



Morgan Lewis

**MANAGING RISK IN TELECOM PURCHASE AGREEMENTS
IN A CHANGING INDUSTRY**

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Essential Goals of an Enterprise User Are In Conflict

- Goal 1: Stability in Long-Term Arrangement
 - Users need to have fixed arrangements in place to assure ongoing ability to manage telecom needs
 - Transaction costs of negotiating a deal can be high, so desire to reduce frequency of full renegotiations
 - Longer and bigger deal typically results in better prices and terms
 - In an era of provider consolidation and reconfiguration, need to assure that deal and relationship remain well-defined

Essential Goals of an Enterprise User Are In Conflict

- Goal 2: Flexibility
 - BUT users also need flexibility within such arrangements to assure that their needs will continue to be met:
 - In an era of continually falling prices, need to assure that rates remain competitive
 - In an era of dynamic technology substitution (VoIP, wireless, etc.) need to assure that technology remains current and continues to meet needs
 - Need contingencies for change in user's own business needs (divestiture, downsizing, acquisition, internal growth)
 - Need to assure against regulatory changes (tariffing, charges, etc.)

Key Negotiating Times

- When existing contracts near expiration
 - Some users use RFPs for telecom needs
 - Others have more informal bidding process, or simply commence renegotiation with existing vendors
 - Best if at least implied (and credible) threat to go elsewhere if negotiations fail
 - Adequate lead time extremely important
 - Manage expiration dates to maximize leverage

Key Negotiating Times

- Renegotiating Agreements Prior to Expiration
 - Merger or acquisition
 - Customer: consolidation of two or more deals with same carrier into the single best deal
 - Carrier: consolidation of users' deals with more than one carrier into the single best deal
 - Divestiture or downsizing of user
 - Internal growth or expiration of a competitor's agreement: the carrot for the carrier
 - Benchmarking; audit process
 - Rollup of several contracts into one, when a user decides to centralize and rationalize purchasing
 - Carrier default

Defining Basic Customer Needs/Risks

- What problems has customer encountered in previous relationships?
- How well or poorly have existing remedial measures worked?
- How responsive has customer found particular carriers?
 - Bear in mind that carriers change internally and through mergers, so even an excellent track record doesn't obviate need for strong contract

Defining Basic Customer Needs/Risks

- What does the foreseeable future hold for market and regulatory changes?
 - Carrier mergers
 - Bankruptcies
 - Spectrum shortages
 - New technologies
- Often need input from all parts of business

Key Issues - Rates and Commitments

- Rates are usually most heavily negotiated piece, but customers must understand issues
 - Waiver of non-recurring charges; recoupment of same
 - Billing increments
 - Clear discount structures -- marginal rate vs. “first dollar” rate
 - Rate benchmarking/indexing in out years (more later)
 - Most favored nation, especially for large deals or deals for most of customer’s needs
 - Customer should understand role of taxes, USF, other charges
 - Be clear on affiliates’ and other users’ ability to get rates
 - Issue of joint vs. several liability for affiliates

Key Issues - Rates and Commitments

- Volume and term commitments (aka MACs, MVCs, MARCs) are generally part and parcel of deals
 - Subcommitments (data, international, e.g.) commonly asked for by carriers but market now frowns upon them
 - Be clear on how commitments are to be satisfied
 - What buying entities are included (e.g. affiliates, franchisees, dealers, JVs)?
 - What selling entities are included (e.g., international affiliates)?
 - What services are included?
 - What about third-party pass-throughs?
 - Are NRCs included?
 - Pre-discount dollars or after-discount dollars?
 - Year 1 rates or out year rates? (A common trap)

Key Issues - Rates and Commitments

- Beware of exclusivity or “primary provider” clauses, which can especially be a problem for out years and affiliates
 - Prevent use of growth as carrot for renegotiation
 - If overbroad, can sweep in services never contemplated
- Beware commitments that ratchet upward
- Use of attainment discounts as trade-off to reduce hard commitment
- Importance of safety margin – affects risk analysis throughout contract; note that as rates decline, safety margin may erode over time

