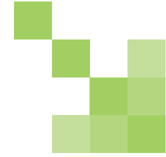
UK (England and Wales)



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GENERAL

1. To what extent does national law specifically regulate outsourcing transactions?

National law does not specifically regulate outsourcing transactions.

2. What additional regulations may be relevant on:

- **A financial services outsourcing?**
- **A business process outsourcing?**
- **An IT outsourcing?**
- **A telecommunications outsourcing?**
- **A public sector outsourcing?**
- **Other outsourcings?**

Financial services

The Financial Services and Markets Act 2000 (FSMA) is the main piece of legislation regulating financial services. The Financial Services Authority (FSA) is the statutory regulator under the FSMA and issues rules and guidance.

An FSA-regulated firm cannot delegate or contract out of its regulatory obligations when outsourcing. It must give advance notice to the FSA of any proposal to enter into a material outsourcing arrangement and of any material changes to such arrangements.

Specific FSA rules on outsourcing are found in Chapter 8 of the Senior Management Arrangements, Systems and Controls sourcebook (SYSC 8). They implement the outsourcing requirements of Directive 2004/39/EC on markets in financial instruments (MiFID). They apply to common platform firms (broadly, firms within the scope of MiFID and/or Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions). However, from 1 April 2009 all firms which are not common platform firms (other than insurers, Lloyd's and underwriters on Lloyd's) must take account of the SYSC 8 rules as if they were guidance.

Central to the rules are specific requirements in relation to outsourcing of critical or important functions. A function is deemed to be critical or important if a defect or failure in its performance would materially impair the firm's:

- Financial performance.
- Ability to comply with its regulatory obligations or provide services.

FSA guidance also provides that, when outsourcing functions that are not critical or important, firms should nevertheless take the SYSC 8 rules into account in a manner proportionate to the nature, scale and complexity of the outsourcing.

SYSC 8 rules impose requirements on, among other things:

- The due diligence to be undertaken in relation to a proposed supplier.
- The outsourcing contract's terms.
- The basis on which the FSA-regulated firm should supervise the outsourced functions and manage the risk of the outsourcing.

There are additional requirements for firms that outsource portfolio management for retail clients to a supplier in a non-EEA state.

Therefore, for an FSA-regulated firm, some of the issues discussed elsewhere in this chapter (for example, service levels (*see Questions 16 and 17*) and contractual terms (*see Questions 20 to 21 and 26 to 30*)) will be subject to a regulatory overlay, and the FSA-regulated firm will have to consider the impact of FSA rules and guidance.

Business process

There are no additional regulations that are relevant to a business process outsourcing.

IT

There are no additional regulations that are relevant to an IT outsourcing.

Telecommunications

There are no additional regulations that are relevant to a telecommunications outsourcing.

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Public sector

Depending on the nature of the contract and its value, a public-sector outsourcing may be subject to UK regulations that implement EC public procurement directives. If so, the awarding authority may be required to:

- Advertise the contract in the *Official Journal* of the EU and follow special procedures.
- Ensure that all bidders are treated equally.

The EU public procurement rules are likely to have a significant impact on the:

- Timing of the pre-contract procedure.
- Award criteria adopted.
- Duration of the outsourcing contract (*see Question 23*).

Even where an outsourcing by a public body falls outside public procurement legislation, the awarding authority should still generally seek to comply with the spirit of the legislation (*OJ C179/2, 1 August 2006*).

In addition, UK private finance initiative (PFI) legislation applies to certain public sector outsourcing arrangements.

Other laws and guidance may also be relevant, such as the:

- Treasury Decision Map Guidance for Procurement.
- Detailed guidance published by the Office of Government Commerce.
- Local Government Acts 1999 and 2000.
- Freedom of Information Act 2000.
- Human Rights Act 1998.

Other

Any prospective supplier or customer should always ensure that a proposed outsourcing is not subject to additional regulatory requirements in other sectors.

LEGAL STRUCTURES

3. In relation to the legal structures commonly used on an outsourcing, please describe how each structure works, and its potential advantages and disadvantages.

