necessary for the provision of the services needs to be addressed. Can those contracts be transferred and, if so, at what cost? Who will be responsible for paying any associated transfer costs? Do the provisions permit the transfer of these contracts to the replacement supplier? If not, who is responsible for procuring any consents needed?

Asset transfer

If any assets are to be transferred from the incumbent to the replacement supplier, on what terms will these be transferred? The replacement supplier will wish to have an opportunity to inspect the relevant assets in order to determine whether it wishes to buy them and, if so, to agree the appropriate purchase price. Will the incumbent give warranties as to the suitability, performance and/or quality of the transferring assets, or will these be transferred on an as-is basis? This is likely to depend on the terms of the original contract between the customer and the incumbent, whether the replacement supplier has been given an opportunity to properly perform due diligence on those assets, and the price that the replacement supplier is paying for those assets.

The invitation to tender

In any competitive tendering exercise, the customer will need to prepare a detailed invitation to tender (ITT), setting out details of the services and operations to be transferred, the customer's requirements in respect of those services, and the criteria against which tenders will be evaluated. (*For an example of an invitation to tender document, see Standard document, Invitation to tender.*)

For subsequent-generation outsourcings, much of this information will be in the hands of the incumbent supplier. Even if the contract with the incumbent requires it to provide the customer with all information needed to prepare the ITT, in practice, the customer will still be dependent on the incumbent and its personnel to help prepare and complete the ITT. Where the incumbent is involved in the preparation of the ITT, it is important to ensure that the criteria against which the bids will be evaluated are not weighted so as to favour the incumbent's bid.

The customer will also need to consider how much information is to be included in the ITT in relation to the existing services, such as the service levels being achieved, and the number of staff (or

full-time equivalents) currently providing the services. Many customers will take the view that they do not wish to unduly influence the proposals of any bidders by specifying existing service and staffing levels (as bidders may then fix their proposed staffing levels accordingly). As a general rule, however, the more information that can be provided to bidders the better; bidders can still be asked for their recommendations as to whether the services or staffing levels should be changed, and whether other improvements can be made to the existing services and service delivery methodology.

Bidders will need to assess in detail the information provided in the ITT in order to decide whether or not to bid for the services and in order to prepare its response. Where the incumbent is bidding, the provision of detailed information in the ITT is of particular importance to other bidders to help convince them that a level playing field has been created, and that the re-tendering process is not being used by the customer merely as a benchmarking or market-testing exercise, where it has every intention of renewing its contract with the incumbent. With this in mind, the more detail and effort that goes into the ITT, the more likely it is that genuine, like-for-like offers will be elicited from the marketplace.

Due diligence by bidders

As part of the due diligence to be undertaken by bidders, a data room will often be set up, with copies of relevant documentation, such as service level statistics, an assets register, and third party contracts. As part of this process, it may be necessary for the incumbent to provide some or all of this information, and it may be necessary for bidders to visit and have access to the sites from which the incumbent provides the services. This will raise concerns for the incumbent, particularly where those sites are used to provide services to multiple customers. The customer will need to recognise that a supplier is likely to insist on certain undertakings and assurances from the customer and each of the bidders before granting access to its sites. In addition,

bidders may wish to interview the incumbent supplier's employees in relation to the provision of the services, although this is often resisted by suppliers.

Finally, in some cases, the incumbent will be asked to make presentations to bidders on the services, for example, at a bidders' conference.

Appointment of a replacement supplier

If a replacement supplier is selected, the transition process will need to be carefully managed to ensure a smooth handover from the outgoing to the incoming supplier.

The transition and handover activities will vary significantly, depending on the readiness of the services to be transferred, and how active a role the outgoing supplier is playing in the transition process. Many of these handover activities will be addressed in an implementation plan that has been drawn up by the replacement supplier and the customer, and included in the outsourcing contract with the replacement supplier. For more details of what may be included in an implementation plan, see *Standard document, Outsourcing agreement: long form and its accompanying drafting note*.