Key Issues - Rates and Commitments

- What are consequences of failure to meet commitments?
 - 100% take-or-pay vs. < 100% shortfall charge vs. retroactive loss or reduction of discounts
 - Carry-forward and carry-back clauses
 - Annual commitment vs. monthly commitment vs. multi-year lump commitment
 - Kick-out once aggregate commitment achieved; customer may go elsewhere or renegotiate early

Key Issues – Contract Term

- Two to three years typical but longer and shorter ones exist
 - The longer the term, the more important it is to address rate adjustment rights and business contingencies
 - Renewal options - year-to-year, full-term again?
 - Who can exercise
 - Negative option vs. positive election
 - Month-to-month
 - Transition services at end of term are key for many users; be sure period is long enough and that rates remain stable

Key Issues – Service Quality

- The importance of Service Level Agreements
 - Technical specifications - many carriers offer premium and standard levels; can often get higher service level in lieu of further price sweetening
 - Provisioning intervals
 - Outage resolution intervals
 - Escalation procedures
- Prioritize customer-critical services, locations, applications
- Specific remedies (credits, termination, etc), not just “objectives”

Key Issues – Termination Rights

- Termination for Convenience
 - Should apply to *customer only*
 - Typically requires termination fee set at some percentage of remaining commitment
 - Carriers start the bidding at 100%, but 25-50% is typical end-point
 - May be sliding scale -- lower % for later years
 - Past overages should count toward remaining commitment
 - Fee should be expressly stated as carrier's sole remedy for early termination
 - Typically, this is also the remedy used when carrier terminates for user breach.

Key Issues – Termination Rights

- Termination for Cause - Breach by Customer
 - Try to limit to nonpayment only; compare “savings clause” for other breaches
 - Need notice and cure rights with real-world intervals
 - Be clear that no termination rights for amounts in pending dispute
 - Limit remedies to termination charge

Key Issues – Termination Rights

- Termination for Cause by Customer
 - Service quality as above
 - Other breaches: confidentiality, failure to provide service timely
 - Governmental action; e.g., regulatory changes make more costly or prevent use of service
 - Increase in surcharges or other fees
 - Force majeure preventing performance for extended period
 - Roll-over into new agreement

Key Issues – Price Adjustments

- Especially important for deals of three years or more
- Service-by-service vs. market basket
- Formal benchmarking -- consultants
- Minimize ability of carrier to dispute benchmarker's results
- Quantitative method of adjusting prices important (average vs. lowest, collar, top tier vs. all available)
- Most favored nation clauses
- Remedy if no agreement can be reached

Key Issues – Changes in Business Needs

- Especially important for deals of three years or more
- Business downturn, loss of key customers (may be less important if commitment is small)
- Divestiture or closure of business unit; right of divested unit to keep taking for some period of time
- Merger or acquisition; joint venture
- Internal reorganization -- move to a different affiliate
- Outsourcing: right to move contract to an outsourcing provider
- Remedy if no agreement can be reached

Key Issues – Technology Changes

- If offered by third parties but not by incumbent carrier
 - Right to request that incumbent carrier provide
 - Go elsewhere and reduce commitment if incumbent carrier can't or won't
 - Issue of what counts as "availability in the marketplace" for triggering this right
- If offered by incumbent carrier
 - Right to reduce commitment to reflect new efficiencies
 - Right to purchase at lowest available price
 - Right to upgrade individual service elements without charge
- Remedy if no agreement can be reached; terminate agreement, or terminate services affected and reduce commitment

Key Issues – Regulatory

- Federal detariffing
 - Recite that contract takes precedence over website and (to extent permissible) tariffs
 - Reduce incorporation by reference to extent possible
 - Address possibility of retariffing
- State and foreign tariffing; make sure of appropriate cross-references and precedence among documents

Key Issues – Regulatory

- Right to partial/complete termination if regulators impose conditions that are adverse to customer
- Carrier will try to impose cost risks - increases in USF and imposition/increase of access charges, e.g.
 - Important to resist this because it can be carte blanche for carrier
 - No mark-up
 - Termination right with or without collar
 - Most favored nation

