Managing Provider Performance of Termination Assistance Services

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In a prior article involving termination rights, we touched on the fact that buyers should include contractual provisions regarding how to transition outsourced services away from a supplier upon termination. This article provides a more complete explanation of how buyers can structure contracts to help ensure a smooth transition of services in-house or to an alternate supplier at the end of an outsourcing relationship.

Buyers should always negotiate a supplier's termination assistance obligations during the initial contract negotiations. Buyers are more likely to obtain favorable termination assistance commitments from a supplier at the beginning of the relationship by leveraging the multiparty RFP negotiation process discussed in an earlier article.

Near the end of the agreement, the relationship between the supplier and the buyer may have broken down, the parties may be in the midst of a dispute over an alleged breach, or the supplier's attention may be focused on winning new business rather than wrapping up an old account. At that time, it will be difficult to negotiate favorable termination assistance terms, even if both parties act in a mature and cooperative manner (which is not always the case).

Termination Assistance Services

When drafting termination assistance provisions, buyers should first determine the time that they will need to transition the services and specify a time frame that will provide time to do so comfortably. We generally counsel buyers that, dependent on the complexity and scope of the services being terminated, they should require suppliers to provide 12 to 24 months of termination assistance. We also recommend that buyers be permitted to specify the length of the termination assistance period, with a right to extend once or twice, as necessary, subject to an overall limit on the length of the termination assistance period.

During the termination assistance period, the buyer will need the supplier to continue to perform the outsourced services until they are handed off to the buyer or a replacement provider. The supplier must also provide any assistance necessary to transfer the services without disrupting the buyer's business.

To ensure a smooth transfer, suppliers should transition the outsourced services in accordance with an exit plan developed and periodically updated by the supplier over the term of the agreement.

The supplier should also be required to perform any other duties which are necessary to transfer the terminated services seamlessly, including providing any training necessary for the buyer or a replacement provider to assume control of the services, returning any buyer data held by the supplier, providing parallel processing and testing services before the final transition, and performing any other transition services which are reasonably requested by the buyer.

For the reasons described above, buyers should also specify that the termination assistance services be performed at the same level of quality as the services were performed prior to termination.

Termination assistance is also important to consider in technology transactions other than traditional outsourcing agreements. For example, if a buyer terminates a software as a service solution, it will not require the full range of termination assistance described above. It will, however, likely need certain services in order to transition away from the supplier's solution, including continued use of the solution for a specified period and return of any buyer data held by the supplier.

Payment for Termination

Assistance

During the termination assistance period, the supplier should continue to provide the services at the same pricing in effect during the term of the agreement. However, the supplier may object to providing certain transition-specific tasks unless it receives additional compensation. Consequently, the parties often agree that any termination assistance services which require resources above and beyond those required to perform the services should be provided for additional fees, but preferably at previously agreed rates.

Although a supplier should be required to provide the termination assistance services regardless of the reason for termination, suppliers will often insist that the buyer pay in advance for any termination assistance services if the supplier has terminated the agreement for cause.

Upon termination, suppliers may be tempted to walk away from the agreement without fulfilling their termination assistance obligations, particularly where there is a dispute between the parties or the supplier believes that the stipulated fees are not sufficient to compensate it for the termination assistance services.

A supplier's refusal to provide termination assistance can significantly disrupt a buyer's business, causing it to incur damages far exceeding whatever fees it may save. To protect themselves (and provide the supplier with an incentive to fulfill its obligations), buyers should exempt damages incurred as a result of a supplier's failure to provide termination assistance services from the limitation of liability.

Assets and Resources Needed

After Termination

To ease the process of transitioning the services, buyers should reserve the right to purchase (or assume the lease for) any machines or equipment which are used to provide the services at specified pricing (frequently the lesser of fair market or book value). A supplier may balk at this open-ended purchase right; in which event, the parties often limit this provision to the machines dedicated to providing the services. This is often advantageous to both parties, since the supplier may have no more use for the machines after termination.

Similarly, suppliers often use proprietary software or other third-party intellectual property which is critical to the operation of the outsourced solution. To ensure that they have the necessary intellectual property rights and prevent the hassle and expense of obtaining such intellectual property rights independently, buyers should include an obligation for the supplier to grant to the buyer (or allow the buyer to purchase) licenses to such software and intellectual property.

Also, if a supplier uses any services provided by a subcontractor or other third party to perform the terminated services, the buyer should include a right for the buyer to assume the contracts governing such third-party services in order to allow continued performance of the subcontracted services.

To continue performing the services after termination, a buyer should also retain the rights it will need in any supplier intellectual property used in the performance or receipt of the services which is not already transferred to the buyer via the agreement. For example, if a supplier has helped the buyer re-engineer its back-office processes so that it can more efficiently use the services, these processes may be proprietary, and the buyer will need a license to continue using these processes after termination.

Often the most critical factor in a successful transition and continued provision of excellent service is the people involved. As such, buyers should include a right to extend offers of employment to the supplier personnel that are instrumental in providing the terminated services and prohibit the supplier from interfering with this process or making counteroffers to personnel to whom the buyer extends offers of employment. Buyers should be mindful that employees located in Europe must be transferred in accordance with the EU Acquired Rights Directive (2001/23/EC), which mandates that employees that are transferred between employers due to a change in ownership of a business must be employed on the same terms and conditions after transition, subject to certain exceptions.

Jim Steinberg, a partner at Kilpatrick Townsend & Stockton, focuses his practice on complex commercial transactions and general corporate matters for telecommunications, financial institutions, health care providers, technology and other companies. Andrew Head, an associate at Kilpatrick Townsend, focuses on technology and business process outsourcing, technology licensing, and strategic alliances and joint ventures.