Making a clean exit:
Planning for an outsourcing exit

Paul O’Hare and Kathryn Dooks (Kemp Little)

Alison Haigh and Nick Cole (UK Asset Resolution)
Overview of today’s presentations

Using the contract process and contract terms to plan for a successful exit

– Paul O’Hare, Head of Outsourcing, Kemp Little

TUPE and other personnel-related issues on exit

– Kathryn Dooks, Employment Partner, Kemp Little

Coffee/networking break

Exit in practice: UKAR’s experiences of a recent major ITO exit

– Alison Haigh, Head of Procurement, UK Asset Resolution
– Nick Cole, IT Procurement Manager, UK Asset Resolution
USING THE CONTRACT PROCESS AND CONTRACT TERMS TO PLAN FOR A SUCCESSFUL EXIT

PAUL O’HARE – HEAD OF OUTSOURCING
Using the contract/contract process to plan for a smooth exit

Introduction

– Exit planning – why does it matter?
– Astrazeneca v IBM – key issues under dispute

Planning for exit

- Pre-contract considerations
- Transition-in and post-go live
- Termination triggers
- Exit phase
Introduction:
Exit planning - why does it matter?

Cannot assume that supplier will co-operate voluntarily on an exit – especially if acrimonious reason for termination

- Likely to involve co-operation with competitor
- Final opportunity to earn revenue from the account
- May provide leverage in any dispute
- Nothing to lose – if acrimonious exit

Vs

- Potential of future/other business
- Threat to reputation if not co-operative

Recent indications that suppliers may be less concerned about risk of reputational damage

- Ericsson v Hutchison 3G (2010)
- AstraZeneca v IBM (2011)
Exit planning
Overview of issues in dispute in AstraZeneca v IBM

Background facts

- MSA for provision of global data centre hosting and related services in 2007
- AstraZeneca terminated MSA for cause in 2011 (which IBM disputed)
- Disputes arose as to scope, timing and price of termination assistance services to be provided by IBM
- MSA, Exit Schedule and Exit Plan contained parties’ rights and obligations in relation to termination and termination assistance
- Migration to replacement supplier delayed, and took more than 12 months from notice of termination
Exit planning
AstraZeneca v IBM: overview of issues in dispute

Relevant Contract Terms:

- MSA stated that IBM had to deliver the services until the end of the exit period.

- But exit schedule required IBM to provide termination assistance until all responsibilities had been transferred to the replacement supplier.

- As an exception to above, where services were provided using ‘shared infrastructure’ IBM had to continue providing that infrastructure for 12 months after the end of the exit period.

- IBM required to provide a fixed price for exit assistance, but amount had been left blank.
Exit planning
AstraZeneca v IBM: overview of issues in dispute

1. Did ‘shared infrastructure’ include data centre facilities as well as IT infrastructure?
   - Shared infrastructure included data centre facilities (because of how term ‘infrastructure’ was used elsewhere in MSA)

2. Could AstraZeneca migrate to replacement supplier gradually by service component/instance or did migration have to be by service line/tower?
   - Exit principles and RFP response (implicitly) supported migration by server component/instance

3. Was IBM required to provide the services after the exit period until all responsibilities had been transferred to the replacement supplier?
   - No: MSA took precedence over schedules and operational documentation

4. Was IBM required to provide a fixed fee for termination assistance?
   - Yes – based on assumed scope and duration of exit assistance
   - Any changes to exit plan which affected scope or duration subject to agreement via change control, including opportunity to increase fixed fee
Exit Planning: pre-contract/tender stage

A good exit strategy starts during contract negotiations…

A really good one starts at the tender stage

- Cover supplier approach to exit in RFP – and include supplier responses in contract

- Take up references from former customers of the bidders
Transition-in and post-go live

Agreement and sign-off of exit plan – rarely happens pre-signature

Process for finalising exit plan as part of migration + obligation to update and test during contract term
- Honoured more in breach than observance
- Financial incentives to ensure compliance
  - Milestone-based payment during migration
  - Financial holdback mechanism for testing and update obligations

Avoid ‘black box’ outsourcing deals
- Ensure access to operational information is in your control…

…and up to date
- Ongoing access/QA rights
- Incentivise compliance – e.g. service level metrics re accuracy
Transition-in and post-go live

Exit strategy as part of governance

- Terms to minimise supplier/technology lock-in risk
- Importance of agreeing rules of road for IPR ownership
  - Typically negotiated in detail for bespoke outsourcing solutions
  - Can get less attention for newer service delivery models
  - But ownership of/access to operational information is key
Pre-exit: term and termination triggers

Termination triggers: termination for convenience

- Termination for cause rarely clear-cut, so having an unfettered exit right is key

- Ensure you have a clear understanding of any T for C charges – and how they have been calculated
  - Stranded costs
  - Unamortised costs
  - Lost profit element?