Direct outsourcing

The simplest structure is a direct outsourcing, that is, an outsourcing contract between the customer and the supplier. This can comprise one or more separate contracts, dealing with core issues (for example, price and duration) with detailed schedules that set out:

- The staff and assets transferred.
- The services provided.
- Service levels.
- The consequences of failing to meet service levels.

If the proposed supplier is not the main trading entity within its group or does not have sufficient assets to meet its potential contractual liabilities, the customer may require a parent company guarantee.

The structure is more complex if the customer procures services on behalf of itself and its group companies. Generally, the customer either:

- Enters into the outsourcing agreement as agent on behalf of its group companies.
- Includes a third-party rights clause to ensure its group companies have directly enforceable rights under the contract.

A supplier should consider including specific contract provisions that control multiple actions by the customer and its group companies, and ensure that its liability limitations and exclusions apply to each and all of them.

If the supplier intends to use subcontractors, the customer may require:

- That the supplier notify it of the choice of subcontractor.
- That the supplier remain liable for its subcontractors' acts and omissions.
- A right to veto particular subcontractors.
- A right, if the supplier suffers a certain level of financial distress, to:
  - pay subcontractors directly; or
  - insist on key subcontractors being assigned to the customer.

Multi-sourcing

The customer enters into contracts with different suppliers for separate elements of its requirements. The issues are generally similar to those experienced in a direct outsourcing (*see above, Direct outsourcing*), but in addition, the customer must ensure interfaces between the different suppliers are carefully managed, to encourage the seamless provision of an overall service.

Indirect outsourcing

This is similar to a direct outsourcing (*see above, Direct outsourcing*), except that the customer appoints a supplier that immediately subcontracts to a different supplier. Often, the second supplier is located outside the UK, and the first supplier is UK-based. The structure shares similar advantages and disadvantages to direct outsourcing, but it is harder for the customer to enforce its rights against the overseas supplier. The resulting level of management and risk sharing may erode some of the potential cost savings.

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Joint venture or partnership

The customer and the supplier set up a joint venture company, partnership or contractual joint venture, perhaps operating in an offshore jurisdiction. Advantages of this structure include that the:

- Customer has a greater degree of control than in other models.
- Customer benefits from the supplier's knowledge and credibility.
- Customer shares in profits generated by third party business that the joint venture conducts.
- Structure is easier than others to transfer to a new supplier or take back in-house on termination.

However, the joint venture structure is complicated and expensive to set up and maintain.

Captive entity

The customer outsources its processes to a wholly owned subsidiary, taking advice from local suppliers on a consultancy basis. This gives the customer direct operational control and may have tax benefits in appropriate jurisdictions. However, there will be significant up-front set-up costs, and risk cannot pass to a third party supplier.

Build operate transfer

The customer contracts with a third party supplier (perhaps overseas) to build and operate a facility. The supplier then transfers the facility to the customer. This is a relatively low-risk model but can be expensive. The customer may ask the supplier to operate the facility in the longer term.

PROCUREMENT

4. Please briefly describe the procurement process that is usually used to select a supplier of outsourced services (including due diligence and negotiation).

The process is typically as follows:

- The customer (and/or its advisers) draws up a specification of the business to be outsourced and identifies potential suppliers. This usually involves the customer conducting due diligence on the function to be outsourced (and any relevant IT), which gives it a clear idea of its requirements, and reduces the potential for having to widen the scope during the tender exercise. It may also conduct some degree of due diligence on potential suppliers (for example, their probity and financial strength, and a review of reference sites).
- A customer may send a request for information (RFI) to potential suppliers. This usually briefly outlines the areas the customer is considering outsourcing and asks questions relating to the supplier's capabilities and competence. The customer may send out an invitation to tender (ITT) in addition or as an alternative, and invite responses. The customer should include in the ITT:
  - all information that it considers the supplier needs to make a bid;
  - a clear and detailed statement of the service requirements; and
  - preferably, a draft contract on which it invites the supplier to comment.
- The customer assesses the responses and shortlists a small number of possible suppliers. The customer should establish its evaluation criteria at an early point. The supplier's capacity and ability are likely to be assessed at this stage.
- After shortlisting, more detailed negotiations begin. The potential supplier(s) generally carry out some degree of due diligence. Work streams are established to conduct commercial, technical and legal negotiation. It is important that these work streams are closely co-ordinated.
- The customer may conduct negotiations with:
  - several short-listed parties (this is complex and costly); or
  - one preferred bidder (which risks loss of competitive tension in negotiation).

