

# Sourcing World

This is a work of significant value to businesses from all industries which are considering their outsourcing options.

This second edition of *Sourcing World* serves as a single starting point of reference for corporations and their advisers. It provides valuable insights and guidance to international sourcing transactions, covering both contractual and commercial arrangements and their regulation.

Written by outsourcing experts, every chapter gives a detailed overview of the legal and regulatory framework within each jurisdiction and of the terms and conditions relevant to finalising an outsourcing deal. This is one of the first works to also cover commercial practices on key negotiation items, such as financial terms and pricing models. Further, this second edition contains a comparative chapter with an overview of common trends and local variations thereof, so that readers can build outsourcing arrangements on the lessons learned from many outsourcing transactions in multiple countries.



SECOND  
EDITION  
2015

Sourcing World

General Editors:  
Lukas Morscher Lenz & Staehelin  
Ole Horsfeldt Gorrissen Federspiel

THE EUROPEAN LAWYER  
REFERENCE

# Sourcing World

Jurisdictional comparisons

Second edition 2015

- Foreword** Lukas Morscher Lenz & Staehelin Ole Horsfeldt Gorrissen Federspiel
- Comparative overview** Ole Horsfeldt Gorrissen Federspiel
- Argentina** Marcelo Eduardo Bombau M & M Bomchil
- Austria** Wolfgang Tichy & Günther Leissler Schönherr Rechtsanwälte GmbH
- Brazil** Fábio LB Pereira & João CA Harres Veirano Advogados
- Canada** Dr Sunny Handa & Me Hélène Deschamps Marquis Blake, Cassels & Graydon LLP
- Czech Republic** Lenka Suchánková Pierstone
- Denmark** Ole Horsfeldt Gorrissen Federspiel
- Finland** Mikko Manner, Anna Haapanen, Juhani Sinkkonen Roschier, Attorneys Ltd.
- France** Thierry Dor & Foulques de Rostolan Gide Loyrette Nouel
- Germany** Prof. Dr Peter Bräutigam & Dr Thomas Thalhofer Noerr LLP
- Hong Kong** Chuan Sun, Victoria White, Fiona Chan & Sheldon Leung  
Freshfields Bruckhaus Deringer
- India** Sajai Singh J. Sagar Associates
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- Singapore** Ian Ferguson & Matthew Hunter Olswang Asia LLP
- Spain** Jorge Llevat, Alejandro Negro, Juan Bonilla & Carmen de Pascual Cuatrecasas,  
Gonçalves Pereira
- Sweden** Thomas Lindqvist & Bojana Saletic Hammarskiöld & Co
- Switzerland** Dr Lukas Morscher Lenz & Staehelin
- Turkey** Gokhan Enkur & Vehbi Geray Bilimer PAE Law Office
- United Kingdom** Ian Ferguson, Dominic Dryden & Matthew Hunter Olswang LLP
- United States** Brad Peterson Mayer Brown LLP

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& Ole Horsfeldt Gorrissen Federspiel

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Publishing Assistant  
Nicola Pender

Design and Production  
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Editing and Typesetting  
Forewords

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# Foreword

**Lukas Morscher, Lenz & Staehelin  
and Ole Horsfeldt, Gorrissen Federspiel**

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Today, outsourcing is an effective and, in most countries, mainstream management tool used to both reduce costs and achieve strategic goals. It is seen across many business activities in all industries, from back-office functions (such as finance & accounting, HR/payroll, facility management or call centres) to core processes (like research & development, production or banking transactions in securities trading) and infrastructure outsourcings (IT and telecoms including network communication and security services or application development and support).

Most businesses have long ventured beyond outsourcing of simple, commoditised services and rely deeply on well-designed value chains across nations and their outsourcing partners' ability and will to fulfil contractual arrangements that underpin strategic objectives, whether they operate onshore, nearshore or offshore.

Outsourcing arrangements, pricing models and the associated governance are becoming increasingly complex. While some globally accepted commercial models and practices have evolved, local regulations and customs still play a large role when negotiating deals. So how can firms be confident that they remain in charge of their own business and in control of their key risks?

The objective of this publication on sourcing law and practice across the globe is to create a single starting point of reference for practitioners – customers, vendors and advisers – involved in sourcing transactions covering both the contractual and commercial arrangements and the regulatory side to things.

The first edition of *Sourcing World* was published in 2012 and covered 19 jurisdictions. We are pleased that this second edition has been expanded and now covers 24 countries.

The format of the chapters, each from leading lawyers in that jurisdiction, follows a common order, thus enabling readers to make quick and accurate comparisons. While covering legal topics, the country contributions are strongly business-oriented and include valuable insights into local commercial practices, in particular related to financial terms and conditions, pricing models and key negotiation issues with price impact.

As local and regional commercial practices and risk allocation models vary significantly – even among countries that are all mature outsourcing markets – we have created a new comparative chapter in this second edition. It is intended to establish an overview and to enable practitioners to be inspired by recent common trends and local variations thereof, and on that basis to

craft outsourcing arrangements that are on the cutting edge and build on the lessons learned from many outsourcing transactions in multiple countries.

We would like to acknowledge the work and support of the legal experts who each have contributed with new or updated country-specific chapters.

*Lukas Morscher, Partner and Head of IT, Telecoms & Media, Lenz & Staehelin*

*Ole Horsfeldt, Partner and Head of Outsourcing, Gorrissen Federspiel*

*Zurich and Copenhagen, November 2014*

# Comparative overview

**Gorrissen Federspiel** Ole Horsfeldt

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## 1. INTRODUCTION

When embarking on an international outsourcing project, the contract drafting process often starts out with a few fundamental choices. What will the structure of the agreement look like? Will it be a framework agreement with local service agreements, central to central, central to local, etc? Very often, tax considerations will drive such structural choices. The other fundamental structural issue is choice of law (and the associated dispute resolution model).

In respect of choice of law, there are fundamentally two alternatives: either the main agreement and all local service agreements and service/work orders are governed by the same choice of law, or the main agreement is governed by the law of the jurisdiction of the customer's and the local service agreements are governed by local law. Irrespective of the choice of model, mandatory local law will apply in many aspects.

This book will assist you in assessing how the choice of a particular local law will work and which mandatory local laws will have to be complied with.

Generally, deciding between a single central law model or a local law model is not difficult, and depends on:

- the local service agreement and the structures of the local parties;
- how the governance model and dispute resolution model are intended to work;
- enforceability issues; and
- the choice of venue.

The real difficulty when negotiating international outsourcing agreements is in assessing and dealing with relevant local commercial practices. If a contract is negotiated in England between international parties but the service delivery is pan-European or pan-Asian, should English commercial practices prevail and how should local practices be taken into consideration? Is there such a thing as a common international outsourcing practice?

The short reply is that there are recognised international practices on a number of key negotiation items, that there are regional variations and that practices vary, based on the maturity of the outsourcing market in a particular region or country.

Based on the country chapters in this book, this comparative chapter identifies such common trends and practices on a number of key commercial issues.

## 2. AVERAGE DURATION OF PROCUREMENT PROCESSES

### 2.1 The average duration of procurement processes in months

It used to be that procurement exercises for large-scale outsourcing projects would take 12–18 months. Driven by a maturing professional advisor community and by customers' need for rapid implementation of business change and cost consciousness, the average procurement time now is only 6–8 months. See Figure 1.

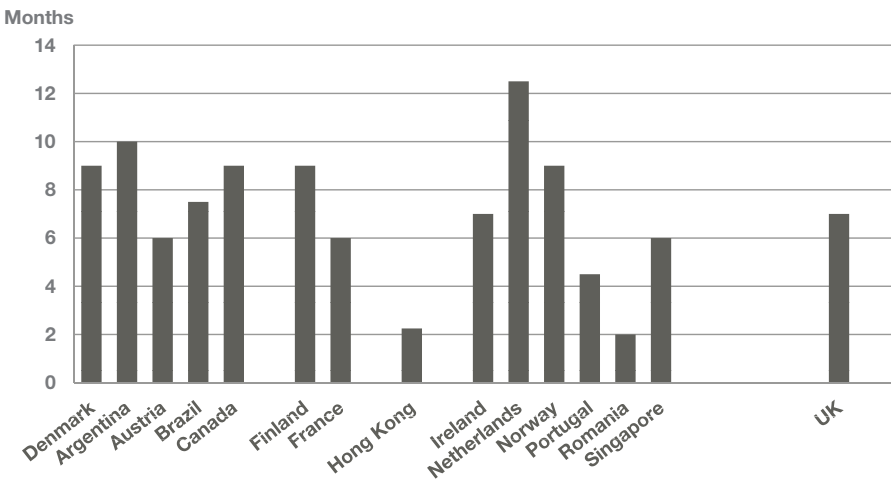


Figure 1: Average duration of the procurement processes

### 3. MANDATORY STATUTORY REGULATION ON OUTSOURCING

#### 3.1 Mandatory statutory regulation of outsourcing

Very few countries have general legislation pertaining to the practice of outsourcing. However, just about every country has sector-specific regulation relevant to the outsourcing of business processes or IT infrastructure. In particular, the telecoms and banking industries are subject to mandatory legal requirements when outsourcing. See Figure 2.

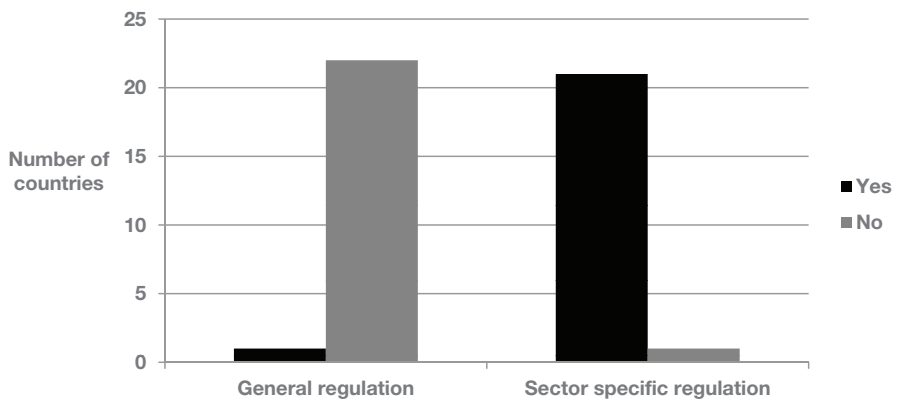


Figure 2: Number of countries with statutory regulation on outsourcing

### 4. PERSONAL DATA

#### 4.1 Mandatory statutory regulation of processing of personal data

The EU's Directive on the Processing of Personal Data has set global standards (while of course only being relevant to processing of data within the EEA and export of data outside of the EEA). Countries such as Argentina, Turkey, Singapore and Hong Kong now have legislation that must be observed when considering the data flows that will apply under an outsourcing arrangement.

### 5. TRANSFER OF EMPLOYEES AS PART OF AN OUTSOURCING TRANSACTION

#### 5.1 Mandatory statutory regulation of transfer of employees as part of an outsourcing transaction

Another EU-based concept, as presented in the Acquired Rights Directive, is the rights of employees when a part of a business is outsourced. This directive appears to be a European speciality – legislation or practices with similar effects will not generally be found outside the EEA.

## 6. TRUE-UP AND BASELINING

### 6.1 Is true-up or baselining a common commercial practice?

True-up or baselining is the practice associated with conducting a verification post-signing of the information and baselines compiled as part of the pre-signing negotiations. Mostly, such verification exercises work on the one hand as a reasonable safeguard to the benefit of the chosen vendor, while on the other hand as an opportunity to renegotiate at a time when the customer has lost all negotiation leverage.

In many mature markets, true-up exercises have been replaced by more elaborate pre-agreement due diligence and due diligence cut-off provisions. However, as illustrated in Figure 3, the true up or baselining practice is still in use in many countries.

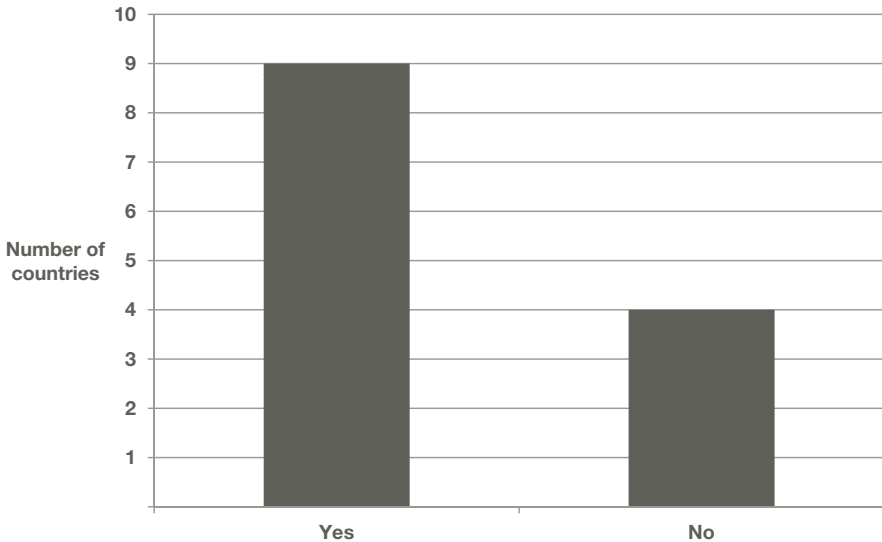


Figure 3: Is true-up or baselining a common commercial practice?

## 7. BENCHMARKING

### 7.1 Is it common commercial practice to benchmark at unit level, tower level or any other level?

The efficiency (from a customer perspective) of a benchmarking clause can be measured on two counts:

- the increments which are subject to benchmarking (fees per resource units, fees per tower or total fees); and
- whether automatic adjustment has been agreed or not. If not, any adjustment will be subject to negotiation and the customer's protection is weak.

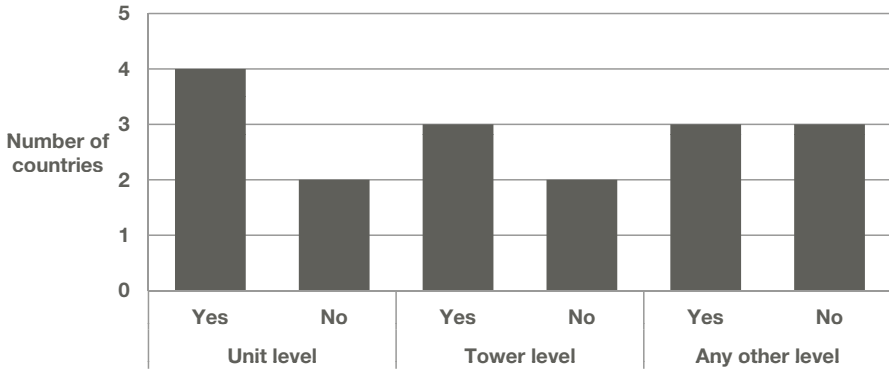


Figure 4: Is it common commercial practice to benchmark at...?

As illustrated by Figure 4, there is no common practice as to the incremental basis for outsourcing. Essentially, this is a negotiation topic that depends on the negotiation power of the customer.

Similarly, there are no clear trends towards automatic adjustments. In mature outsourcing markets, Western Europe and the USA, there is a tendency towards automatic adjustments. However, the unilateral right to require adjustments is tempered by caps applicable to yearly or total adjustments.

## 8. DURATION OF AN OUTSOURCING ARRANGEMENT

### 8.1 What is the common duration of an outsourcing arrangement in years

In recent years, most consultancies have advised that customers should opt for 4–5 year outsourcing arrangements. Certainly, there are few of the 10 year plus deals around, which used to be the norm for complex arrangements, but there is no evidence globally that outsourcing agreements in general have shorter terms than 5–7 years. See Figure 5.

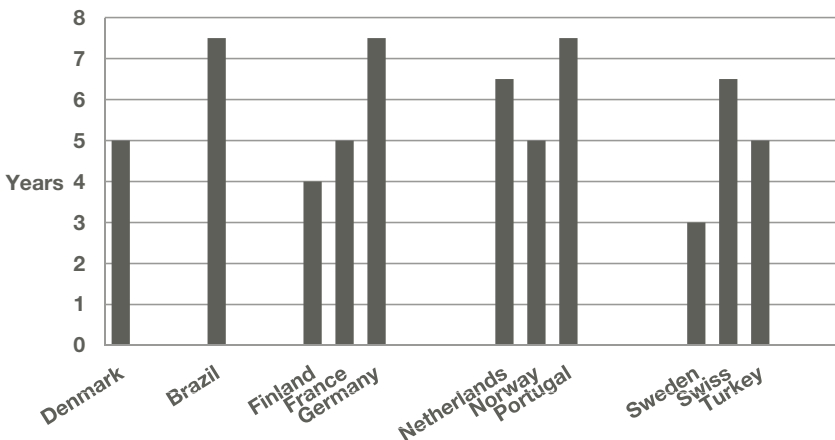


Figure 5: Common duration of an outsourcing arrangement

## 9. TERMINATION FOR CONVENIENCE BY THE CUSTOMER

### 9.1 Is it common practice for the customer to have a right to terminate for convenience?

A key element in the flexibility of an outsourcing agreement is whether the customer may terminate a part of an agreement for convenience, typically against the payment of termination fees. As illustrated by Figures 6 and 7, termination for convenience may take place per service tower, site or country, depending on the nature of the agreement. There is no clear global practice as to the parts of an agreement by which termination for convenience can take place, but there is an established practice that termination for convenience will apply in respect of both an agreement in its entirety and of parts of an agreement.