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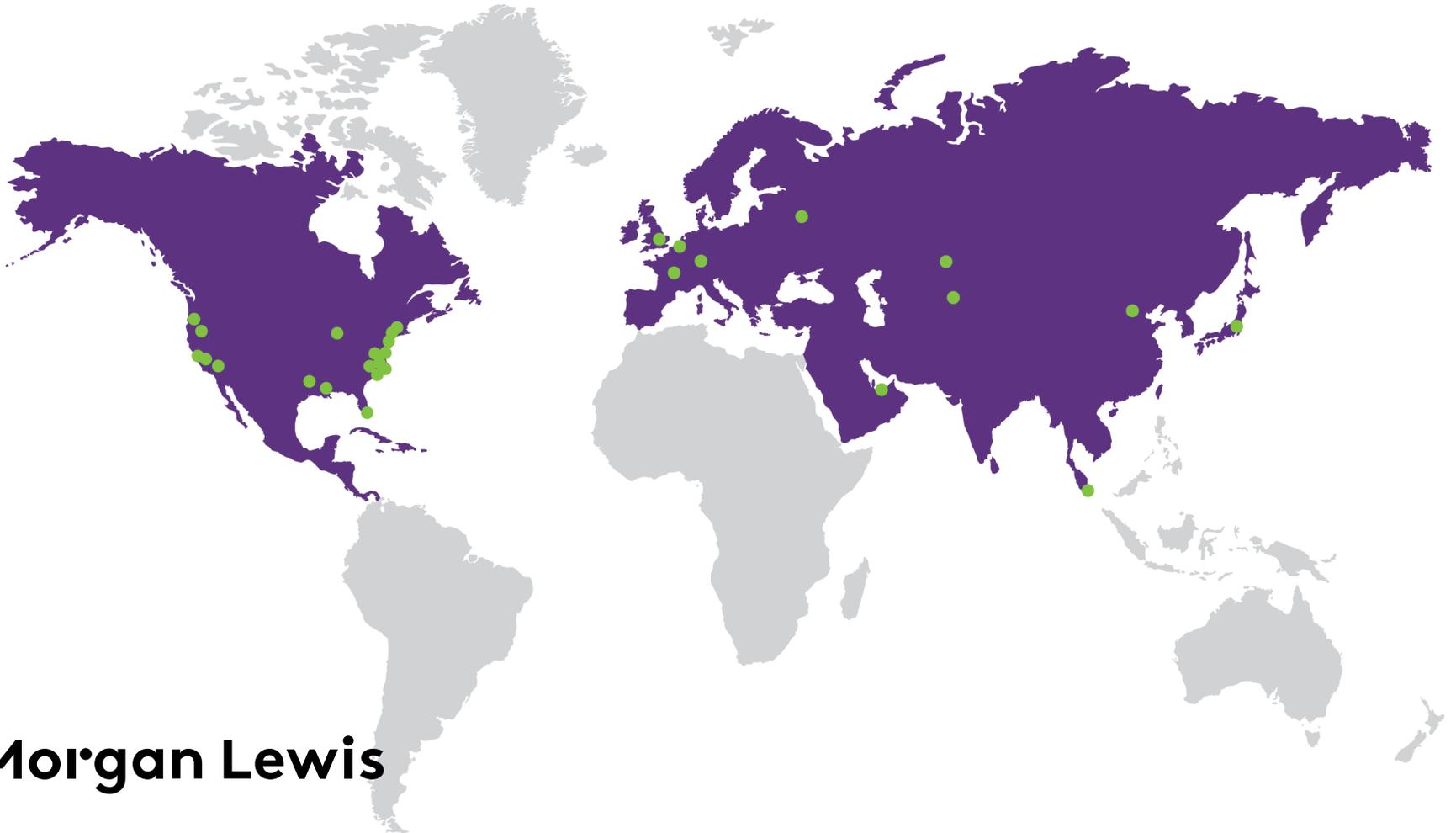
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Q&A and follow-up

- You may submit questions for us using the Q&A tool on your screen
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**PART II – OUTSOURCING ALERT:
ISSUES TO CONSIDER WHEN
NEGOTIATING NETWORK
OUTSOURCING TRANSACTIONS**

The Topics

- What is network outsourcing?
- An overview of the market
- Key considerations for the outsourcing contract

What is Network Outsourcing?

