Effective and Efficient Contracting Process

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Agenda

- The Issue
- Overview: Contracting and Negotiating Processes as Relationship-Builder
- Top Ten Tips for Negotiations
- Q&A

Note: The views expressed herein are those of the authors and not necessarily those of Kirkland & Ellis LLP or any of its clients. Moreover, the issues addressed herein are not dispositive of the legal issues in a particular transaction.
The Issue
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- The Outsourcing Contract Journey
  - At the end of the outsourcing journey the ultimate benefits realized can be significant
  - However, the path to that destination takes substantial effort and time
  - The challenge is to make the journey less arduous and time-consuming without sacrificing safety and security
The Issue

- The Outsourcing Contract Journey
  - Historically, the prevailing approach to outsourcing contracts was to heavily document and strongly bias agreements that were monolithic in scope and long in term
  - More recently, the approach has been to reduce scope (e.g., best in breed or towers) and term (e.g., three year term versus seven year term)
  - Currently, using the following contracting and negotiating processes can help make the journey less risky and demanding
Overview: Contracting and Negotiating Processes as Relationship-Builder
Overview: Contracting and Negotiating Processes as Relationship-Builder

The Relationship Mindset: Attitude Toward a Possible Relationship

- There is a tendency to think of sourcing as procurement; typically, it is not the same as commodity procurement
- It is helpful to think of outsourcing or other long-term sourcing transaction as a relationship akin to a marriage
  - Two parties making a long-term commitment to one another
  - The sourcing agreement as a “pre-nup”
- The sourcing relationship may create an exclusive (de facto or de jure) monopoly supplier to a certain degree
Overview: Contracting and Negotiating Processes as Relationship-Builder

Courtship: Getting to Know One Another (due diligence)

- From a customer standpoint, the provider selection process should be robust and thorough
  - Assess provider’s track record of service and flexibility, ability to achieve objectives, financial viability, reputation, corporate structure (e.g., for parent guarantee), litigation history, and other factors applicable to the specific services or service provider
  - Communicate thoroughly throughout the process
    - Include management, operational personnel, subject matter experts
    - Use regular meetings and broad access to keep process on-track
    - Consider internal sensitivities regarding communications
    - Consider privilege issues
Overview: Contracting and Negotiating Processes as Relationship-Builder

Courtship: Getting to Know One Another (due diligence) (cont.)

- Communicate thoroughly throughout the process (cont.)
  - Interview past/existing/current customers of provider; interview different business constituencies of customer
  - Consider the quality of infrastructure and personnel and long-term health of provider
  - Perform background checks – security measures, privacy, protection of confidential information, intellectual property, litigation history, media search, etc.

- From a provider standpoint, “know thy customer” is crucial to a successful engagement
Overview: Contracting and Negotiating Processes as Relationship-Builder

The Contract: A Prenuptial Agreement

- View the contract as an opportunity to improve understanding of the other party, the parties’ respective interests, and the transaction – not as a hindrance or box to check
- Approach the contract as the last best chance to establish the relationship on a strong foundation
- Allocate time and resources sufficient to allow a comprehensive process and quality analysis and work product
- Involve counsel at inception
- Consider privilege issues when engaging and communicating with advisors
Overview: Contracting and Negotiating Processes as Relationship-Builder

The Contract: A Prenuptial Agreement

- Identify potential issues in the relationship
  - Issues related to fundamental commercial terms (e.g., scope, price, and performance metrics/service levels)
  - Specific risks and concerns of each of the parties (e.g., provider’s concerns regarding revenue recognition, protection of IP, limitation of liability, data security)
- Industry risks and dynamics
- Extrinsic issues (e.g., change in law, geopolitical risk)
Overview: Contracting and Negotiating Processes as Relationship-Builder