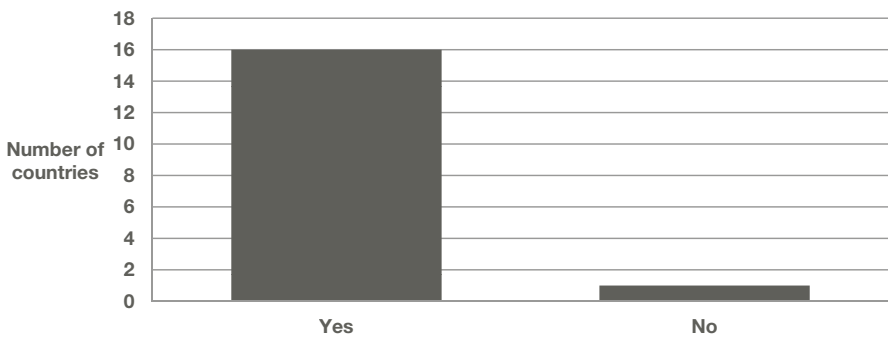


Figure 6: Is it common practice for the customer to have a right to terminate for convenience?

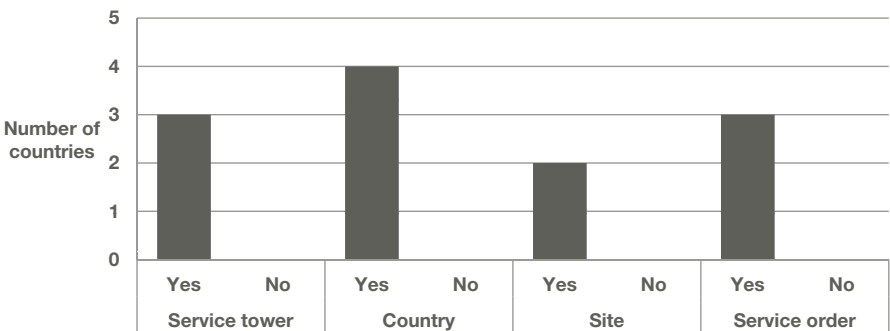


Figure 7: Which parts of an agreement may a customer commonly terminate for convenience?

# Singapore

**Olswang Asia LLP** Ian Ferguson & Matthew Hunter\*

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## **1. BUSINESS PRACTICE (INTERNATIONAL DIVISION OF LABOUR, BREAKING-UP VALUE CHAINS)**

### **1.1 Describe generally the maturity of the outsourcing market in your jurisdiction**

The market in Singapore is varied.

Singapore is a hub for many international companies in the Asia-Pacific region. The majority of these companies outsource some of their infrastructure and business processes. These arrangements are sometimes part of a global or regional outsourcing that has been initiated by the company's headquarters in, for example, Europe or the US.

The public sector in Singapore has been active in outsourcing in the past, but it appears now that the public sector is reversing this process and bringing infrastructure and business processes back in-house. There was a feeling that too much had been outsourced or, probably more precisely, too much know-how and skill had been outsourced and the public sector was too reliant on the suppliers. Another factor is digitisation. The Singapore government is a big supporter of e-government and, wherever possible, tries to automate, transform and digitise its services. This means that fewer resources are required to provide services and less ongoing support is needed from suppliers.

Otherwise there is no clear trend in favour of outsourcing. SMEs and local companies have not adopted outsourcing (of information technology (ITO) or business processes (BPO)) in the same way as similar organisations in Europe and the US have. This is because the cost savings are not as obvious. Singapore is in a region that still provides a lot of low-cost labour. The region has a youthful population that tends to be early adopters of technology. This means that companies do not need to rely so much on suppliers to provide this resource. Another reason why companies have not turned to suppliers is because of employment law. It is easier in Singapore to engage agency workers on a temporary basis, so companies use staff augmentation models to carry out their own transformation projects on an ad hoc basis.

There is also a cultural difference that has affected outsourcing. Many local companies are reluctant to outsource because they are risk averse and trust themselves to provide services more than they trust a supplier.

In the financial services sector, the Monetary Authority of Singapore (MAS) has set out detailed guidance about the steps that a regulated institution (local and international) must take if it wishes to outsource

\*The authors wish to acknowledge the contributions of and thank Oo Ban Leong at Prolegis LLC and Shaun Lee and Daniel Jung at Olswang Asia LLP.

services. In many markets, the financial services sector is generally one of the heaviest users of ITO and BPO, but in Singapore MAS's detailed regulations has resulted in a slower and more cautious approach to outsourcing.

There are a couple of exceptions to this trend of slow uptake locally of outsourcing:

- cloud-based services (see below); and
- digitisation and transformation. Local companies (big and small) are increasingly adopting digital and automated solutions. This is not seen as outsourcing but more as implementing improvements to processes and efficiency levels (often with the help of a supplier) by leveraging new technologies.

## **1.2 How are cloud-based services affecting traditional outsourcing models?**

A study by the Infocomm Development Authority of Singapore (IDA; effectively the chief information officer of Singapore) found that large companies (1,000+ employees) in Singapore are highly mature in terms of cloud adoption, with 40 per cent of business adopting software as a service (SaaS) and more than 90 per cent of the market segment already leveraging infrastructure as a service (IaaS). The benefits of cloud solutions are also attracting smaller companies. Singapore is a technology hub in the region. The government provides a number of funding options to start-up companies, especially those in the IT space, who take advantage of cloud solutions.

Singapore maintains a leading position in ASEAN in terms of cloud adoption and maturity, according to a market study commissioned by IDA. The government has gone a step further, and IDA has launched a number of initiatives to promote and support the adoption of cloud. IDA's focus is on seeding cloud efforts and sharpening the overall competitiveness of Singapore with the adoption of cloud. IDA recognises the benefit of cloud services and encourages companies in Singapore to benefit from them, but wants the use of cloud services to be secure. IDA has therefore published its own Multi-Tier Cloud Security (MTCS) Certification Scheme. Its aim is to encourage the adoption of sound risk management and security practices by cloud service providers through certification. IDA has provided assistance with the certification process (including grants) and a number of suppliers have already been certified.

For financial services institutions, MAS, in the past, has been averse to the use of cloud (in particular, public cloud) because cloud is seen as a threat to Singapore's reputation as a secure environment for financial services. However, it appears from its recent consultation this year on its outsourcing regulations that MAS is viewing cloud more favourably. MAS listed cloud (or rather SaaS, platform as a service (PaaS) and IaaS) as types of outsourcing transaction and refers to multi-tenanted solutions in its consultation. MAS appears to be saying that regulated institutions can use cloud solutions so long as they comply with the usual guidelines for outsourcing.

### 1.3 Describe the current supplier landscape

Most (if not all) of the major international suppliers (including Accenture, IBM, HP, Tata, Wipro, CSC) operate in Singapore. There are also a number of local suppliers, such as NCS and The Optimum.

## 2. PROCUREMENT PROCESS, ROLE OF BUSINESS ADVISORS AND MATURITY OF THE CONSULTANCY INDUSTRY

### 2.1 Describe generally the procurement process

#### Public sector

Public procurement is governed by the Government Procurement Act 1994 and related regulations. The Ministry of Finance is responsible for the Government Procurement (GP) policy framework, which governs how government agencies conduct their procurement within the GP framework.

The GP framework is based on the principles of fairness, transparency and value-for-money:

- **Transparency.** An open and transparent procurement system. The Singapore government's procurement requirements, procedures and evaluation criteria for quotations and tenders are published openly on the Government Electronic Business (GeBIZ) portal.
- **Open and fair competition.** Suppliers are given equitable opportunities and access to compete on a level playing field and are treated fairly. Suppliers are given the same information for them to prepare their bids.
- **Value for money.** The Singapore government procures from sources that can best meet its requirements and which offer the best value. Value for money is derived from the optimal balance of benefits and costs on the basis of total cost of ownership. Value for money does not necessarily mean that a tender or quotation must be awarded to the lowest bidder.

The need for any intended procurement must be approved by the relevant approving authority before the procurement process can commence.

Depending on the estimated value of the procurement, the procurement procedure adopted could be by way of a small value purchase (up to SGD 3,000 in estimated procurement value), quotations (SGD 3,000, up to SGD 70,000), or tender (more than SGD 70,000).

There are three types of tender procedures:

- **Open tenders.** Tender notices are posted on the GeBIZ website to invite any supplier who may be interested to bid based on the requirements specified.
- **Selective tenders.** Selective tenders are used for more complicated purchases with sophisticated requirements. Applicants are shortlisted based on their capabilities through an open pre-qualification exercise. The shortlisted applicants are then invited to submit their tenders.
- **Limited tenders.** These tenders are by invitation only, and may be open to one or a few suppliers. Limited tenders are used when the project concerns national security, or when it is not feasible or practical to call for open tenders.

The default tender procedure is generally an open tender.

Public procurements, especially the open and selective tenders, involve standard terms and conditions, and there is little or no scope to amend those. If the relevant agency or body is amenable to negotiating the terms and conditions, this will either be in the course of a limited tender and/or will be flagged in the invitation to tender.

Following the relevant tender process, the procurement procedure continues with an evaluation stage and finally the approval of the award of the contract:

- Evaluation. Suppliers' bids are evaluated holistically, according to the principle of value for money. This means that the suppliers' offers are evaluated not only in terms of price, but also whether they have complied with all the requirements in the tender specifications and other factors such as quality of the goods and services, timeliness in delivery, reliability and after-sales service support. Depending on whether it is a quotation or a tender, one or more officers will evaluate suppliers' bids before making their recommendation to the appropriate approving authority for consideration.
- Approval of award. To ensure checks and balances in the procurement process, the officer(s) evaluating the bids must be different from the officer(s) approving the award of the bid. This applies for both quotations and tenders. Quotations are approved by at least one officer, while tenders are approved by a tender board of at least three officers. The approving authority considers the recommendation and justifications, and may seek clarifications from the evaluating officer(s) before accepting the recommendation. An award notice with the name of the supplier awarded the contract, as well as the contract sum awarded, will be published on GeBIZ.

### **Private sector**

The outsourcing organisation should define its requirements and assess which suppliers could meet them. This process might involve inviting potential suppliers to respond to a request for information (RFI) and/or a more limited number of potential suppliers to submit bids against a request for proposal (RFP). The number of potential suppliers invited to participate depends on the type, complexity and value of the proposed outsourcing.

A supplier is usually selected to negotiate the outsourcing contract with the customer. Occasionally, in more complex transactions or where a customer wishes to maintain competition, two or more potential suppliers may be required to participate in parallel contract negotiations. Parallel negotiations may be difficult to manage given the increased resources required from the customer and can add significantly to the costs of procurement.

### **2.2 What is the average duration of a private procurement process?**

If the procurement process is measured from the start of a project internal to the customer (ie from taking a decision that an activity should be outsourced), including the RFP process through to the go-live date, the

duration of the process can vary significantly. A smaller outsourcing project can be completed within a couple of months, whereas a larger outsourcing project usually takes at least a year.

### **2.3 Which roles and tasks are generally performed by business advisors, including legal advisors?**

Business advisors are often engaged during the supplier selection process, in the course of contract negotiations, during the implementation and day-to-day operation of the outsourced services, and on exit from the outsourcing contract. There are not as many experienced advisors based in Singapore as in Europe and the US.

The best sourcing advisors will have experience of the new technology solutions, how to implement them, the relevant suppliers and the latest pricing models. Some advisory firms offer only strategic advice, while others will assist and run the transaction.

There are also in-house legal teams and external law firms that specialise in sourcing transactions. They provide assistance from the start of a transaction (including advising on strategy) and during the RFP process, the contract negotiation and any subsequent steps.

Very few advisory firms offer the full spectrum of advice and support required for the entire project lifecycle, ie from strategy development to solution design (including target operating model and supplier selection), implementation (including negotiating and contracting) and ongoing supplier relationship/contract management. Traditionally, an organisation looking at a sourcing transformation project may need to engage a number of business advisors to support it. There are only a few advisors who offer an integrated advisory service.

## **3. STATUTORY RULES, INDUSTRY SPECIFIC REQUIREMENTS AND REGULATIONS**

### **3.1 Which statutory rules govern sourcing transactions in general?**

There are no national laws specifically regulating outsourcing transactions in Singapore.

### **3.2 What are the legal or regulatory requirements concerning outsourcing in any industry sector?**

#### **Financial services**

Financial institutions (as defined by section 27A(6) of the Monetary Authority of Singapore Act (Cap.186)) are regulated by the Monetary Authority of Singapore (MAS). In connection with any outsourcing, financial institutions must comply with the following:

- the MAS Guidelines on Outsourcing (2004, updated 1 July 2005); there is a proposed new draft of these guidelines, which is accompanied by a new notice that MAS is currently consulting on;
- the MAS Notice 634 Banking Secrecy, Conditions for Outsourcing (19 February 2003, revised 25 May 2004);

- the MAS Circular on IT Outsourcing and related Technology Questionnaire (14 July 2011); and
- the MAS Guidelines on Technology Risk Management (June 2013) and MAS Notice on Technology Risk Management (21 June 2013).

The 2004 MAS Guidelines on Outsourcing set out MAS's expectations of a financial institution that has entered into an outsourcing or is planning to outsource its business activities to a supplier. A financial institution must notify MAS when it is planning or has entered into a material outsourcing, or is planning to vary a material outsourcing.

The 2004 Guidelines define 'material outsourcing' as an outsourcing arrangement which, if disrupted, has the potential to significantly impact a financial institution's business operations, reputation or profitability. However, note that the reference is to 'significant' IT outsourcing in the MAS Circular on IT Outsourcing.

The 2004 Guidelines require a financial institution to assess, in an outsourcing, the degree of materiality to the institution. MAS lists the factors to be considered. Outsourcing of all or substantially all risk management and internal control functions, including compliance, internal audit and financial accounting, is deemed material.

A financial institution is also required to undertake periodic reviews of its outsourcing arrangements to identify new material outsourcing risks as they arise. Material outsourcing risks may also arise when the supplier, in a material outsourcing, subcontracts.

MAS also requires financial institutions to notify it of:

- any adverse development arising in an outsourcing that could significantly affect the financial institution; and
- any breach of legal and regulatory requirements by the supplier.

Regardless of the materiality of the outsourcing, the guidelines specify certain contractual provisions and safeguards to be included in the outsourcing agreement between the financial institution and its supplier.

MAS may require a financial institution to terminate or make alternative outsourcing arrangements if the confidentiality of its customer information or the ability of MAS to carry out its supervisory functions cannot be assured.

MAS Notice 634 Banking Secrecy, Conditions for Outsourcing provides that, when a bank in Singapore outsources to a supplier any operational function which will be performed by the supplier outside Singapore and disclosure of customer information to the supplier is involved, the bank must comply with conditions set out in the appendix to that notice.

The 2011 MAS Circular on IT Outsourcing sets out obligations on financial institutions, including a requirement to complete and submit a detailed Technology Questionnaire for Outsourcing and consult with MAS before committing to any significant IT outsourcing. Outsourcing involving customer personal or account data, transactions, deposits, loans, payment card data, trading details and investment portfolios is generally considered as significant.

The 2013 MAS Guidelines and Notice on Technology Risk Management are the most recent MAS pronouncements which have an impact on outsourcing by financial institutions. They do not replace or supersede the 2004 Guidelines on Outsourcing or the 2011 Circular on IT Outsourcing. However, specified guidelines, circulars and security advisories were cancelled on the issuance of the 2013 Guidelines and Notice. These include the 2008 Internet Banking and Technology Risk Management Guidelines, the 2009 Circular on Endpoint Security and Data Protection and the 2010 Circular on Information Systems Reliability, Resiliency and Recoverability.

The 2013 Guidelines are statements of industry best practices which financial institutions are expected to adopt. While the 2013 Guidelines are not legally binding, MAS will take a keen interest as to how and the extent to which financial institutions have implemented them, and stresses that the degree of observance with the spirit of the 2013 Guidelines by a financial institution will impact MAS's overall risk assessment of that financial institution.

MAS Notice 644 on Technology Risk Management contains prescriptive requirements for availability, recoverability and reliability of critical systems (for example, ATMs, online banking systems and systems which support payment, clearing or settlement functions). The notice applies to financial institutions and not just banks.

The notice requires the financial institution to:

- put in place a framework and process to identify critical systems;
- maintain high availability and ensure that the maximum unscheduled downtime for its critical systems does not exceed four hours within 12 months;
- recover critical systems in four hours or less in the event of any disruption to the critical system; and
- inform MAS in writing within one hour of discovery of the relevant system malfunction or IT security incident, and submit a root cause and impact analysis report to MAS within 14 days (or such longer period as MAS may allow) of occurrence.

MAS emphasises that outsourcing by financial institutions, in any configuration or at any location, should not impede MAS in carrying out its supervisory functions, and therefore its guidelines, circulars, notices, regulations are applicable to financial institutions which operate systems that are used by Singapore operations but hosted overseas.

Financial institutions are required to put in place a proper framework, policies and procedures to evaluate, approve, review, control and monitor the risks of all its outsourcing activities and to carry out due diligence, before the supplier is appointed, to determine its viability, capability, reliability, track record and financial position.

MAS stipulates that the power of regulatory authorities to carry out inspections, supervisions or examinations of the supplier's roles, responsibilities, obligations, functions, systems and facilities must be set out in the outsourcing agreement. MAS has clarified that the right to examine suppliers to obtain information stored at or processed by suppliers, and

the right to access any report or finding made on the services rendered to financial institutions is integral to MAS's supervisory efforts.

