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In This Issue:

Alternatives to “Scorched Earth”:

[Collaborative Contracting](#)

[Remember the Larger Purpose](#)

[Keep It Simple](#)

[Play Fair](#)

[Respect the Other Side](#)

[Nomenclature Matters](#)

[Clean Up Your Own Mess](#)

[Beware of “Worst Case” Thinking](#)

[Remember Who’s in Charge](#)

Alternatives to “Scorched Earth”

The ritual has become all too familiar - like a weird mating dance.

A major company decides to outsource. It engages seasoned consultants and attorneys, armed with forms, templates and processes galore. They conduct an assessment, construct a “base case” budget, then issue a request for proposals, complete with the latest, most stringent terms known to the attorneys. After bidders’ conferences, sales presentations and other rituals, proposals are submitted, scrutinized and discussed; until one or two finalists are selected for the final “death march” toward signature documents. Few prisoners are taken (although some participants taken from their day jobs for months at a time may think they have been held hostage).

Many observers now believe that the process has become too costly, protracted and contentious. From start to finish, the whole rigmarole may last eighteen months. Professional fees may run well into seven figures. The participants emerge exhausted, with business relationships bruised. Cynics mumble about costs and even the advisers’ motivations. No reputable professional merely runs the meter, of course, and knowledgeable observers understand that fat closing binders actually contain important protections. Nonetheless, the question is symptomatic and disturbing.

More to the point, the results often disappoint. Customers grumble that costs exceed expectations, but performance does not. Suppliers may struggle to make acceptable returns. Both sides have difficulty managing relationships successfully. Expectations may or may not be well aligned, and in any event, when the ink is dry, the original requirements may be out of date. The contracts themselves increasingly resemble government contracts: acres of turgid prose, laden with obscure terminology. Their complexity defies both easy comprehension and efficient administration. Time that might be devoted to planning the future is spent quibbling over wording and remote contingencies.

Might there be a better way? We think so.

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Collaborative Contracting.

Many of our clients, customers as well as suppliers, increasingly favor a *collaborative*, rather than an *adversarial* approach to outsourcing. The differences are, at bottom, philosophical and more real than apparent. The phases, processes and even documents look much the same, but the attitudes, outlook and (hopefully) results differ.

The adversarial method adopts familiar procedures and nomenclature from competitive bidding for public contracts and commodity procurement. It presumes an adversarial, even antagonistic, relationship between contractor and customer. Customers seek the most favorable terms in order to assure maximum control and leverage after signing – in somewhat the same way that tough leases protect landlords after the tenant moves in. The more complex and stringent the contract, the greater the likelihood (indeed, probability) that when difficulties arise the supplier will be out of compliance and the customer will enjoy some leverage or other advantage. Ideally, the customer would transfer most risk to the contractor, retain firm control of operations, and deploy a full armory of remedies in case of difficulty. Behind the aggressive negotiating position and tactics, the basic strategy is defensive. The suppliers also play defense: conceding as little as possible, responding tactically to questions, then hedging after selection – a tendency that customers liken to “bait and switch” tactics. At times, the process resembles cross-examination, rather than dialogue.

Neither side has any monopoly of wisdom, virtue or innocence. Given the chance – in a sole source opportunity, for example – some suppliers will propose equally lopsided contracts with long terms, few remedies, generous allowances for cost-of-living and other adjustments, little assurance of long term savings, and minimal, costly exit rights. Their goal, like that of the most aggressive advisors to customers, is maximum leverage for unilateral, rather than mutual, advantage.

The adversarial processes rest, in part, upon some misconceptions:

- The relationship between an outsourcer and its customer is ongoing, active and interdependent, unlike buyers and sellers (who part company after the closing), landlords and tenants, or borrowers and lenders (who are content to leave one another alone, so long as payments are punctual).
- Customer and supplier need not (and should not) be antagonists. Outsourcing is not a zero-sum game, where gain can only come at the other side's expense. Neither party succeeds unless both succeed. The customer expects good service for a competitive, manageable and (above all) lower cost. Otherwise, outsourcing rarely makes sense. The supplier needs a contract it can perform, successfully and profitably. Unlike legendary used car dealers, they cannot make up losses with volume. Unless both sides' goals are achieved, trouble is virtually certain, no matter what the contract says. Reality has a way of asserting itself. Myopic focus upon cost reduction, to the exclusion of all other considerations, may prove counterproductive. Wary, defensive and suspicious attitudes may obscure opportunities.

