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RENEGOTIATING YOUR OUTSOURCING AND TECH SERVICES DEALS

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BUSINESS ISSUES AND DRIVERS IN TECH RENEGOTIATIONS

Common Renegotiation Drivers

- Approaching Expiration
- Change in Customer's business
  - Significant growth or reductions due to acquisitions or divestitures
- Material deviation from original scope of services
- Changes in methodologies/ technologies
- Poor performance by vendor (real or perceived) – Customer not satisfied
- Requirements to change contract economics (discussed more fully below)
- Change in Customer's management
- Change in sourcing strategy
- Desire to bring core services back in-house
- Desire to access new or different solutions
- Disagreement on contract interpretation
- Unrealized expectations
- Governance issues (discussed more fully below)

Common Renegotiation Drivers: Changing the Economics

- Reduce prices to perceived market levels
- Implement different pricing models
  - Shift from fixed to variable pricing
  - Eliminate or reduce minimum commitments
- Enhance feasibility (reduce termination/resourcing restrictions)
- Address unexpected “additional” charges
- Address failed transformational efficiencies
- Recognize recovery of service provider cost savings resulting from transformation/standardization

What Defines A Financial Successful Deal?

Manufacturer

How Much Revenue Did The Deal Generate?

Value Added Reseller

How Much Gross Profit Did The Deal Generate?

How Do Customers Define a Financially Successful deal

Does It Meet Our Budget?

- *Where did we get that number?*

What Is The Discount Off Of List Price?

- *Not a static number*

What Is The ROI?

- *Who provides the worksheet?*

What Do The Research Organizations Say?

- *Where did they get their numbers?*

Before Renegotiating Terms and Conditions: Things to Consider

- Understand Business Unit Benchmarks

- Understand pricing options at the time of purchase & currently

- General understanding of the costs to buy new competitor

RENEGOTIATION LEVERS AND AVOIDERS IN THE EXISTING OUTSOURCING CONTRACT

Renegotiation Levers and Avoiders in the Existing Outsourcing Contract

- When renegotiating an outsourcing contract, the precise language of the contract becomes extremely important.
- Each party reviews the contract for support to bolster its position. Is there any contractual basis for requesting renegotiation or avoiding renegotiation?
- The use of the contract to restructure the outsourcing relationship is therefore important not only during renegotiation, but also during initial structuring and negotiation of the contract.
- The key contract terms that I will be discussing include:
  - Term
  - Defining Scope of Services
  - Pricing Terms
  - Measuring Performance
  - Termination Rights
  - Unwinding the Relationship
  - Other Key Provisions

Term

- Initial Term
  - Is the expiration date approaching? If yes, may provide leverage. If no, may have to find other leverage points.
  - Upfront investments made by Vendor amortized over initial term. Termination fees.
- Extension Options
  - Unilateral Rights to Extend
    - Does Customer have the unilateral right to extend at a price determinable by the contract (i.e., without renegotiation)? If yes, does Customer want those terms? If yes, can avoid renegotiation.
  - Evergreen Contracts
    - If either party has the right to refuse an extension, that right can be used to force renegotiation
  - Automatic Short Extension if No Agreement to Extend
    - If no unilateral right to extend, then extension will require renegotiation of at least price. If Customer has this type of provision can give Customer some leverage to offset Vendor's leverage provided by the costs and efforts of insourcing and re-sourcing.

Defining Scope

- Many renegotiations driven by dispute over fees – Customer feeling overcharged, Vendor feeling that it is not making sufficient profit.
- Scope definition - Specific Definition (Vendor's desire) vs. General Definition (Customer's desire)
- Detailed SOW
- Sweep-in Clauses
  - Services Currently Performed by In-Scope/Displaced Employees
  - Services Not Described in SOW but Required for Proper Performance of the Services
  - Changes to the Services that are not Material or Can Be Performed Using Existing Resources
- Continuous improvement – technology and process evolution – without price increase
- New Services and Projects – Mandatory Change
- Acquisitions; Internal Growth of Business
- Divestitures; Downturn in Business