While MAS accepts that financial institutions may not have the legal prerogative to amend legacy outsourcing contracts, it expects financial institutions to ensure that the regulatory supervision requirement is met when revising, renewing or extending legacy outsourcing agreements.

The current consultation from MAS on its outsourcing notice and guidelines suggests that MAS will tighten some of the requirements on outsourcing. The key changes proposed by the MAS relate to:

- a more detailed due diligence process, including a requirement to carry out due diligence on the staff of the supplier;
- a requirement to report adverse incidents to MAS; and
- more detailed requirements covering regular audits and reviews of outsourcing arrangements.

It is not yet known, at the time of writing, when the new rules will come into force.

### **Cloud computing**

As cloud computing is a form of outsourcing, the guidance in the 2013 MAS Guidelines would apply.

### **Business process**

Other than in relation to financial institutions, there are no additional regulations relevant to a business process outsourcing.

### **IT**

Other than in relation to financial institutions, there are no additional regulations relevant to an IT outsourcing.

### **Telecommunications**

Telecommunications operators are regulated by IDA.

The Telecommunications Act 1999 (Cap. 323), as amended, does not directly prevent or restrict a telecommunications operator from outsourcing. Nonetheless, there may be specific restrictions in the conditions of any IDA licences (whether facilities-based or services-based) held by that telecommunications operator that could prevent or restrict the outsourcing transaction.

### **3.3 What are the applicable rules regarding control or monitoring of the supplier, reporting to the regulator, rights of access to, and audit of, the supplier's records to be granted to the regulator, segregation of staff, functions or entities?**

Section 3.2 above includes the applicable rules regarding audit and reporting in the financial services industry.

### **3.4 Which services (if any) must be performed by a regulated or specially licensed entity, or any specially trained personnel?**

There is no general requirement for suppliers to be licensed or regulated, but regulated financial institutions have an obligation to ensure, as a minimum, that their supplier has the ability, capacity and any authorisation required by law to perform the outsourced services reliably and professionally. See section 3.2 above for more details.

In addition, government policy for the public sector is that certain data should remain in Singapore and that MTCS certification is required for participation in government tenders.

### **3.5 What are the requirements for regulatory notification or approval of outsourcing transactions in any industry sector?**

Regulatory notifications to MAS and/or approval by MAS of the outsourcing arrangement are required for financial institutions (*see section 3.2 above*).

## **4. DATA PROTECTION, TRANS-BORDER DATA FLOWS, PROFESSIONAL SECRECIES, CLOUD COMPUTING**

### **4.1 What are the requirements for a third party to process data on behalf of the data controller?**

If an organisation is using a supplier to process data on its behalf, the organisation is responsible for the performance of that supplier under the Personal Data Protection Act 2012 (PDPA).

Best practice for organisations undertaking activities that will be caught by the PDPA is as follows:

- undertake an appropriate level of due diligence to assure itself that the supplier is capable of complying with the PDPA;
- if the supplier is based outside of Singapore, or if its servers or systems are based outside of Singapore, the customer will be aiming to ensure that the jurisdiction in question has an adequate level of protection;
- include appropriate contractual protections in the outsourcing agreement; and
- for suppliers to include appropriate back-to-back obligations in their agreements with subcontractors.

Financial services institutions that use a supplier to process data on their behalf should also consider MAS's requirements. See section 3.2 above.

### **4.2 What are the rules and regulations regarding data protection and data security, confidentiality of customer data, banking secrecy and other professional secrecies?**

The PDPA places obligations on how organisations collect, use and disclose personal data.

The banking secrecy rules under section 47 of the Banking Act 2008 (Cap.98) place financial institutions under statutory obligations of secrecy in respect of customer account information. Financial institutions are allowed to disclose information about customers and their accounts only in very limited circumstances. The additional MAS rules and guidelines discussed

above also apply if a financial institution transfers its customer data to suppliers.

#### **4.3 Which rules govern the transfer of data outside your jurisdiction?**

Organisations are not permitted to transfer personal data outside of Singapore unless they provide a *'standard of protection to personal data so transferred that is comparable to the protection under the [PDPA]'*. There is currently no 'white list' of jurisdictions that are deemed to offer appropriate levels of protection, although established data protection regimes (eg in Europe) would be more likely to pass the test than those without an existing legal framework.

The Personal Data Protection Commission (PDPC) has provided guidance on the transfer of personal data outside of Singapore. The PDPC has confirmed that personal data may also be transferred outside of Singapore pursuant to contractual protection or binding corporate rules that ensure adequate protection of the data comparable to that under the PDPA.

#### **4.4 Are data transfer agreements contemplated or in use?**

There is no prescribed form of data transfer agreement, but organisations will already be using their own forms of data transfer agreement to transfer personal data outside of Singapore in accordance with the PDPC's guidance. There is no requirement to notify or obtain approval from the PDPC for transfers of personal data outside of Singapore.

#### **4.5 Is a data transfer agreement sufficient to legitimise transfer, or must additional requirements (such as the need to obtain consent) be satisfied?**

A data transfer agreement is sufficient to legitimise a transfer of personal data outside of Singapore. It is best practice to notify individuals that this will be the case in a company's privacy policy, but this is not a legal requirement.

#### **4.6 In cloud computing, which precautions (contractual, factual, others) are usually taken to protect, or to allow control over, the data?**

Users of cloud computing are often under obligations not to transfer data into or out of certain jurisdictions, or they may wish not to do so due to concerns about regulatory interception or inadequate security, and this has led to the development of local cloud environments (where data is not transferred outside Singapore). Customers with sensitive data (eg banks and healthcare organisations) may prefer to use a 'private cloud' model, even though much of the economic benefit promised by cloud computing is lost.

Users of cloud computing use their contracts with cloud service providers to protect their data. They may also carry out due diligence on cloud service providers and review the arrangements periodically. Many customers of cloud computing (especially customers with sensitive data, customers who are sharing a lot of data with the cloud service provider and customers spending significant sums with cloud service providers) often ask for an

audit right in order to protect their data. Audit is rarely an easy point to negotiate in an outsourcing transaction, and is even less so in a public cloud arrangement, where suppliers see audits as a security risk and expensive to service in the context of the lower cost solution they are providing. Customers are therefore considering other options, such as third party audits, self-audit by the supplier, limited review rights and/or third party certification.

#### **4.7 How is supplier liability for breach of data protection requirements generally handled?**

##### **Liability under the PDPA**

The kinds of financial liabilities that organisations could be exposed to under the PDPA include fines of up to SGD 1 million. It is not expected that the PDPC will, at least in the first instance, issue fines and publicly 'name and shame' offenders; rather, it is more likely that the PDPC will carry out private investigations into wrongdoings and seek confirmations and undertakings from organisations that are in breach of the PDPA.

Most of the obligations in the PDPA apply to customers rather than suppliers. Customers will therefore be subject to more scrutiny and exposed to more liability under the PDPA. However, both customers and suppliers are liable for certain obligations under the PDPA, including the obligation to keep the personal data secure.

##### **Liability under laws protecting confidentiality**

Breach of confidence in relation to customer data can give rise to:

- damages claims;
- injunctions preventing further authorised use of the relevant information; and
- in certain circumstances (eg banking secrecy), an award of an account of the profits made by virtue of use of the confidential information (usually imposed on the bank, rather than the supplier).

Businesses may also face enforcement action by the PDPA, including fines (see above). Firms in the financial services sector may be exposed to significantly higher fines for failing to protect customer data (based on financial services legislation rather than the PDPA). Fines can go up to SGD 250,000. However, as with the PDPC, in the first instance it is probably more likely that the MAS will investigate any alleged non-compliance rather than publicly 'name and shame'.

##### **Contractual liability**

The parties are generally free to exclude most forms of liability. The parties can also agree a financial limit on liability. This can be a fixed amount, or a percentage or multiple of the contract value. See section 11.4 below for more on this.

## **5. ASSET DEAL, LEGAL CONCEPTS AND MECHANICS**

### **5.1 What legal concepts apply to the transfer of assets in an outsourcing?**

The purchase of immovable property in Singapore has to be effected by deed. The deed is registered at the Singapore Land Registry to secure priority and provide evidence of title. However, title passes on signing of the deed, not on registration.

Transfers of intellectual property and licences must generally be made in writing and, depending on the type of right, can require registration at the Intellectual Property Office of Singapore. The licensor's consent may also be required.

The transfer of movable property will typically be formalised in a sale and purchase agreement signed by the relevant parties.

Transfers of contracts must be made in writing. The terms of each contract should be reviewed to see if it can be assigned without consent of the counterparty.

### **5.2 Are there particular considerations for the transfer of assets offshore?**

To the extent that the customer is a Singapore company and needs to transfer (probably by way of a licence arrangement) its own technology to a supplier in a jurisdiction outside of Singapore for the purposes of that supplier using that technology to provide services to the customer, the application of export and licensing controls under Singapore's Strategic Goods (Control) Act 2002 (Cap. 300) (SGCA) should be considered.

The SGCA applies to so-called 'dual-use' assets, which are goods/technology capable of being used for both a military and non-military purpose.

The SGCA regulates the export and transfer of strategic goods, strategic goods technology, and goods and technology capable of being used to create weapons of mass destruction. These exports and transfers include the electronic transfer of these strategic goods and technology, including the intangible transfer of technology (ITT).

Parties who wish to export relevant strategic goods and technology or engage in ITT must first obtain the relevant permit from Singapore Customs.

## **6. HR, TRANSFER OF UNDERTAKING, MASS DISMISSAL, REPUTATION ASPECTS**

### **6.1 In what circumstances (if any) are employees transferred by operation of law:**

#### **6.1.1 to a supplier in an initial outsourcing?**

#### **6.1.2 to a supplier on a change of supplier?**

#### **6.1.3 back to the customer on termination of an outsourcing?**

In practice, an outsourcing in Singapore may or may not involve a business transfer. The question of whether a business transfer is involved goes towards determining whether employees are transferred by operation of law to the recipient company.

There are two categories of employees in Singapore:

- employees who do not fall within the ambit of the Singapore Employment Act 2009 (Cap.91) (SE Act) (non-EA employees); and
- employees falling within the ambit of the SE Act (EA employees).

Non-EA employees are employees with 'managerial or executive functions', which include:

- the authority to influence or make decision on issues such as recruitment, discipline, termination of employment, assessment of performance and reward;
- involvement in the formulation of strategies and policies of the enterprise; and
- the management and running of the business.

They also include professionals with tertiary education and specialised knowledge/skills, whose employment terms are comparable to those of managers and executives. However, with effect from 1 April 2014, if the managerial or executive functions are earning less than SGD 4,500 per month they will be regarded as EA employees for the purposes of the SE Act.

EA employees are:

- workmen (as defined in the SE Act) who are in receipt of a salary not exceeding SGD 4,500 per month; and
- employees (other than workmen) who are in receipt of a salary not exceeding SGD 2,500 per month.

Under section 18A(1) of the SE Act, the transfer of employment for EA employees takes place automatically upon the transfer of an undertaking, or part of an undertaking, from one person to another. There will not be any automatic transfer of contracts of services for non-EA employees. The practice is to terminate their employment contracts with the transferor and for the non-EA employees to be offered new employment contracts with the transferee.

The SE Act defines an '*undertaking*' as including any '*trade or business*' and '*transfer*' as including '*the disposition of a business as a going concern and a transfer effected by sale, amalgamation, merger, reconstruction or operation of law*'.

The above considerations would apply on the initial outsourcing, on a change of supplier and on termination of the outsourcing agreement.

## **6.2 If employees transfer by operation of law, which terms and effects apply?**

Section 18A(1)(a) of the SE Act stipulates that the transfer of undertaking will not operate to terminate a contract of service of an EA employee but that contract of service will have effect after the transfer as if originally made between the employee and the transferee, and that the period of employment of the employee will count as the period of employment with the transferee (that is, the transfer will not break the continuity of the period of employment).

The period of employment is likely to be relevant to the computation of service-related entitlements, such as annual leave, maternity leave and notice of termination (if relevant).

Section 18A(2)(a) of the SE Act provides that the transferor's rights, powers, duties and liabilities under or in connection with the relevant contracts of service will be transferred to the transferee.

In the case of non-EA employees, the relevant employment contracts with the transferor will have to be formally terminated and the employees immediately re-employed by the transferee. Unless contractually agreed otherwise, there is no need for the transferee to offer the non-EA employees new terms of employment. There is no rollover of liabilities and obligations from the transferor to the transferee. In practice, however, companies commonly provide offers for re-employment on substantially similar terms and allow a rollover of benefits so as to retain the required employees.

### **6.3 How can the customer (contractual or other) retain particular employees, or make them redundant?**

If the customer wants to retain a particular employee, it could do this by agreement with the supplier and employee. It could also reassign the employee away from the services, or the employee could object to the automatic transfer and be re-engaged by the customer.

There is no legislation in Singapore providing for payment of compulsory retrenchment (that is, redundancy) benefits on termination of an employee by reason of retrenchment. It would be a matter for the parties to determine as a matter of contract. In the absence of any contractual entitlement (whether express or implied), retrenchment benefits are not required.

For EA employees, section 45 of the SE Act states that no employee who has been in continuous service with an employer for less than three years will be entitled to any retrenchment benefit on the termination of his service on the ground of redundancy or by reason of any reorganisation of the employer's business. From 1 April 2015, an employee who has been in continuous services with an employer for at least two years can request retrenchment benefits. The SE Act does not impose a positive obligation on the employer to pay retrenchment benefits and is silent on the amount of retrenchment benefit payable to employees.

### **6.4 To what extent can a supplier harmonise terms and conditions of transferring employees with those of its existing workforce?**

The transferee effectively steps into the shoes of the transferor as the employer of the transferred EA employees. However, notwithstanding sections 18A(1)(a) and 18A(2)(a) of the SE Act, it may not be possible to offer the exact same terms of employment to the transferred EA employees in practice. Section 18A(12) of the SE Act allows the transferee to negotiate with employees for the purpose of agreeing to terms of service that are different from those preserved under section 18A(12).

Accordingly, the transferee may seek to harmonise the differences in employee benefits. To the extent that there may be differences in the terms

of employment (administratively or otherwise), these differences should be implemented as a variation of contract. If the variations are likely to materially affect the employees' contractual entitlements, the employees' consent should be obtained in the course of the harmonisation exercise. Where the differences are purely administrative, it is likely that notice of the changes will suffice.

### **6.5 Can the parties structure the employee arrangements of an outsourcing as a secondment?**

Secondment can be used in outsourcing arrangements. Most employees (depending on the terms of their contracts of employment) can be required to go on secondment. The parties should enter into a secondment agreement to formalise the terms of the arrangement. The agreement(s) implementing the outsourcing should be clear as to which party is responsible for managing the seconded employees – for example, which company exercises exclusive control over the allocation and performance of the seconded employee during the period of secondment – as this may give rise to tax issues.

### **6.6 Describe notice, information and/or consultation obligations of the customer and/or supplier in relation to employees or employees' representatives**

As soon as it is reasonable and before a transfer under section 18A of the SE Act takes place, to enable consultations to take place between the transferor and the affected EA employees/trade union of the affected EA employees (if any), the transferor must notify the affected EA employees and the trade union of the affected EA employees (if any) of:

- the fact that the transfer is to take place, the approximate date on which it is to take place and the reasons for it;
- the implications of the transfer and the measures that the transferor envisages it will, in connection with the transfer, take in relation to the affected employees or, if it envisages that no measures will be so taken, that fact; and
- the measures that the transferee envisages it will, in connection with the transfer, take in relation to the affected employees who, by virtue of the transfer, become employees of the transferee after the transfer or, if it envisages that no measures will be so taken, that fact.

As soon as it is reasonable, the transferee must give the transferor such information so as to enable the transferor to perform the duty imposed on him with regard to the above consultation.

If consultations are not reasonably conducted, the Minister of Manpower may order the consultations to be conducted in a certain form and manner. This order may result in completion of the transfer of undertaking to the transferee being delayed.

If any dispute arises in relation to the transfer of employees, the Commissioner of Labour has the power to delay or prohibit the transfer of employment and order the transfer of employment to be subject to such

terms as the Commissioner considers just. Therefore, it would be advisable to conduct consultations with EA employees or their trade union as soon as is practicable so as to avoid any unforeseen delay to the completion of the transfer of employment.

Further, the terms of a collective bargaining agreement (if any) may contractually impose additional specific consultation obligations on the transferor in relation to the transfer of employment. If so, any deadlines for consultation as provided for in the collective bargaining agreement must be complied with.

### **6.7 Describe the consequences (civil and/or criminal) of non-compliance with any of the above requirements**

Where there is a dispute between a transferred employee and the transferee company, either party may refer the matter to the Commissioner for Labour for adjudication. The Commissioner may delay or prohibit the transfer of the employee concerned, or order the transfer of the employee and set such terms as the Commissioner considers just.

Section 19 of the SE Act also provides that any employer who does not comply with the above requirements can be liable for a fine not exceeding SGD 5,000 and/or to imprisonment for a term not exceeding six months.

## **DUE DILIGENCE, TRANSITION, SERVICE COMMENCEMENT, TRUE-UP**

### **7.1 Describe the due diligence processes and methods commonly used by suppliers and customers**

The customer usually, as part of its plans to outsource a part of its business, conducts due diligence on the function to be outsourced (including the people, assets, IT and processes currently involved). This helps the customer to prepare its requirements. The more effort the customer puts into this due diligence process at the start, the lower the risk that the customer will have to change (or even increase) the scope later on during the process.

