

Minimizing Outsourcing Risk

Martindale-Hubbell posed the following question to provide a variety of views on this important topic:

How can companies avoid common problems when drafting outsourcing contracts and agreements?



S. Brian Levett

Partner

Miller Thomson LLP
blevett@millerthomson.com

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Defining the service that the supplier performs is the most important first step. The customer needs to be realistic about what it has and what it wants. Working with outside advisers is one way to work through what is initially a due diligence process. Once the scope of work has been defined, along with the required service levels, it is possible to assess and document the other key components, including the change order process, audit, reporting, governance, incentives, dispute resolution, termination and transition.



Steven J. Friedman

Shareholder

Littler Mendelson P.C.
sfriedman@littler.com

The first rule is to carefully review the substance of the agreement. One of the most important provisions to review in the agreement is the provision containing the standard of care that the outsourcing entity owes to the client because of the obvious need for legal protection when something goes awry. Without clear language relating to responsibility for errors and omissions, jousting may occur over which party has responsibility for a problem, and it can be a huge surprise to clients when the outsourcing entity doesn't take immediate responsibility.



Robert M. Conway

Partner

Duane Morris LLP
rmconway@duanemorris.com

Include standards for the supplier to meet, and make sure they are measurable. Too often, standards are difficult, and sometimes impossible, to measure. Consider including not only damages for the supplier failing to meet the standards but also incentives for exceeding them.

These are often long-term contracts, and once the functions have been outsourced, they are not easily re-established within the company. Accordingly, there should be some mechanism for periodically adjusting the price for the services that takes into account then-current conditions.

Outsourcing can be so useful that it's easy to overlook how rocky such relationships can become. However, problems or misunderstandings can crop up and expectations may not be met. To avoid ongoing problems and poor service, terms and expectations should be clearly defined in the initial contracts.



John D. Bray

Shareholder

Cox Smith Matthews Incorporated
jbray@coxsmith.com

These are business and not legal issues, but are still important to keep in mind while drafting outsourcing agreements:

- Know how your customers and employees will react. If they disapprove, it may adversely affect your business and you may not realize the anticipated benefits.
- Maintain confidentiality and control the message. You do not want your employees or customers finding out before you are ready to make an announcement. You want them to hear your message about the benefits of outsourcing before someone else's misinformed, and possibly inflammatory, comments.



Jeffrey D. Mokotoff

Partner

Ford & Harrison LLP
jmokotoff@fordharrison.com

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- Familiarize yourself with standard industry provisions. If you contract with a staffing agency, understand that, as a matter of law, the agency will be the primary party responsible for complying with certain laws concerning its employees (e.g., workers' compensation, FLSA, FMLA).
- Have a provision protecting your proprietary information, as well as a provision requiring employees of the outsourcing company to execute nondisclosure agreements.
- Consider having an on-site coordinator from the outsourcing company who will oversee interviewing, handle problems related to its employees, counsel them and conduct performance evaluations.



Kelly L. Frey

Shareholder

Baker, Donelson, Bearman, Caldwell & Berkowitz, PC
kfrey@bakerdonelson.com

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Create service levels/remedies that work:

- Concentrate on practical rather than technical service levels; "99.9 percent uptime" means nothing if the 0.1 percent downtime is during a critical business transaction.
- Focus on maintaining business continuity (not just drafting legal remedies). No legal remedy can compensate for the loss of customer confidence if you have a system failure from which you can't quickly recover.
- Everything fails eventually. Include a requirement for a disaster recovery process but also make sure the process actually works.

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Illustrations by Holly Haugen