- Network outsourcing is a multiyear or annuity contract/relationship involving the purchase of ongoing network or telecom management services for managing, enhancing, maintaining, and supporting premises or core network infrastructure or enterprise telecommunications assets (including fixed and wireless).
- In addition to network or telecommunications management, network outsourcing isolates those services specifically delivered in a longer-term contract in support of network infrastructures: consulting/advisory services, network AD and integration, network infrastructure deployment, and support services.

(Gartner)

Network Infrastructure (defined)

Equipment, associated attachments, features, accessories, peripherals and Cabling and Software that are part of, or used to provide or support, the following (including Changes and replacements thereto):

- WAN: All WAN Equipment (including routers, network acceleration devices, firewalls, intrusion detection devices (IDS), intrusion prevention devices (IPS), multiplexers, modems, access circuits (including internet), backbone circuits, channel banks, CSU/DSUs, and associated diagnostic Equipment) and other Equipment, Software and tools used to manage, monitor, operate, and support the WAN;
- LAN: All LAN Equipment (including switches, bridges, intelligent and non-intelligent hubs, gateways, remote access devices, intrabuilding Wiring, and associated diagnostic Equipment) and other Equipment, Software, and tools used to manage, monitor, operate, and support the LAN;
- Wireless: WiFi access points and controllers and point-to-point bridges (including WiMAX);
- Voice Systems, including:
 - Telephony: All Infrastructure used to support and enable, or used by Authorized Users in connection with telephony services (including PBXs, PBX ports, key system ports, voicemail boxes, telephone handsets (and hands-free devices), conference sets (e.g., polycom), and fax converters) and parts and spares for the foregoing; and
 - Voice Over Internet Protocol (VOIP): All Infrastructure used to support or enable, or used by Authorized Users in connection with VOIP and session initiation protocol (SIP);
- Conferencing Systems: All Infrastructure used to support or enable, or used by Authorized Users in connection with audio conferencing, web conferencing, video conferencing, and telepresence;
- Enterprise Network Operations Center (ENOC); and
- Other Network Systems

Transport Systems

- Transport Systems: All Transport Systems, including all Transport Facilities and associated Software supported or provided by Service Provider in connection with the provision, Monitoring, or management of the Transport Services, including circuits

Network Services

- Service Provider shall be responsible for the procurement, provision, installation, delivery, management (including full Lifecycle support), Refresh, administration, operation, and support of the Network Environment, including Field Support and IMACs (the "**Network Services**"). The Network Services include the Managed Network Services and the Transport Services.
 - The "**Managed Network Services**" include all Network Services except for the Transport Services.
 - The Transport Services include all Services to manage, provide, and support the Transport Systems, including the management of Third Party Providers (as a customer of record or acting as an agent of Customer) including other Transport Vendors, and consists of the following:
 - Voice Transport Services, including the provision, delivery, and support of local service, long-distance service, toll-free inbound services, and cloud call routing services;
 - Data Transport Services:
 - MPLS circuits;
 - Private cellular circuits, including the Equipment and Services required to provide data Transport Services with authorized cellular carriers;
 - Point-to-point ATM and frame relay circuits;
 - Internet circuits;
 - Satellite System circuits; and
 - Analog circuits.

Market Forecast

- Managed Network Services
 - Internet Protocol (IP)/Virtual Private Network (VPN) services
 - Local Area Network (LAN)/Wide Area Network (WAN) services
 - WLAN services/Ethernet links
 - IP telephony services
 - Video conferencing and unified communications
- As a professional service, Managed Network Services extend from primary operational support to the entire life cycle management of a network.
- The Managed Network Services market is expected to grow from \$30.67 billion in 2014 to \$50.83 billion by 2019. Companies such as Alcatel-Lucent, Accenture, Ericsson, Huawei, Nokia Siemens Networks (NSN), and IBM are key market players.

(About MarketsandMarkets)

Key contract issues

- Scope
- Transition
- Managed Third Party
- Service Levels
- Termination
- Exit Rights
- Liability
- Audit
- Pricing
- Invoicing

Scope

- What is in scope?
- All Network Services or a subset?

