

OUTSOURCING IN A GLOBAL VILLAGE

Amy-Lynne Williams

Michael Erdle

Deeth Williams Wall LLP

Toronto, Ontario, Canada

INTRODUCTION

Today, when we speak about outsourcing, we could be talking about domestic outsourcing, near-shore outsourcing, off-shore outsourcing or global outsourcing.

Global outsourcing is different from offshore outsourcing. "Offshoring" can involve sending a business process to India or elsewhere, or having processing done in another country for a domestic operation. Global outsourcing usually involves contracting with one vendor to supply a service or product to all the customer's offices, subsidiaries and affiliates wherever they may be in the world.

The issues in a global outsourcing transaction are pretty much the same as in a domestic or offshore outsourcing - times 100.

In a global outsourcing, the laws will be different in each country and in some countries the issues will be new. Things that are no problem in your home country can become huge stumbling blocks in another country. Several different languages and business cultures will usually be thrown into the mix as well.

Of course, since the very nature of the global deal is an outsourcing arrangement spanning many countries and in some cases, many continents, counsel will be dealing with large and sophisticated customers and suppliers. This is a blessing. You cannot do these deals easily with clients on either side who are not well versed in the challenges to be faced doing business in multiple countries.

In fact, you cannot do this type of deal at all without talented business, financial, tax, insurance and systems people both at the customer and supplier level who know the international framework. The experts on each side need to talk to each other and need to keep the legal teams in the loop at every step in the process.

The early involvement of teams from all business, tax, finance, risk management and in-house legal teams is essential - the earlier the better.

You also need international access to the supplier's and the customer's corporate counsel, outside counsel, financial and tax experts and in some cases regulatory experts – usually from several different sources.

There is no sense trying in this paper to set out the laws that will govern a global outsourcing deal. That depends on what countries are involved and the law is the least of your worries in some cases. Just keeping everything straight and on track is the biggest challenge at times.

This paper will take a practical look at some ideas for structuring and implementing a global outsourcing.

We will use as our guide here, two global outsourcing projects our firm was involved in. Each deal involved close to 50 countries.

Both deals were critical to the operations of our client, the customer, on a worldwide basis and their wish to standardize their operations and procedures.

Here are just the “top ten” observations we had on the journey. Certainly not all areas are covered – that would take an entire book.

1. **STRUCTURE**

The preferred way to structure a global outsourcing transaction is to set up a master transfer and services agreement and local agreements with the individual corporate entities of the customer and supplier to implement the arrangement in each country. Local asset transfer and employee transfer agreements are also used to transfer the assets and employees to the supplier in accordance with the local tax and employment laws.

The master transfer and service terms may be in separate agreements or contained in the same agreement. The master agreement will govern the international relationship and the terms of the master will be incorporated by reference into the local agreements.

The local agreement will usually be between local affiliates of the supplier and the customer. The master agreement will include a form of local agreement to be signed by the affiliates. The local agreement may be in the same language as

the master agreement or in the local language. In some jurisdictions it *must* be in the local language.

Master Services and Transfer Agreement

The Master Services and Transfer Agreement will usually include terms dealing with:

- The term of the arrangement.
- The transfer of employees, assignment of customer third party contracts and the transfer of assets to the supplier.
- A detailed services description for the global business.
- Provisions for transition to the new supplier.
- The overall pricing structure, invoicing requirements and payment provisions.
- Valuation formulas for equipment and other assets to be transferred to the supplier.
- General principles for employee transfers, including equalization payments, seniority and repatriation.
- Termination rights of the parties and transition assistance provisions.
- Change management provisions.
- Regulatory matters affecting the provision of the services.
- The governance structure.
- Terms of intellectual property ownership and licensing.
- Customer audit rights worldwide.
- Warranties and indemnities of both parties.
- Limits of liability.
- Insurance requirements for the supplier on a worldwide basis, including for general liability, property damage, employer's liability, crime insurance, errors and omissions.

- Obligations of both parties for data protection, confidentiality and security.
- Dispute resolution procedures, including the escalation of disputes, the requirement for mediation or arbitration or a choice of court.
- Governing law.