The customer also normally conducts due diligence on potential suppliers (eg their financial strength, their reputation and their processes). A large part of this work focuses on the security measures that are in place to protect the customer's data. Some of this due diligence on the supplier can be carried out by way of an RFI or RFP issued to potential suppliers. The due diligence can also be carried out on the suppliers by way of further site inspections and meetings. Many customers also look to see if there is a cultural fit (as well as the technical and capability fit) with the supplier.

As part of the tender process, suppliers are also often provided with an opportunity to carry out due diligence or to see the results of the customer's due diligence process. Customers usually only permit this to be done by a limited number of suppliers and subject to non-disclosure agreements.

Either party can carry out further due diligence after contract signature as part of the contract process to establish a baseline against which service provision can be measured. This is often referred to as post-contract verification. This means that parts of the contract may be renegotiated if

assumptions that were relied upon to conclude the contract prove to be false during the due diligence carried out after the contract signature. The fees, the services and the service level agreements (SLAs) can all change. If the parties are aware that post-contract verification will take place, they should agree a process that will be followed (to try to preserve as much certainty as possible). For example, they could agree that any changes to the fees of the SLAs will be capped, topped or tailed.

## **7.2 How do suppliers usually try to protect their business case?**

There are a number of tools that a supplier may use to protect its business case.

- If the supplier cannot confirm the fees, the scope or the SLAs at contract signature (because the supplier has not been able to confirm enough facts eg through due diligence), the supplier might ask to verify these facts after contract signature (see section 7.1 above).
- Where the supplier recognises that it will only be able to carry out some of its obligations if the customer (or a third party that it is not responsible for) does certain things, the supplier might include these as 'dependencies' in the contract. This means that the supplier is not obliged to carry out some of its obligations until the dependencies have been fulfilled. The parties usually negotiate these dependencies as part of the contracting process. The customer usually says in the contract that it is not contractually obliged to perform the dependencies, but the supplier will be relieved from its relevant obligation if the customer does not do so. Sometimes the parties may agree that the supplier is entitled to recover additional costs for delays by the customer.
- The parties often agree to a change control mechanism in the contract. This means that if there are changes (eg to the scope or the volumes) that have not already been dealt with in the contract, the parties will negotiate these changes into the contract.

## **7.3 How are services usually measured upon service commencement?**

Service specifications are typically produced by the supplier in collaboration with the customer's technical and commercial teams. Customers may use specialist sourcing consultants to support them.

The outsourcing agreement will include detailed service descriptions against which certain service levels will be assigned. These service levels are used by the parties to monitor and measure service performance. Some of the service levels will be designated as critical performance indicators (CPIs) or key performance indicators (KPIs), and failure by the supplier to meet a CPI or a KPI would trigger payment by the supplier to the customer of a service credit.

Service credits are generally offset against the fees, and are usually relatively modest amounts. The aim is to compensate the customer for poor service without the need to pursue a claim for damages or terminate the contract, and to motivate the supplier to meet the performance targets.

Typically, the supplier and customer will agree an amount equal to a percentage of fees payable for the services which the supplier will put at risk under the service credit scheme.

Service credits are often expressed to be the sole remedy of the customer for the particular failure concerned, but this should be without prejudice to the customer's wider rights in relation to more serious breaches of the contract or persistent failures in performance, both of which should also be dealt with. Service credits are generally enforceable, provided they are a genuine pre-estimate of the customer's loss rather than a contractual penalty.

## **8. CHARGING, ADJUSTMENT OF FEES, AUDITING, BENCHMARKING**

### **8.1 Describe the charging methods commonly used in an outsourcing**

The majority of outsourcing transactions are ITO, although most BPO deals have a significant IT component and most ITO deals involve some process redesign. The distinction between ITO and BPO is thus blurring.

While the full spectrum of pricing models are possible in the market, many deals end up being fixed price for a fixed scope or fixed deliverables. Where the customer is unable to establish fixed scope or criteria because, for example, of their expanding or changing market, or generally because the outsourcing market is (relative to Europe or the US) less mature, the pricing model on the deal ends up being unit or transaction based or full-time equivalent (headcount) based. Outcome-based pricing models are very rare.

### **8.2 Describe customary change management procedures**

Customary change management procedures usually allow a party to request changes to the contract. Change requests are usually discussed by the parties, but the request is usually written down at some point in the process because eventually, if the change is agreed, it will become part of the contract.

A customer may make a change request if its needs change (eg it requires higher or lower volumes from the supplier).

Most change control provisions normally only permit changes where they are required by law or where both parties can reach an agreement.

### **8.3 Are there other adjustment mechanisms?**

Typically, outsourcing agreements will include indexation provisions using agreed cost of living indices, particularly if services are provided from an offshore jurisdiction.

If there is an international element to the outsourcing agreement (eg the services are provided across the Asian region), the agreement may address variations in foreign exchange rates against the billing currency by reference to an agreed external rate. For regional deals, there may be a requirement for local invoicing in local currency.

Given the diversity of tax regimes across the Asian region, regional deals will require tax input when they are structured.

Outsourcing agreements sometimes include benchmarking provisions, but this would not be appropriate in fixed price deals.

#### **8.4 Describe the contract rules for disputed charges and related consequences**

It is common to have a contractual provision to deal with disputed charges. The customer is usually allowed to dispute an invoice with a supplier that the customer thinks, in good faith, is incorrect. There is often a limited period of time during which the customer can do this (eg a number of weeks or months). The customer is usually obliged to pay any undisputed part of the invoice. It is also common to set out a process to resolve invoice disputes, with escalation levels and timelines.

If a customer does not pay undisputed charges for a certain period of time, then the supplier often has a contractual right to suspend/terminate the services. The parties are free to agree a time period for payment. This is commonly one or even two months, with an additional grace period before the supplier can exercise its rights to suspend or terminate the agreement for non-payment.

#### **8.5 What are the contractual rules usually applied to auditing?**

Audits allow the customer to review the supplier's charges (and the basis for charging, including customer's usage in unit pricing arrangements), performance and compliance with its obligations under the outsourcing agreement. Depending on the services, security audits may be appropriate. Audits may also be required for regulatory reasons (see section 3.3 above).

The contract usually sets out the process for instigating an audit. The customer is generally required to give advance notice of its intention to audit the supplier (unless it is not able to do so for regulatory reasons, or where fraud or other serious wrongdoing is suspected). The contract also sets out the process for defining the objective of the audit, the type of information that must be provided, the onsite access the auditor may have to premises and systems, and the people the auditor may speak with. The parties may agree to split the costs, and the supplier will often seek to limit the number of audits which may be performed.

The consequences of an audit should also be considered. If the supplier has overcharged or undercharged the customer, appropriate repayments should be made. If the supplier is in breach of other obligations, the contract may set out in general terms the steps the supplier should undertake in order to rectify the breach.

#### **8.6 Describe common benchmarking methodologies**

Outsourcing agreements usually address a number of key issues in relation to benchmarking, including:

- timing of initial benchmarking and frequency thereafter;
- a shortlist of potential benchmarkers;
- allocation of benchmarker's costs;

- scope of services to be benchmarked, including whether services are benchmarked in totality or by service category or geography;
- treatment of different geographies in the benchmark to ensure accurate local comparisons;
- definition of basis of benchmarking (peer group, commensurate services, volumes, locations and service levels) to promote like-for-like comparisons;
- size and selection of the representative samples;
- the process to be undertaken, including timelines;
- normalisation of data (eg treatment of outliers) and calculation used to determine a price to be benchmarked against;
- provision of the report by the benchmarker, with an opportunity for both the customer and supplier to review the report and query the results; and
- the consequences of an adverse benchmark:
  - (i) whether a price adjustment is automatic within certain threshold amounts;
  - (ii) whether the customer has a termination right for cause or convenience; and
  - (iii) how any disputes are to be handled.

## **TAX ASPECTS, TAX EFFICIENCY IN GROUP STRUCTURES, TRANSFER PRICING**

### **9.1 What are the main tax issues that arise in an outsourcing in relation to:**

#### **9.1.1 transfers of assets?**

Stamp duty is payable on documents connected to the transfer of property, including leases, sale and purchase agreements and mortgages, at the following rates, in each case assessed at the higher of the purchase price or market value of the property:

- up to SGD 180,000: 1 per cent;
- SGD 180,001 to SGD 320,000: 2 per cent; and
- SGD 320,001 and over: 3 per cent.

Additional stamp duty of up to 16 per cent of the higher of the purchase price or the value of the property is payable on a sliding scale if the property transferred is residential, industrial or 'residential and mixed-residential' and was acquired less than four years from the date of its prior acquisition.

No stamp duty is due on the transfer of other tangible assets such as equipment and machinery, but GST may apply (see below).

Singapore does not have any capital gains tax.

#### **9.1.2 value added tax (VAT) or other sales tax?**

GST is a broad-based consumption tax levied on the import of goods (collected by Singapore Customs), as well as nearly all supplies of goods and services in Singapore. GST is payable at 7 per cent.

Exemptions exist for the sale and lease of residential properties, the provision of most financial services and where the business (as a whole

or part of it) is transferred as a going concern. Export of goods and international services are taxable, but are currently zero-rated.

### **9.1.3 service charges or other taxes at source?**

GST may be payable (see above).

### **9.1.4 withholding taxes?**

When a person makes payment of a specified nature (this will include, for example, technical service fees) to a non-resident company or individual, there is a requirement to withhold a percentage of that payment and pay the amount withheld (the withholding tax amount) to the Inland Revenue Authority of Singapore. The payer is required to withhold tax at 15 per cent of the gross income payable to the non-resident professional, or the non-resident rate of 20 per cent if the non-resident professional elects to be taxed on net income.

### **9.1.5 stamp duty**

Stamp duty is payable on transfer of real property as detailed above. There is no stamp duty payable on the transfer of tangible assets.

### **9.1.6 corporate tax?**

A company is taxed at a flat rate on its chargeable income regardless of whether it is a local or foreign company. The corporate tax rate is currently 17 per cent, but certain tax exemptions are available. There is a full tax exemption available on the first SGD 100,000 of income for qualifying start-ups (other than investment holding companies and property development companies) and a partial exemption available for all qualifying start-ups on subsequent bands of income. In addition, companies will be granted a 30 per cent tax rebate capped at SGD 30,000 for each year of assessment in 2013, 2014 and 2015.

### **9.1.7 other tax issues?**

N/A.

## **9.2 What precautions are usually taken to arrange for tax efficiency?**

Tax efficiency is most likely to be achieved through a contractual arrangement or partnership so that the customer and supplier remain separate. Such arrangements allow the parties to access losses generated but do not create new tax filing requirements.

Where the parties are related, transfer pricing rules operate to reduce Singapore tax deductions for the customer if the costs charged by the supplier exceed an arm's length price. Similarly, a Singapore supplier is subject to tax on an arm's length price for the services if the actual costs charged are less than an arm's length price.

## **10. TERM AND TERMINATION, NOTICE PERIODS, MANDATORY TERMINATION, PROLONGATION RIGHTS, TERMINATION MANAGEMENT**

### **10.1 What are the rules and regulations regarding the term of an outsourcing agreement and/or length of notice period?**

There is no legislated maximum or minimum length of notice period for termination or otherwise. Notice periods are generally left to the parties to determine in the outsourcing agreement. In the absence of a notice period for termination and where the agreement does not have a fixed term, Singapore common law will imply a 'reasonable' notice period. What is 'reasonable' will depend on the individual circumstances.

### **10.2 Which events justify termination of an outsourcing agreement without giving rise to a claim in damages against the terminating party as a matter of mandatory law?**

The Singapore courts recognise that the innocent party to a contract is entitled to elect to terminate the contract where the term breached is a condition of the contract. A condition is a term designated by the parties as being so important that a breach of that condition will justify the termination of the contract regardless of the consequence of the breach.

An innocent party may choose to terminate the contract where there has been a breach of a term, the consequence of which has been to substantially deprive the innocent party of the benefit it was to have received under the contract.

Where there has been negligent or fraudulent misrepresentation, the innocent party is entitled to terminate and/or rescind the contract *ab initio*.

However, the Singapore courts do not recognise the legal doctrine of 'fundamental breach' insofar as it purports to render exclusion/limitation clauses null and of no effect.

A contract might also come to an end because of the doctrine of frustration. Frustration occurs when unforeseen supervening events arise without default of either party such that the nature of the contract has become so radically different that the performance of the contractual obligation would be fundamentally different from the obligations initially contemplated and undertaken. As a result, the Singapore courts consider that it would be unjust to hold the parties to their initial contractual obligations. As the effect of this doctrine is somewhat draconian, the mere fact that the contractual obligations have become more onerous to perform is insufficient grounds to amount to frustration.

The adjustment of rights and liabilities of parties to a frustrated contract is governed by the Frustrated Contracts Act 1985 (Cap.115).

### **10.3 What contractual termination rights are usually included in the outsourcing agreement?**

The parties are free to agree specific termination rights. Common examples include:

- material breach, and for such breaches which may be cured, it is usual to include a cure period (often 30 days or more);
- minor but persistent breaches which, taken together, amount to a material breach; the type of breach and number of breaches needed to trigger the termination right may be specified for clarity;
- insolvency and insolvency related proceedings;
- change of control of the supplier or its parent;
- termination for convenience by the customer on notice;
- breach of confidentiality provisions;
- breach of intellectual property rights and licence; and
- regulatory reasons.

#### **10.4 Are there termination for convenience rights?**

The parties are free to agree specific termination rights, which can block or extend rights implied by general law, including termination for convenience by the customer on notice. This allows the customer to switch suppliers without having to give a reason (for example, if it is generally dissatisfied but unable to demonstrate any clear breach). This is usually an expensive option, since the supplier often requires compensation for early termination.

#### **10.5 Are there implied rights for the customer and/or supplier to continue to use licensed IP rights or gain access to relevant know-how post-termination?**

In the absence of a contractual provision entitling the supplier to use the customer's licensed IP post-termination, there are no implied rights to use licensed IP right following termination of the outsourcing agreement. The parties are free to agree on the continued use of licensed IP rights post-termination.

#### **10.6 Describe particular aspects of termination management, assistance by the supplier**

An exit plan is essential for outsourcing agreements. It should deal with matters such as:

- the return of assets and software;
- the treatment of employees;
- the provision of information and know-how to a new supplier or the customer if services are being brought back in-house; and
- a timetable for the termination assistance, with clarity as to the duration of the termination assistance and key milestones; continuation of service provision and maintenance of the service levels during the termination assistance period up until handover to the incoming supplier or back to the customer.

A supplier may seek to limit its obligations in respect of termination assistance where the supplier has terminated the agreement due to non-payment or the customer's material breach, and may also seek upfront payment for termination assistance.

**10.7 Are disputes common in respect of exit services and transition from one vendor to another and if so please describe the nature of such disputes and how they are resolved?**

Issues between the parties in respect of exit services and transition from one supplier to another are common. This is to be expected as a relationship comes to an end, especially if it ends on bad terms. Problems may arise because:

- an outgoing is reluctant to provide exit services (or to provide exit services to a high standard) because it is losing business (and possibly even losing business to a competitor); or
- the parties did not consider in detail (when the contract was negotiated) what exit obligations should be performed and therefore this has to be negotiated at the point of termination.

**11. REMEDIES, RISK MANAGEMENT AND PROACTIVE MEASURES**

**11.1 Which remedies and/or reliefs are available to the customer under law for bad or non-performance by the supplier?**

Damages for the supplier's breach of the outsourcing agreement will be available as of right to the customer. Under common law, the customer is entitled to those losses that are directly caused by the supplier's breach where the losses are reasonably foreseeable or where special circumstances exist and have been notified to the supplier in a situation where it is reasonable to hold the supplier liable.

Penalties in contracts are unenforceable. However, it is acceptable to include provisions for liquidated damages for breach of contract provided they are a genuine pre-estimate of the likely loss which would be suffered by the relevant party.

Where the breach is sufficiently serious or where it is contractually provided for, the customer may also terminate the agreement.

In certain circumstances, specific performance may be ordered. However, where the outsourcing requires extensive co-operation of the parties involved, it is unlikely that specific performance will be ordered.

**11.2 Which customer protections are typically included in the contract to supplement statutory remedies/relief?**

An outsourcing agreement usually contains rights and remedies to protect the customer from a supplier's breach or failure, including:

- service credits for service level breaches;
- step-in rights (in the case of material breach by the supplier);
- audit rights to cover financial, operational and security aspects of the agreement;
- defined termination events, including termination for convenience;
- appropriate governance or escalation structure with a clear dispute resolution procedure; and
- adjustment of charging mechanisms that may have been more beneficial to the supplier (eg minimum revenue commitments).

The agreement usually contains certain supplier obligations to provide the customer with protection, such as obligations to:

- measure and report service levels, highlighting actual and foreseeable problems, and obliging the supplier to remedy faults and take preventative action to minimise reoccurrences;
- maintain adequate insurance coverage (often with agreed limits and coverage);
- arrange execution of a parent company guarantee; and
- indemnify the customer for certain breaches and losses.

### **11.3 Which warranties and indemnities are typically included in a contract?**

It is usual for a supplier to:

- warrant that it is entitled to enter into the agreement and perform its obligations;
- warrant that it will perform the services with reasonable care and skill, in a timely and professional manner, and in accordance with applicable laws and recognised industry standards;
- warrant that material information provided by it in the proposal stages was and remains accurate, complete and not misleading;
- warrant that it has required certifications and accreditations, and operates in accordance with defined standards related to the services; and
- indemnify the customer against loss suffered due to the supplier's actions related to IP breaches, breach of confidentiality, damage to property and wilful acts or omissions;

It is usual for the customer to provide more limited warranties, such as to:

- warrant that it is entitled to enter into the agreement and perform its obligations; and
- provide assurances concerning title and condition of assets transferred to the supplier, including the absence of liabilities under transferred contracts (if not transferred 'as is').