The Contract: A Prenuptial Agreement

- Build a foundation of trust and cooperation through the contract negotiation process – the living together
  - The provider will be taking over a critical function of the customer and potentially changing it in fundamental ways
  - The parties must establish a solid working relationship to address inevitable change and other issues in the future
  - One-sided contract with onerous burdens on the provider may be a Pyrrhic victory that creates a “breach-in-waiting” or work-to-rule approach
  - One-sided contract with insufficient protections and meaningful remedies for the customer may serve to jeopardize the relationship and may damage the perception of the provider in the marketplace
Overview: Contracting and Negotiating Processes as Relationship-Builder

The Marriage Contract: A Good Relationship Alone Is Necessary but not Sufficient …

- Note that an effective sourcing agreement must have clear governance and dispute resolution processes and appropriate incentives and disincentives to keep the parties’ interests aligned.
- Do not underestimate the need for a solid agreement with detailed exhibits and schedules because as time passes, the individuals initially involved may move on.
- Ultimately, even the best contract might not save an engagement if the parties are poorly matched or their respective interests are misaligned.
Overview: Contracting and Negotiating Processes as Relationship-Builder

The Marriage Contract: A Good Relationship Alone Is Necessary but not Sufficient…

- Contract has many different functions/purposes
  - Memorializes the agreement and the intent of the parties at the time of entering into the agreement
  - May be necessary to satisfy legal requirements (e.g., Statute of Frauds; assignment of IP rights)
  - Serves a prophylactic purpose (but note that in litigation, even if you win, you lose)
  - Allocates risks and responsibilities
  - Provides incentives and disincentives to shape behavior
  - Provides a roadmap for actions when things change or go wrong
Top Ten Tips for Negotiation
Top Ten Tips for Negotiations

Tip #1: Do Not Start Work before all Contract Documents Are Executed

- Beginning to engage a provider for work prior to executing the definitive contract documents can reduce flexibility
  - More difficult to walk away from an engagement if the provider has already started performing the engagement
- If the parties must commence work prior to executing the definitive contract documents:
  - Ensure that the work product has intrinsic value
  - Shape the engagement as a pilot that is not dependent on the ultimate engagement
  - Have alignment mechanism in place (e.g., tie all or some portion of the payment to the provider to completion of the definitive documentation)
- Agree upon how any pre-definitive/interim agreement will be rolled into the definitive agreement and scope of work
Top Ten Tips for Negotiations

Tip #2: Recognize That Negotiation Is Not a Zero Sum Game

- Parties should not look at negotiation as a battle to be “won”
  - Final contract documents should be “fair and balanced” to reflect the appropriate risks and incentives for optimal outcomes and performance by both parties
  - “Winner take all” mentality is not conducive to building a strong foundation for an ongoing, long-term relationship
- However, parties need to understand that risk of failure often falls disproportionately on the customer – therefore, agreements must appropriately address the balance of risk
Top Ten Tips for Negotiations

Tip #3: Do Your Homework

- Understand the contracts to be negotiated and the background materials (e.g., RFP response, customer’s business case, etc.)
- Work from a term sheet if appropriate or helpful
- Research the other party’s agreements – prior agreements and public domain sources (EDGAR, other regulatory filings, court documents, etc.)
- Prepare issues lists, document summaries, and potential compromise and fallback positions
Top Ten Tips for Negotiations

Tip #4: Develop a Good Working Relationship

- Strive for face-to-face meetings for key negotiating sessions
  - Read body language
  - Be sensitive to nuance, particularly when dealing with foreign counterparties
- Use a “partnering” approach – engage in give and take
- Maintain long-term focus
- Avoid extreme positions
  - Do not take false hard line positions
  - Consider loss of credibility when a party ultimately caves on an extreme position or line in the sand
Top Ten Tips for Negotiations

Tip #5: Have the Right People in the Room (or not)

- Negotiate during scheduled sessions, on home turf if possible
- Make sure each party has its decision-makers available
- Identify members of the deal team on both sides early on
- Even if not leading the negotiations, have business people present even when the lawyers are going through the terms and conditions (there is no such thing as a purely “legal issue”)
- Limit/control operations personnel’s involvement in negotiations
- Leave option open to bring in senior personnel to resolve thorny issues or to reinforce hardline positions
Top Ten Tips for Negotiations

Tip #5: Have the Right People in the Room (or not)(cont.)