A key issue for the customer will be to ensure that the outgoing supplier's exit management plan and the replacement supplier's transition plan dovetail with each other, and are consistent, including in terms of activities, timescales and allocation of roles and responsibilities. Is it clear, for example, which of the outgoing and incoming suppliers is responsible for matters such as updating the procedures manuals, and preparing the asset inventories and lists of third party contracts to be transferred if this has not already been achieved?

From the incoming supplier's perspective, it will wish to ensure that any obligations which need to be fulfilled prior to handover, such as the drawing up of procedures manuals to be used or handed over, have already been undertaken, and that it is not taking on any backlogs of

work which should already have been completed (whether by the outgoing supplier or the customer) without being able to charge for such additional matters.

It is important for the customer not to lose sight of its day-to-day operational needs and the delivery of the services during the transition period, and to ensure that any potential deterioration in services during this period is addressed. Where the outgoing supplier is required to provide significant assistance during exit, it may legitimately raise concerns about its ability to provide this assistance while, at the same time, continuing to provide the services and meet the service levels. This issue may be overcome by the customer paying for the allocation of additional staff to the services and/or by closer monitoring of service levels during this period. In any event, and as a practical matter, most outgoing suppliers will wish to act responsibly during the exit period and to work with customers and the replacement supplier to ensure a smooth handover is achieved.

Human resources issues

One of the main changes brought about by TUPE 2006 was to make it more likely that an outsourcing will be a "relevant transfer". Under TUPE 2006, a "relevant transfer" occurs where either:

- There is a transfer of a business, undertaking or part of a business or undertaking which is a transfer of an economic entity that retains its identity (a business transfer) (*regulation 3(1)(a), TUPE 2006*); or
- A client engages a contractor to do work on its behalf, reassigns such a contract or brings the work "in-house" (a service provision change) (*regulation 3(1)(b), TUPE 2006 and regulation 3, Northern Ireland Regulations*).

For more information, see *Practice note, Employment issues on outsourcing*.

A considerable proportion of subsequent-generation outsourcing transactions will constitute a relevant transfer to which TUPE will apply. Accordingly, em-

ployees will transfer by operation of law from the incumbent to the replacement supplier and the various obligations in relation to informing and consulting, harmonising their terms and conditions and providing employee information will need to be addressed.

One of the main changes made by TUPE 2006 was to introduce an obligation on the transferor to provide certain information, such as the identity of the employees who will transfer together with details of any recent claims or potential claims (*see Practice note, TUPE transfers: Business transfers*). The information only needs to be provided, however, at least 14 days before the transfer, which in turn means that it may be of limited value in the context of a second-generation outsourcing, where parties are often required to fix prices well in advance of the transfer date (unless the information provided in accordance with the regulation turns out to be incorrect, in which case a just and equitable award can be made against the transferor).

The changes made by TUPE 2006 do not, however, extend to obliging the outgoing supplier to indemnify the incoming supplier for liabilities for acts and omissions which may transfer. Nor do the revised regulations oblige the outgoing supplier to refrain from making changes to terms and conditions or the identity of transferring staff during the period leading up to the transfer (provided that the transferor complies with its information obligations - see previous paragraph). This means that there is nothing to prevent the outgoing supplier introducing some form of "poison pill" (such as a special bonus payment) with a view to putting off incoming suppliers. By the same token, there is nothing to stop the outgoing supplier assigning poorly qualified or inexperienced staff to the contract, which is more commonly known as "social dumping".

It will be important, therefore, to carefully review the contract with the existing supplier to see whether such matters are covered, and, if so, whether the contract does so in a manner which can be enforced for the benefit of the replacement supplier or suppliers. This may oc-

cur by the contractual terms giving the replacement supplier the right to enforce the contractual protection directly (whether under the third party rights legislation or by, for example, requiring the outgoing supplier to enter into some form of commitment with the replacement supplier, such as a deed of indemnity). Alternatively, the contract may provide that the customer may confer the benefit of the contractual arrangement on a replacement supplier, and that any loss incurred pursuant to the terms of such secondary arrangement will be taken into account for the purpose of calculating any loss under the original contractual provisions.