*Service Provider shall procure, provide, manage and support all Transport Services, including the management of Third Party Providers **(as a customer of record or acting as an agent as directed by Customer)**. As part of the Transport Services, Service Provider shall be responsible for voice Transport Services (including the provision, delivery, and support of local service, long-distance service, toll-free inbound services, paging services, and cloud call routing services) and data Transport Services, including dial-up modem banks, MPLS (including VPN tunneling), private cellular (including the Equipment and services required to provide data transport services with authorized cellular carriers), point-to-point ATM and frame relay circuits, and internet and analog circuits.*

Scope

- Where do security services come in?

As part of the Managed Network Services, Service Provider shall (a) operate and maintain connectivity for all voice and data Networks, (b) monitor Network performance and Capacity, (c) perform voice and data design and integration, (d) obtain, maintain, renew, and manage FCC licenses and (e) perform Network security functions as directed by XXX.

Service Provider shall follow and implement all Customer security standards and policies. Service Provider shall implement and install in the Network Environment the agents and tools used by Service Provider, Customer, or Third Party Providers providing the Security Services.

Transition

- Pre-contract diligence of the existing environment and mapping to the new solution
 - Inventory
 - Assets and circuits (can they be pinged?)
 - Create/validate documentation and asset databases
 - Circuits
 - What is the life? Can they be terminated without charge?
 - What is the overlap time? How will that impact the business case?
 - Coordinate with Third Party Providers for the planning, delivery, and maintenance of circuits and demarcation points.
- Time line for cutover (by site or region?)
- Ability to change time line or put time line on hold
- Remedies if cutovers do not occur as planned

Managed Third Party Contracts

- Managed vs. Support contracts
- Is consent necessary?
 - Tracking the progress of Network transport orders and managing the installation prior to the IMAC, from order origination through final testing, implementation, and use.
 - Canceling Network transport services that are no longer required after completing the IMAC.
- Invoice validation requirements
 - TEMS?

Service Levels

- Types
 - Response time
 - Availability
 - Incident response and recovery
 - Time to repair/restore
- How are they measured?
 - Timing
 - Geographies?
- Third party failure – is that an excuse?
- Amounts at risk

Termination

- For convenience
- For cause
- For change in control
- Not “for cause”
 - Change in regulations
 - Change in business case
 - Force majeure disruption
 - Others

Exit Rights

- Then what happens ...
 - People
 - Assets
 - Right to transfer third-party contracts
 - Return of IP
- Termination Assistance
 - Duration
 - Scope
 - Costs

Liability

- Direct damages
- Indirect damages
- Security breaches
- Responsibility for third-party providers?

Audit

- Fees
- Books and records
- Facilities
- Processes
- Third parties?
- Disclosure requirements

Pricing

- Service Provider “management” fees
- Transport rates
 - Can they be pre-established?
 - What about all of the “other fees”? Can they be defined?
 - What are the change mechanisms?
 - Benchmarking

Pricing

- What are the commitments?
 - MRCs/Volume commitments
 - Minimum commitments by Circuit
 - How long?
 - What if there is an upgrade?
 - Notice requirements for removing
 - Overlap requirements
 - Termination fees by Tower/by Circuit
 - What happens when you change models?

Market Watch

- For the portion of the data transport services that the Service Provider is providing under its own arrangements rather than through Third Party Contracts in existence as of the Effective Date, the Service Provider will, at Customer's request, on or after the first anniversary of the Effective Date, but no more than once in any 12-month period, determine the prevailing market costs and performance (e.g., industry service levels) of data transport services.
- Customer shall have the option to participate in any such market watch activities.
- To the extent that the market watch reveals that the data transport Fees under this Agreement are higher than those prevailing in the market, after considering the Service Provider's reasonable recovery for management services, then the Fees for data transport services under this Agreement shall be reduced to eliminate such variance effective with the next invoice after the completion of the market watch activity.
- There shall be no upward adjustment to any Fees as a result of any market watch activity.

Invoicing

- Service Provider managed service fees
- Transport rates
 - Pass through?
- Inflation
- Currency
- Local country requirements

Wrap Up

- The big drivers
 - Globalization
 - Changes in technologies and solutions
 - Subject-matter expertise
- Convergence of telecom and outsourcing agreements
 - The shift to “managed services”

Biography



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Barbara Melby has been active in the outsourcing and commercial transaction legal market for the last 20 years. As leader of the firm's outsourcing and strategic commercial transactions practice, and one of the leaders of its privacy and cybersecurity practice, she represents clients in such complex transactions as outsourcing, strategic alliances, technology and data-related agreements, and other services transactions. She also advises businesses on privacy and security issues that arise in transactions involving sensitive data and technologies.

