Title: Common Problems in Technology Outsourcing Transactions: How to Recognize and Avoid Them
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ASSOCIATION OF CORPORATE COUNSEL

Moderator: Steven R. Garrett
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Steve Garrett: Just a reminder, today's conference is being recorded.

Welcome to the Association of Corporate Counsel nonprofit organizations committee Web site and entitled; "Common Problems in Technology Outsourcing Transactions," How to recognize and avoid them.

My name is Steve Garrett, and I will be the moderator for today's presentation. I am the Associate Vice President and General Counsel for the Texas A&M research foundation. I also serve as the chair of the Web cast subcommittee of the nonprofit organizations committee of ACC.

Our panelist today is John Nicholson a Senior Associate in the global sourcing group of the law firm Pillsbury Winthrop Shaw Pittman, a firm that is a sponsor of the ACC non profit organization committee.

Mr. Nicholson is located in the firm's Washington, D.C. office where he focuses on negotiating and documenting complex technology transaction and also specializes in data privacy and computer security.

He is a frequent speaker on issues associated with technology transactions, privacy and security and writes a legal issues column for "Log In" the magazine of UNIX, the advanced computing systems association.

Before joining Pillsbury, Mr. Nicholson was the international project manager for an Oracle implementation of the mid sized company and was acting director of information technology.

Before law school, he was a physicist with the U.S. Department of Energy super conducting, Super Collider program.

Mr. Nicholson received a BA from Williams College and a JD-MBA degree from Vanderbilt University.

This Web cast is being presented through ACC's updated Web cast page. Attendees may post questions for Mr. Nicholson by using the chat button on your screen. Your question will not appear on the other attendees screen, but will be visible to Mr. Nicholson and myself.

To ask a question, enter your text into the box and click the button that says send. If a question occurs to you after the close of this presentation, you can send them to Mr. Nicholson at john.nicholson@pillsburylaw.com.

This Web cast is being recorded and an audio file for this Web cast will be available for replay on the ACC Web site about three hours after the end of the presentation. It will also be archived on the ACC Web site for about a year.

During the course of the Web cast, you will see a satisfaction survey on your screen. Please take a moment or two to respond to this survey. It is a very useful tool for ACC to organize and present Web cast that are interesting and informative to ACC members.

Now let me turn the presentation over to Mr. Nicholson.

John Nicholson: Good afternoon or good morning depending on where you happen to be. My name is John Nicholson and as Steve said, I'm with the law firm of Pillsbury Winthrop Shaw Pittman.

What we're going to discuss today are common problems in the acquisition of technology hardware, software and associated services. Some of what we'll discuss will be applicable to sourcing contracts of all types, services contracts for anything your organization might need.

The problem with technology sourcing activities is that technology is an infrastructure that enables your business to happen and the providers of those hardware, software and services are experts at what they do and that includes being experts in negotiating the deal with you. They design their contract. They frequently give you their standard form.

When they're preparing their contract they look very carefully at the allocation of risks associated with the contract, and they are willing to use their leverage and the fact that you need their services to get what they want out of a deal.

In most cases, this doesn't make them bad people and it's what any business would do in their situation. But unfortunately, these lopsided negotiations tend to produce very unhappy relationships. Most surveys have shown that roughly that 50 percent of outsourcing deals fail for one reason or another.

Virtually all technology implementation or customization projects, especially large software projects run late, are over budget and don't provide the functionality and services that the customers expect. All of those unhappy relationships, late projects, overruns, et cetera mean wasted money and effort and they mean a lot of wasted energy in terms of your management of those deals and those services.

The purpose of this talk is to help you understand where the issues and risks associated with those deals can lay and how you can recognize them ahead of time and avoid those problems even before you sign the contract.

So where do the problems begin? The first thing we're going to talk about is an outsourcing deal. Outsourcing is when you hire a third party to provide some portion of the services you do yourself.

Outsourcing has gotten a reputation as only being shifting services to India or some other country, but that's only a narrow set of outsourcing and it's usually referred to as off shoring. Outsourcing services happen all the time here in the U.S. using U.S. or in any other country that you happen to be in.

Where the problems start is right at the very beginning. You're an organization executive who's under pressure to do something. Your budget is always under pressure. Your funds are under pressure. Your members are demanding more services. Your customers are demanding more things, and you have fewer and fewer resources to provide it.