### **11.4 Describe the common limitation and/or exclusion of liability**

The parties are generally free to agree to exclude most forms of liability. The key issues and exceptions are set out below:

- The Singapore courts will construe exclusion or limitation of liability clauses strictly against the party seeking to rely on it. Accordingly, explicit wording is required if exclusions or limitations are intended to apply to liability arising from a party's negligence or deliberate breach. This also applies to indemnity clauses which fulfil the same purpose.
- Limitation of liability clauses are interpreted less stringently than total exclusion of liability clauses.
- Exclusions or restrictions of liability for misrepresentation must satisfy the 'reasonableness' requirement under the Unfair Contract Terms Act (see Misrepresentation Act 1994 (Cap. 390)).

- Exclusions or restrictions of liability for death or personal injury caused by a party's negligence are void and unenforceable pursuant to the Unfair Contract Terms Act. In the case of other loss or damage, the exclusion or restriction of liability for negligence must satisfy the Unfair Contract Terms Act's reasonableness requirement.
- If the parties are dealing on the other's written standard terms of business, any exclusion or restriction of liability for breach of contract must satisfy the Unfair Contract Terms Act's reasonableness requirement. This is so even if both parties are commercial/business entities.
- Under the Sale of Goods Act, implied terms as to title to assets cannot be excluded or restricted, while those relating to satisfactory quality, fitness for purpose and certain other matters can only be restricted where this meets the Unfair Contract Terms Act's reasonableness requirement.

Subject to the above, the supplier (and usually the customer) aims to exclude liability for:

- indirect and consequential loss; and
- loss of business, profit or revenue, including where these constitute a direct loss.

In contrast, the customer usually tries to ensure that it is able, under the agreement, to recover all its direct loss (including direct loss of profit, business and revenue). The parties often list certain losses they have agreed are direct losses and recoverable.

The parties usually agree certain types of liability for which there is no financial cap (such as to comply with laws as stated above and reflect the commercial arrangement between the parties, eg for certain indemnities). For all remaining types of liability the parties usually agree on a financial limitation on liability, which may be a fixed amount or a percentage/multiple of contract value for a defined period. Current practice suggests that a percentage provides some benefits as it flexes with the value of the contract (and risk and reward are balanced).

The supplier should take care that the drafting of the cap does not restrict its right to recover for non-payment of charges that are properly due to it from the customer, and the customer should consider whether service credits count towards the cap or not.

### **11.5 Are there statutory set-off rights and can they can be contractually excluded or limited?**

Various rights of set-off arise under the general law (such as legal set-off, equitable set-off, bankers set-off and insolvency set-off). Each is subject to different limits. A contract term can extend or restrict the rights for common law rights of set-off. Insolvency set-off supersedes any contractual rights of set-off between a creditor and an insolvent debtor. Either one party or both could agree not to claim in the other's insolvency or to subordinate any claim it makes in the other's insolvency to claims of other creditors (although this is rarely done in outsourcing agreements).

## **12. INSURANCE**

### **12.1 What types of insurance are readily available in your jurisdiction?**

The types of insurance available include:

- professional indemnity;
- public liability;
- employers' liability;
- business interruption;
- fidelity; and
- directors' and officers' liability.

## **13. SUBCONTRACTING AND ASSIGNMENT**

### **13.1 Which rules and regulations apply to subcontracting and assignment of obligations under the contract?**

A party may subcontract its obligations under a contract or assign the benefit (ie rights) of a contract unless the contract prohibits it. Contracts often require the consent of the other party to any subcontracting or assignment. If (in addition to the benefit) the burden (ie the obligations) of the contract is also to be transferred, then a novation is required (by means of a tripartite agreement under which one original contracting party is replaced by the new party, thereby technically terminating the original agreement and immediately entering into a new agreement on the same terms between the new parties).

### **13.2 What contractual arrangements are usually made regarding subcontracting and assignment?**

It is common to include contractual provisions setting out which obligations (if any) can be subcontracted and to whom, although the contract usually states that the contracting party remains primarily liable for the acts and omissions of its subcontractors.

Parties often agree that the contract may be transferred in whole without consent in some cases, such as to affiliates, and with consent to other third parties. There is often a prohibition on assignment to competitors of the counterparty.

## **14. JURISDICTION, LITIGATION, ARBITRATION, MEDIATION, FAST TRACK DISPUTE RESOLUTION**

### **14.1 Describe statutory rules and practice regarding contract management, governance and escalation**

Whilst there are no statutory rules on contract management, it is common to include in the contract provisions setting out the escalation of disputes through operational and management structures before either party may seek recourse outside the contract (other than in respect of injunctive relief).

It is common for parties to seek agreement through informal dispute resolution before seeking recourse outside of the contract.

Despite its very western outlook and business environment, Singapore places a high(er) degree of emphasis on promoting consensus where

possible. Accordingly, informal alternative dispute resolution methods which focus on conciliation and consensus are popular and common.

#### **14.2 What are the usual provisions regarding applicable law and arbitration clauses?**

Parties are generally free to choose the governing law of their contract and any non-contractual obligations arising out of or in connection with it, and it is common to include an election as to the jurisdiction in which any claims will be heard. There are some areas of law where it is not possible to exclude mandatory provisions of local law, such as those affecting consumers, employees and personal data.

Arbitration is becoming more popular. If the arbitration clause provides, an arbitral award is binding on the parties. One key benefit of arbitration is that arbitral bodies can hear proceedings confidentially, so the dispute does not become public. Another key benefit of arbitration is that an arbitration award is much easier to enforce against a counterparty established in another jurisdictional (often the case in multijurisdictional outsourcing arrangements). It is often perceived to be cheaper than litigation, but this is not always the case.

# United Kingdom

## **Olswang LLP**

Ian Ferguson, Dominic Dryden & Matthew Hunter\*

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### **1. BUSINESS PRACTICE (INTERNATIONAL DIVISION OF LABOUR, BREAKING-UP VALUE CHAINS)**

#### **1.1 Describe generally the maturity of the outsourcing market in your jurisdiction**

The market for outsourcing in the UK is mature. According to a report by Oxford Economics in November 2012, the UK outsourcing industry generates nearly GBP 200 billion per year and accounts for about 8 per cent of the UK's total economic output. The industry is the UK's second largest employer, accounting for 3.3 million jobs, which is equivalent to about 10 per cent of the UK workforce. Information technology and data-related services are the biggest type of outsourcing, accounting for nearly 39 per cent of total revenues.

In 2014, ISG research showed that the public sector has outstripped the private sector in the UK outsourcing market. The total contract value of public sector outsourcing agreements reached GBP 51 billion in the latest two year period, compared with GBP 30 billion for the private sector.

In the private sector, the greatest demand for outsourced services comes from the financial services industry, which is significantly ahead of other industry sectors.

In the private sector, there has been a noticeable shift away from large outsourcing transactions with a single supplier to smaller, multi-sourcing solutions to encourage competition and mitigate risk. The customer's primary challenge in multi-sourcing arrangements is avoiding an oversized retained function whilst being able to integrate services and manage multiple suppliers effectively.

In contrast, in the public sector there has been a contraction in the number of smaller contracts, from 46 per cent of the market in 2010–11 to 40 per cent in the period since 2012.

The KPMG Sourcing Advisory 2nd Quarter 2014 Global Pulse Survey identified that the retained organisation/transition/governance/challenges, inadequate change management capabilities and inadequate executive/management support are the top challenges to service delivery improvements. These challenges apply equally to single supplier and multi-sourcing arrangements.

There has been an increase in demand for shared services solutions, and customers are beginning to look at converting some of their support

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function assets and processes from cost centres into revenue-generating businesses. There are opportunities for suppliers who are prepared to be innovative in creating pricing models to partner with customers in these revenue generating ventures.

Most suppliers now include cloud computing services in their portfolio. There has been debate over whether cloud computing services are a new offering or a repackaging of existing services and delivery models. Suppliers of these services are promoting the services as new and therefore demand different commercial models, including contractual terms, from those typically used for outsourcing transactions.

Most recently, digitisation of services is having a big impact. Customers that are new to outsourcing as well as existing customers are taking advantage of new technologies in order to digitise and therefore transform their existing processes. There are a number of driving factors:

- the need to respond to shifts in consumer behaviour: they are demanding more information through digitally connected and mobile devices;
- the need to provide users with a better and integrated experience;
- new and more efficient processes are cutting costs and resource requirements;
- services are improving as a result of these new processes; and
- customers that replace a patchwork of legacy systems with brand new processes and technology create safer and more secure systems.

A good example of this kind of change is Lloyds Banking Group, one of the UK's biggest banks. Since 2011, the bank has undertaken a group-wide programme to simplify its operations, aiming to reduce costs and improve customer experience. This has included a digitisation strategy and a transformation of its entire business through increased automation. The bank has realised significant savings as a result and expects savings to total GBP 2 billion by the end of 2014.

## **1.2 How are cloud-based services affecting traditional outsourcing models?**

Cloud services commonly used include software as a service (specific applications or whole platforms), often with the ability to modify and add to software through web services, and data storage (utility computing). Customers are adopting more cloud services in the market and seem to accept (and benefit from) the plug-and-play solutions that cloud service providers offer, which are scalable and have utility-based pricing models. However, there are likely to be bespoke cloud-based solutions, particularly for regulated industries and financial services.

## **1.3 Describe the current supplier landscape**

The major outsourcing suppliers, such as Accenture, CSC and IBM, continue to dominate the UK market, but Indian suppliers such as Infosys, Wipro and TCS have made considerable inroads. In the business process outsourcing (BPO) market, there are a number of specialist suppliers who can often

provide more focused and customised solutions. Offshoring has become a key component of most suppliers' outsourcing proposition, particularly where cost reduction is a key business driver. There are undoubtedly political challenges to large-scale offshoring in the public sector, but the private sector has embraced this model. However, some UK service recipients have brought some of the services back onshore, especially where these services are more customer facing (such as call centres), relocating the operations to lower cost regions in the UK.

## **2. PROCUREMENT PROCESS, ROLE OF BUSINESS ADVISORS AND MATURITY OF THE CONSULTANCY INDUSTRY**

### **2.1 Describe generally the procurement process**

#### **Public sector**

The UK has implemented EU Directives which cover procurement (including outsourcing) by public sector organisations and utilities. The Public Contracts Regulations 2006 (SI 2006/5) and the Utilities Contracts Regulations 2006 (SI 2006/6), which implement the 2004 EU Directives (the Public Sector Directive (2004/18/EC) and the Utilities Directive (2004/17/EC), came into effect in the UK on 31 January 2006.

#### **The Public Contracts Regulations apply where:**

- the procuring body is a 'contracting authority' which includes central government and local authorities;
- the relevant contract covers public works, services or supplies; and
- the estimated value of the contract (excluding VAT) exceeds certain financial thresholds.

Contracts to which the Public Contracts Regulations apply must be advertised by way of an OJEU notice in the EU's Official Journal.

There are four types of public procurement procedures under the Public Contracts Regulations and a minimum number of candidates must be invited to tender:

- Open – this is used for the procurement of commodity products which do not require a complex tender process and no negotiations are permitted;
- Restricted – only those interested parties who satisfy the contracting authority's selection criteria are invited to participate. No negotiations are permitted;
- Negotiated – this can only be used in very limited circumstances. Only those interested parties who satisfy the contracting authority's selection criteria are invited to participate. It is possible to undertake this procedure without prior publication of an OJEU notice where, for example, an Open or Restricted procedure did not produce any tenders or there is only one contractor in a position to carry out the work. An OJEU notice is required where, for example, an Open or Restricted procedure was discontinued or the contract specifications cannot be established with sufficient precision. In both cases, tenderers may negotiate the terms of the contract with the contracting authority; and

- Competitive Dialogue – this can be used for particularly complex contracts. Only those interested parties who tend for the contract and satisfy the contracting authority’s selection criteria are invited to participate. During the ‘dialogue’ tenderers are permitted to discuss all aspects of the proposed contract with the contracting authority, and are permitted to propose solutions to meet the contracting authority’s requirements and then submit their final bid on the basis of their solution.

The Public Contracts Regulations also allow contracting authorities to enter into framework agreements with certain suppliers under which individual contracts can then be awarded as required.

After extensive public consultation and discussion in the EU, the 2014 EU Procurement Directives have been adopted by the EU institutions and were published in the Official Journal of the EU on 28 March 2014. They came into force on 17 April 2014. EU member states now have two years to implement them in national legislation. The previous regime was criticised for taking too long, and for being resource heavy and inflexible. A number of changes have been introduced to address these issues. The UK Cabinet Office has stated that it is preparing for early transposition, so that *‘the UK can take advantage of the additional flexibilities in the new rules as soon as possible’*.

Some of the significant changes are:

- More flexible procedural rules with increased opportunity to negotiate. A lighter-touch regime for certain low-value health and social services contracts (due to their diversity across member states) will be implemented. Contracting authorities will be able to dictate their own procedures, provided that they advertise their contracts properly and adhere to the established principles of equal treatment and transparency.
- Simplified tendering through e-procurement. Contract notices can be submitted online and tender documentation can be download following publication of a notice.
- Benefits for SMEs. When procuring large contracts, a contracting authority must now justify why the large contract could not be broken down into smaller lots. Contracting authorities will no longer be able to specify a turnover of more than three times the contract value in a pre-qualification questionnaire.

### **Private sector**

The outsourcing organisation should define its requirements and assess which suppliers could meet them. This process might involve inviting potential suppliers to respond to a Request for Information (RFI) and/or a more limited number of potential suppliers to submit bids against a Request for Proposal (RFP). The number of potential suppliers invited to participate depends on the type, complexity and value of the proposed outsourcing.

A supplier is usually selected to negotiate the outsourcing contract with the customer. Occasionally, in more complex transactions or where a customer wishes to maintain competition, two or more potential suppliers

may be required to participate in parallel contract negotiations. Parallel negotiations may be difficult to manage given the increased resources required from the customer and can add significantly to the costs of procurement.

## **2.2 What is the average duration of a private procurement process?**

If the procurement process is measured from the start of a project internal to the customer (ie from taking a decision that an activity should be outsourced), including the RFP process through to the go-live date, the duration of the process can vary significantly. A smaller outsourcing project can be completed within a couple of months, whereas a larger outsourcing project usually takes at least a year.

## **2.3 Which roles and tasks are generally performed by business advisors, including legal advisors?**

Business advisors are often engaged during the supplier selection process, in the course of contract negotiations, during the implementation and day to day operation of the outsourced services, and on exit from the outsourcing contract.

Before embarking on an outsourcing transaction an organisation should have a clear understanding of its operating model. This helps clarify which services, functions or processes it should outsource, how it should engage with the market to outsource successfully, and then how to manage the outsourcing arrangement once it is in place (eg by defining the most appropriate relationship management and governance model and planning what internal capability to retain).

Experienced sourcing advisors can assist with all of these stages. The best sourcing advisors not only have experience of the particular type of outsourcing but also know the market well, including the relevant suppliers and latest pricing and sourcing models. Some sourcing advisory firms offer only strategic advice, while others will assist and run sourcing procurement processes. There are advisory firms that specialise in particular types of sourcing (eg communications technology) or services that support outsourcing (eg benchmarking). In addition, it is common to seek support from legal advisors (either in-house or in private practice).

There are in-house legal teams and external law firms that specialise in sourcing transactions. They provide assistance from the start of a transaction (including advising on strategy) and during the RFP process, the contract negotiation and any subsequent steps.

Very few advisory firms offer the full spectrum of advice and support required for the entire sourcing lifecycle, ie from strategy development to solution design (including target operating model and supplier selection), implementation (including negotiating and contracting) and on-going supplier relationship/contract management. Traditionally, an organisation seeking to outsource may need to engage a number of business advisors to support it. There are a few business advisors who offer an integrated advisory service.

### **3. STATUTORY RULES, INDUSTRY SPECIFIC REQUIREMENTS AND REGULATIONS**

#### **3.1 Which statutory rules govern sourcing transactions in general?**

There are no rules governing sourcing transactions in general, although in certain sectors regulation applies (see section 3.2 below), and the following rules of more general application may be particularly relevant to certain sourcing transactions:

- Transfer of Undertakings (Protection of Employment) Regulations 2006 (see section 6 below);
- Data Protection Act 1998 and the Data Protection Directive (95/46/EC) (see section 4 below);
- Competition Act 1998, Enterprise Act 2002 and the Treaty on the Functioning of the European Union;
- Export Control Act 2002 (see section 5 below);
- Unfair Contract Terms Act 1977.

#### **3.2 What are the legal or regulatory requirements concerning outsourcing in any industry sector?**

##### **Financial services and insurers**

International and UK regulations impose obligations on financial institutions seeking to outsource certain of their functions. In the UK, these are often simply referred to as 'MiFID' (from the Markets in Financial Instruments Directive (2004/29/EC)).

For practical purposes, the relevant requirements were consolidated into the FSA Handbook published by the Financial Services Authority (FSA), which was appointed under the Financial Services and Markets Act 2000 (FSMA). However, on 1 April 2013, the functions of the FSA were transferred to the Financial Conduct Authority (FCA) and the Prudential Regulatory Authority (PRA). The FSA's requirements on outsourcing now form part of both the FCA and PRA Handbooks. The handbooks set out principles, rules and guidance, including the 'senior management arrangements, systems and controls' (SYSC), some of which are specifically relevant to outsourcing by regulated entities (including banks, building societies and insurers).

