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# A PRACTICAL GUIDE TO OUTSOURCING AGREEMENTS

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Adam D. Vereshack



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## **A Practical Guide to Outsourcing Agreements**

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**A PRACTICAL  
GUIDE TO  
OUTSOURCING AGREEMENTS**

**To my wife Ellen, for her patience,  
encouragement and understanding.**

# PREFACE

In my practice, I read a diverse and extensive number of technical, business and legal publications every week. Just as I was starting this book, I came across the article below. Of all the papers I have read that deal with the points raised in this article, it struck me at the time (and still does) as such a well-written and extremely readable summary of the problems facing information technology agreements in general, and outsourcing agreements in particular, that I was determined to include it in this book. So here it is. I would like to thank the author, Paul Kallenbach of Minter Ellison, for his permission to use this material.

Adam Vereshack  
Toronto, May 2005

## 10 WAYS TO MAKE SURE YOUR IT CONTRACT GOES OFF THE RAILS

Ever wondered why so many large IT projects end up going off the rails? In fact, studies have shown that around half of IT projects end up in various states of failure, recrimination or disarray. Well, in honour of all of those failed endeavours, here are some basic tips on how not to run an IT project. Obviously, we're not responsible should you actually choose to follow these instructions. But if a mere 50 per cent chance of failure just doesn't do it for you, please read on ...

### 1. You agreed to what?

As a supplier, start by ensuring that you have only the most basic and superficial understanding of your customer's needs. At all costs try to avoid raising direct questions during the tender process, or conducting an audit of your customer's initial position or requirements, as these may actually provide you with an understanding of the scope and how complex their business really is. After all, it's nice to have surprises. It's also a good idea for at least one party (but preferably both) to handsomely reward the negotiating team for reaching a deal in a way that is totally divorced from the commercial outcome.

This will help ensure that everyone starts off with a contract that is both uncommercial and unworkable.

## **2. You didn't agree to what?**

If you're the customer, try to leave key issues (such as service levels or disaster recovery) to a very late stage in the negotiations, particularly if the project is critical to your business. That way, you'll probably be pressured into signing a deal with key principles unclear or unsettled. If you're really fortunate, the supplier's performance in those areas will deteriorate pretty much immediately.

## **3. You mean we're supposed to make a profit?**

If you're the supplier, try to underprice the contract, so that it can only ever operate at a loss (preferably a sizeable one). Also, consider locking yourself in at this price for five, maybe even ten years. However, you'll also have to make sure there's no benchmarking or price review mechanism to deal with all that red ink.

## **4. Who needs clarity?**

Try to describe the services to be provided in as little detail as possible — perhaps jot them down on the back of a paper napkin and staple to the contract or leave the relevant schedule blank. Alternatively, if you've got some time on your hands, attach every document that's ever been written relating to the project, and then liberally cross-reference between them, especially the contradictory parts. Under no circumstances give any clue as to which documents are more important.

## **5. Process? What process?**

Spend lots of time developing useful and practical processes for managing scope changes, communication, project reporting, asset tracking, resource planning, early problem identification and dispute resolution. Then completely and utterly ignore them. Consider forming a project committee that never meets or decides anything.

If difficult issues come up, avoid raising them at all costs. After all, who needs more conflict in their life? It's also helpful if you commit nothing to writing, particularly minutes of important meetings or significant agreed outcomes.

In addition, also make sure that your own processes are completely ineffective, your internal communication poor, and your record keeping non-existent.

If you're the supplier, this will mean you probably won't charge for all the hard work you've done.

If you're the customer, you'll most likely end up paying for services you didn't receive. Either way, you'll be able to demonstrate how charitable you are.

## **6. Spoiling for a fight**

From the very start, show them who's boss. If you've managed to negotiate a superior commercial position, exploit it, and make sure the other side knows you're taking advantage (otherwise, where's the fun?). Be belligerent and obstructive: for example, why not query every single invoice (no matter how small the amount)? Don't compromise or be fair. Make sure you communicate these tactics to staff at all levels, so that everyone knows it's "us versus them". If you're successful enough, very soon the environment will become so adversarial and unpleasant that key project staff (with their undocumented project know-how) will make a dash for the emergency exit.

## **7. Nothing less than perfection**

If you're the supplier, make sure that your pricing assumes absolutely perfect performance, leaving no margin whatsoever for any adverse events. After all, what could possibly go wrong? Even better, ensure that the service levels you're committed to are impossible to achieve.

That way, any profit margin you've allowed for will be quickly consumed by the generous service credits you've agreed to for failing to meet those service levels. On the other hand, if you're the customer, don't prioritise service levels according to business needs. This will ensure that you will pay a sizeable premium to keep all systems at a critical level of readiness.

