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The Year of Living Dangerously: *Six Outsourcings in Twelve Months – Lessons Learned.*

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 **IAOP**

- We recently engaged in an intensive negotiating process, on behalf of a financial services customer, for six outsourcing arrangements over approximately a 12 month period, with six globally recognized outsourcing vendors
- We derived a number of key lessons from this negotiation experience, based on the same issues continuously surfacing in all of the different transactions
- We have aggregated these issues into ten lessons, which we believe are helpful for parties about to negotiate an outsourcing transaction.

A. Advisor out of band

1. Issue

- Customer and Vendor in negotiations on provision of services as one part of overall business transformation requiring multiple silos & vendors
- Business advisor is advising Customer on business transformation
- Advisor leaks information to Vendor & Customer Executive Team in an effort to be perceived as an “influencer”

2. Damage

- Extremely harmful to negotiation dynamic
- Significantly undermined Customer negotiation team

3. Solution

- Rules of engagement

B. Executive out of band

1. Issue

- Customer Executive engages out of band with vendor despite instructions not to.

2. Damage

- Reduces credibility of customer negotiation party.
- Encourages further out of band negotiations.

3. Solution

- Rules of engagement

C. Operations Team is out of band

1. Issue

- Where technical teams are not appreciating greater picture & concerned over negotiations “slowing down” implementation.

2. Damages

- Risk of party having to negotiate on all three fronts (i.e. at the table; at the executive level; & at the operational level).

3. Solution

- Rules of engagement

Lessons:

1. At the table negotiating party has to be supported 100% by their executive.
2. Executive needs to set the example for, and direct, operations to do same.
3. Trusted & autonomous team at the table.

1. Role

- Optimally, draft agmt attached to procurement doc
- Response should be comprehensive issues list, not a mark-up.

2. Why

- a. How the party responds to req'mt for issues list sets expectations for negotiation process. Warning signs.
- b. Forces parties to self-distill business from drafting issues.
- c. List should be comprehensive: party should not surface new material items during negotiation process.
 - Parties can then determine the key business issues.
 - If no progress on those, then parties should end bargaining.
 - This is an early warning sign of potential for deal success/failure.

Case Study 1:

- Vendor lied.
- Also, went back on prior agreements at the table repeatedly.
- Makes it very difficult to determine when any issue is actually resolved.
- Behaviour leads to issues with ability of Vendor to perform and trust in relationship with Vendor.
- Client needs to take strong stand against this.

Lesson: Walk away from table right away.

Case Study 2:

- Vendor settled issue at table. Next day returned and explained that had not received the required executive buy-in
- Very transparent.
- Occurred only once. Explained clearly issue.
- Negotiating team took responsibility with acknowledgement that they “owed” client for re-opening this point.
- Builds trust in relationship with Vendor.

Case Study

- Client Executive parachuted in at final round.
- Not involved during process to date. Was unaware of:
 - what points had been given already
 - history of why certain issues were concerns
 - negotiating dynamic (e.g. previous backtracking etc.)
- Thus gave away key points in an effort to “get deal done”.

Lesson: Executives:

- Can be brought in at final round to determine last 2 to 3 major issues
- Should be well briefed as to where to target efforts & only deal with same
- Otherwise, only brought in if impasse and escalation required.

- Need experienced negotiating team with right people.
- If not, then need to take action to ensure that appropriate people in place.
- **Issues**
 - Danger for Vendor: wrong people at table makes client nervous.
 - BUT danger of customer attempting to have Vendor team supplemented or someone removed is that it can alienate those already at the table.
 - Removing problematic personnel and not bluffing:
- Working groups should be operating in background (e.g. preparing technical schedules or business case/pricing) in parallel.

Run the scenarios

1. Understand where the **real risks** are
 - especially interaction of liability caps, disclaimers and indemnities
2. Understand where the **real damages** lie in each scenario. E.g.
 - Personal info: not huge damages in Canada but higher in US
 - Transition-out:
 - complexity of transition - if vendor doesn't assist with transition is there a reasonable contingency plan?
 - Could it lead to lost business, such that damages should be outside the cap/indirect damages disclaimer?
 - SLAs: quantity and construction meant to incent performance

- Understanding what is actually important and expressing it clearly to the other party
- i.e. What are the hills to die on
- A clear explanation of why you are taking a firm position goes a long way
- For example, rights of publicity. Ordinarily not a controversial issue, but Client was much more adverse to publicity because was in the process of other confidential transactions where adverse disclosure would have been highly damaging.

- Know in advance your BATNA (Best Alternative To Negotiated Agreement)... and stick to it.

Case Study 1

- Negotiations were not making any progress.
- Escalated to Client management, which expressed ultimatum
- BUT did not follow-through when issues were not resolved.
- Empty threats undermine negotiating team. Better not to have expressed in the first place.

Case Study 2

- Client actually walked away from a potential transaction.
- Concerns re ability of Vendor to deliver so terminated the deal.

Lesson: Do not diverge from Business Case Baseline

- In heat of negotiations, too easy to make concessions that result in failure to achieve original objectives
- Key problem with ISO 37500 Outsourcing Standard is that it suggests moving the business case baseline during course of the deal

1. Internally

- internal exec panicked & killed deal without consulting with deal team.
- **Lesson:** importance of regular checkpoints btw deal team & internal decision makers on issues which could kill deal.

2. Externally

- making sure message being presented at negotiating table (e.g. issue being of key importance) is appropriately communicated up the chain (including to executive and technical teams).

1. Early Start Work & ESA

- Very common for the Client to be surprised by the need for early start work & ESA. No reasons that this should be the case. Determine this early.
- **Issues:**
 - a. Is Client losing leverage due to work underway?
 - b. Content needs to be short and direct, cannot replicate full breadth of MSA, but appropriate care (especially re: liability caps) must be taken.
 - c. Unpaid ESA work: “you owe us” if the deal does not proceed vs. paid, self-contained engagement: once completed, the work is finished, with no additional commitment.

2. During negotiations

a. Importance of reasonable meeting cadence.

- Schedule regular meetings weeks in advance to ensure progress
- Too many meetings = illusion of progress, too few = lost momentum.

b. Timing on introducing major issues (e.g. pricing).

- Preference should be to do it at beginning, to set baseline.
- While scope may be uncertain, makes changes to baseline transparent

c. Watch the parking lot

- Issues parked to be addressed together/at later stage.
- However, too many issues can pile up which creates illusions of progress.

d. Agreement creep: Last minute changes when you think you are done.

3. Negotiation Fatigue

- i.e. burning out the negotiating team
- Expressly recognizing deal fatigue is important as it allows you to deal with it. E.g.:
 - allowing appropriate down-time between deals.
- The breaks allow the deal team to refresh on what is important

- Recognizing these risks is the first step. Also recommend two specific tools.
 1. **Rules of engagement**
 - Clearly setting out negotiation ground rules can address many issues
 2. **Contract Summary**
 - Can address agreement creep via contract summary that has already been presented to the board, usually in advance of signing
 - If last minute changes affect it, explain to other party that board has already approved on this basis so changes would be problematic
 - Also, does agreement conform with corporate risk standards?
- Establishing governance rules is recognized as critical for the actual outsourcing transaction
- However, it is too often not recognized as critical for the negotiations also