Pricing Terms

- How is the Customer charged under the contract?
- Variable pricing structure with meaningful ARCs and RRCs to handle material fluctuations in service volumes
  - Renegotiation triggers
  - Can the baselines be renegotiated?
- Deemed terminations for convenience
- Minimum fees
- Inflation risk (on-shore and off-shore); Currency fluctuation risk
- Tax allocation (domestic and foreign, current and future)
- Right to withhold disputed charges
- Benchmarking (discussed more fully below)
- Gain sharing from technology and process evolution
  - Does the contract provide for any guaranteed savings? Other provisions for shared benefits or risks? Have they been implemented/applied?
- Customer right to audit Vendor charges

Measuring Performance

- <u>Service Levels - Objective Measure</u>
  - Defining objective standards of performance (examples: speed, availability, reliability, accuracy)
  - Are the right things being measured?
  - Service Level Credits – sufficient amount of fees at risk?
  - Has the Vendor met its service level obligations?
  - Under what circumstances is the Vendor excused from service level failures and are they relevant?
  - Is there a termination right associated with Vendor's failure to meet its service level obligations?
  - Periodic Adjustments?
  - Self-Executing Continuous Improvement?
  - Does the Customer have the right to add service levels? To make adjustments to the service level methodology metrics?

Measuring Performance

- Customer Satisfaction - Subjective Measure
  - Customer and Vendor shall conduct mutually agreed upon satisfaction surveys.
  - Details of who prepares the survey, who conducts the survey, who is surveyed and who bears the costs of the survey.
  - What happens if results are not satisfactory?
  - Vendor obligated to improve customer satisfaction?
  - Customer and Vendor required to enter into good faith negotiations with a view to address the dissatisfaction? What if renegotiations are not successful?
  - Does the contract contain this type of provision?
  - Has the Vendor complied?
  - What were the results?
  - Did the Vendor comply with its response obligations?

Measuring Performance: Benchmarking

- If Customer feels it is getting overcharged compared to the market, a benchmarking provision can give Customer the right to conduct a measurement and comparison benchmarking process to compare the fees and service levels applicable under the contract to what's prevailing in the market.
- What happens if the benchmarking process indicates that Vendor's pricing/performance for the benchmarked service is inferior to the comparative peer group?
- Automatic adjustment formulas?
- Are the Customer and Vendor required to enter into good faith negotiations with a view to decreasing the fees and increasing the service levels within the range established by the peer group? What if renegotiations are not successful?
- If the contract contains a benchmarking provision, has one been performed?

Termination Rights

- Effective leverage comes from the client developing viable alternatives that are financially, technically, and tactically feasible and desirable, and being ready, willing and able to execute.
- The single most powerful tool for creating leverage is the ability to get up and walk away from the table without a deal.
- Is termination with the incumbent an option?
  - At expiration?
  - For convenience?
    - What is the cost? If not unduly burdensome, can provide leverage in renegotiation.
    - Can you terminate in part or only the entire relationship?
  - For cause? Is renegotiation an option in the presence of a default?
  - Termination for cause rarely clean. However, plausible claim of right to terminate for cause can provide negotiation leverage.

Termination Rights

- Is insourcing or resourcing an option of Customer? In whole or in part?
- Exclusivity covenant?
  - Right to use third parties
  - Termination transition
  - Cooperation
  - Confidentiality restrictions and requirements
- Minimum fees?
  - Can effectively remove the option of Customer to insource or resource
- Deemed termination for convenience?
- Price renegotiation trigger?
- If you don't renew or if you can terminate, insource or resource, what are the transition risks and mitigation options?

Unwinding the Relationship

- Termination Assistance – For Any Termination
  - Time Period
  - Costs
  - No degradation in on-going Services
  - Is Vendor required to cooperate with third parties engaged by Customer?
- Confidentiality Restrictions
  - Are third parties engaged by Customer permitted to have access to confidential information of Vendor?
  - Are the third parties required to enter into a confidentiality agreement with Vendor?