Either party may carry out further due diligence after contract signature as part of the contract process to establish a baseline against which service provision can be measured.

TRANSFERRING OR LEASING ASSETS

5. What formalities are required to transfer the following assets on an outsourcing:

- **Immovable property?**
- **IP rights and licences?**
- **Movable property?**
- **Key contracts?**

While the supplier will generally need to use relevant customer assets, this can be achieved by granting a right to use the asset (whether on a shared or exclusive basis) rather than outright transfer. Retaining title to the asset, licence or contract can give the customer greater protection on the eventual termination of the outsourcing contract.

Immovable property

Transfer of title to immovable property must be in writing and, in many cases (depending on the nature of the title involved), will require registration. Where the asset is a lease or licence, the consent of the landlord or licensor may be required.

IP rights and licences

A transfer of IP rights generally must be in writing and may require registration of the transfer, depending on the rights involved.

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The transfer of IP licences should be by written assignment and may, in addition, require the licensor's consent (where the licence is expressed as personal or there is an express restriction on assignment). Particular attention is needed where the licence is held in the name of another group company. Where this is the case, approval should be obtained at an early stage.

Movable property

A written assignment is usually sufficient to transfer movable property for evidential purposes. Where assets are leased, the transfer may require the counterparty's consent.

Key contracts

The assignment of key contracts must be effected in writing. Any contract to be transferred should be identified at an early stage and its terms reviewed, to identify whether assignment is possible without the counterparty's express consent. Alternatively, if the terms of the contract permit, the customer can retain ownership of the contract and allow the supplier to supply the services to the counterparty as agent of the customer on a "back-to-back" basis.

As with the transfer of any contract or licence, consideration should be given as to whether the burden of the contract should also transfer to the supplier, either by:

- Novation.
- Express indemnity (which leaves some residual risk with the transferor).

6. What formalities are required to lease or license the following assets on an outsourcing:

- **Immovable property?**
- **IP rights and licences?**
- **Movable property?**
- **Key contracts?**

Immovable property

As with outright transfer, written documents are required and the need for the landlord's consent should be considered (*see Question 5, Immovable property*).

IP rights and licences

A written agreement should be entered into as a matter of good practice to record the terms agreed in relation to the grant of a licence to use IP rights. For the leasing or licensing of existing licences, see below, *Key contracts.*

Movable property

A written lease should be entered into as a matter of good practice to record the terms agreed.

Key contracts

The concept of a contract being leased or licensed is not generally recognised under English law. In practice:

- Rights under a contract can be assigned (subject to consent where necessary).
- Rights and liabilities can be novated.
- A third party can exercise rights or perform obligations as an agent or subcontractor of the contracting party.

Therefore, good practice dictates that the customer:

- Make a written contract that clearly categorises the basis on which it is leasing the contract to the supplier.
- Consider the need for counterparty consent.

TRANSFERRING EMPLOYEES

7. In what circumstances (if any) are employees transferred by operation of law:

- **To an incoming supplier on an initial outsourcing?**
- **To an incoming supplier on a change of supplier?**
- **Back to the customer on termination of an outsourcing?**

Initial outsourcing

If the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) apply, the customer's employees who work on the service being outsourced automatically transfer to the supplier. The employees have a right to opt out of TUPE and resign from their employment without any compensation instead of transferring. However, employees rarely exercise this right.

TUPE applies to almost all initial outsourcing exercises, even where the supplier intends to carry out activity in a different way from the customer.

Parties cannot contract out of TUPE, but they can agree to apportion the financial consequences of its effects.

If TUPE does not apply, employees do not automatically transfer, but can accept employment with the transferee on a non-TUPE basis (if the transferee chooses to offer it).