A salesperson comes to you and says that his company can do something for you, whether it's your IT services, your back office services or any other outsourceable function, and they can do it as well or better than you can do it yourself using global best practices and at a lower cost than it cost you to provide. Who wouldn't say yes?

This creates several problems. The first one is associated with timing. Sales people run on cycles. They get their commissions at the end of the month, end of the quarter, end of the year and their – the vendor organization wants that deal done so they can report their results. They have an incentive to get the deal done as quickly as possible.

The executive, who has been approached by the salesperson, wants to get the deal done as quickly as possible as well. Because as soon as the salesperson says, I can save you 10 percent, 15 percent, something like that, that executive says OK, if we get the deal done by X date I can start booking those savings from that date on.

I need to stop here for a second and address a technical point. I've received two questions saying my voice keeps fading in and out. That was – the first time that question was asked it was during the introduction and I didn't hear that fading in and out, so it's possible that the questioner is having a technical issue. If you are, can I suggest that you disconnect and dial right back in? That may address your problem.

(Meghan): John, this is (Meghan), too I just want to remind participants that they can send an e-mail if they're having any technical issues to accwebcast@commpartners.com. That's commpartners.com, so that we can try to help them.

John Nicholson: And I've also received a second, is there a telephone link to the conference? So (Meghan), if you can address that as well.

(Meghan): I'm sorry, John.

John Nicholson: I've received a second question asking me if there's a telephone link to the conference. ((inaudible)) a little bit more time.

(Meghan): There is and again, if they can send an e-mail to that accwebcast@commpartners.com I will be happy to provide them with the backup audio information.

John Nicholson: Great.

(Meghan): Thank you.

John Nicholson: Thank you very much.

(Meghan): You're welcome.

John Nicholson: As I was saying, the organization executive immediately looks at his budget or her budget, and says starting on this date that the salesperson wants my deal done I can start booking this savings against my budget.

This creates enormous time pressure on the deal, and it leads to poorly defined scope because you tend to rush the negotiation. It also leads to a loss of negotiating leverage.

As soon as you as an executive have committed to getting those savings, you have sacrificed an enormous amount of your leverage because you are now committed inside of your organization to delivering those savings, which means that if the deal takes longer than possible or than planned, or if it doesn't happen at all there's a decent chance that money has already been taken out of your budget or has been committed to something else.

That puts enormous pressure on getting the deal done, and gives the vendor tremendous negotiating leverage.

The second problem that happens in outsourcing deals is differing expectations. When the sales person comes to you and says, my company can do whatever your IT group does, the executive who's receiving that message hears, they will do everything my people do, which includes staying late, doing work on weekends, whatever is necessary to get the job done and at no additional cost. Because the salaries for people who are currently providing those services tend to be fixed, so that's the customer expectation.

From the vendor perspective, the vendor comes in and says, there are X many people performing these services, I'm going to scope this many people providing this many hours worth of services and if anything extra needs to be done than that would result in a change order. That fundamental disconnect is one of the largest reasons for sourcing deal failure.

The third problem though is the perception of poor customer services. The IT culture is to do whatever it takes to solve a problem. As long as resources aren't fixed, as long as those people are just on salary that's not a problem for you.

However, when a vendor comes in and figures out that your people not only spend eight hours a day doing their normal work but the tend to work overtime, they tend to come in on weekends, they make themselves available at night via pager, all of those incremental extra services can add up and they can be much more costly for a vendor to provide.

When you realize how much it would cost for a vendor to provide those same services, you may choose to scale back and have the vendor provide its more basic service. When you do that though, your end users can get very upset because suddenly services that they're relied on disappear.

I did a deal for one company who had a level one and a half desk top support. And what that was, was a person from the help desk who was dedicated to going to individual end users desk if a problem couldn't be resolved over the phone or via computer and trying to make sure that that problem was actually not resolvable before the problem got escalated to a vendor help desk. The end users loved that personal service.

The customer outsourced their help desk function to a company that was going to move the help desk to Canada. Obviously sending a person to the desk top from Canada wasn't feasible and they elected to phase out that service.