- Lead negotiators likely should not be the individuals who will have direct, day-to-day responsibility with respect to the implementation and operation of the sourcing arrangement
  - Negotiations can become contentious
  - This helps avoid putting operations personnel in position of taking unreasonable positions with people with whom they will have to work
- On the other hand, it can be helpful to have present the representatives from both customer and provider who will have to live with the contract
  - Helps them understand the dynamics of the deal
  - Precludes future disclaimer of responsibility on basis they did not have input into the deal thereby improving accountability
Top Ten Tips for Negotiations

Tip #6: Check Your Ego/Emotions at the Door

- Remember, the negotiation is not about you or about whether you “win” or “lose” (see also Tip #2)
- Never lose sight of what is best for your organization as a whole
- Do not take a failure of the parties to agree, or the other party’s position, on an issue personally
  - Remember that at times, there will simply be disagreement
  - Remember that “no” is not a bad word
- Use posturing sparingly and judiciously
- Consider the degree of openness in communications but do not lie
Top Ten Tips for Negotiations

Tip #6: Check Your Ego/Emotions at the Door (cont.)

- Note that each party should air all issues in the negotiations and trust the other party to escalate issues internally as appropriate
  - Going over the head of the other party’s negotiating team to bring an issue or concern directly to that other party’s senior management poisons the well going forward
  - Trust and transparency are lost, potentially leading to drawn out negotiations and a greater likelihood that the negotiation becomes an emotional issue for some
Top Ten Tips for Negotiations

Tip #7: Document Everything You Can; Do Not “Agree to Agree”

- Document entire transaction to the greatest extent possible for execution with the master agreement so as to minimize loss of interrelatedness of terms and to avoid loss of leverage
- Do not assume that schedules and exhibits are business or technical documents that can be detailed at a later date
  - Do not leave schedules and exhibits to the last minute
  - Note that these are where the performance requirements, scope of services, pricing, and many of the most important details are going to be addressed
- Where details must be provided at a later date, include default approach (for when parties are unable to agree)
Top Ten Tips for Negotiations

Tip #7: Document Everything You Can; Do Not “Agree to Agree” (cont.)

- Get agreement on the principle, then on the language
  - Prepare business people for this approach so they understand why the parties may not trade drafts after each negotiation session
- Agree on the issue and make sure each party understands what has been agreed
  - Do not rely on ambiguity (usually)
  - Clarify where the agreement is unclear (and do not be afraid to restate the conclusion for clarity)
Top Ten Tips for Negotiations

Tip #8: Understand the Totality of Issues

- Tendency to want to try to resolve issues as they are identified
  - Better approach to negotiations is to walk through agreement from beginning to end rather than a hierarchy of issues
  - Some negotiators and many stakeholders are inclined to try to minimize the number of issues or the appearance of there being a lot of issues as the parties proceed through the agreement

- However, issues are often interrelated, or come up in multiple places throughout a document
  - Parties should be careful about agreeing to a change or making a concession in one place where that might be inconsistent with treatment of a similar issue elsewhere
  - More productive to “trade” on issues when they can be grouped and handled on a global basis
Top Ten Tips for Negotiations

Tip #9: Shut up

- Remember, silence is golden
  - Listen – the less said, the better
  - Once your position is stated, stop talking
  - Do not be afraid to let the other party talk itself into making your point
  - Once an issue is closed, stop talking

- Try to understand specifically what is motivating the other party

- Let the other party make the first move/offer

- Do not bid against yourself
Top Ten Tips for Negotiations

Tip #10: Know When to Fold ‘Em

- Be willing to walk away from a bad deal (and do not be afraid to communicate that)
- Drive the process with a sense of urgency but be patient
  - Do not let other party “run the clock” against you
  - Note that a stated deadline can operate as a disincentive to completion and result in overall longer duration – unless you are willing and able to walk away
Thank You
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