Local Agreements

The Local Agreements will usually cover:

- The identity of the local contracting parties.
- Services to be delivered in that country.
- Amounts to be paid at the local level.
- Currency of invoicing and payment. Get early tax, finance and legal review of the local payment terms and tax requirements.
- Foreign exchange or inflation adjustments, if any.
- Legal or regulatory requirements in that country.
- Incorporation by reference of the master agreement terms.
- Governing law. If possible, have the local agreements governed by the same law that governs the master agreement, to ensure consistency of rights and obligations. In some jurisdictions the local agreement will need to be governed by the local law, however.
- Choice of language. Again, if possible, it should be the same as the master but some countries require that the local agreement be in the local language. In the master, deal with which translation of the agreements will govern interpretation.
- Dispute resolution.

Points to Consider

- Clarify whether the supplier is equipped to invoice from a local entity to the customer's local entity or whether the supplier can only invoice from a central office. Consider any tax and other implications of both central and local to local billing.

- Get assurances from the supplier that the proposed services can actually be offered in all target countries - and not “we hope to be there soon”.
- Get assurances from the supplier that it will guarantee the performance of its local entities. If the local entity cannot provide the service, the main contracting supplier entity must arrange for it to happen.
- Be aware of the political climate in each country. This could have an impact on the ability of the supplier to provide services in that country; the ability to move currency or the ability to obtain any required regulatory approvals. A change in the political climate, local laws or regulations could have an impact so the parties need to be aware of changes at all times and provide for such contingencies in the master agreement.
- Determine whether there are legal or political impediments to the ability of the supplier to offer goods or services in all the countries in which the customer does business. For example, a Canadian supplier can offer goods and services to companies in Cuba, but a US supplier cannot.
- Disaster recovery. The availability of local resources as well as local regulations and the volatility of the political climate can also affect the necessity for differing levels of disaster recovery in particular countries.
- Consider whether the customer’s equipment to be transferred to the supplier must be moved to other countries. Are there any export or import restrictions on the ability to do this? For example, if one of the customer’s sites is closed, can the equipment be moved to another site in another country? Which party will be responsible for any import or export issues?
- Determine the language of performance in each country.
- Check on the availability of resources in each country and the breadth of the employment pool. If the customer is providing the services now with its own people and they are transferred to the supplier, are there available substitute contractors and personnel in other companies in the area that can be used in the event of termination of the local agreement?

- Decide how multiple time zones and language requirements are to be handled for help desk and other user interface functions.
- Determine whether there are any restrictions on the transfer of money out of any of the jurisdictions.

2. DUE DILIGENCE

Due diligence in a global deal can be a daunting prospect, with many countries and thousands of contracts, employee arrangements, tax issues and equipment inventories to be checked. Many suppliers and customers decide to limit due diligence initially to the markets with the greatest volume or greatest number of sites so that a macro view of the project scope, risk factors and possible complications can be obtained without having to check all markets – particularly ones where the volume may be low. If full due diligence is not going to be done however, the parties need to cover how to deal with surprises that may come up after signing.

Points to Consider

- Who pays to do due diligence? If the supplier does it, will the customer pay all or part of the cost? If the customer does it, what reliance will the supplier place on the results?
- Will the parties use a due diligence questionnaire that will uncover details for the most critical issues? The questionnaires will probably be filled out by the customer's employees. Decide whether the supplier will do site visits with the customer at key sites to verify the data. Confidentiality becomes a concern, if dozens of customer staff are filling out questionnaires and supplier staff are on-site asking lots of questions. Sooner or later people will know something is going on. Customer and supplier need to have a clear communications strategy and consistent to message to maintain staff morale and secure their participation.
- What due diligence needs to be done by the customer on the supplier's sites to confirm availability of required locations, security arrangements, etc.?

- How accurate and complete does the due diligence have to be at each stage of the deal?
- Who owns the results of the due diligence?
- How will errors or omissions in the due diligence be handled? Will there be an adjustment to the price or obligations after signing? If so, what is the timeline to uncover these errors or fill in the missing information?

3. CULTURE

It is important to think about the style of negotiation that is typical in the country (or countries) you are dealing with for the Master Agreement and Local Agreements. Try not to upset the balance too much. It is not really a successful negotiating tactic in this type of deal to make everyone dislike each other or foster a lack of trust. These deals are based on the need for trust and lawyers need to work within this framework.