- Outsourced services are rarely commodities in the usual sense. IT services, web-enabled business processes and other “staples” of large-scale outsourcing involve combinations of rapidly-changing, sometimes unstable technologies, supported by large numbers of skilled personnel. The solutions offered may vary substantially from one deal to the next, and evolve over the life of the relationship. Sometimes, key elements are under development when contracts are written. Sophisticated IT and business process services therefore differ fundamentally from such commodity services as laundry, building security or custodial service, let alone such commodities as wheat, soybeans and pork bellies.
- Adversarial processes and thinking tend to overlook the reasons why good contracts succeed. Fear is rarely the primary (or best) motive. All contracts necessarily prohibit, police and provide legal protection for “worst cases.” There are good reasons for audit clauses, termination rights and the rest, but they are not the whole story. Good contracts are constitutions for business relationships. They work for the same reasons as treaties between nations: both contracting parties understand that performance serves their best interests, and accept that, overall, the terms are fair. Successful contracts allocate risks and responsibilities in ways that help motivate parties to perform even – or perhaps especially – when things go awry.

Negotiation is not a love feast. No elixir dispenses with the need to consider “worst cases.” The process should unfold in a disciplined way through the familiar phases of assessment, selection and negotiation. No one questions the value of preparation. Haste often yields remorse. Everyone appreciates the invigorating effects of competition, which helps assure customers the most favorable terms, and compels bidders to offer the best combination of quality, service and cost. That said, the process need not resemble a bullfight or gladiatorial combat. Blood on the sand is not the idea.

The differences between collaborative and adversarial relationships begin with attitudes and philosophy during selection. We have found that the following themes and principles help our clients to build better working relationships more expeditiously, with less friction, acrimony and expense:

Remember the Larger Purpose.

Negotiations are not debates, contests or adversary proceedings. The goal is not to win every point, but to build sound foundations for a business relationship: one that gives both sides incentives to perform, and positions both parties to succeed, as they must, if either side is going to succeed. Negotiation can be an opportunity to anticipate and resolve a wide range of issues in advance, and begin building habits of candor, civility and mutual respect that will help to resolve issues that no one can now anticipate. Professional advisors’ (and senior executives’) most important contribution can be to set a tone that facilitates that kind of discussion, notwithstanding normal competitive and other predispositions of some participants. Good lawyers are not only advocates, but counselors and facilitators who attempt to identify, articulate and then reconcile competing, legitimate interests. Long run success – *mutual* success – and not immediate advantage must be the primary goal.

Moreover, the contract is only one part (by no means the most important) of a larger picture that includes scope, technical and performance requirements, charges and other costs, people and assets. Outsourcing involves a business relationship, a deal, and a set of contract documents. In order to succeed, all three must be in reasonable harmony. Merely to focus upon terms and conditions is to miss (and perhaps jeopardize) the larger picture. Contract language can never replace common sense, business judgement, or trust.

Keep It Simple.

During negotiations, exhausted clients look forward to placing the contract “in a drawer,” never to be seen again (let alone opened or read). Lawyers deplore this, believing that contracts protect their clients, and contain tools for managing the business relationship – as indeed they do. But if those tools are entombed in massive, unintelligible documents, who can blame the poor client who sets the contract aside in order to get on with business? Intricate provisions for all contingencies may be useful in case of legal proceedings, but can be cumbersome (and perplexing) on a day-to-day basis.

No one would expect to write a contract on the back of an envelope. Providing diverse services to large companies, in many locations, with a variety of pricing metrics, service levels and other requirements necessarily involves some complexity. But has the growth of “standard” forms of agreement from, say 75 to 150 pages really provided corresponding benefits or value? Must an export control clause, for example, fill half a dozen pages? Can anyone actually manage a complex business relationship with layers of charts, rules and procedures? Can anyone spell “overkill” (or “over-lawyer”)?

At some point, complexity baffles users (as IT professionals know only too well). Service levels, for example, are designed to assure quality, through regular reporting and, in case of failures, financial sanctions; but they are useless when, after an outage, the errant supplier receives a free pass because the customer no longer understands the complex calculations required to assess service credits.

Professional habits predispose attorneys toward complexity. Young lawyers are trained to spot every issue, no matter how arcane or obscure. This may impress law professors and senior partners. Sophisticated clients do appreciate (and fairly expect) attention to detail. The fact remains – and is sometimes overlooked – that even in complex transactions, comparatively few issues are either vital or potentially lethal. Retaining a sense of proportion is healthy, and can help to reduce numbing complexity.

Lawyers eschew risk. Ideally, they prefer to shift risks to the other side, or else wrap risks in a protective cocoon of rules, presumptions, processes and verbiage. In fact, no one can eliminate all risks, foresee and write rules for all contingencies, or manage a business with rules of civil procedure. Negotiation tends to complicate matters further, with still more words: layers of insertions, negotiated compromises and the like. Time and other pressures limit the ability to edit, while technology makes it possible to produce enormous documents quickly. No one could have been so prolix in the era of carbon paper. Now, contracts as thick as telephone books are almost routine.