Without excellent communication to the end users that the company had made that decision, the end users would have perceived that as a customer service failure on the part of the vendor and that would have began to eat away at the relationship between the customer and the sourcing vendor.

So we have rushed negotiations and poor scope developing, differing expectations, poor communications with end users and that leads to a very, very unhappy relationship. In fact, Vantage Partners did a study of the foremost causes of partnership failure in outsourcing transactions and two thirds of the deals that failed, failed because of a poor or damaged relationship, and all of that traces back to those three items.

So, how do we avoid it? The real way to do it is to treat an outsourcing deal like buying a used car. And I'm constantly astounded at the times where executives will make decisions related to their business in terms of acquiring technology in ways that they would never make decisions related to their own personal lives.

First, recognize that doing a deal properly takes time. For very large outsourcing deals it can take as much as six to nine months. If you're going to compete a deal you need time to develop your request for proposal, you need time to send it out to the vendors, you need time to answer the questions, you need time to receive their responses, negotiate the deal, all under the lack of time pressure that gives leverage to the vendor, you should compete the deal.

None of you could imagine going to a single car vendor and saying, I'm going to buy a car from you and I'm not going to talk to anyone else. As soon as you do that you lose your leverage. The element of competition keeps your leverage in the contract negotiation process.

You should maintain the competition for as long as possible. If you can, even go as far as to having parallel traffic negotiation for as long as possible in order to maximize the competition between at least two vendors.

You should also do your bet to hold the vendor accountable for promises they make in their proposals or their marketing material. You will not be able to – or it's very unlikely that you will be able to attach those to the contract, but pay attention to what they promise when they're proposing versus what they try to limit in terms of their risks when they're negotiating the contract.

If you can look at where they're trying to scale back on their promises because their sales people have over promised to you then you know that there's an element of risk in that area.

In general, don't do things that undercut your negotiating leverage. Be very careful about vendor end run contact with senior executives. All of the major technology services providers have high level contact with CEOs, CFOs, anyone that they think can make a difference in their getting the deal and getting it on terms that are more favorable to them.

They will do everything they can to make sure that they can get that contact at a higher level than whomever your negotiating team has contact with. And they will try to get their message tot hose senior executives before you can.

What you should do is talk to the person, the senior executives and get them to support your negotiating team. If a senior executive is approached by a vendor that you're having a negotiating with, although it may be challenging, try to get that senior executive to either support your team or at least consult with the team before that senior executive makes any commitments to the vendor.

You should try to talk to the person with the authority to make the deal. Vendors are very good at sending in a negotiator who has no authority. They present you with their standard form contract in the same way that a car salesman presents you with their standard package, and if you want to make any changes to it they want to help you.

They're your friend. They want you to do the deal, but they have to go back to their management for approval for any changes that you have to make. They treat it as a car sale, and they do their best to make sure that any change is as difficult as possible for you.

The thing to avoid, in those situations, is those delays inherent in going back to their management, turn right back to the time pressure to get the deal done. If a senior executive is expecting the deal done by a certain date, and the sales person or the vendor negotiator is (companying) back and saying, oh, you know, I have to get my management's approval, we have to go back to the lawyers, it's going to take a lot of time, I'll do my best, the negotiating team for the customer is under pressure from their management o get the deal done and the vendor recognize this and play that delaying game so that the customer has to give in on positions in order to get the deal done. And that's yet another way that the vendors try and get the deal done as quickly as possible and on as favorable terms as possible.

Most importantly, recognize that this is business. It's not personal. It is a business. Try to keep the emotion out of the negotiation. Recognize that doing a large outsourcing deal can be a full time job for the people involved and they're having to do it in addition to whatever their daytime job is. The more you can give those people support and assistance in doing their daytime job, the better they will be able to negotiate a deal. Signing the deal ends the process.

Vendors frequently try to include statements in the contract that say they will continue to do due diligence after the contract is signed, and if they find anything that needs to change the contract then the contract will be reopened and renegotiated to account for that additional information, to the extend possible, try to avoid anything like that.

Avoid things in the contract such as assumptions and dependencies where the consequences aren't clearly specified. Some typical examples of these are provided on the screen and are things like, this statement of work is based on the information provided to date, changes will be identified and agreed to during the planning phase and will be handled via change control.