Points to Consider

- How many lawyers should be at the meetings? In many countries, only one or two lawyers are welcome at the table and the North American style of teams of lawyers at every meeting may be unwelcome and counter-productive.
- Given the obstacles inherent in making any complex international relationship work well, the lawyers on both sides need to be part of the team that helps to build that relationship.
- Where will the negotiations be conducted?
- How much time will be set aside for the lawyers and business people to meet at any one time? If the teams have to travel far distances allow a week or two at a time for the meetings.
- Meeting coordination is critical: Group meetings to assign tasks and flag issues; break-out meetings for technical, finance, tax, HR, logistics, legal and insurance etc.; internal team meetings to discuss issues and escalation to senior management if needed.

- How many agreements will be used? In some countries, the habit of using dozens of agreements to break up all the constituent elements of the deal is not common and insisting on this can throw off the negotiation.
- Clarify the various levels of approval within the supplier and customer organizations so that all parties are sure when they actually have agreement on a point and when it is still open for approval at a higher level. Determine who the decision makers are and clarify when “yes” really means “yes”.
- Will the supplier in each country be required to comply with the customer’s code of conduct? Many companies have public codes that need to be adhered to in each country and the supplier might have a different way of doing business in some of them. It is important for there to be consistency in the way the customer’s business is conducted around the world.

4. PERFORMANCE MEASUREMENT

The parties need to work out a mechanism to measure technical performance as well as the performance of the outsourcing relationship. Taking the pulse of the arrangement on a regular basis is the key to avoiding surprises going forward and fostering a spirit of cooperation. An “us versus them” attitude on either side will not work.

Points to Consider

- Determine whether service levels will be measured by country, by critical market or some other measure.
- How will the parties deal with the problem of measuring what was done before the deal and managing expectations? It is likely that the customer is not even measuring some of the service levels it is insisting the supplier must meet.
- How will performance issues be escalated so they can be resolved, not litigated?
- All parties need to maintain some sensitivity to local conditions and user expectations and history. What is delivered in a major market may be

different from what the customer is actually experiencing in the smaller venues and the users in those venues may have a more hands on approach to delivering service. They will not want that to change.

- Will the measurement of the service levels be tied to the imposition of monetary penalties for failures or will the parties use a “bonus/malus” or other measurement that concentrates more on the resolution of problems than just payment for errors?
- If a failure to meet service levels can result in termination, determine whether the termination relates to the specific service in the local country or that service in all jurisdictions. If partial termination of the services is agreed, at what point is the whole deal off?
- Change management processes need to be built in the agreement as well. They are critical in any outsourcing arrangement but particularly important in a global context where things are always changing. New customer locations may be added and existing locations closed or moved. The parties also need to agree on how new technologies will be handled and any long range obligations of the supplier for technology planning and proactive management of the supplier’s and customer’s technology and resources.

5. FINANCE AND TAX

The finance and tax issues arising out of a contract for services to be provided to affiliates or subsidiaries around the world can be very complicated. Questions need to be answered in each affected country with respect to many different aspects of the deal. Invoicing, currency for billing and payment and the liability for taxes must all be dealt with in detail.

Points to Consider

- Will the supplier bill in a stated currency (e.g., USD) or will invoicing in each country be in that country’s local currency?
- If the billing is to be done in one stated currency worldwide, how will the parties handle exchange rate fluctuations in the local countries so that some local entities are not disadvantaged in the future?

- Will the supplier bill from a central location or will a local supplier entity bill the local customer entity?
- Will there be annual benchmarking of prices and performance?
- Will the supplier provide a guarantee of promised savings?
- Who will bear the financial responsibility for withholding taxes?
- Is a central bank or any other form of clearance required for payments?
- Is there a tax treaty between the country of residence of the major contracting parties and each local country in which services will be performed?
- Does it matter if the services are performed by a non-resident?
- Does it matter if the services are invoiced from another country?

6. EMPLOYEES

Most global outsourcings include the transfer of customer employees in the affected business units to the supplier. This may involve a few countries or many. In each country the issues that arise from the transfer of employees must be dealt with in accordance with the laws of that country. The costs of transferring employees, particularly in a union context, or in countries where the supplier may be required to take all employees in the business unit, can be significant. Counsel and HR personnel in each country must be consulted early on to assess the exposure for both parties.

Points to Consider

- In each country, are the parties dealing with an automatic transfer or does local law allow offer and acceptance to certain selected employees?
- If there is an automatic transfer, how is the group defined?
- What happens to employees who are not transferred – do they stay with the customer, are they offered other positions or are they to be fired? Who pays the costs?
- Are there collective agreements in any of the local countries?
- What are the pension implications in each country?