Change of supplier

TUPE applies to a change of supplier. Therefore, subject to the opt-out (*see above, Initial outsourcing*), the employees working on the outsourced service transfer from the existing supplier to the new supplier.

Termination

TUPE also applies where the outsourcing terminates and the customer brings the services back in-house. The supplier's employ-

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ees transfer to the customer. In this situation, the customer may take on more employees than it originally transferred (subject to the opt-out (*see above, Initial outsourcing*)).

8. Please describe the terms on which employees would transfer by law, including any effect on pensions, employee benefits or other matters (including collective agreements) that the transfer may have.

General terms

Under TUPE, employees transfer on all their existing terms of employment, although special rules apply to occupational pension schemes (*see below, Pensions*). Any employment liabilities (for example, arrears of pay and discrimination claims) also transfer.

Pensions

The treatment of pensions on a TUPE transfer depends on whether the transferor operated an occupational pension scheme, or paid contributions into personal pension schemes on behalf of employees:

- Old age, survivors' or disability benefits under an occupational pension scheme do not transfer, but all other benefits do. For example, an employee's entitlement to a pension at normal retirement age (which is an old age benefit) does not transfer, but a right to take early retirement on redundancy (which is not an old age benefit) does. (Regardless of which rights under an occupational pension scheme transfer, the transferee has a separate obligation to provide pension arrangements for the transferred employees. These do not have to be equivalent to the transferor's scheme, but must meet certain minimum standards.)
- Where the transferor made contributions to employees' personal pension schemes, or to a group personal pension, this obligation transfers.

Employee benefits

All contractual benefits transfer under TUPE (for example, holiday, car allowance, medical insurance).

Difficulties arise where the transferred employees belonged to a share or share option scheme operated by the transferor, which the transferee cannot replicate. In that situation, the transferee usually takes on a modified obligation, for example, providing a profit-sharing scheme.

Other matters

Collective agreements transfer under TUPE. The transferee is usually able to terminate the agreement (but this may give rise to adverse employee and trade union relations issues).

9. What information must the transferor or the transferee provide to the other party in relation to any employees?

The transferor must provide the transferee with the following information on the transferred employees:

- Their identity and age.
- Certain particulars of employment (including notice, holiday, pay, hours, job title and place of work).
- Details of any disciplinary or grievance procedure involving the employee in the last two years.
- Details of any legal claim brought by the employee in the last two years or which the outgoing employer believes the employee may bring.
- Details of any collective agreements.

The transferor must provide this information at least 14 days before the transfer, and keep it up to date.

10. What information and consultation obligations arise for the transferor and the transferee in relation to employees or employees' representatives?

The transferor must inform any recognised trade union or, if there is none, elected employee representatives of "affected employees", about the transfer and consult with them on any proposed measures, for example, redundancies, or changes to terms and conditions or working practices.

"Affected employees" means both:

- Employees that transfer.
- Employees that remain with the transferor and are affected by measures taken in connection with the transfer.

After the transfer, if the transferee proposes measures that will affect the transferred employees, it must:

- Notify the transferor of the measures.
- Consult with transferred employees and any of its own employees affected by the measures.

The transferor should preferably begin this consultation before signing the outsourcing agreement. However, unless it wishes to implement measures such as redundancies, it is generally acceptable to wait until conclusion of the contract. In this case, it should not suggest in its internal statements that it has made decisions in relation to any measures. It should, where possible, refer to "proposals" and state that matters are "subject to consultation". Where there is no trade union or existing worker representative group, the timetable must allow for the election of employee representatives.

The penalty for failure to inform and consult is up to 13 weeks' pay per employee. The transferee is jointly and severally liable for any failure to inform or consult.

Where there are proposals to make 20 or more employees redundant within 90 days of the transfer, the employer making these redundancies must also consult with trade union or employee representatives under section 188 of the Trade Union and Labour Relations (Consolidation) Act 1992, at least 30 or 90 days before the first dismissal (depending on the number of dismissals).

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Redundancies must often be implemented immediately after transfer, which can cause practical difficulties. Strictly, the transferee should implement the dismissals, and therefore conduct the consultation. In practice, the transferor often carries out the pre-transfer consultation, supported by the transferee.