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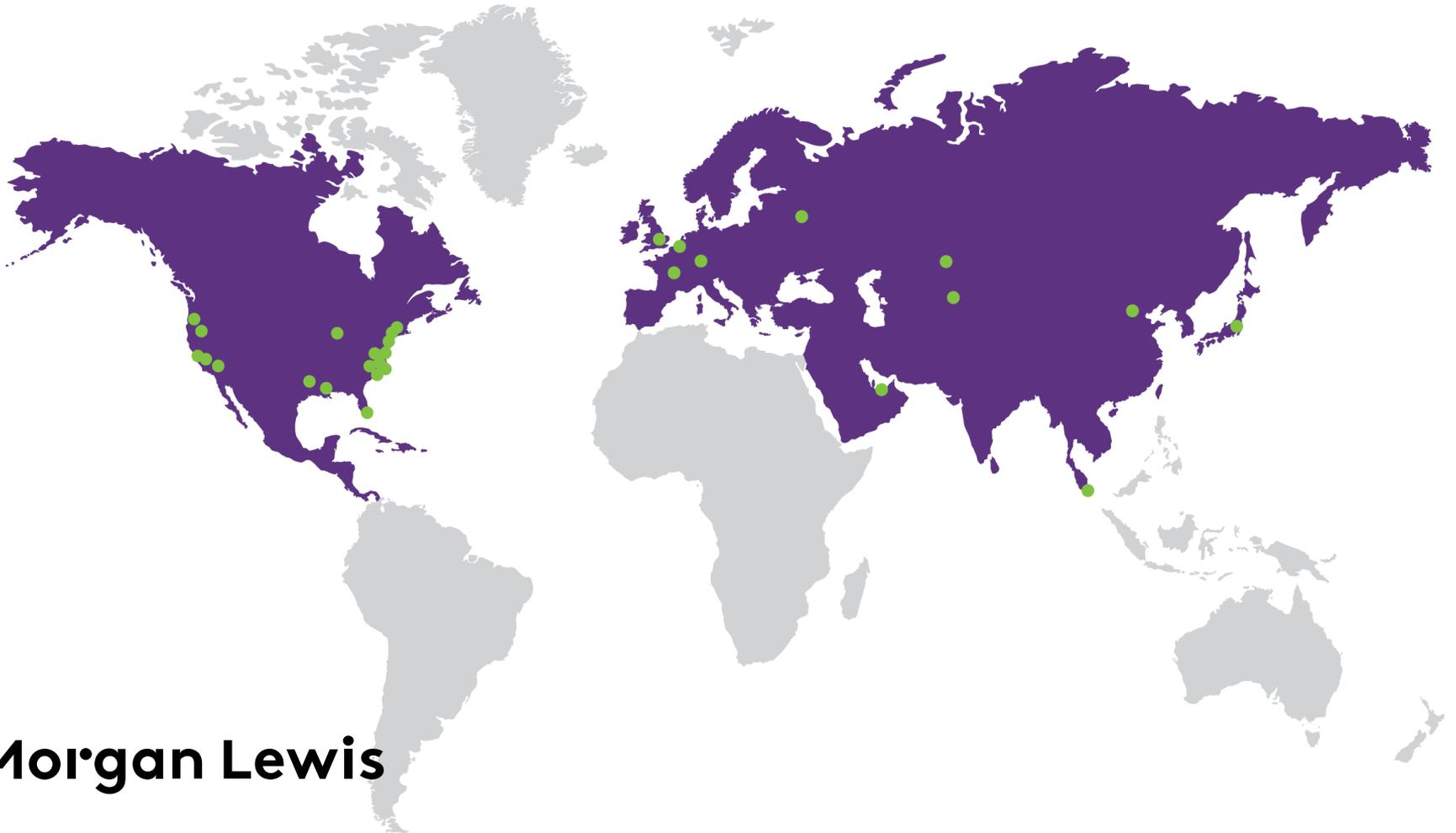
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