- Which party will pay the costs of any terminations or pension imbalances?
- How will accrued vacations and bonuses be handled?
- Will the supplier provide an indemnity from future claims by transferred employees?
- Will the supplier be required to take a certain number of employees and retain them for a minimum period?
- Consider whether some of the transferred employees are also providing services that are not being outsourced. If this is the case, how will those services be delivered after transition?
- When does the transfer take effect?
- Who do the employees to be transferred report to during transition?
- Must the supplier provide substantially similar, or equal, benefits and compensation?
- Will the supplier be required to keep named employees on the Customer account for a minimum period after transfer?
- Who bears the costs to terminate employees after signing?
- Can the customer “repatriate” the employees after termination?
- Is the customer obligated to take people back if the deal is cancelled within a certain period of time?
- Are there any relocation obligations and which party pays?

7. **TRANSITION**

Global outsourcing deals must provide for a structured transition to implement the transaction around the world. The logistics of trying to implement the arrangement in too many countries at once are a nightmare so most deals provide for a phased approach to implementing the deal.

Usually countries with the highest volume are implemented in stages and countries in which there are regulatory issues are left for later.

Communication within the customer organization is critical. The transition plan must have buy-in from all management and executive levels within each country. Bear in mind that most of the executives in each country may only have a passing knowledge that the deal is being done at all and the details may not have been shared internationally.

Points to Consider

- Set a target date for completion of transition and penalties or other consequences if the date is not met, depending on which party is responsible for the failure.
- Regulatory requirements must be addressed before transition, including how to deal with changes in the local laws or other applicable legal requirements during the term of the agreement.
- Consider whether the activity contemplated requires local licenses, government approvals or clearances and what notification requirements exist.
- Consider how to deal with a regulatory requirement that requires the supplier to suspend activities in a country for a period of time.
- If transition is not completed on time, decide if there will be a cut off date after which force majeure applies. Consider financial incentives to ensure the supplier looks for creative ways to perform.

8. TERMINATION

In a perfect world a global outsourcing deal will be implemented logically and the implementation will be flawless, as will the performance of both parties of their respective obligations.

Unfortunately, the world is not perfect at all and opportunities for a failure to perform are more plentiful the more countries are involved. The parties need to carefully work through the consequences of termination of all or part of the outsourcing arrangement if it comes to that.

Points to Consider

- Whether a local entity will be entitled to terminate services just in its country or whether this will trigger the ability of the master agreement supplier or customer to implement an overall termination of the service in question or the entire arrangement.
- If local entity terminations are going to be permitted, consider whether overall termination is inevitable, once a threshold number of terminated locations are reached.
- How will termination assistance services be coordinated and who will deliver them in each country?
- Will the customer be required to buy back equipment and take back employees?
- The licensing back of intellectual property rights and the knowledge transfer required on termination must be dealt with carefully.

9. DATA PROTECTION AND SECURITY

The issues surrounding data protection and security of the customer's data and other confidential information will be critical for both parties. Not only must local data protection laws be examined to determine the requirements to be met, the parties must also comply with any laws affecting audits and controls required by companies that are listed on the public stock exchanges.

Points to Consider

- What are the legal requirements for audit of supplier security, controls and processes and delivery of attestation reports? Consider whether Statement on Auditing Standards No. 70 (SAS 70, 5970 Audits) or Sarbanes-Oxley Act 2002, or both, will apply.
- What are the supplier obligations to comply with all customer security requirements including requirements for protection, retention and backup for all data?

- What are the restrictions on movement of data and limits on countries where it can be stored? Remember that data stored in a country is subject to the laws of that country.
- The supplier must comply with various laws relevant to the customer's business with respect to the custody, use and control of personal information, for example, in the EU, the *Directive on the Protection of Personal Data With Regard to the Processing of Personal Data and the Free Movement of Such Data*. Under the Directive, organizations that collect EU citizens' personal information must ensure that transborder transfers, for any purpose, are limited to jurisdictions which have been deemed by the European Commission to provide "adequate protection" for that data.
- In Canada, the federal *Personal Information Protection and Electronic Documents Act ("PIPEDA")* stipulates that an organization remains responsible for information in its possession or custody, including information that has been transferred to a third party for processing.
- For special categories of personal information, such as financial information, other laws may impose even more stringent measures (e.g. in Canada, there are special requirements in *Bank Act*; *Telecommunications Act* and other federal and provincial laws).
- Check for any industry specific outsourcing guidelines that may be in effect for the customer's business.
- Consider the implications of the *USA Patriot Act*.
- Decide whether the agreement will provide that the supplier is to resist government attempts to access data under security powers.