The customer needs to endeavour to make sure that it does not confer any benefit on a replacement supplier in respect of which it cannot obtain back-to-back protection from the incumbent. This means that the terms of the subsequent-generation contract will have to mirror certain aspects of the contract with the outgoing supplier.

Difficulties arise where the replacement supplier demands protection (often legitimately in the light of the concerns which can arise under TUPE) beyond that conferred by the contract with the outgoing supplier. In these circumstances, the customer may simply be prepared to risk taking on these potential liabilities itself. If not, the matter is likely to become a pricing issue, with the replacement supplier "risk pricing" for the potential of a claim. It should be noted that the customer will often be on the back foot in these circumstances, as the matter properly could have been avoided if the earlier-generation contract had adequately covered the issue in the first place. As such, many customers who believe that they can simply step back in such circumstances are in for a rude awakening, particularly as a considerable proportion of first-generation contracts do not make adequate provision for exit.

A further consideration is that many parties will expect the provisions relating to the commencement of subsequent-generation outsourcing and the exit from it to be reciprocal. This means that persuading the replacement supplier to sim-

ply take a risk may not be prudent if this means that the difficulties arising from the earlier-generation contract will be perpetuated when the subsequent-generation contract comes to an end. In turn, if is often advisable for the customer to endeavour to ensure that the subsequent-generation contract is more comprehensive, even if this involves an element of pain in terms of correcting the issues arising from the earlier contract.

The outsourcing contract with the replacement supplier

The form of outsourcing contract for a second or subsequent-generation outsourcing transaction will be very similar to a first-generation outsourcing agreement, although certain specific issues, as detailed below, will need to be addressed, and the customer will inevitably have learnt valuable lessons as part of the re-tendering and transition processes, which it will wish to factor into the subsequent-generation contract.

For examples of outsourcing agreements which may be used and adapted for use in a second or subsequent-generation outsourcing, see *Standard documents, Outsourcing agreement: long form and Outsourcing agreement: shorter form*.

Areas of the contract which need particular attention in relation to a second or subsequent-generation outsourcing include:

Employment warranties

The customer is unlikely to be able to provide any warranties in relation to the staff transferring from the outgoing to the replacement supplier. However, increasingly, customers are requiring that the benefit of any employee warranties and indemnities given by the outgoing supplier on exit, will automatically extend for the benefit of a replacement supplier, as well as the customer. (*See also Human resources issues above.*)

Third party contracts

As third party contracts may need to transfer from the outgoing to incoming supplier, rather than from the customer,

this area may need particular attention. Typically, the contract will require both the customer and the replacement supplier to take steps to procure the transfer of these contracts to the replacement supplier. This may, for example, involve the parties leveraging existing relationships with those third parties in order to achieve the transfer. Where transfer charges are payable, the parties will need to agree, in advance, who will bear those charges. Where a transfer is not possible, or not possible on terms acceptable to the customer and replacement supplier (for example, where an unreasonable transfer charge is being levied by the other contracting party), the outsourcing contract will need to include appropriate provisions to deal with this. The parties will need to pay particular attention to any impact that this will have on pricing and charges. For example, where the third party contract cannot be transferred to the replacement supplier, will this result in an increase in the termination charges which the customer is required to pay to the outgoing supplier (on the basis that the ongoing payment obligations under that contract will remain with the outgoing supplier)? In addition, the replacement supplier will need to consider the impact that any failure to obtain the benefit of a third party contract will have on its ability to deliver the services and/or the price at which the services are to be delivered.

Exit

Addressing what is to happen on exit will be an important factor in any outsourcing negotiation. The provisions relating to the commencement of subsequent-generation outsourcing and the exit from it will often not be reciprocal and the contract may need to provide increased flexibility for the future. This may mean, for example, addressing the re-tendering and exit in relation to parts of the services which in many cases have not been adequately addressed in earlier-generation deals. What is clear is that all outsourcing contracts should, as far as possible, include the flexibility to re-tender and transfer all or parts of the services to different suppliers or back in-house on exit, to address the likely changes required by future-generation outsourcing deals.