- Are these consistent with the service delivery model you’ve been sold (e.g. Cloud)
Pre-exit: term and termination triggers

Termination triggers: termination for cause

- Termination rights for repeated poor performance (as well as one-off major breaches) are key

- Setting the bar: specified vs unspecified ‘material’ breaches
  - State of Indiana v IBM – IBM avoided material breach by meeting 50% - 80% of SLAs
    (NB: US case law)

- (Note: these are in addition to other termination rights e.g. financial distress/insolvency, change of control etc)
Exit Phase: Exit periods and extension rights

Exit periods and extension rights

- Rule of thumb – exit generally takes longer than expected
  - Build in time for a proper tender process
  - Remember that migration can’t start until replacement supplier has been appointed

- Exit period extension rights – with appropriate supplier protections
  - Subject to overall time limit
  - Minimum period of notice

- Be clear about what services can be extended (esp for data centre/cloud-based contracts)
Agreeing the Exit Schedule and Exit Plan

Capture exit principles/objectives in exit schedule
   – Will help resolve ambiguities in contract/exit plan

Ensure exit schedule/plan permits phased/gradual migration
   – By service component.instance (where applicable)

Agree baseline fixed price for exit assistance before contract signature
   – Based on scope and pricing assumptions
   – Changes managed via change control
   – Link payments to milestone achievement

Cost implications on termination for cause
   – At no charge vs good-leaver/bad-leaver payment terms

Lock-down of supplier personnel
   – Continuity of service delivery and exit personnel
Agreeing the Exit Schedule and Exit Plan

Information required to facilitate re-tendering exercise
– Ensure it can be obtained and disclosed before start of exit period

How will each asset-type be dealt with
– Hardware and equipment – dedicated and shared
– Software licences – whose name/any geographic restrictions etc
– Contracts
– Personnel
– Data (including format requirements)
– Information – increasingly important, but often inadequately addressed
Agreeing the Exit Schedule and Exit Plan

Information

- Service/infrastructure set-up and configuration
- Asset/software distribution information
- Analysis of database space/sizing
- Service delivery model – including resource-types and numbers

Operational and procurement teams should be tasked pre-contract with identifying key information required

Knowledge transfer requirements

- Process manuals/databases
- Is work-shadowing/reverse work-shadowing appropriate?
TUPE AND OTHER EMPLOYMENT LAW ISSUES ON EXIT

KATHRYN DOOKS – EMPLOYMENT PARTNER
# TUPE on exit

**Points for the client to consider when approaching exit:**

<table>
<thead>
<tr>
<th>Question</th>
<th>Action</th>
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<tbody>
<tr>
<td>Does TUPE apply on exit?</td>
<td>What is happening to the services? (back in-house, new supplier, offshoring, fragmentation?)</td>
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<tr>
<td>What does the agreement say about TUPE on exit?</td>
<td>Blanket indemnity?</td>
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<td>Who is in scope to transfer?</td>
<td>Does the replacement supplier require the staff?</td>
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<tr>
<td>Request employee liability information from incumbent</td>
<td>Pass on to replacement supplier</td>
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<tr>
<td>Request replacement supplier’s measures</td>
<td>Pass on to incumbent</td>
</tr>
<tr>
<td>Ensure incumbent undertakes information and consultation process</td>
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Does TUPE apply on exit?

Exceptions:
- Doesn’t apply to:
  - a specific single event or task of short-term duration
  - procurement or supply of goods

Note that, unlike the standard test, there is no need to have a transfer of assets or a major part of the workforce
Arguments that TUPE doesn’t apply (1)

**Activities**
- activities must be “fundamentally or essentially the same as those carried out by the alleged transferor”

**Organised grouping of employees**
- team of employees need to be “essentially dedicated”
- Eddie Stobart case

**No transfer where change of client, as well as contractor**

**No professional services exclusion**
Arguments that TUPE doesn’t apply (2)

Principles

- A service provision change can occur where the activities are distributed among a number of contractors, provided that it is possible to identify with which contractor they end up.

- TUPE may be avoided where services are randomly distributed

Examples

- *Kimberley Group Housing Limited v Hambley* EAT [2008] – TUPE applied to a transfer of a contract for the provision of asylum seekers from one service provider to two service providers.

- *Clearsprings Management Limited v. Ankers* EAT [2009] – activities previously undertaken by one contractor awarded to several contractors with “*no discernible pattern of reallocation*”
Off-shoring – does TUPE apply?

- *Holis Metal Industries Limited v GMB EAT [2008]*

- Options for dealing with consultation obligations:
  - 1. Collective consultation; Transfer; Dismissal.
  - 2. Transfer; Collective consultation; Dismissal.
Points to document at the outset

- Mutual understanding as to whether TUPE will apply
- Obligation to provide employee information at any time (don’t rely on statutory 14 days)

In the period up to the transfer

- Obligation to ensure that staff are (or are not) assigned to other activities before the transfer
- Obligation to limit changes to remuneration and other arrangements in lead up to the transfer

Transfer

- Apportionment of:
  - pre-transfer and post-transfer liabilities; and
  - pre-transfer costs and expenses (e.g. holidays and salaries)
- “Wrong pocket” provisions – if too many / not enough staff transfer

Special arrangements – such as:

- Post-transfer reorganisations or relocations
- Blanket indemnities to ensure that no staff transfer
- Cherry picking provisions to allow the incoming contractor to retain selected staff
- Different approaches if arrangement terminates for material breach etc?
The future of TUPE

- **Reasons for the review:**
  - The 2006 Regulations – “gold-plating” of EU Directive and burden on business
  - Difficulties surrounding the harmonisation of employee terms and conditions
  - Insolvency in a TUPE context
  - The need for guidance on ETO reasons
  - The interface between TUPE and collective redundancy consultation

- **September 2013:**
  - SPC test retained
  - Employee liability information needs to be provided more than 28 days before transfer
  - Allowing transferees to renegotiate terms in collective agreements one year after the transfer provided no less favourable to employees
  - Clarity on ETO reasons, especially in cases involving changes of location
  - Confirmation of current case law on activities
  - Microbusinesses can consult directly with staff, no need to elect representatives

- **Legislation into force January 2014**
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