10. DISPUTE RESOLUTION

In a global outsourcing, disputes are almost inevitable, so the master agreement must be set out a clear dispute escalation procedure to try to keep disputes at a manageable level and provide for a resolution before the relationship suffers. It needs to provide how formal disputes will be handled if the internal managerial approach is not successful.

For most customers and suppliers, termination is not really a remedy – it is a penalty for both sides, so the resolution of matters in dispute is the goal. In addition, the parties to the master agreement will probably want to deal with problems that arise at the local level as well. This is partly to prevent the relationship from suffering a “death by a thousand cuts” through unresolved local disputes that poison the international relationship and partly to avoid having to handle lawsuits or arbitration procedures all over the world.

The parties will probably also want to keep the fact of the dispute between them out of the public eye, so many outsourcing arrangements provide for private dispute resolution mechanisms to resolve problems, such as mediation and international arbitration in a neutral location.

Good governance procedures are critical in a global deal. The intricacies of trying to manage service delivery and performance issues in an arrangement that could span dozens of countries requires that the parties thoroughly explore how the relationship is going to be managed, how performance issues will be escalated and how changes or new projects will be handled and approved. The governance structure will also form the basis for the first line of the dispute resolution process. It is important that both parties dedicate significant, senior level resources to this structure.

Disputes under the local agreement should be dealt with by the parties to the master agreement in accordance with the dispute mechanism that is agreed to under the master. The goal is to make sure that the various subsidiaries and affiliates of the main contracting parties are not fighting lawsuits or engaged in mediation around the globe. This not only is expensive, it can defeat the purpose of the global outsourcing. The parties might as well just deal with local suppliers in the region.

Points to Consider

- Tie in the project and relationship governance procedures and teams with the dispute escalation process. The parties who are the most intimately acquainted with the deal and how things are progressing may be the best people to deal with the first signs of trouble. They also need to know

when to hand it off to the next level of management if the dispute cannot be resolved.

- Decide what level of executive needs to be involved in final resolution attempts before the dispute is sent outside. Will the CEO be involved?
- Tie in the service level measurement and penalty structure to the overall dispute resolution mechanism if the technical parties can no longer resolve the issue.
- What rules will govern outside involvement? If mediation is the first step, how will the mediator be chosen?
- If arbitration is an option, what rules will be used?
- What is the language to be used in any outside proceeding?
- Will arbitrators be agreed on ahead of time or just a basis of required arbitrator qualifications – e.g., someone with at least ten (10) years of demonstrated experience in the information technology industry, either as a consultant, principal or advisor?
- Where will the arbitration proceedings be held?
- Will the arbitrator's award be final or subject to appeal?
- Will some disputes be able to bypass arbitration – e.g. intellectual property or breach of confidence claims?

CONCLUSION

This paper does not, by any stretch of the imagination, cover all the points that must be covered in a global outsourcing transaction. It merely highlights some of the complexities that need to be addressed.

Outsourcing worldwide is becoming more common as the “global village” becomes more prevalent for more companies, but it is still, by definition, reserved for companies, both suppliers and customers, with operations around the world and a mandate to standardize operations or business services on a global basis.

The complications that can arise in a global deal may be similar to those in a domestic or offshore arrangement, but they are certainly multiplied by the number of countries involved.

Early involvement by finance, tax, insurance, systems and legal teams is essential and a realistic timetable to coordinate and deal with the issues is critical – although, unfortunately, not always available.

Amy-Lynne Williams

Michael Erdle

Deeth Williams Wall LLP

150 York Street, Suite 400

Toronto, Ontario

CANADA

M5H 3S5

awilliams@dww.com

merdle@dww.com

The authors, Amy-Lynne Williams and Michael Erdle, are solely responsible for the content of this article.

Please return to the "ideas" page <http://www.techmankanata.com/ideas.htm> to select other articles written by Amy-Lynne Williams. The ideas page contains articles on a variety of subjects written by well respected authorities.