What you really want is to lock down as much as possible what the consequences of any change will be. You can't anticipate every change, but if you can document what the possible consequences of changes will be in terms of rate changes, scope changes, other significant changes then if a change is discovered that results in a delay to a project you can already have a calculation methodology for how you change the price given the change in the time. That way you can negotiate the consequences of those changes even before you sign the deal when you still have leverage to negotiate.

Another example of pricing assumptions came from a desk top implementation agreement. When you look at this chart it shows that the vendor has thought through all of the details required to provided the services, and we estimated – the customer estimated that there would be 1200 assets involved in the program for three years and changing them out would have all of those timing steps.

All of these things look good, and given that information wouldn't you be comfortable signing that deal? Well, the problem is there's no --there was no adjustment in the contract for what happened if any of these assumptions weren't true.

If there were more assets, if there were less assets, if it turned out that any of these activities took more or less time, all of those things would have changed the pricing assumption that the vendor used to calculate their charges and the vendor would have come back and asked for more money or more time or more resources because the vendor contract would include the provision that said, if those assumptions weren't true, then it would be subject to a change order. And for the purposes of these deals change order is spelled with a dollar sign.

It's very important to understand the scope of an agreement. The services that are within the scope of a contract are within that contract's pricing term and it's important to take the time to get the scope right. Services that are outside the scope of the contract will be priced as new or additional services.

If you do the scope incorrectly or ambiguously you can expect to pay twice for services. Once because you thought it was included and the second time when you discover that the vendor didn't think it was included.

The way to start identifying scope is to look at the factors of production, the people involved in the deal, facilities, equipment, software and third party services. If you start there you'll make a good start toward avoiding leaving anything out.

There's a great daily comic strip related to the IT industry called "User Friendly" and it's available at userfriendly.org. In this one an ISP has secured a multi million dollar technical services contract to perform services – stuff that's technically possible. While most vendor contracts are not quite that bad they frequently state scope in terms of vague or otherwise nonspecific statements of what will be done. What you need to understand in terms of a contract is what precisely is in scope and what is outside of scope.

So as the people from the technology vendor go back and challenge the person who wrote the contract he explains that he doesn't want their technical people to have to commit to a hard set of deliverables. So they can get out of anything too troublesome by saying it's not technically possible.

Vendors rarely make their contracts vague on purpose, but frequently what happens is they submit a proposal to you without having done detailed due diligence about the services that you might need. The proposal frequently includes all of the services they could possibly provide to you and it usually h as a signature page on the back of it.

Even when you elect not to take certain of those services, they frequently just ask you to sign the proposal as the statement of work, which means you have contracted for those additional services even though you didn't want them and it's something to be very careful of when you receive the proposal from the vendor.

One of the best ways to manage vendors in an outsourced environment is to use service levels. Service levels are objective levels of performance. They measure how well a vendor does the required services and they explicitly contemplate some element of failure. You'll frequently see service levels in contracts that say – or in internal requirements that say, you will do X 100 percent of the time. That's simply a service requirement. It's not a service level.

A requirement is something like the mainframe will be available 24x7x52. The service level says the mainframe will have an availability of 99.7 percent. So anticipating that the mainframe will fail sometime or be down sometime you set a level below which the vendor cannot drop. The way you enforce service levels is with service level credit.

Vendors frequently argue that making them pay a credit for failing to meet service is some kind of penalty. It's not. You're contracting for and you're willing to pay for service at a very specific level. If you don't get the service at that level you shouldn't have to pay as much for the poorer service.

Vendors also frequently say that if they're going to give you credit for not meeting that service level they deserve to have a bonus for exceeding that service level. That's generally not accurate. The reason why is that it's very difficult to accurately value that superior service.

For example, you may say that you want your e-mail systems to be up 99.9 percent of the time, and you're willing to pay to achieve that level. If you can accurately calculate the marginal benefit of service above the 99.90 percent level then that might be a specific instance where you can receive a bonus, but simply saying that because they can be exposed to a credit they should receive a bonus isn't accurate.

Service level credits are generally a percentage of monthly fees for ongoing services and they can range from lows of five to seven percent of monthly revenue and they can be as high as 25 percent of monthly revenue, but that's actually getting up into the range where it's punitive to the vendor and has a negative impact on the quality of service provided by the vendor.