Unwinding the Relationship

- Customer's right to the services and assets necessary for it to continue the operation of its business are very important when renegotiating the outsourcing contract.
- Rights to Hire Vendor Personnel; possible transfers under EU Laws
- Customer ownership, license and access rights to:
  - Customer Data
  - Equipment
  - Software
  - Third Party Service Agreements
  - Vendor Proprietary IP
  - Vendor Third Party IP
  - New Developments
  - Procedures Manual/Other Work Product

Other Key Provisions

- Damages
  - Each party must assess its potential liability to the other party
  - Limitations on liability and exceptions
- Dispute Resolution
  - What is the dispute resolution process under the contract and has it been followed?
  - With respect to future steps in the process (e.g., litigation in a particular jurisdiction), do they provide renegotiation leverage. For example, litigation and public disclosures vs. confidentiality of arbitration.
- Continued Performance
  - Does the contract expressly provide for obligation of continued performance during dispute?
- Review of Ancillary Agreements and Documents
  - Have there been amendments to the contract through change control documents or other documents?
  - How would any ancillary agreement be affected by renegotiation?

RENEGOTIATION - IMPROVING YOUR CONTRACT

Due Diligence – Business Issues

- History
  - Pre-Contract History
  - Business Drivers - Issues to be Solved
- Original Negotiation
  - Starting Positions of Both Parties
  - Most Important / Difficult Business Issues
  - Final Agreed Positions
- Operations
  - Business/Operations Successes
  - Business/Operations Failures
  - Changes / Improvements Over Time

Due Diligence – Business Issues

- Financial
  - Billing Issues – Procedures and Substance
  - Expense Issues
  - Profitability Issues
- Current Issues/Drivers
- Market
  - Benchmarking Service Levels/Charges
  - New Competitors

Due Diligence – Relationship Issues

- Original Negotiation
  - Executive Sponsors / Negotiation Teams
  - Buy-in of organizations
- Operations
  - Executive Sponsors
  - Relationship Managers / Operation Teams
  - Understanding of Contract (Differences from "typical")
- Cultural Issues
  - Client expectations – Business drivers
  - Style and Structure differences

Due Diligence – Relationship Issues

- Governance
  - Meetings – Regularity and Productive?
  - Participation – Right Persons from Both Sides Issues
- Change Management
  - Willingness to Change
  - Procedural Issues (Documentation, Follow-through)
- Dispute Resolution
  - Governance Level Appropriate
  - Speed
  - Executive Support - Participation

Due Diligence – Contract Issues

- Documentation
  - Agreement
  - Exhibits
  - Amendments
  - Services Documentation / E-mails / Understandings
- Legal Personal
  - Original Negotiation
  - Operations / Amendment Issues
  - Current Team
- Change Management
- Claims / Disputes

Amendment – New Agreement

- Ease of Negotiation
  - Relationship issues - avoid re-negotiating previous issues
  - Efficiency – concentrate on new deal issues
- Market Changes
  - Technology Changes Require New Form
  - Change of Service Scope
  - Client / Service Provider Form Agreements
- New Vendors
  - RFP Process

Prior Claims

- Due Diligence
  - Documentation
  - Status of Governance, Change, and/or Dispute Resolution
  - Settlement proposals
- Separate Agreement?
- Releases
  - Unknown claims

Contract Provisions

- Amendment vs. Restatement
  - Extent of changes
- Term
  - Longer terms
  - Easier termination
- Scope
  - Additional Definition
  - Process for Scope Additions / Changes
  - Financial Terms

Contract Provisions

- Pricing
  - Experience – documentation
  - Flexibility for time and volume
  - Expense experience / specifications
- Change Management and Governance
  - Participants
  - Process Improvements
  - Surveys and Feedback

Biography

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Scott Robins is CEO and Founder of Virtual Procurement Services. VPS has been reducing and recovering technology spends for customers since 2009 and specializes in the negotiation and renegotiating of IT related service contracts as well as net new capital purchases (Cisco, IBM, NetApp, VMware, EMC, HP, Dell, Microsoft, SAP, ORACLE...). VPS provides actual cost structures (based on the results of our proprietary predictive analytics tool) to measure the fully burdened costs and complete understanding of supplier's pricing processes to obtain the best results for its clients.

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Michael L. Pillion brings more than 25 years of experience navigating high-stakes transactions to his outsourcing, technology, and commercial transactions practice. He has a diverse client base that spans the health insurance, life sciences, energy, financial services, and real estate industries. He counsels clients in structuring, negotiating, realigning, and terminating information technology (IT) outsourcing and business process outsourcing (BPO) transactions, technology transactions including software as a service (SaaS) and cloud deals, complex commercial transactions including joint ventures, and real estate leasing deals.