##### **Public sector**

The public sector procurement rules are described in section 2.1 above.

#### **3.3 What are the applicable rules regarding control or monitoring of the supplier, reporting to the regulator, rights of access to, and audit of, the supplier's records to be granted to the regulator, segregation of staff, functions or entities?**

Certain regulated entities (broadly, financial institutions and insurers) are subject to the rules set out in the FCA and PRA Handbooks which include:

- Control or monitoring: if a firm outsources critical or important functions or any relevant services and activities, it remains fully responsible for discharging all of its obligations under the regulatory system (FCA and PRA Handbooks, SYSC 8.1.6).

- Reporting: a firm must deal with its regulators in an open and cooperative way (FCA Handbook, Principle 11).
- Regulatory audit: a firm, its auditors, the FCA and any other relevant competent authority must have effective access to data related to the outsourced activities, as well as to the business premises of the supplier, and the FCA and any other relevant competent authority must be able to exercise those rights of access (FCA Handbook, SYSC 8.1.8).
- Segregation of staff, functions or entities: a firm should have personnel with responsibility for supervising and monitoring the outsourced function on an ongoing basis, and sufficient competence at a senior level in-house to enable them to resume control over the outsourced function if necessary (FCA and PRA Handbooks, SYSC 8.1.8).

### **3.4 Which services (if any) must be performed by a regulated or specially licensed entity, or any specially trained personnel?**

There is no general requirement for suppliers to be licensed or regulated, but regulated financial services and insurance firms have an obligation to ensure that their supplier has the ability, capacity, and any authorisation required by law, to perform the outsourced services reliably and professionally. In the financial services and insurance sectors, suppliers may also be regulated by the FCA and the PRA in their own right, particularly where they perform control functions as part of the services outsourced to them.

### **3.5 What are the requirements for regulatory notification or approval of outsourcing transactions in any industry sector?**

Regulated financial services and insurance firms must deal with regulators in an open and cooperative way (FCA Handbook, Principle 11), which includes giving the FCA notice of any proposal which could have a significant impact on the firm's risk profile or resources, including entering into, or significantly changing, a material outsourcing arrangement (FCA Handbook SUP 15.3.8).

## **4. DATA PROTECTION, TRANS-BORDER DATA FLOWS, PROFESSIONAL SECRECIES, CLOUD COMPUTING**

### **4.1 What are the requirements for a third party to process data on behalf of the data controller?**

If a third party (ie a supplier or its subcontractors) processes personal data on behalf of a data controller (ie a customer), the broad requirements under the UK Data Protection Act (DPA) are that the data controller must ensure that the third party applies sufficient security to the personal data and process it only in the manner and for the purposes instructed by the data controller. The obligations in the DPA do not apply directly to data processors, but the data processors have to comply with certain parts of the legislations because data controllers are required under the DPA to pass the obligations on to the data processors.

In addition, if data is to be sent from the UK outside the European Economic Area, the data controller needs to ensure additional measures are in place to ensure the export is permitted (see section 4.3 below).

#### **4.2 What are the rules and regulations regarding data protection and data security, confidentiality of customer data, banking secrecy and other professional secrets?**

Under the 7th principle of the DPA, data controllers are obliged to keep personal data secure. Data controllers are expected to pass this obligation on to data processors in their contracts with data processors.

In addition, most suppliers are likely to be under a duty to keep customer personal data and customer client personal data confidential, both under contract and the law of confidence.

Banks and other FCA-regulated entities also have a responsibility for safekeeping customer personal data under FCA regulation, subject to certain exceptions. Suppliers providing services to these customers can expect to be subject to additional requirements as a result of this extra layer of regulation applicable to these customers.

#### **4.3 Which rules govern the transfer of data outside your jurisdiction?**

Personal data cannot be transferred from the UK outside the European Economic Area (EEA) unless the receiving country or territory ensures an 'adequate' level of protection for the rights and freedoms of data subjects in relation to the processing of personal data.

The European Commission (EC) has confirmed that certain countries provide an adequate level of protection for personal data, including Andorra, Argentina, Canada, Faroe Islands, Guernsey, Isle of Man, Israel, Jersey, New Zealand and Switzerland.

The EC also considers that personal data sent to a US entity which has registered under, and is compliant with, the 'Safe Harbour' scheme is adequately protected.

It is permissible to send personal data to other countries if the UK exporter is satisfied that, in the particular circumstances, there is an adequate level of protection. See also section 4.4 below.

#### **4.4 Are data transfer agreements contemplated or in use?**

In the UK, there is automatic permission to transfer personal data outside the EEA as long as an agreement is entered into to govern that transfer in the form of the Model Clauses approved by the EC in its decision of 5th February 2010. There is no need for any UK regulator to approve the agreement.

#### **4.5 Is a data transfer agreement sufficient to legitimise transfer, or must additional requirements (such as the need to obtain consent) be satisfied?**

A compliant data transfer agreement is sufficient.

#### **4.6 In cloud computing, which precautions (contractual, factual, others) are usually taken to protect, or to allow control over, the data?**

Users of cloud computing are often under obligations not to transfer data into or out of certain jurisdictions, or they may wish not to do so due to concerns about regulatory interception or inadequate security, and this has led to the development of regional cloud environments (where data is not transferred outside the EEA) and, less frequently, local cloud environments (where data remains onshore). Customers with sensitive data (eg banks and healthcare organisations) may prefer to use a 'private cloud' model, even though much of the economic benefit promised by cloud computing is lost.

Users of cloud computing use their contracts with cloud service providers to protect their data. They may also carry out due diligence on cloud service providers and review the arrangements periodically. Many customers of cloud computing (especially customers with sensitive data, customers who are sharing a lot of data with the cloud service provider and customers spending significant sums with cloud service providers) often ask for an audit right in order to protect their data. Audit is rarely an easy point to negotiate in an outsourcing transaction, and is even less so in a public cloud arrangement, where suppliers see audits as a security risk and expensive to service in the context of the lower cost solution they are providing. Customers are therefore considering other options, such as third party audits, self-audit by the supplier, limited review rights and/or third party certification.

#### **4.7 How is supplier liability for breach of data protection requirements generally handled?**

##### **Liability under the DPA**

The UK Information Commissioner (ICO) can impose civil fines of up to GBP 500,000 for a 'a serious breach' of the DPA. In the case of a breach, the ICO can also issue an enforcement notice against a business requiring it to take (or refrain from taking) specified steps in order to comply with the DPA. Failure to comply with an enforcement notice is a criminal offence. The DPA contains a number of other criminal offences, notably offences relating to obtaining or disclosing personal data without consent and selling or offering to sell such data. Prosecutions can also be brought against directors and officers of companies that have committed offences under the DPA. However, as mentioned above, the DPA, and therefore these sanctions, only apply to the data controller. In an outsourcing transaction, the supplier is usually a data processor. If the supplier's actions result in the data controller being subject to one of these sanctions, the data controller's remedy against the supplier is a contractual one. See Contractual liability below.

If an individual suffers damage as a result of a breach of the DPA, he can bring an action for damages against the relevant business (again, this business is usually the data controller, not the data processor). In addition, financial services firms may be exposed to higher fines for failing to protect customer data (again, usually imposed on the financial services firms rather than the supplier). See Liability under laws protecting confidentiality below.

### **Liability under laws protecting confidentiality**

Breach of confidence in relation to customer data can give rise to:

- damages claims;
- injunctions preventing further authorised use of the relevant information; and
- in certain circumstances (eg banking secrecy), an award of an account of the profits made by virtue of use of the confidential information (usually imposed on the bank, rather than the supplier).

Businesses may also face enforcement action by the ICO, including fines (see above). Firms in the financial services sector may be exposed to significantly higher fines for failing to protect customer data (based on financial services legislation rather than the DPA). For example, in 2010, the UK branch of Zurich Insurance was fined over GBP 2 million for failing to protect the security of confidential information when outsourcing to a South African affiliate.

### **Contractual liability**

The parties are generally free to exclude most forms of liability. The parties can also agree a financial limit on liability. This can be a fixed amount, or a percentage or multiple of the contract value. See section 11.4 below for more on this.

## **5. ASSET DEAL, LEGAL CONCEPTS AND MECHANICS**

### **5.1 What legal concepts apply to the transfer of assets in an outsourcing?**

For the transfer of movable or immovable property, a written assignment should be entered into between the customer and the supplier. Transfers of immovable property usually need to be registered with the UK Land Registry.

Where either movable or immovable property is leased, licensed or charged, the consent of the lessor/licensor/lender is typically required.

Transfers of intellectual property rights and licences must generally be made in writing and, depending on the type of right, can require registration at the UK Intellectual Property Office. The licensor's consent may also be required.

Transfers of contracts must be made in writing. The terms of each contract should be reviewed to see if the contract can be assigned without the consent of the counterparty.

### **5.2 Are there particular considerations for the transfer of assets offshore?**

An asset exported from the UK that is subject to export control (ie listed on the UK Strategic Export Control Lists, subject to End-Use Controls or to sanctions) requires a licence before it can be exported. The UK Export Control Organisation assesses whether licences are required and licences are issued by the Secretary of State for Business, Innovations and Skills.

## **6. HR, TRANSFER OF UNDERTAKING, MASS DISMISSAL, REPUTATION ASPECTS**

### **6.1 In what circumstances (if any) are employees transferred by operation of law:**

#### **6.1.1 to a supplier in an initial outsourcing?**

#### **6.1.2 to a supplier on a change of supplier?**

#### **6.1.3 back to the customer on termination of an outsourcing?**

The Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) provides protection for UK employees when a relevant business transfer or service provision change occurs. Under TUPE, employees transfer automatically from the old employer (transferor) to the new employer (transferee).

TUPE applies if there is an organised grouping of employees (including a single employee) situated in the UK immediately before transfer whose principal purpose is to provide the services which are being outsourced or in-sourced. This may occur where the employees transfer:

- to the supplier in an initial outsourcing;
- to the supplier on a change of supplier; or
- back to the customer on termination of an outsourcing (an 'in-sourcing').

If the employee does not want to transfer, he or she can object to the transfer and effectively resigns from his or her employment without compensation.

### **6.2 If employees transfer by operation of law, which terms and effects apply?**

#### **General**

TUPE preserves continuity of employment and employee transfer on the same terms and conditions of employment with the exception of old age, survivors' or invalidity benefits under an occupational pension scheme and any criminal liabilities. All contractual benefits transfer under TUPE. The transferee takes over all rights and obligations arising from the contracts of employment and inherits any outstanding employment liabilities.

#### **Pensions**

Under the Pension Act 2004 if, prior to the transfer, the transferring employee is in, or is entitled to join, an occupational pension scheme, the transferee must provide the employee with a minimum level of pension benefits. The transferee is not obliged to provide an identical pension arrangement.

The transferor's obligations in respect of an employee's membership of a personal, group or stakeholder pension scheme transfer to the transferee under TUPE. Responsibility for any entitlement to enhanced redundancy pay or early retirement benefit under an occupational pension scheme also transfers.

### **Collective agreements and trade union recognition**

All terms of collective agreements made in respect of transferring employees, which are in force at the date of the transfer, transfer to the new employer under TUPE. The transferee must voluntarily recognise any independent trade union which has been voluntarily recognised by the transferor in respect of some or all of the transferred employees if these employees retain an identity which is distinct from the remainder of the transferee's business. The transferee may be able to terminate the collective agreement and elect not to recognise a trade union subject to meeting certain specified requirements.

### **6.3 How can the customer (contractual or other) retain particular employees, or make them redundant?**

If the customer wants to retain a particular employee it could attempt to do this by agreement with the supplier and employee. It could also reassign the employee away from the services or the employee could object to the automatic TUPE transfer and be re-engaged by the customer.

Where the sole or principal reason for a dismissal is the transfer itself, that dismissal is 'automatically unfair' unless the sole or principal reason for dismissal is an economic, technical or organisation (ETO) reason entailing a change in the workforce. Employees with at least two years' service can bring a claim for unfair dismissal (damages for which are capped at around GBP 85,000, but could be less depending on the employee's salary). The transferee inherits liability for any pre-transfer dismissals which are not for an ETO reason.

Dismissal on the grounds of redundancy is an accepted ETO reason, but it must be the dismissing employer's reason. Therefore, a customer would not have an ETO defence if it dismisses any employee before the transfer on the grounds of redundancy because the supplier does not have a requirement for their role.

An employee who has been made redundant is (subject to meeting certain qualifying conditions) entitled to statutory redundancy pay calculated using a formula based on age, length of service and week's (capped) pay. The employee may also be entitled to enhanced redundancy pay under their contract or because of custom or practice.

### **6.4 To what extent can a supplier harmonise terms and conditions of transferring employees with those of its existing workforce?**

Under TUPE, agreed changes to transferring employees' contract of employment where the sole or principal reason for the variation is the transfer itself are void and unenforceable. However, if the sole or principal reason for the variation is an ETO reason entailing changes in the workforce and the employee agrees to this variation, the variation is not void. A variation is also not void where the terms of the contract permit such a variation.

In practice, it is often difficult to harmonise terms and conditions with certainty for the supplier that those new terms are enforceable.

### **6.5 Can the parties structure the employee arrangements of an outsourcing as a secondment?**

The parties can structure a secondment agreement but should do so with the employee's consent because a secondment arrangement does not prevent TUPE from applying. To ensure that a TUPE claim is not made later on, the employee should object to the transfer and be re-engaged by the customer before being placed on secondment. The use of a secondment arrangement is not without risk (see *Celtec v Astley* (HL 2006 IRLR 635)) and needs to be considered carefully prior to implementation.

### **6.6 Describe notice, information and/or consultation obligations of the customer and/or supplier in relation to employees or employees' representatives**

In good time before the transfer, the transferor and transferee must inform trade union or elected employee representatives of their 'affected' employees of the transfer and consult on any changes or 'measures' that might arise in relation to it. Affected employees include employees who do not transfer but are affected because of measures taken in connection with the transfer. The transferee is required to provide the transferor with details of any measures it is proposing to take in respect of the transferring employees.

For transfers on or after 1 May 2014, the transferor is obliged to provide the transferee with employer liability information at least 28 days before the transfer unless there are special circumstances which prevent this (this is an increase from 14 days following the recent changes to the regulations).

If it is proposed to make 20 or more employees redundant in a 90 day period, the dismissing employer needs to inform and consult with any recognised trade union or employee representative in accordance with the statutory timescales before the first dismissal takes effect. This can be done concurrently with the TUPE consultation process before the transfer occurs, provided certain conditions are fulfilled (in particular, the transferor must consent to the transferee commencing collective redundancy consultation with its employees before the transfer occurs). Additional information and consultation obligations may apply if the employer has a national or European works council or other information and consultation agreement in place.

### **6.7 Describe the consequences (civil and/or criminal) of non-compliance with any of above requirements**

The penalty for failure to inform and consult under TUPE or in respect of a collective redundancy is up to 13 weeks' pay per affected employee. The transferor and transferee are jointly and severally liable for any award of compensation.

The transferor can also be fined for each employee for whom the employee liability information was not provided.

In addition, where a transfer involves (or would involve) a substantial change in working conditions to the material detriment of a transferring employee, the employee could resign and treat themselves as dismissed.

Depending upon the circumstances, the transferor or transferee could be liable for unfair dismissal damages.

Parties commonly agree apportionment of liability and appropriate indemnities in respect of such claims in the outsourcing agreement.

## **7. DUE DILIGENCE, TRANSITION, SERVICE COMMENCEMENT, TRUE-UP**

### **7.1 Describe the due diligence processes and methods commonly used by suppliers and customers**

The customer usually, as part of its plans to outsource a part of its business, conducts due diligence on the function to be outsourced (including the people, assets, IT and processes currently involved). This helps the customer to prepare its requirements. The more effort the customer puts into this due diligence process at the start, the lower the risk that the customer will have to change (or even increase) the scope later on during the process.

The customer also normally conducts due diligence on potential suppliers (eg their financial strength, their reputation and their processes). A large part of this work focuses on the security measures that are in place to protect the customer's data. Some of this due diligence on the supplier can be carried out by way of an RFI or an RFP issued to potential suppliers. The due diligence can also be carried out on the suppliers by way of further site inspections and meetings. Many customers also look to see if there is a cultural fit (as well as the technical and capability fit) with the supplier.

As part of the tender process, suppliers are also often provided with an opportunity to carry out due diligence or to see the results of the customer's due diligence process. Customers usually only permit this to be done by a limited number of suppliers and subject to non-disclosure agreements.

Either party can carry out further due diligence after contract signature as part of the contract process to establish a baseline against which service provision can be measured. This is often referred to as post-contract verification. This means that parts of the contract may be renegotiated if assumptions that were relied upon to conclude the contract prove to be false during the due diligence carried out after the contract signature. The fees, the services and the service level agreements (SLAs) can all change. If the parties are aware that post-contract verification will take place, they should agree a process that will be followed (to try to preserve as much certainty as possible). For example, they could agree that any changes to the fees of the SLAs will be capped, topped or tailed.

### **7.2 How do suppliers usually try to protect their business case?**

There are a number of tools that a supplier may use to protect its business case, such as:

- If the supplier cannot confirm the fees, the scope or the SLAs at contract signature (because the supplier has not been able to confirm enough facts, eg through due diligence), the supplier might ask to verify these facts after contract signature. See section 7.1 above.