If the vendor doesn't feel that they're getting a fair deal then the vendor will not provide you with good service. Generally service level credits in the range of 10 to 15 percent of revenue are about right.

So to sum up, to avoid problems in outsourcing deals treat it like buying a used car and avoid buying a lemon. Take the time to do the deal right, maximize your leverage by competing the deal, avoid allowing provisions that reopen the deal after signing, clearly understand what you want and what it cost for you to get now. Clearly understand and document what you're getting, clearly understanding the price and how it might change, and use service levels and credits to manage vendor performance.

The one other thing you should think of in these situations is what will happen at the end of the deal and we're going to discuss that more when we talk about software licenses next or later in the presentation, because other types of deals have problems too. It's not just outsourcing. Hardware leases have problems. Software licensing development implementation deals, services deals have problems, and it's pretty much everything other than hardware purchases and sometimes even those.

Everything we discuss in this section is also relevant to negotiating sourcing deals, outsourcing deals. Now saying that there could be problems with the hardware lease may sound kind of silly, but what kind of problems could happen? Leasing equipment tends to be within the spending authority of many executives. They go out and they get the toys that they want.

Doing a leasing deal may involve them getting nonstandard equipment or software and it may create security issues. And like car leases, most of the problems come at the end. When you do your return leasing companies base their financials on the assumption that a certain percentage of software will be lost, damaged or inconvenient to return. They calculate their revenue based on those assumptions.

Most organizations are terrible at tracking lease assets especially desk tops and lap tops. Most organizations are even worse at returning them to the (lessor). And when you return it, you need to be sure that there's some time of meaningful process for data erasure.

In the era where customers are concerned about data privacy and there are things like the choice point data breach all of the other data security breaches that are happening and that are being publicized in the newspaper, if you're returning leased desk tops and lap tops to a vendor you need to have a meaningful data erasure provision.

Destroying the hard drive may be the only practical option, but then you have to pay for the hard drive, and most leases don't provide for meaningful data erasure. And when I say meaningful data erasure, there are things that people do regularly that they think are erasing the data off their hard drive but is actually leaving everything there.

You need to have an experienced, competent technical person review the data erasure provision of any lease to make sure that your hard drives are going to get erased and that your data will be erased.

So, how can you avoid lease related problems? All IT equipment acquisition should be coordinated through the IT department or procurement on or the other. The standard operating procedure should be that IT will provide technology solutions.

The challenge is that they have to do it in a manner that supports your business needs. You need to have procurement involved in all leases. And if the lease deal is large enough, you should have legal involved as well.

You need to pay very careful attention to end of lease requirement. Develop a plan for complying with requirements even before you receive the equipment. Be honest about your capability, in your asset tracking system live up to the requirements of the end of lease. If not, anticipate that you will take the financial hit for failing to return those boxes.

Understand whether people move things without your knowing it. Data erasure should be in accordance with your organization's data erasure policies. If you don't have a data erasure policy

I strongly suggest that you develop one quickly, implement it thoroughly and test your compliance with it.

If necessary, talk to someone. Talk to your legal department. Talk to an experienced lawyer about what is necessary in terms of data erasure.

Software licensing, another place where companies can run – organizations can run into a lot of trouble. A software license is a legal contract between the software author or distributor and the user. It’s more like a rental agreement. You agree to pay specified fees and comply with certain restrictions and in return they allow you to use the software.

You should read your software licenses very carefully. If you violate the terms of the license you’ve breached a contract and you might have violated certain laws like the Digital Millennium Copyright Act, The No Electronic Theft Act, the Uniform Computer Information Transactions Act known as UCITA, which has only been passed in a few states but is very vendor friendly.

What a license says and doesn’t say is very important. Your software license should cover what software is included in the license. Make sure – software is frequently issued in modules. Make sure that the functionality you think you’re getting is provided by the module that the software license says you’re getting, the scope of use for any software and any restrictions on its use as well as any different restrictions on the use of the documentation.

Frequently software licenses bundle both the software and the documentation under the definition of software. Restrictions that apply to software aren’t necessarily appropriate to the documentation. You may want to make copies of the documentation to incorporate into your training manuals, for example, to teach your people how to use the software.