Sheer complexity has become part of the problem. Drafting, negotiating, revising and reconciling all of those words takes time and costs money. The results can be so cumbersome – even bewildering – that contracts cannot serve as the tools clients are

entitled to expect. No one can foresee or write rules for every possible situation and contingency, but good lawyers can devise workable, practical processes for resolution of issues and conflicts when they occur.

We have found that shorter, simpler documents cost less to prepare – in time, legal expense and aggravation – and are much easier for clients to manage, but still provide ample legal protection.

Play Fair.

Everyone heard this playground maxim as young children. The principle remains sound.

Negotiations often begin with ostensibly “standard” forms. Often, they are a kind of “wish list” full of harsh terms vaguely reminiscent of bankers’ form loan agreements (the kind that pledge the borrower’s first-born as collateral). In outsourcing, some customer forms oblige suppliers to perform whatever services the customer formerly performed, imagines it performed, or may desire, at lower cost, while service levels rise and charges fall. The slightest miscue may have dire consequences. Change orders, if allowed, may require an Act of Congress. And so on. Suppliers’ “standard” forms may go to the other extreme – exclusive arrangements for long terms with few remedies, generous cost-of-living increases, no exit and weak (or nonexistent) performance commitments. Anything beyond “bare bones” service will cost more money. How much? Just you wait and see.

No one seriously expects anyone to sign these “standard” forms as written, unless they are naive, desperate or poorly advised. Rather, draconian terms are tactical. The idea is to start from an “aggressive” position, then fight a rear-guard action, yielding ground a millimeter at a time, so as to hold the balance of advantage when negotiations conclude. After several rounds of negotiation, the parties usually arrive at some middle ground. So why not save time, grief and money and start there? Experienced counsel know the usual range of acceptable compromise. Clients paying the bills rarely care about setting precedents for future deals. Starting from balanced, realistic positions allows the parties to focus on more important issues – scope, price, performance, people, transition and the rest – and minimizes debilitating debate that reinforces suspicion. Respect, courtesy, candor and trust are better foundations for long term working relationships than suspicion or pressure tactics.

Collaborative negotiation respects the Golden Rule: do not unto others as you would not be done unto. Mindful of the paramount goal – mutual success – never propose terms that would be wholly unacceptable if roles were reversed, or embarrass the unsophisticated or unwary if they pass unnoticed into a signed contract. This does not mean opening positions without room for movement, or mute acquiescence to the other side’s requests. It does mean conceding, without being asked, whatever is normal and customary, that the other side should fairly expect.

Clear, reasonable terms help to hold business relationships together when things go wrong (as they are bound to). From time to time, each party will find, after reviewing the fine print, that it must absorb the cost of some unpleasant surprise. No one likes bad news, but bad news is more palatable when the language is clear (rather than debatable) and self-evidently fair.

Wise counselors seek favorable terms that respect and accommodate both parties' interests. Unfair, over-reaching or unconscionable terms are not only wrong, but counter-productive. They waste time, cost money, and undermine trust.

Respect the Other Side.

Wariness and skepticism are virtues in business, and in the practice of law. Polyanna, whatever her charms, might not have lasted long as a negotiator. At the other extreme, cynicism and suspicion corrode business relationships. Major outsourcing transactions are serious business, to which the participants devote many thousands of hours and hundreds of thousands, even millions of dollars. Such levels of effort deserve respect.

Too often, business people (and jaded professional advisers) make facile, unfavorable assumptions about others' motives when, more often than not, the "other guys" are just doing their jobs, trying to protect their company's bottom line and other interests. One need not accept the other side's position in order to respect their good faith and professionalism. Errors are more likely to be oversights or miscalculations than skullduggery. When the other side errs, it is usually wiser to reach some sensible accommodation than to dig in; and better to do the decent thing and speak up, rather than let obvious errors pass unnoticed. Doing the right thing is good business, especially when embarking upon a business relationship likely to last years.

Time taken to listen and attempt to understand the other side's interests and point of view – whether or not one agrees – is usually time well spent. What do they need in order to succeed? Which of their concerns are fundamental, as opposed to merely desirable (from their point of view)? What are the relationships within their organization? Who has authority to decide? Who is accountable? These kinds of questions are more important than speculation about motives, and more likely to have objective, meaningful answers. Moreover, approaching negotiation issues in this way helps to establish good patterns for later management of outsourced operations after the deal is signed, and the lawyers and consultants have gone home.

Nomenclature Matters.