## **8. You think you own what?**

Consider ignoring IP issues. Then, if you're the customer, important data or materials that you once owned will probably end up in the



supplier's hands. This will increase the chance that you'll be locked into that supplier, or have to make hefty payments for the return of materials you always thought were yours. You may even have the luxury of sitting back and watching your competitors gain market share with your once confidential information.

## **9. She'll be right, mate**

Are you concerned about the supplier's financial viability? Don't worry about asking for performance guarantees. After all, they're sure to struggle through. Also, if you're completely dependent on their software, don't ever ask for the source code or require it to be put in escrow. That way, when the supplier does go belly up, there'll be no way you or anyone else will be able to support the business critical software that you've just spent two years implementing.

## **10. You're leaving?**

It's just far too much of an effort to think through when you may need to exit the relationship, or what you'll need to do at that time. So don't worry about it. After all, what are the chances of your business being bought? Or the supplier becoming insolvent? Or the supplier failing to perform? Or the customer not paying? Or the relationship just going bad? Also, in no event address the process for transitioning personnel, data and know-how to the new supplier. That way, all the valuable things you've learnt from the project will be lost, and you'll be free to make the same mistakes all over again.

## ACKNOWLEDGMENTS

I would like to acknowledge the assistance of several people in the writing of this book: Paul Boniferno, upon whose work a substantial portion of Chapter 4 is based; Eric Gertner, who served as my personal *Encyclopaedia Legalis*; Greg Winfield, who taught me that it is not possible to become an expert in Pensions and Pension Benefit Plans through a one weekend self-guided home study course; my wife Ellen, who, if she ever quit her day job, could certainly become a full-time legal editor; and finally Larry Page and Sergey Brin, without whose creation, I would actually have had to go to a “bricks and mortar” library.

## ABOUT THE AUTHOR

Adam Vereshack is a Partner in the Technology, Communications and Intellectual Property Group of McCarthy Tétrault in Toronto. He has been practising information technology (IT) law for almost 30 years. Mr. Vereshack's practice focuses on IT and business process outsourcing transactions. Since 1991, he has been involved in over 20 outsourcing transactions. He also has extensive experience with legal issues relating to a wide range of other types of complex IT transactions including strategic alliances and system acquisitions as well as technology development and licensing arrangements. He has provided legal advice on issues relating to the Internet and electronic commerce matters including electronic banking and brokerage arrangements, website development and hosting agreements and numerous transactions involving application service providers. Mr. Vereshack appears in the 2004 Canadian Legal Lexpert Directory, a guide to the leading law firms and practitioners in Canada, as a leading lawyer in the area of Computer and IT Law.

He is a member of the Canadian Bar Association, the Science & Technology Group of the American Bar Association, the Computer Law Association, the Licensing Executive Society (USA and Canada), and the Toronto Computer Lawyers' Group.

Mr. Vereshack received his B.A. from the University of Toronto and his LL.B. from Osgoode Hall Law School. He was called to the Ontario Bar in 1976.

# TABLE OF CONTENTS

<i>Preface</i> .....	vii
<i>Acknowledgments</i> .....	xi
<i>About the Author</i> .....	xiii
<i>Glossary</i> .....	xxxix
<b>Chapter 1: Introduction</b> .....	1
1.01    Some Initial Disclaimers .....	1
1.02    The Purpose of This Work .....	2
1.03    Reasons for Outsourcing .....	2
1.04    A Note on the RFP Process .....	3
1.05    Service Provider Selection .....	4
A.    Sole Sourcing .....	4
B.    Multi-Service Provider Bid Process.....	5
C.    Parallel Negotiations.....	5
D.    Multi-Service Provider Solutions.....	5
1.06    Playing “Hard Ball”.....	6
1.07    A Note on the Structure of the Outsourcing Agreement .....	7
1.08    Types of Outsourced Services .....	8
Key Points .....	8
<b>Chapter 2: Opening Part of the Agreement</b> .....	9
2.01    The Opening .....	9
2.02    The Contract Date.....	9
2.03    The Parties .....	9
A.    One Service Provider and One Customer .....	10
B.    One Service Provider, One Customer and Its Affiliates .....	10
C.    Customer with Affiliates in Few Countries .....	11
D.    Customer with Affiliates in Many Countries .....	12
2.04    The Recitals.....	12
2.05    A Note on Definitions .....	13
2.06    The Term of the Agreement .....	14
Key Points .....	15
<b>Chapter 3: Initial and Transitional Matters</b> .....	17
3.01    Overview of Initial Matters .....	17
3.02    Purchase of Customer Assets .....	17
3.03    Additional Assets and Sales Back .....	18
3.04    Access to Transferred Assets.....	19

