

Update

Preparing for Disengagement: What You Wished You Had Put In Your Exit Contract ... and Still Can

by Sara Cullen

It is inevitable that your contract will end, naturally through expiration or unnaturally through early termination. Irrespective of the cause of the termination, it is likely that some, or even all, of the services within the contract will not stay with the incumbent service provider. Some services will be back-sourced; some will be eliminated; some the incumbent supplier will continue to provide; and some a new supplier will provide. An Australian-based survey revealed that while a prevailing number of services are retained with the incumbent, 75% of respondents gave at least some services to

an alternative supplier, and 41% brought at least some services back inhouse (see Figure 1) [1].

Given the near-certain probability that some services, if not the entire contract, will not be retained by the incumbent supplier, disengagement often receives little attention at the time a contract is formed. It is imperative, however, that every client has appropriate disengagement provisions, or it will suffer the painful experience of either begging for help from an unwilling supplier or paying extraordinary fees to obtain such help.

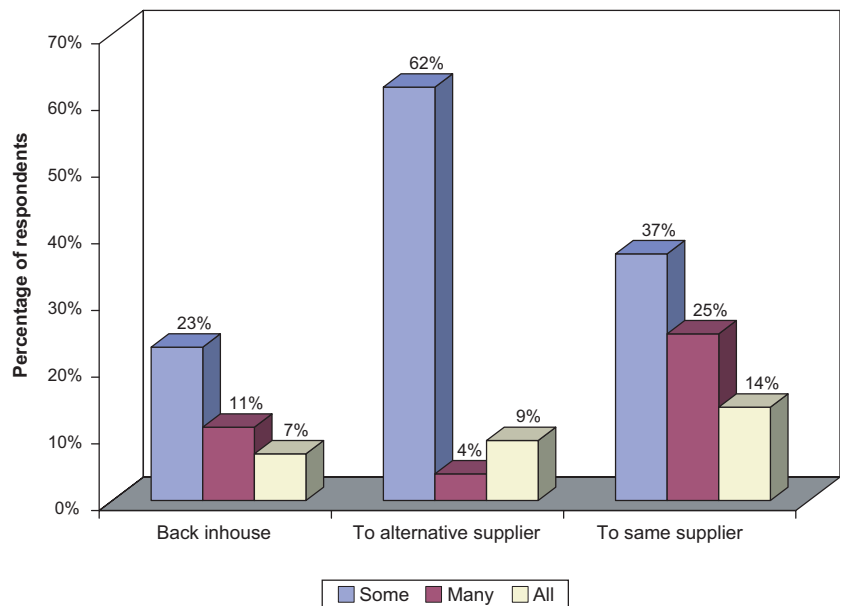


Figure 1 — End-of-contract decisions [1].

DISENGAGEMENT PROVISIONS

Intent of the Disengagement

First, the intent of the disengagement should be clearly articulated. This provision typically states that the parties agree that disengagement must be conducted such that the business of the client is able to continue to operate as if the termination circumstances and resultant disengagement had not occurred.

Duty to Continue Services

This provision requires the supplier to continue providing the services as per normal operations during the disengagement period. However, it also gives the client the right to complete the services itself, or engage a third party to complete any part of the services, which allows for suspension of payments otherwise due to the supplier regarding services taken out of the supplier's hands.

Disengagement Assistance

This provision requires the supplier to provide all reasonable disengagement assistance to the client for the orderly transfer of the disengaged services to support the client's requirements for business continuity during the disengagement period. It also specifies the workforce and other resources that will be made available to provide disengagement assistance.

Disengagement Plan

This plan contains the details of the procedures, processes, responsibilities, and obligations that arise after the client gives notice of termination or upon expiry of a term, as well as defines the disengagement period. Most important, it specifies the obligations of both parties (or all three parties) and the resources that the parties are to provide.

Most clients require this plan in the initial bid by the supplier along with the transition-in plan, putting both into separate schedules to the contract. However, in some cases, the client may merely require the supplier to provide such a plan upon notice.

Staff or Asset Transfers

Staff and asset transfer clauses allow the client to obtain staff and assets that it transferred to the supplier at the start of the contract or that it would like to "buy in" to continue the services. The conditions for the transfer included in these provisions typically are the following:

- The offer of employment process, any payments to be made to the supplier, and the right of the employee to reject the offer
- The manner in which the assets will be priced (typically fair market value as determined by an independent valuer or book value)
- The period in which the transfers must occur or the right(s) expire

This section of the disengagement provisions also requires the supplier not to hinder the process in any way, allow access to staff for recruitment processes, such as interviews, as well as access to assets for condition audit, inventory, and/or valuation purposes.