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Peter M. Watt-Morse, one of the founding partners of the firm's Pittsburgh office, has worked on all forms of commercial and technology transactions for more than 30 years. Peter advises companies on business process (BP) and information technology (IT) outsourcing transactions. He also handles technology acquisition, development, licensing, and distribution agreements; strategic alliances and joint ventures; IP creation and strategy; university and governmental technology transfer issues; and general corporate and commercial matters.

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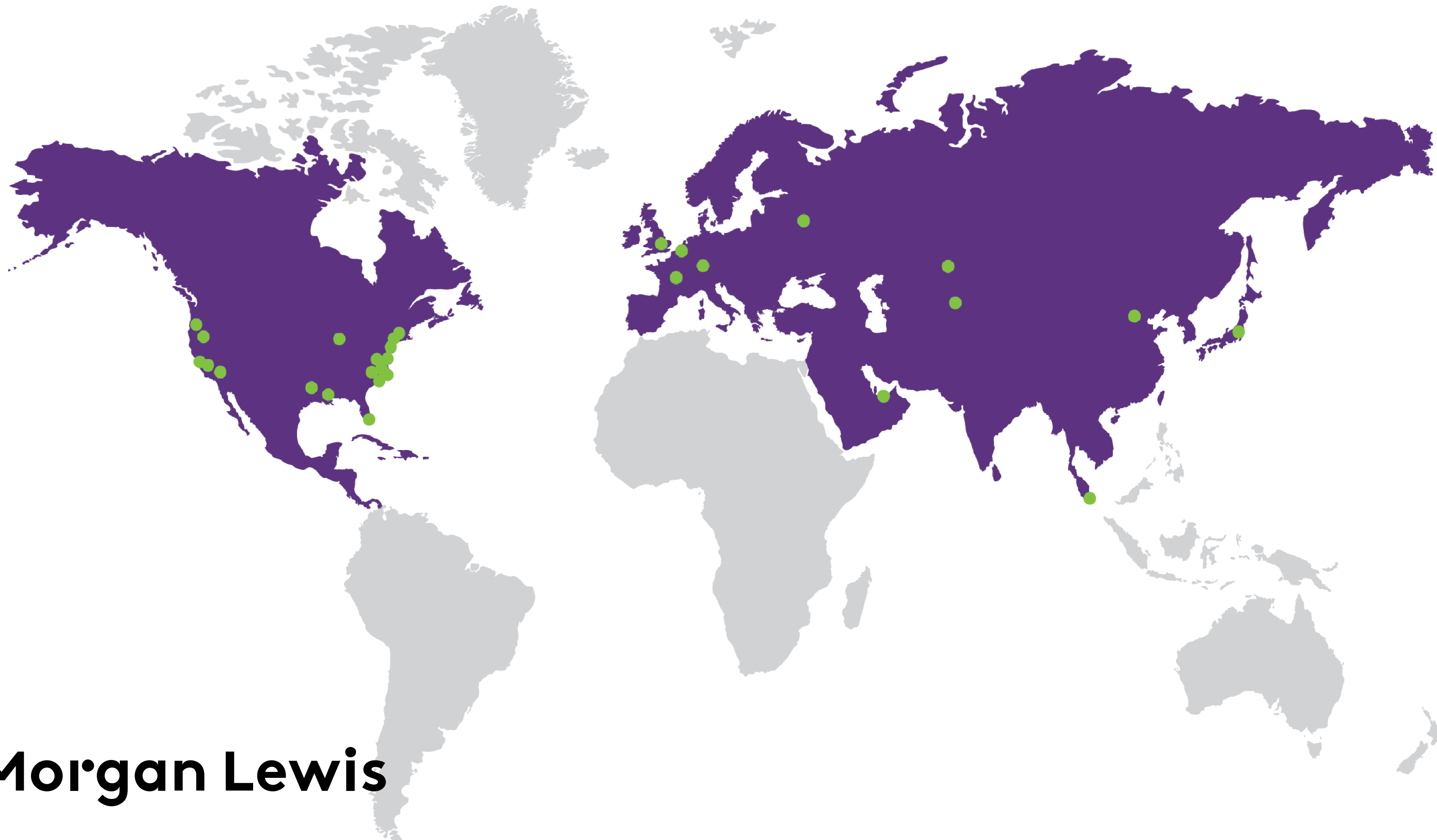

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THANK YOU