Lawyers pepper documents with abbreviations, acronyms and "defined" or capitalized terms. Everything described by the statement of work or swept into scope by a dragnet clause becomes a "Service." Mandatory "Service Levels," measured and reported monthly, are distinct from general "performance standards," such as the obligation to deliver good service that meets industry standards. In principle, this is good draftsmanship and helps to assure clarity, consistency and precision. But there can be too much of a good thing. Would anyone recognize an "Eligible ARD In-Scope Employee" on the street corner? Not likely – and this kind of verbiage can make contract documents unintelligible to business people.

More fundamentally, labels shape thinking. Sales presentations often refer to "partnership," a term that lawyers dislike because it implies joint ownership, liability and the rest (even though the business relationship may resemble a kind of partnership). But if outsourced services are more than commodities, should documents refer to suppliers of services as "Vendors" – as though they were purveyors of paper clips, lock

washers and wing nuts? “Supplier” or “Service Provider” are at least neutral, though impersonal. “Customer” has favorable connotations (since all businesses claim to be “customer-focused”), but why not just use company names? No company entrusting crucial operations to a contractor wants to think of itself as just another customer. No one refers to family members as “Husband,” “Wife” or “Offspring” or addresses co-workers as “Boss,” “Subordinate,” “Secretary” or “Receptionist.” Good businesses that meet the public address their customers by name. So should good contracts.

Clean Up Your Own Mess.

Most people learned this in kindergarten, or earlier (especially if they had siblings). It seems obvious, as well as fair. How does this axiom figure in outsourcing transactions?

- For the customer, turning inefficient or erratic operations over to someone else does not, by itself, assure progress or savings. “Mess for less” is rarely an effective strategy. When outsourcing to effect change, the customer should anticipate some dislocation and friction. Enlisting someone else to do the “dirty work” does not necessarily make things easier (or, initially, any cheaper). Similarly, suppliers should never peddle untested, partially developed solutions as though they were stable and proven. When troubles ensue, the supplier’s reputation and credibility will be among the first casualties.
- When allocating risks and responsibilities, each side should be accountable for matters within its own control. Generally, neither side writes insurance for the other side’s acts or omissions. For this reason, most indemnities are reciprocal. If either party treats transferred employees badly, infringes a patent, contaminates the environment, breaks the law, breaches a third party contract, or does a variety of other things within its control, it should be responsible. Once again, unpleasant or expensive consequences are more likely to be palatable when the parties recognize that risks and responsibilities were allocated fairly.

Beware of “Worst Case” Thinking.

Building a business relationship is a bit like construction. One must spend time not only with renderings and scale models, but also with soils tests, seismic stability, fire suppression and other remote, unpleasant contingencies. In much the same way, outsourcing contracts must deal with audits, payment and other disputes, termination rights, service outages, disaster recovery and a host of other improbable, ugly situations. These things necessarily take up disproportionate time and attention, just like engineering a building to withstand an earthquake or hurricane. But they should not obscure larger benefits that both sides anticipate, and the give-and-take (including occasional, inevitable tensions) surrounding contentious contract issues should not be allowed to affect (or infect) business relationships. These are knotty, but eminently soluble, contract issues, provided that – once again – each side fairly respects the other’s legitimate interests. The risks, unpleasant as they are to contemplate, are usually remote.

Remember Who's in Charge.

Advisors sometimes flatter themselves that they “run the deal.” If true, this is usually a mistake, for the business belongs to their clients, who must make things work afterward, and live with the consequences. The “standard” form books, templates, checklists and processes beloved by attorneys and consultants contain much accumulated experience, and help to assure consistent quality in an institutional practice; but they are not a substitute for experience and judgment, as applied to each client’s unique circumstances. No single form, template, method, or strategy suits all situations. In almost every transaction, the right solution will involve some variations upon conventional wisdom. Wisdom comes, after all, not from form books or recipes, but from knowledge, experience and asking the right questions – even when answers may depart from conventional wisdom.

The client, whose business it is, and who pays the bills, is in charge of its own destiny. Clients give instructions and make ultimate decisions. We merely give advice.

However, we have learned from experience that clarity trumps complexity and long run success is best built upon foundations of fair play and mutual advantage. Kinder and gentler can also be faster, cheaper and better.

In addition to publishing the monthly Outsourcing Digest, periodic Client Alerts and white papers, we will also produce occasional Commentaries. Baker & McKenzie Commentaries will address outsourcing issues and roadblocks beyond strictly legal matters.

Our goal in publishing Commentaries is to contribute to improving the outsourcing marketplace. If you have suggested topics or ideas that you would like to contribute to this effort, please contact Michael Mensik at michael.s.mensik@bakernet.com.

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