3.05	Contracts .....	19
3.06	Assigned Contracts.....	20
	A. Required Consents .....	20
	B. Use of Software .....	21
	C. Deemed Agency.....	21
	D. Liabilities .....	21
3.07	Managed Contracts.....	22
3.08	Suspended Contracts .....	22
3.09	Customer-Retained Contracts.....	23
3.10	Pre-existing Service Provider Contracts.....	24
3.11	Assignment of Assigned Contracts.....	24
	A. Customer Obligations .....	24
	B. Service Provider Obligations .....	25
3.12	Early Transfer of Assigned Contracts .....	25
3.13	Representations and Warranties of Customer.....	26
3.14	Inconsistent or Insufficient Contract Rights.....	26
3.15	Sole Use of Customer Software.....	27
3.16	Exclusion of Liabilities and Adjustments for Prepaid Amounts .....	27
3.17	Equitable Adjustments.....	28
	A. Undisclosed Information.....	28
	B. Due Diligence .....	29
	C. Adjustments .....	30
3.18	Operating Procedures Manual .....	30
	A. Technical Operations .....	31
	B. Administrative Operations .....	31
	C. Relationship Operations.....	31
	D. Quality Assurance Operations .....	31
3.19	The Transition Plan .....	32
	A. Preparation of the Transition Plan .....	32
	B. Review of the Transition Plan.....	33
	C. Preliminary Transition Plan .....	33
	D. Transition Services.....	34
	E. Customer Obligations .....	34
	F. Transition of Employees .....	35
3.20	Damages for Failure to Achieve Transition Milestones .....	35
	A. Liquidated Damages .....	35
	Table 3.20-1 .....	36
	B. General Damages.....	36
3.21	Effect of Failure to Achieve Transition Milestones ...	37
3.22	Termination for Failure to Achieve Key Transition Milestones .....	37
	A. Constructing Termination Rights.....	37
	B. Saving Provisions .....	38

Key Points .....	38
<b>Chapter 4: Transfer of Employees.....</b>	<b>41</b>
4.01 Definitions .....	41
4.02 Overview .....	41
4.03 Confidentiality.....	42
4.04 The Legislative Framework.....	43
4.05 The Guarantee Period.....	44
4.06 Transferable Employees .....	44
4.07 Procedures for Offers of Employment.....	44
4.08 Customer Obligations to the Service Provider .....	46
4.09 Customer Obligations to Transferring Employees .....	46
A. Outstanding Bonuses .....	46
B. Banked Vacation Time .....	46
C. Pre-retirement Vacation .....	47
4.10 Transfer of Transferring Employee Data.....	47
4.11 Service Provider Employment Documentation .....	48
4.12 Commencement of Employment .....	48
4.13 Terms of Employment by Service Provider .....	49
A. Remuneration.....	49
(i) Base Salary .....	49
(ii) Performance Incentives, Promotions and Bonus.....	49
B. Hours and Schedule of Work.....	50
(i) Hours of Work and Overtime .....	50
(ii) Vacations.....	50
C. Duties and Responsibilities .....	50
D. Benefits Plans .....	50
(i) Eligibility.....	50
(ii) Date of Hire .....	51
(iii) Coverage.....	51
E. Pension Benefits .....	52
(i) Types of Pension Plans.....	52
(ii) Continuity of Pension Plans .....	52
(iii) Variations of Plans .....	53
Table 4.13-1.....	53
(iv) Pension Plan Examples .....	54
(v) Cessation .....	54
(vi) Continuity .....	54
F. Possibility of Advancement .....	56
G. Location of Employment .....	56
H. Job Security.....	57
4.14 Unionized Employees.....	58
4.15 Use of Key Personnel .....	59
4.16 Non-Solicitation .....	59