Handover Assistance

Handover occurs when another supplier has won the contract. The provisions address the obligation by the supplier to:

- Review all procedures, diagrams, work-in-progress, documentation, software, and so on with the successor

- Provide the successor with access to all necessary information relevant to the ongoing provision of similar services
- Conduct training of the successor as directed by the client
- Participate as directed by the client in any parallel testing
- Allow the successor access to the supplier's site where deemed necessary by the client to assist in the orderly handover

In addition, these provisions describe the obligations of all parties (successor, former supplier, and client) regarding the handover acceptance process, testing, and the signing of a tri-party handover acceptance form evidencing that all parties have fulfilled their obligations and that the successor is now in charge.

Novation and Assignment

These provisions are required if there are subcontracts, licenses, or other agreements that need to be transferred to the successor. Novation has the successor "stepping" into the contract as the party from the inception of the agreement being transferred; assignment has the successor stepping in from a specified date. Such provisions typically require the supplier to novate, assign, or procure the novation or assignment of the following:

- Software (third-party or supplier-developed) that has become incorporated in the services to the client in the form in which it is utilized within the services
- Subcontracts, maintenance agreements, leases, and so on under the incumbent supplier to the extent the relevant second party (if any) allows the supplier to do so

Typically, the supplier is required to pay all novation/assignment fees

and related transaction costs and execute the novation/assignment.

Cancellation of Third-Party Services

This provision requires the supplier to cancel all services from third parties that will not be novated/assigned and will no longer be required, at no cost to the client. It is important that the provision explicitly states that the client will have no liabilities for any services unable to be cancelled.

Vacate Client-Owned Premise

If the supplier has staff or equipment being accommodated at the client site(s), this provision states the requirements regarding vacating the site, removing equipment and leaving the site in no less condition than when it became occupied by the supplier's staff or equipment.

Deliver Up

This provision requires the supplier to "deliver up" all of the following:

- Backup of all data, programs, libraries, code, and so on in a form reasonably requested by the client together with any medium containing or capable of reproducing that backup
- Material (electronic and paper-based) forms of the client's confidential information: data, records, documents, drawings, and so on in the form required by the client
- Documents that are necessary to enable the services to be provided by the successor in a manner that ensures orderly transition and continuity of service (e.g., system logs, problem tracking/resolution data, performance data, naming conventions)

- The surrender and cease of all access points, including links to the client's computer systems and access passes to the client's sites
- Assets and property owned by the client in the custody, control, or possession of the supplier

Data Accuracy

This provision states that the supplier guarantees that the delivered-up data is accurate and up to date. It also requires the supplier to undertake — to the extent that it is unable to comply with the accuracy requirement — the procurement of any replacement data for the client as necessary to ensure compliance, or alternatively to pay the client the reasonable costs of doing so.

Data Destruction

This provision requires the supplier to destroy any of the client's confidential information together with any reproduction of that information and any medium containing or capable of reproducing that information, if requested by the client.

Client Audit Rights

The client typically reserves the right to audit compliance with the disengagement plan and the disengagement provisions.

Post-Disengagement Assistance

Post-disengagement puts obligations on the supplier, subsequent to the disengagement period, to perform the following, if requested by the client:

- Answer questions regarding the services on an as-needed basis
- Turn over any remaining client-owned reports and

documentation still in the supplier's possession

- Provide the client with access to all necessary information relevant to the ongoing provision of the disengaged services
- Arrange or procure the secondment of its workforce as reasonably required by the client subject to payment for such staff at pre-agreed rates
- Provide access to any information and records in connection with any litigation to which the client is a party

The post-termination period does need to be specified, as the former supplier should not be expected to perform such services indefinitely. Depending upon what the parties agree, post-termination assistance may be provided at no additional cost to the client; but there may be additional fees (typically an hourly rate) that must be agreed upon up front, or the client runs the risk of being charged far above normal market rates.

DEED OF DISENGAGEMENT

Fortunate clients that had not included the desired disengagement provisions within the current contract can still "bolt" them onto the deal through a separate deed of disengagement. However, it is entirely up to the supplier to agree to such a deed. The most successful approach has been before the client seeks other suppliers, and most certainly before the client announces its intentions to not continue with the incumbent supplier.

REFERENCE

1. Cullen, S., P.B. Seddon, and L.P. Willcocks. *IT Outsourcing Practices in Australia*. Deloitte Touche Tohmatsu, 2001.

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