Many software licenses say that you only have the right to make one archival back up copy of the software. If that's the case, then you only have the right to make one archival backup copy of the documentation if it's included in the defined term of software, something to be careful of.

Duration of the license, and that's where you have to start thinking about what's going to happen with the software license ends and any related services that are going to be provided along with it in terms of consulting, enhancement of the software, support and what's that's going to cost and how it will be provided to you.

The software license should cover pricing and payment terms and then all of the things that the business people tend to ignore because they're down at the back of the contract, confidentiality, warranties and indemnities, limitation of liability, the vendors ability to terminate the license or the services, right to publicity, choice of law, things that are very relevant to your ability to enforce that software license and your rights under that software license.

For example, Virginia has passed UCITA. UCITA is a very vendor friendly law relating to software and among other things, it includes self help provisions that enable software vendors to actually reach in and turn off software if you're violating the license. These are things to be very careful of and something only the legal department is really adequately capable of analyzing.

Similarly with limitations of liability, warranties and indemnities the impact of confidentiality provisions, those are places where the legal department needs to get involved in the negotiation of any software license.

So what if the software you've bought is complicated, like a PeopleSoft or some kind of enterprise resource planning system or some kind of large software package that doesn't do everything that you need or needs some level of expertise in order to implement it? Somebody has to modify or customize it, build interfaces to other applications, roll it out and test it. The potential candidates are your IT group, the software vendor or a third party consulting firm.

Modifications and customizations are different things and it's important to understand the difference. Customizations are changes to the source code. They are rarely necessary and they're usually a bad idea. If in order to implement a piece of software you have to customize the software that can take you out of the upgrade path and many vendors won't support customized software.

The only reason why you would generally want to customize software is if there is some business process that is absolutely unique to your organization's competitive advantage and you cannot change that process and you need to change the software to match the process and you need to change the software to match the process.

Modifications on the other hand, generally don't involve recoding the base software. They don't involve access to source code. They use predefined exits in the software combined with third party or custom developed applications that are separate from the core software. Those are generally a better way to get additional functionality or modified functionality out of your software.

Implementation, customization, modification projects always take longer than planned and they always run over budget, always. Simply accept that fact and plan for it accordingly.

But there are ways to minimize those things. You can manage your vendors by doing a percentage hold back, just like a construction contract. You can take some kind of credit for late delivery, which would be a percentage that increases if the project isn't completed on schedule. You can take a discount on their rate as their price exceeds budget. You can do some kind of cost sharing as price exceeds budget.

With all of those it's very important to understand what the acceptance criteria for the software project are, when is it done and when do you get to accept it, and also understand what the scope is. If the cost is ambiguous then it's very difficult to argue that they haven't delivered what you were expecting.

Things to watch out for in this space are joint responsibility. Your people will need to do some things but the vendor should be responsible for the project as a whole. The project plan should clearly specify what your organization is responsible for and when. And the vendor should have to inform you if any failure by you threatens the schedule, otherwise they don't get a schedule adjustment.

Vendors frequently try to stage acceptance of software projects in terms of saying they've delivered stage one and one you've accepted it they consider stage one to be your problem. And if there are later problems associated with stage one, you've accepted it and therefore they don't have to fix it or if they do have to fix it, it's a change order.

What you should try to do is tie acceptance to the delivery of the overall functionality of the project. You may do interim acceptances, but changes to those interim acceptances that are necessary in order to achieve the overall result of the project and to receive the functionality that you expected to be getting as specified in the acceptance criteria should be the vendors problem.

Negotiating technology sourcing deals is a skill that requires training and practice. It's a combination of negotiating a normal business deal combined with an understanding of the business impact of the technology. It's not rocket science, but the vendors have experienced skilled negotiators who understand the details of the deal they want you to sign.

Vendors will use their entire organization in a coordinated manner to get you to sign the deal they want you to sign. They will apply leverage in every way they can in terms of timing, price pressure and executive pressure in order to get you to sign the deal as quickly as possibly so they can get – start getting paid as quickly as possibly.

Again, this doesn't make them bad people. This is just the approach that they will use in order to maximize the benefit to their business and their shareholders.

Creating the right negotiating team and supporting those team members from the top of your organization down will enable you to get the best deal.