Key Points .....	60
<b>Chapter 5: Services .....</b>	<b>61</b>
5.01 Outsourcing Transactions .....	61
A. General .....	61
B. Information Technology Outsourcing .....	61
C. Business Process Outsourcing .....	62
D. Information Technology and Business Process Outsourcing .....	63
5.02 Implied Services .....	63
5.03 Responsibility for the Systems .....	64
A. Acquisition .....	64
B. Maintenance and Support Services .....	64
5.04 Asset Management Services .....	65
A. Asset Database .....	65
B. Software Licence Management and Compliance .....	65
C. Management and Planning .....	66
D. Warranty Management .....	66
5.05 Reports .....	66
5.06 Compatibility of Resources .....	67
5.07 Shared Environment .....	67
5.08 Web Hosting Services .....	68
5.09 Efficient Resource Usage .....	68
5.10 Corrections .....	69
A. Errors Due to Service Provider .....	69
B. Errors Due to Third-Party Suppliers .....	69
5.11 Quality Assurance .....	69
5.12 Contaminants .....	70
A. Definition .....	70
B. Obligations of Service Provider .....	70
5.13 Location of the Services .....	71
5.14 Use of Service Provider Facilities .....	71
5.15 Use of Customer Facilities .....	71
5.16 Security .....	73
A. Service Provider Controlled Facilities .....	73
B. Customer Service Locations .....	73
C. Security Breaches .....	74
5.17 Departure from Customer Service Locations .....	74
5.18 Planning — The Annual Operating Plan .....	74
A. Development and Approval .....	74
B. Contents .....	75
C. Timing .....	75
5.19 Exclusivity and Repatriation .....	76
5.20 New Customer Entities .....	77

5.21	Divested Customer Entities .....	77
	Key Points .....	78
<b>Chapter 6: Project Services .....</b>		<b>79</b>
6.01	General .....	79
6.02	Project Process .....	79
	A. Project Plans .....	80
	B. Documentation .....	80
	C. Functional Requirements .....	80
	D. Design Specifications .....	81
	E. Project Services Methodology .....	82
	F. Reporting .....	83
6.03	Acceptance Testing .....	84
	A. Delivery .....	84
	B. Testing .....	85
	C. Non-Material Deficiencies .....	85
	D. Corrections .....	85
6.04	Retesting .....	86
6.05	Implementation .....	87
	Key Points .....	88
<b>Chapter 7: Improvements and Gain Sharing .....</b>		<b>89</b>
7.01	Quality Improvements .....	89
7.02	Quality Improvement Reviews .....	89
7.03	Cost Saving Improvements .....	90
7.04	Cost Saving Improvement Reviews .....	90
7.05	Gain Sharing .....	91
	A. General Approach .....	91
	B. Detailed Approach .....	91
	C. Defining the Calculations .....	92
	D. Determining the Measurement Methodology ....	92
	E. Gain Sharing Calculations .....	93
	Table 7.05-1 .....	93
	F. Reporting on Gains .....	93
	G. Gain Sharing Payments .....	94
7.06	Gain Sharing Reviews .....	94
7.07	Gain Sharing Project Services .....	94
	Key Points .....	95
<b>Chapter 8: Charges and Adjustments .....</b>		<b>97</b>
8.01	General .....	97
8.02	Charges for Baseline Services .....	97
	A. Calculation of Baseline Service Charges .....	97
	B. Example of Calculations .....	98
	Table 8.02-1 .....	99
8.03	ARCs, RRCs and Deadbands .....	99



	A. ARCs and RRCs .....	99
	B. The Deadband .....	100
	Illustration 8.03-1 .....	100
8.04	Contracting for ARCs, RRCs and Deadbands .....	101
8.05	Changes and Resource Baseline Resets .....	101
8.06	Resource Planning .....	103
	A. General .....	103
	B. The Resource Plan .....	103
	C. The Long Range Plan .....	103
	D. Annual Operating Plan .....	104
8.07	Charges for Hourly Services .....	104
	A. Hourly Services .....	104
	B. Hourly Service Rates by Job Classification .....	105
	Table 8.07-1 .....	105
	C. Hourly Service Expenses .....	106
8.08	Pass-Through Expenses .....	107
8.09	Cost of Living Adjustments .....	107
8.10	Benchmarking Reviews .....	109
8.11	Most Favoured Customer Pricing Commitment .....	111
8.12	Most Favoured Customer Pricing Procedures .....	112
8.13	Discounts .....	113
	A. The Prepaid Discount .....	113
	B. The Discount .....	114
	C. Termination for Convenience .....	114
8.14	New Services Credit .....	114
	Key Points .....	115
<b>Chapter 9: Invoicing, Payment and Taxes .....</b>		<b>117</b>
9.01	Invoice Details .....	117
9.02	Invoicing .....	117
	A. Payment of Baseline Service Charges .....	117
	B. Payment of Other Charges .....	118
	C. Late Charges .....	118
	D. Credits .....	119
	E. Overpayments .....	119
9.03	Entire Payment .....	120
9.04	Means of Payment .....	120
9.05	Repayments, Liabilities and Refunds .....	120
	A. Prepayments and Liabilities .....	120
	B. Refunds .....	121
9.06	Allocation of Charges .....	121
9.07	Disputed Charges .....	121
9.08	Termination for Cause and Payment Timing .....	122
9.09	Records .....	122
9.10	Taxes .....	123