- Where the supplier recognises that it will only be able to carry out some of its obligations if the customer (or a third party that it is not responsible for) does certain things, the supplier might include these as ‘dependencies’ in the contract. This means that the supplier is not obliged to carry out some of its obligations until the dependencies have been fulfilled. The parties usually negotiate these dependencies as part of the contracting process. The customer usually says in the contract that it is not contractually obliged to perform the dependencies, but the supplier will be relieved from its relevant obligation if the customer does not do so. Sometimes the parties may agree that the supplier is entitled to recover additional costs for delays by the customer.
- The parties often agree to a change control mechanism in the contract. This means that if there are changes (eg to the scope or the volumes) that have not already been dealt with in the contract, the parties will negotiate these changes into the contract.

### **7.3 How are services usually measured upon service commencement?**

Service specifications are typically produced by the supplier in collaboration with the customer’s technical and commercial teams. Customers may use specialist sourcing consultants to support them.

The outsourcing agreement will include detailed service descriptions against which certain service levels will be assigned. These service levels are used by the parties to monitor and measure service performance. Some of the service levels will be designated as critical performance indicators (CPIs) or key performance indicators (KPIs), and failure by the supplier to meet a CPI or a KPI would trigger payment by the supplier to the customer of a service credit.

Service credits are generally offset against the fees, and they are usually relatively modest amounts. The aim is to compensate the customer for poor service without the need to pursue a claim for damages or terminate the contract, and to motivate the supplier to meet the performance targets.

Typically, the supplier and customer will agree an amount equal to a percentage of the fees payable for the services which the supplier will put at risk under the service credit scheme.

Service credits are often expressed to be the sole remedy of the customer for the particular failure concerned, but this should be without prejudice to the customer’s wider rights in relation to more serious breaches of the contract or persistent failures in performance, both of which should also be dealt with. Service credits are generally enforceable, provided they are a genuine pre-estimate of the customer’s loss rather than a contractual penalty.

## **8. CHARGING, ADJUSTMENT OF FEES, AUDITING, BENCHMARKING**

### **8.1 Describe the charging methods commonly used in an outsourcing**

The most common charging models for outsourced services are cost plus, fixed charges and unit pricing.

#### **Cost plus**

In a cost plus model, the actual cost to the supplier of providing services (often reviewed on an open book basis) is charged, plus additional costs (often a percentage of costs) to reflect the supplier's overhead and/or agreed profit margin.

#### **Fixed charges**

Fixed charges are usually only appropriate where the volume and scope of services is constant or at least predictable. The main benefit for the customer is certainty of charges; the downside is that the charges are rarely transparent.

#### **Unit pricing or baseline model**

A baseline model is a form of unit pricing based on baseline levels of usage or output for specific basic commodity services such as help desk and desktop services.

Suppliers may require a minimum fee commitment to cover the personnel, infrastructure and equipment required to perform the services. Subject to such a 'collar', ARCs (Additional Resource Charges) and RRCs (Reduced Resource Charges) may be used to handle volume fluctuations above and below the baseline. A pricing 'cap' may also be used, such that sustained volumes above the cap triggers a pricing renegotiation.

#### **Other pricing models**

Pay per use might also be a suitable pricing model (eg for certain commodity IT services where processors, software or storage can be switched on or off quickly and inexpensively).

Agreements may incorporate gain sharing. This involves the supplier committing to achieving certain agreed savings in the service charges and being entitled to share (in agreed proportions) any excess savings over and above those targets. The customer benefits from a less expensive service whilst the supplier is incentivised to look for further cost reductions as it stands to gain a share of the savings. Guaranteed maximum and target cost models also use a form of gain share although the supplier also takes a degree of risk (pain share).

Suppliers also have ad hoc charges which may need to be factored into the pricing outside the core pricing model, such as transition and implementation costs or hardware refresh.

In outsourcing arrangements where the supplier is taking more of a 'partner' role, we are starting to see 'gain-share' and 'pain-share' pricing

models. This is where the level of the supplier's remuneration depends on its standard of performance and the final outcome/level of success of the partnership.

## **8.2 Describe customary change management procedures**

Customary change management procedures usually allow a party to request changes to the contract. Change requests are usually discussed by the parties, but the request is usually written down at some point in the process because eventually, if the change is agreed, it will become part of the contract.

A customer may make a change request if its needs change (eg it requires higher or lower volumes from the supplier).

Most change control provisions normally only permit changes where they are required by law or where both parties can reach an agreement.

## **8.3 Are there other adjustment mechanisms?**

If not done automatically (eg using ARCs and RRCs (see section 8.1 above)), the outsourcing agreement should include a process to discuss and agree the cost impact of changes in business volumes.

Outsourcing agreements often contain obligations on the supplier to reduce its charges to the customer over time. The price reductions may arise through various means, including productivity gains, transformation of processes and/or implementation of new technology. Benchmarking may also be used to ensure the charges remain competitive.

Charges may be indexed periodically using agreed cost of living adjustment (COLA) indices. The most common indices used are those which relate to retail prices or average earnings in the service delivery locations.

If there is an international element to the outsourcing agreement (due to the customer's locations or the supplier's delivery model), the contract might provide for variations in foreign exchange rates against the billing currency by reference to an agreed external index. The parties often choose to fix the exchange rate for an initial period, and thereafter adjustments are made by reference to an external rate.

## **8.4 Describe the contract rules for disputed charges and related consequences**

It is common to have a contractual provision to deal with disputed charges. The customer is usually allowed to dispute an invoice with a supplier that the customer thinks, in good faith, is incorrect. There is often a limited period of time during which the customer can do this (eg a number of weeks or months). The customer is usually obliged to pay any undisputed part of the invoice. It is also common to set out a process to resolve invoice disputes, with escalation levels and timelines.

If a customer does not pay undisputed charges for a certain period of time, then the supplier often has a contractual right to suspend/terminate the services. The parties are free to agree a time period for payment. This is commonly one or even two months, with an additional grace period before

the supplier can exercise its rights to suspend or terminate the agreement for non-payment.

### **8.5 What are the contractual rules usually applied to auditing?**

Audits allow the customer to review the supplier's charges (and the basis for charging, including customer's usage in unit pricing arrangements), performance and compliance with its obligations under the outsourcing agreement. Depending on the services, security audits may be appropriate. Audits may also be required for regulatory reasons (see section 3.3 above).

The contract usually sets out the process for instigating an audit. The customer is generally required to give advance notice of its intention to audit the supplier (unless it is not able to do so for regulatory reasons or where fraud or other serious wrongdoing is suspected). The contract also sets out the process for defining the objective of the audit, the type of information that must be provided, the onsite access the auditor may have to premises and systems, and the people the auditor may speak with. The parties may agree to split the costs, and the supplier will often seek to limit the number of audits which may be performed.

The consequences of an audit should also be considered. If the supplier has overcharged or undercharged the customer, appropriate repayments should be made. If the supplier is in breach of other obligations, the contract may set out in general terms the steps the supplier should undertake in order to rectify the breach.

### **8.6 Describe common benchmarking methodologies**

Outsourcing agreements usually address a number of key issues in relation to benchmarking, including:

- timing of initial benchmarking and frequency thereafter;
- a shortlist of potential benchmarkers;
- allocation of benchmarker's costs;
- scope of services to be benchmarked, including whether services are benchmarked in totality or by service category or geography;
- treatment of different geographies in the benchmark to ensure accurate local comparisons;
- definition of basis of benchmarking (peer group, commensurate services, volumes, locations and service levels) to promote like-for-like comparisons;
- size and selection of the representative samples;
- the process to be undertaken, including timelines;
- normalisation of data (eg treatment of outliers) and calculation used to determine a price to be benchmarked against;
- provision of the report by the benchmarker, with an opportunity for both the customer and supplier to review the report and query the results; and
- consequences of an adverse benchmark:
  - (i) whether a price adjustment is automatic within certain threshold amounts;

- (ii) whether the customer has a termination right for cause or convenience; and
- (iii) how any disputes are to be handled.

## **9. TAX ASPECTS, TAX EFFICIENCY IN GROUP STRUCTURES, TRANSFER PRICING**

### **9.1 What are the main tax issues that arise in an outsourcing in relation to:**

#### **9.1.1 transfers of assets?**

A transfer of assets in an outsourcing arrangement may result in tax consequences:

- for the transferor: taxes on chargeable gains, effective clawback of capital allowances claimed on the assets transferred, and a potential requirement to account for VAT on the assets transferred if the transferor is VAT-registered (unless the transfer is a transfer of a going concern for VAT purposes);
- for the transferee: the potential for VAT to be charged by the supplier on assets received, and a charge to stamp duty (in the case of a transfer of shares) or stamp duty land tax (in the case of a transfer or grant of an interest in real estate); and
- where the customer and supplier are connected, transfer pricing may require tax adjustments if the price allocated to the transfer of the assets is less than market value.

#### **9.1.2 value added tax (VAT) or other sales tax?**

The fee for services supplied to the customer by the supplier are generally subject to UK VAT at 20 per cent unless the supplies are VAT exempt. VAT is principally a liability of the supplier unless the supplier is based outside of the UK, in which case the customer is likely liable for any such VAT under the reverse charge procedure. In any event, even where the supplier is liable for such VAT, it is likely that the customer is contractually liable to pay an amount to the supplier equal to such VAT.

In an outsourcing context, it is often difficult to argue that the outsourced services are VAT exempt, even where the customer is making exempt supplies (eg in the financial sector).

Where the customer is fully taxable, any VAT on the outsourced services is usually recovered in full in the usual way as input tax. However, where the customer is not fully taxable (particularly in the financial services and healthcare industries), the customer is limited in the amount of VAT which can be recovered.

#### **9.1.3 service charges or other taxes at source?**

The UK does not impose service charges or similar taxes on services other than VAT as described above.

#### **9.1.4 withholding taxes?**

Income tax may be withheld by a UK payer in respect of interest and royalties (although such withholding tax is not due on payments made to a UK company). The UK withholding tax rate is 20 per cent, but this may be reduced or eliminated where a tax treaty applies. Dividends paid by a UK company are not subject to withholding taxes.

#### **9.1.5 stamp duty?**

The UK charges stamp duty at 0.5 per cent on the transfer of shares (but not the issue of new shares) and stamp duty land tax at up to 15 per cent on the transfer or grant of an interest in real estate. Outsourcing services do not, usually, trigger either tax.

#### **9.1.6 corporate tax?**

The customer is generally able to deduct the costs of outsourcing services for corporate tax purposes, subject to the requirement that such costs are charged on an arm's length basis where the supplier is a related party. In these circumstances, where the cost charged exceeds the arm's length price, the excess is disallowed for UK corporate tax purposes.

#### **9.1.7 other tax issues?**

N/A.

### **9.2 What precautions are usually taken to arrange for tax efficiency?**

Tax efficiency is most likely to be achieved through a contractual arrangement or partnership so that the customer and supplier remain separate. These arrangements allow the parties to access losses generated but do not create new tax filing requirements.

Where the parties are related, transfer pricing rules operate to reduce UK tax deductions for the customer if the costs charged by the supplier exceed an arm's length price. Similarly, a UK supplier is subject to tax on an arm's length price for the services if the actual costs charged are less than an arm's length price.

Further tax efficiency can sometimes be achieved through VAT grouping the supplier and customer if this is commercially achievable without the need to resort to any artificial structuring.

## **10. TERM AND TERMINATION, NOTICE PERIODS, MANDATORY TERMINATION, PROLONGATION RIGHTS, TERMINATION MANAGEMENT**

### **10.1 What are the rules and regulations regarding the term of an outsourcing agreement and/or length of notice period?**

With the exception of rules regarding public procurement, English law does not specifically regulate minimum or maximum terms for an outsourcing transaction. In longer outsourcing agreements, it is common to have a break point at which the customer may terminate the agreement upon prior notice without payment of any termination compensation. Often outsourcing

agreements have automatic renewal for an additional 12 or 24 month periods if a party does not give notice of termination.

If an outsourcing is regulated by the UK public procurement regulations (see section 2.1 above), the term of the agreement is that stated in the Official Journal of the EU and may only be extended in accordance with the public procurement regulations. If the outsourcing agreement is a framework agreement, the maximum duration of such an agreement is four years. In addition, if the contracting party is a local authority the best-value regime set out under the Local Government Act 1999 requires the local authority to carry out a best-value review every five years.

Agreements that include exclusive or minimum purchase and supply obligations, especially those with a term of five years or more, need to comply with EU and UK competition law.

The term of the agreement may also trigger reporting requirements. It may be necessary or at least advisable in certain circumstances to notify an outsourcing arrangement to the relevant authorities under EU or UK merger control legislation, and the duration of an outsourcing agreement may be a relevant factor. Guidance from the UK Office of Fair Trading states that an outsourcing arrangement is likely to fall within the scope of the Enterprise Act 2002 if the arrangement involves the permanent (or long-term) transfer of assets, rights and/or employees to the supplier and where those transferred elements can be used to supply services other than to the original owner/employer.

English law does not regulate the notice period required to terminate an outsourcing agreement. The parties may agree varying notice periods for different types of termination (eg convenience, cause or other express rights).

### **10.2 Which events justify termination of an outsourcing agreement without giving rise to a claim in damages against the terminating party as a matter of mandatory law?**

Under English common law, a repudiatory breach of contract gives rise to a right of termination, where:

- a reasonable person would conclude that the other party no longer intends to be bound by it (for example, through express actions such as abandonment of its obligations); or
- the breach has the effect of depriving the other party of a substantial part of the benefit to which it was entitled under the agreement. A repudiation of this sort can arise as a result of a single, significant breach or an accumulation of more minor breaches that together amount to repudiation.

Repudiatory breaches include a breach of a condition of a contract and a fundamental breach of an intermediate term. The circumstances which gave rise to the repudiatory breach may also result in a cause of action for contractual damages.

### **10.3 What contractual termination rights are usually included in the outsourcing agreement?**

The parties are free to agree specific termination rights. Common examples include:

- material breach, and for such breaches which may be cured, it is usual to include a cure period (often 30 days or more);
- minor but persistent breaches which together amount to a material breach; the type of breach and number of breaches needed to trigger the termination right may be specified for clarity;
- insolvency and related proceedings;
- change of control of the supplier or its parent;
- termination for convenience by the customer on notice (see section 10.4 below);
- breach of confidentiality provisions;
- breach of intellectual property rights and licences; and
- regulatory reasons.

### **10.4 Are there termination for convenience rights?**

The parties are free to agree specific termination rights, which can block or extend the rights implied by general law, including termination for convenience by the customer on notice. This allows the customer to switch suppliers without having to give a reason (for example, if it is generally dissatisfied but unable to demonstrate any clear breach). This is usually an expensive option, since the supplier often requires compensation for early termination.

### **10.5 Are there implied rights for the customer and/or supplier to continue to use licensed IP rights or gain access to relevant know-how post-termination?**

In the absence of a contractual provision entitling the supplier to use the customer's licensed IP post-termination, there are no implied rights to use licensed IP following termination of the outsourcing agreement. The parties are free to agree on the continued use of licensed IP rights post-termination.

### **10.6 Describe particular aspects of termination management, assistance by the supplier**

An exit plan is essential for outsourcing agreements. It should deal with matters such as:

- return of assets and software;
- treatment of employees (including pursuant to TUPE);
- provision of information and know-how to a new supplier or the customer if services are being brought back in-house;
- a timetable for the termination assistance, with clarity as to the duration of the termination assistance and key milestones; and
- continuation of service provision and maintenance of the service levels during the termination assistance period up until handover to the incoming supplier or back to the customer.

A supplier may seek to limit its obligations in respect of termination assistance where the supplier has terminated the agreement due to non-payment or the customer's material breach, and may also seek upfront payment for termination assistance.

### **10.7 Are disputes common in respect of exit services and transition from one vendor to another? If so, please describe the nature of such disputes and how they are resolved**

Issues between the parties in respect of exit services and transition from one supplier to another are common. This is to be expected as a relationship comes to an end, especially if it ends on bad terms. Problems may arise because:

- an outgoing supplier is reluctant to provide exit services (or to provide exit services to a high standard) because it is losing business (and possibly even losing business to a competitor); or
- the parties did not consider in detail (when the contract was negotiated) what exit obligations should be performed and therefore this has to be negotiated at the point of termination.

## **11. REMEDIES, RISK MANAGEMENT AND PROACTIVE MEASURES**

### **11.1 Which remedies and/or reliefs are available to the customer under law for bad or non-performance by the supplier?**

A customer's English common law remedies in the event of a supplier's failure or poor performance may, depending on the failure, include:

- restitution for damages;
- specific performance; and/or
- termination of the agreement.

English law implies terms into contracts:

- rights as to title and quiet possession (section 12 of Sale of Goods Act 1979 or section 2 of Supply of Goods and Services Act 1982 (SGSA));
- that goods must be fit for purpose and of satisfactory quality (sections 3-5 of SGSA); and
- that services must be performed with reasonable care and skill (section 13 SGSA).

The English courts have also found a common law duty for services to be of satisfactory quality and reasonably fit for their purpose.

### **11.2 Which customer protections are typically included in the contract to supplement statutory remedies/relief?**

An outsourcing agreement usually contains rights and remedies to protect the customer from a supplier's breach or failure, including:

- service credits for service level breaches;
- step-in rights (in case of material breach);
- audit rights to cover financial, operational and security aspects of the agreement;
- defined termination events, including termination for convenience;

- appropriate governance or escalation structure with a clear dispute resolution procedure; and
- adjustment of charging mechanisms that may have been more beneficial to the supplier (eg minimum revenue commitments).