In summary, take the time to do any deal right. Maximize your leverage by competing the deal, avoid reopening the deal after signing, avoid those provisions that say they will do due diligence, that they will continue to do research after you've signed the deal and anything new that they discover will be documented in a change order.

Use service level and service level credits to manage vendor performance. Don't automatically accept the idea that a credit is a penalty or that because they're at risk for a credit they also deserve a bonus. There may be times when a bonus is appropriate, but there should be specified and calculable economic value to you for exceeding that service level.

Create the right negotiating team. Include your legal department. Clearly understand what you want and what it cost you now. Clearly document what you're getting. Clearly understand and document the price and the ways that it might change, and understand how the agreement can end and what happens when it does.

For a software license, for example, what kind of rights do you have at the end of the deal? Do you keep using the software? Do they have to help you transition from that software to a new software? What rights do you have to the information that is stored in that software? How do you get access to that information? How does that data get transferred back to you? Understanding what happens at the end of the deal, even before you start the deal is critical.

Steve Garrett: Thanks, John.

John Nicholson: Thank you.

Steve Garrett: At this point and time we're going to open for questions and comments. Some of them have come in, and before you do let me just take the opportunity to remind everybody to please participate in the Web cast evaluation which is found in the link box. You click on that, it will open up the survey for you.

So with that, would you like to try and answer some of these questions that have come in?

John Nicholson: Sure. I'll take them. There are a couple that came in early. One person actually asked 10 to 15 percent of what back when I was talking about service level credit. That's generally 10 to 15 percent of the monthly revenue for fees. Service level credits can range from 5 to 7 percent of monthly revenue on up to 25 percent, but 10 to 15 percent is usually a good guide.

Next question, could you comment on approaches that have worked well for you and your clients in terms of negotiating risks and liability? We always prefer a broad unilateral indemnity, full exclusion of consequential damages and absolutely no limitation on vendor liability.

Obviously, the supplier would like a mutual indemnity and a clear cap on damages including third party claims. Other than pricing and the service legal agreements, it is this liability trinity that is always the biggest stumbling block in negotiating our services and outsourcing agreements, and that's absolutely true.

Negotiating a limitation of liability is a challenging thing and is usually one of the walk a way points for a vendor in a deal. Usually the limitation of liability in most of the deals that I do excludes consequential damages, excludes punitive damages and other similar damages, excepting certain cases.

We also usually have a liability cap of 12 to 15 months of services fees, and that's relatively standard in the industry. If you're doing a small deal where there's a lot of money involved, 12 to 15 months may not be a whole lot of money, and you may choose to set some kind of fixed cap of $1 million, $2 million, something that put enough teeth in it that it's meaningful but that doesn't break the bank for the vendor.

Where we escape from the limitation on liability is in situations where there is an indemnity. If the vendor is responsible for indemnifying you for any violations of intellectual property rights, gross negligence, personnel, violations of confidential information, things that the vendor would normally indemnify you for than those things should be excluded from the cap and they should be excluded from the limitation on types of damages as well. Because if they disclose your confidential information the only damages resulting from that are consequential damages.

Those things are all relatively standard in the outsourcing industry and if the person who asked that question has additional questions on that I'd be happy to answer them in an e-mail.

Next question, what about if the business unit did not have specific service levels? Is there an industry service level, and what about those service levels you don't know should be monitored when you enter into the agreement?

If you under – documenting service levels is challenging and if you don't measure things before you enter the deal if you take the time to negotiate the deal you can actually spend that time monitoring and establishing your baseline service levels.

If you look at the scope of services that are going to be provided by the vendor, the places where you want to try to measure service levels are the places where they can actually impact your end users or impact your bottom line.

If you measure things that would impact customer satisfaction then you're probably measuring the right things in terms of service levels, and there are frequently industry bench marks that you can get.

There are also – you can also build in a process into your contract for establishing new service levels, base lining them, figuring out what the right level is. But again, establishing service levels can also be a challenging aspect of negotiating any deal.

One questioner asked what are some special risks with vendors located in India.

One of the biggest risks in doing any outsourcing deal with a vendor outside of the U.S. is primarily cultural. In many cultures yes doesn't necessarily mean yes. And in many cultures there is a pressure not to say no.

I actually – in a prior career when I was managing an Oracle implementation, we had a team of Indian programmers who were working as part of the implementation and when I would say, is it possible to do something? They would immediately say yes and set about doing it.