The agreement usually contains certain supplier obligations to provide the customer with protection, such as obligations to:

- measure and report service levels, highlighting actual and foreseeable problems and obliging the supplier to remedy faults and take preventative action to minimise reoccurrences;
- maintain adequate insurance coverage (often with agreed limits and coverage);
- arrange execution of a parent company guarantee; and
- indemnify the customer for certain breaches and losses.

### **11.3 Which warranties and indemnities are typically included in a contract?**

It is usual for a supplier to:

- warrant that it is entitled to enter into the agreement and perform its obligations;
- warrant that it will perform the services with reasonable care and skill, in a timely and professional manner and in accordance with applicable laws and recognised industry standards;
- warrant that material information provided by it in the proposal stages was and remains accurate, complete and not misleading;
- warrant it has required certifications, accreditations and operates in accordance with defined standards related to the services;
- indemnify the customer against loss suffered due to the supplier's actions related to IP breaches, breach of confidentiality, damage to property and wilful acts or omissions; and
- indemnify the customer against future liability in relation to employees transferred to the supplier as part of the outsourcing.

It is usual for the customer to provide a more limited list of warranties and indemnities, such as to:

- warrant it is entitled to enter into the agreement and perform its obligations;
- provide assurances concerning title and condition of assets transferred to the supplier, including the absence of liabilities under transferred contracts (if not transferred 'as is'); and
- indemnify the supplier against historic liability in relation to employees transferred to the supplier as part of the outsourcing.

### **11.4 Describe the common limitation and/or exclusion of liability**

The parties are generally free to exclude most forms of liability, subject to the important conditions outlined below in respect of business-to-business contracts:

- an exclusion of liability for fraud or fraudulent misrepresentation is unenforceable;

- exclusions or restrictions of liability for misrepresentation must satisfy the requirement of reasonableness in Unfair Contract Terms Act 1977 (UCTA) (section 3 Misrepresentation Act);
- any attempted exclusion or restriction of liability for death or personal injury caused by negligence is wholly ineffective under section 2(1) UCTA;
- if the parties are dealing on written standard terms of business, any exclusion or restriction of liability for breach of contract must satisfy UCTA's reasonableness requirement. This does not apply where the parties are not dealing on the supplier's standard terms;
- there is no rule of law that an exclusion or restriction of liability for deliberate breaches cannot be effective; whether the clause covers such breaches is a matter of construction, and clear language must be used;
- in the case of other loss or damage caused by negligence, the exclusion or restriction of liability must satisfy UCTA's reasonableness requirement. 'Negligence' includes breach of any express or implied term of a contract requiring the exercise of reasonable skill and care in the performance of the contract or any common law duty to take reasonable care or exercise reasonable skill (section 1(1) UCTA). Clear words must be used to exclude liability for negligence, and this common law rules applies even when UCTA has been satisfied;
- any attempted exclusion or restriction of liability for death, personal injury or loss of or damage to property caused by defective products is wholly ineffective (section 7 Consumer Protection Act 1987);
- liability for breach of the terms implied into contracts by law as to title and quiet possession cannot be excluded or restricted by contract (sections 6(1) and 7(3A) UCTA); and
- liability for breach of the terms implied by law as to conformity of goods with description or sample or as to their quality or fitness for a particular purpose can be excluded or restricted in business-to-business agreements provided the term satisfies the reasonableness test (sections 6(3) and 7(3) UCTA).

UCTA does not apply to certain agreements, including international supply contracts, contracts of insurance and any contract relating to the creation, transfer or termination of an interest in land or intellectual property.

Subject to the above, the supplier (and usually the customer) aims to exclude liability for:

- indirect and consequential loss; and
- loss of business, profit or revenue, including where these constitute a direct loss.

In contrast, the customer usually tries to ensure that it is able, under the agreement, to recover all its direct loss (including direct loss of profit, business and revenue). The parties often list certain losses they have agreed are direct losses and recoverable.

The parties usually agree certain types of liability for which there is no financial cap (such as to comply with laws as stated above and reflect the

commercial arrangement between the parties, eg for certain indemnities). For all remaining types of liability the parties usually agree on a financial limitation on liability, which may be a fixed amount, or percentage/multiple of contract value for a defined period. Current practice suggests that a percentage provides some benefits as it flexes with the value of the contract (and risk and reward are balanced).

The supplier should take care that the drafting of the cap does not restrict its right to recover for non-payment of charges that are properly due to it from the customer, and the customer should consider whether service credits count towards the cap or not.

### **11.5 Are there statutory set-off rights and can they can be contractually excluded or limited?**

Various rights of set-off arise under the general law (such as legal set-off, equitable set-off, bankers set-off and insolvency set-off). Each is subject to different limits. A contract term can extend or restrict the rights for common law rights of set-off. Insolvency set-off supersedes any contractual rights of set-off between a creditor and an insolvent debtor. Either one party or both could agree not to claim in the other's insolvency or to subordinate any claim it makes in the other's insolvency to claims of other creditors (although this is rarely done in outsourcing agreements).

## **12. INSURANCE**

### **12.1 What types of insurance are readily available in your jurisdiction?**

The types of insurance available include:

- professional indemnity;
- public liability;
- employers' liability;
- business interruption;
- fidelity; and
- directors' and officers' liability.

## **13. SUBCONTRACTING AND ASSIGNMENT**

### **13.1 Which rules and regulations apply to subcontracting and assignment of obligations under the contract?**

A party may subcontract its obligations under a contract or assign the benefit (ie rights) of a contract unless the contract prohibits subcontracting or assignment. Contracts often require the consent of the other party to any subcontracting or assignment. If (in addition to the benefit) the burden (ie the obligations) of the contract is also to be transferred, then a novation is required (by means of a tripartite agreement under which one original contracting party is replaced by the new party, thereby technically terminating the original agreement and immediately entering into a new agreement on the same terms between the new parties).

### **13.2 What contractual arrangements are usually made regarding subcontracting and assignment?**

It is common to include contractual provisions setting out which obligations (if any) can be subcontracted, and to whom, although the contract usually states that the contracting party remains primarily liable for acts and omissions of its subcontractors.

Parties often agree that the contract may be transferred in whole without consent in some cases (such as to affiliates), and with consent to other third parties. There is often a prohibition on assignment to competitors of the counterparty.

## **14. JURISDICTION, LITIGATION, ARBITRATION, MEDIATION, FAST TRACK DISPUTE RESOLUTION**

### **14.1 Describe statutory rules and practice regarding contract management, governance and escalation**

Whilst there are no statutory rules on contract management, it is common to include in the contract provisions setting out the escalation of disputes through operational and management structures before either party may seek recourse outside the contract (other than in respect of injunctive relief).

It is common for parties to seek agreement through informal dispute resolution before seeking recourse outside of the contract.

### **14.2 What are the usual provisions regarding applicable law and arbitration clauses?**

Parties are generally free to choose the governing law of their contract and any non-contractual obligations arising out of or in connection with it, and it is common to include an election as to the jurisdiction in which any claims will be heard. There are some areas of law where it is not possible to exclude mandatory provisions of local law, such as those affecting consumers, employees and personal data.

Arbitration is becoming more popular. If the arbitration clause provides, an arbitral award is binding on the parties. One key benefit of arbitration is that arbitral bodies can hear proceedings confidentially, so the dispute does not become public. Another key benefit of arbitration is that an arbitration award is much easier to enforce against a counterparty established in another jurisdictional (often the case in multijurisdictional outsourcing arrangements). It is often perceived to be cheaper than litigation, but this is not always the case.

# Contact details

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## FOREWORD

Dr Lukas Morscher  
Lenz & Staehelin  
Bleicherweg 58  
8027 Zurich  
Switzerland

T: +41 58 450 80 00  
F: +41 58 450 80 01  
E: lukas.morscher@lenzstaehelin.com  
W: www.lenzstaehelin.com

Ole Horsfeldt  
Gorrissen Federspiel  
H. C. Andersens Boulevard 12  
1553 Copenhagen V  
Denmark

T: +45 33 41 41 41  
F: +45 33 41 41 33  
E: oho@gorrissenfederspiel.com  
W: www.gorrissenfederspiel.com

## ARGENTINA

Marcelo Bombau  
M & M Bomchil  
Suipacha 268  
Piso 12  
C1008AAF  
Ciudad A. de Buenos Aires  
Argentina

T: +54 11 4321-7500  
+54 11 4321-7503  
F: +54 11 4321-7555  
E: marcelo.bombau@bomchil.com  
W: www.bomchil.com

## AUSTRIA

Wolfgang Tichy & Günther Leissler  
Schönherr Rechtsanwälte GmbH  
Tuchlauben 17  
A-1014 Vienna  
Austria  
T: +43 1 53437 50227

F: +43 1 53437 6100  
E: w.tichy@schoenherr.eu  
g.leissler@schoenherr.eu  
W: www.schoenherr.eu

## BRAZIL

Fábio Luiz Barboza Pereira  
Veirano Advogados  
Av. Brigadeiro Faria Lima, 3477  
16º andar  
04538-133 - São Paulo SP  
Brazil

T: + 5511 2313 5700  
F: + 5511 2313 5990  
E: fabio.pereira@veirano.com.br  
W: www.veirano.com.br

## CANADA

Sunny Handa & Hélène Deschamps  
Marquis  
Blake, Cassels & Graydon LLP  
600 de Maisonneuve Boulevard West  
Suite 2200

Montréal QC H3A 3J2  
Canada  
T: +1 514 982 4008 (SH)  
+1 514 982 4042 (HDM)  
F: +1 514 982 4099  
E: sunny.handa@blakes.com  
helene.deschampsmarquis@blakes.com  
W: www.blakes.com

## CZECH REPUBLIC

Lenka Suchánková & Tomas Schollaert  
Pierstone

Na Příkopě 9  
110 00 Prague 1  
Czech Republic  
T: +420 224 234 958  
E: lenka.suchankova@pierstone.com  
tomas.schollaert@pierstone.com

W: [www.pierstone.com](http://www.pierstone.com)

## **DENMARK**

Ole Horsfeldt  
Gorrissen Federspiel  
H. C. Andersens Boulevard 12  
1553 Copenhagen V  
Denmark  
T: +45 33 41 41 41  
F: +45 33 41 41 33  
E: [oho@gorrissenfederspiel.com](mailto:oho@gorrissenfederspiel.com)  
W: [www.gorrissenfederspiel.com](http://www.gorrissenfederspiel.com)

## **FINLAND**

Mikko Manner, Anna Haapanen &  
Juhani Sinkkonen  
Roschier, Attorneys Ltd.  
Keskuskatu 7 A  
FI-00100 Helsinki  
Finland  
T: +358 20 506 6519 (MM)  
+358 20 506 6597 (AH)  
+358 20 506 6538 (JS)  
E: [mikko.manner@roschier.com](mailto:mikko.manner@roschier.com)  
[anna.haapanen@roschier.com](mailto:anna.haapanen@roschier.com)  
[juhani.sinkkonen@roschier.com](mailto:juhani.sinkkonen@roschier.com)  
F: +358 20 506 6100  
W: [www.roschier.com](http://www.roschier.com)

## **FRANCE**

Thierry Dor & Foulques de Rostolan  
Gide Loyrette Nouel  
26 cours Albert 1er  
75008 Paris  
France  
T: +33 1 40 75 60 00  
F: +33 1 40 75 69 83  
E: [dor@gide.com](mailto:dor@gide.com)  
[rostolan@gide.com](mailto:rostolan@gide.com)  
W: [www.gide.com](http://www.gide.com)

## **GERMANY**

Prof. Dr Peter Bräutigam  
Noerr LLP  
Brienner Straße 28  
80333 Munich  
Germany

T: +49 89-28628-145  
F: +49 89-280110  
E: [peter.braeutigam@noerr.com](mailto:peter.braeutigam@noerr.com)  
W: [www.noerr.com](http://www.noerr.com)

## **HONG KONG**

Chuan Sun & Victoria White,  
Freshfields Bruckhaus Deringer  
11th Floor, Two Exchange Square  
Central  
Hong Kong  
T: +852 2846 3400  
F: +852 2810 6192  
E: [chuan.sun@freshfields.com](mailto:chuan.sun@freshfields.com)  
[victoria.white@freshfields.com](mailto:victoria.white@freshfields.com)  
W: [www.freshfields.com](http://www.freshfields.com)

## **INDIA**

Sajai Singh  
J. Sagar Associates  
2 Frontline Grandeur  
14 Walton Road  
Bangalore 560 001  
India  
T: +91 80 435 03627  
F: +91 80 435 03617  
E: [sajai@jsalaw.com](mailto:sajai@jsalaw.com)  
W: [www.jsalaw.com](http://www.jsalaw.com)

## **ITALY**

Domenico Colella  
Orsingher Ortu – Avvocati Associati  
Piazza di Campitelli, 3  
00186 Roma  
Italy  
T: +39 06 45599200  
F: +39 06 69970021  
E: [domenico.colella@orsingher.com](mailto:domenico.colella@orsingher.com)  
W: [www.orsingher.com](http://www.orsingher.com)

## **THE NETHERLANDS**

Edward de Lange & Jort de Jong  
Loyens & Loeff NV  
Postbus 2888, 3000 CW Rotterdam  
Blaak 31, 3011 GA Rotterdam  
The Netherlands  
T: +31 10 224 62 24

F: +31 10 412 58 39  
E: edward.de.lange@loyensloeff.com  
jort.de.jong@loyensloeff.com  
W: www.loyensloeff.com

## **NORWAY**

Espen Werring & Thor Jusnes  
Haavind AS Bygdøy allé 2  
Pb 359 Sentrum  
NO-0101 Oslo  
Norway  
T: +47 22 43 30 00  
F: +47 22 43 30 01  
E: e.werring@haavind.no  
t.jusnes@haavind.no  
W: www.haavind.no

## **PORTUGAL**

Octávio Castelo Paulo & Luís Neto  
Galvão  
Sociedade Rebelo de Sousa  
& Advogados Associados, R.L.  
Rua D. Francisco Manuel de Melo, 21  
1070-085 Lisbon  
Portugal  
T: +351 21 313 20 00  
F: +351 21 313 20 01  
E: octavio.paulo@srslegal.pt  
luis.galvao@srslegal.pt  
W: www.srslegal.pt

## **REPUBLIC OF IRELAND**

Wendy Hederman & Philip Nolan  
Mason Hayes & Curran  
South Bank House, Barrow Street  
Dublin 4  
Ireland  
T: +353 1 614 5000  
F: +353 1 614 5001  
E: pnolan@mhc.ie  
whederman@mhc.ie  
W: www.mhc.ie

## **ROMANIA**

Cătălin Băiculescu  
Țuca Zbârcea & Asociații  
Victoriei Square  
4-8 Nicolae Titulescu Ave.  
America House  
West Wing, 8th Floor, Sector 1  
Bucharest 011141  
Romania  
T: +40 21 204 88 90  
F: +40 21 204 88 99  
E: catalin.baiculescu@tuca.ro  
W: www.tuca.ro

## **SINGAPORE**

Ian Ferguson & Matthew Hunter  
Olswang Asia LLP  
10 Collyer Quay  
Ocean Financial Centre  
#05-01  
Singapore 049315  
T: +65 6720 8278  
F: +65 6720 8279  
E: ian.ferguson@olswang.com  
matthew.hunter@olswang.com  
W: www.olswang.com

## **SPAIN**

Jorge Llevat & Alejandro Negro Sala  
Cuatrecasas, Gonçalves Pereira  
Almagro, 9 – 28010  
Madrid  
Spain  
T: +34 91 524 77 17  
+34 93 290 55 85  
F: +34 91 524 71 24  
+34 93 290 55 38  
E: jorge.llevat@cuatrecasas.com  
alejandro.negro@cuatrecasas.com  
W: www.cuatrecasas.com

## **SWEDEN**

Thomas Lindqvist & Bojana Saletic  
Hammarskiöld & Co  
PO Box 2278  
103 17 Stockholm  
Sweden  
T: +46 8 578 450 00  
F: +46 8 578 450 99  
E: thomas.lindqvist@hammarskiold.  
se  
bojana.saletic@hammarskiold.se  
W: www.hammarskiold.se

## **SWITZERLAND**

Dr Lukas Morscher  
Lenz & Staehelin  
Bleicherweg 58  
8027 Zurich  
Switzerland  
T: +41 58 450 80 00  
F: +41 58 450 80 01  
E: lukas.morscher@lenzstaehelin.  
com  
W: www.lenzstaehelin.com

## **TURKEY**

Gokhan Enkur & Vehbi Geray  
Bilimer  
Pelister Atayilmaz Enkur Law Office  
Maya Meridien Plaza  
Ebulula Mardin Cad. No:16/30  
Akattlar Istanbul 34335  
Turkey  
T: +90 212 351 88 86  
F: +90 212 351 88 87  
E: gokhan.enkur@pae-law.com  
vehbi.bilimer@pae-law.com  
W: www.pae-law.com

## **UNITED KINGDOM**

Ian Ferguson, Dominic Dryden &  
Matthew Hunter  
Olswang LLP  
90 High Holborn  
London WC1V 6XX  
UK  
T: +44 20 7067 3000

F: +44 20 7067 3999  
E: ian.ferguson@olswang.com  
dominic.dryden@olswang.com  
matthew.hunter@olswang.com  
W: www.olswang.com

## **UNITED STATES OF AMERICA**

Brad L Peterson  
Mayer Brown LLP  
71 South Wacker Drive  
Chicago, IL 60606  
USA  
T: +1 312 701 8568  
F: +1 312 706 8187  
E: bpeterson@mayerbrown.com  
W: www.mayerbrown.com