My question was actually to find out whether it could be done and how much it would cost. They took my question as can you do it, and can you do it now. Once we got over that cultural hurdle we communicated much better. But dealing with outsourcing vendors in other countries is primarily a communications issue and a cultural issue.

There really aren't as many risks in dealing with vendors in India other than those cultural issues because India has such a vested interest in supporting technology services and making sure that technology companies succeed in doing their deals.

A couple more questions. We have about five minutes, so I'll try to get to those. In choosing a state for choice of law – and actually one question just popped up that's also related to India, so I will get to that. Are data protection and privacy law provisions in India comparable to the U.S.?

No. India is actually in the process of implementing a data privacy scheme that is much more similar to the EU Data Protection Act. They haven't succeeded in passing the law yet, I don't believe, but they're working towards that model rather than the U.S. model.

Dealing with data privacy on the EU model can be very different from dealing with the U.S. data privacy laws, but that would be the subject of an entirely different talk.

What about the situation where a company is highly regulated and the vendor performance or lace thereof may cost hefty regulatory fines and penalties? If a vendor does not move off 12 months of fees any thoughts on how to build in protections that would address this situation?

If you're working in a very highly regulated environment, vendors are frequently of the opinion that they shouldn't be responsible for those penalties. I disagree and if they want to compete and provide services in that arena they have to be willing to accept those risks.

One important thing to recognize though is you're not hiring the vendor to be your insurance company. If you performing the service for yourself would be subject to that risk it may or may not be fair to pass 100 percent of the risk onto the vendor, that just because you're now paying the vendor to provide those services for you the vendor is now subject to insuring you for all of those penalties and fines.

If the vendor – if you provide direction to the vendor and you tell the vendor you explicitly must comply with these policies and procedures than you may be able to get direct damages from the vendor associated with breaches of your policies and procedures that result in your failure to comply with laws. However, those my still be subject to the limitation of liability. A lot of that depends on how big a deal it is for the vendor, how much risk the vendor is willing to take and how much negotiating leverage you have.

If you're in a situation in a highly regulated industry and a vendor's willingness to step up to that level of liability is a critical item for your deal than the more you compete the deal the more you can get the vendor to step up as part of signing up for the deal.

Steve Garrett: We have time for about one more question, John, and then we'll have to wrap it up.

John Nicholson: I see. Last question, what is your opinion on adding a clause requiring termination for chronic service level failure?

Well, in most contracts you have – there are generally several options for determination for cause. The first one is simply termination for material breach. And if you can argue that chronic service level failures are material breach than you can get in under simply termination for cause for material breach.

We frequently also include what we call the death of a thousand cuts termination provision where a vendor consistently breaches the agreement in terms of failure to provide service, failure to perform, none of which may individually rise to the level of a material breach, but collectively they require you, the customer, to spend so much time and management attention on the deal, and the deal is just so painful and unsatisfying that collectively they rise to the level of a material breach.

That is relatively standard in the industry, and also vendors don't like it they generally accept it if pressed.

And intermediate standard would be termination for chronic service level failures where if you have certain critical service levels and they fail to meet them X number of times in a row or X number of times in a year, say they fail to meet a specific service level three months in a row or two months in a row or any – four times in a year then that is predefined as a material breach. That's another mid step approach that can work.

With that, I will say thank you very much for your attention and my e-mail address is in the presentation. I will be happy to receive other questions and I hope that this was helpful for everyone.

Steve Garrett: All right. That closes today's Web cast. I'd like to thank John for his time and the excellent presentation. I also want to thank his firm, Pillsbury, Winthrop, Shaw, Pittman for sponsoring our Web cast.

Once again, let me remind our audience that the audio file for this Web cast will be available on the ACC Web site. That's www.acca.com in case you haven't been there today. That will be available about three hours from now, I believe, and it will be archived there for about a year.

I also want to thank our audience for attending our Web cast. And remember, if you have any questions related to today's topic you can send them to Mr. Nicholson. His web address is on his presentation. In case you don't have that handy it's john.nicholson@pillsburylaw.com.

And in closing, I want to remind everybody to fill out the survey if you would please.

That concludes today's Web cast. Thank you very much.

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