Additional consultation obligations apply if the transferee or transferor has a National or European Works Council.

11. To what extent can a transferee harmonise terms and conditions of transferring employees with those of its existing workforce?

Under TUPE, any change to employees' terms and conditions for a reason connected with the transfer is void (even if the employees agree to the change) unless it is an "economic, technical or organisational reason entailing changes in the workforce" (ETO reason). Examples of ETO reasons include:

- Redundancy.
- A reorganisation involving changes in the roles of some or all of the employees.

A change to terms and conditions purely to harmonise with those of the transferee's existing workforce is not an ETO reason, and is therefore void. However, if the changes are beneficial, employees are unlikely to challenge them.

12. To what extent can dismissals be implemented before or after the outsourcing?

Dismissals can be implemented before or after the outsourcing, but any dismissal for a reason connected with a TUPE transfer is automatically unfair, unless it is for an ETO reason (*see Question 11*). Employees with at least one year's service can claim unfair dismissal.

Liability for any pre-transfer dismissals by the transferor passes to the transferee under TUPE, unless the dismissal was for an ETO reason.

13. In what circumstances (if any) is it possible for the parties to structure the employee arrangements of an outsourcing as a secondment?

It is sometimes possible to structure the arrangements as a secondment, perhaps on a short-term basis or for senior employees, but there always remains a risk that TUPE will apply. It is usually preferable to assume that TUPE applies, and provide for this in the outsourcing agreement.

DATA PROTECTION

14. What data protection issues may potentially arise on an outsourcing and how are they typically dealt with in the contract documentation?

Under the Data Protection Act 1998 (DPA), which implements Directive 95/46/EC on data protection, issues can arise in relation to:

- Transferring and processing employees' personal data.
- Ensuring that the supplier acts in all other respects purely as a data processor, for example, that it applies sufficient security to other personal data and uses it only for the purposes that the customer permits (*Seventh Data Protection Principle (DPA) (Seventh Principle)*).

The contract documentation generally deals with both matters, usually by including an undertaking by the parties to comply with the terms of the DPA. The wording also usually reflects the text of the Seventh Principle, in relation to the supplier's obligations as data processor.

Where data is to be exported for processing outside the EEA, issues arise under the Eighth Data Protection Principle (*DPA*) and the parties may need to put in place additional measures to ensure that the export is permitted, such as contracts incorporating model terms approved by the European Commission.

The DPA also contains pre-contract obligations (for example, regarding how due diligence on the supplier and transferring employees is carried out). Employees can use an alleged DPA infringement to try to delay or frustrate an outsourcing negotiation.

SERVICES

15. How is the services specification typically drawn up and by whom?

The parties usually draft the services specification together, although the supplier often takes the lead, based on its previous experience of similar projects.

Where the parties agree to develop a detailed specification as part of the services after contract signature, the agreement may attach the customer's requirements as a separate schedule. Usually in these circumstances:

- There is an obligation on the supplier to ensure that the service description or specification is developed to reflect the customer's requirements.
- The customer's requirements are stated to take precedence over the service description.

16. How are the service levels and the service credits scheme typically dealt with in the contract documentation?

The parties usually identify and agree a set of objective measurable criteria to measure performance (key performance indicators (KPIs) or service levels). These could be that deliveries of products in a logistics contract will be made within specific time periods or that telephone calls to a call centre will be answered within a defined period. These service levels are combined with a:

Country Q&A

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- Process for recording and reporting on success or failure in achieving the targets.
- Formula under which financial compensation is paid to the customer if targets are not met (for example, variance from the required level of performance by a specified percentage). These are referred to as service credits or liquidated damages.

The service levels and service credits can form part of the services specification or are laid out in a separate schedule to the main agreement (service level agreement (SLA)).

Generally, the service credits are offset against the fees otherwise payable to the supplier and are usually relatively modest. The aim is to compensate the customer for poor service without the need to pursue a claim for damages or terminate the agreement, and to motivate the supplier to meet the performance targets.

The service credits should be expressed to be the sole remedy of the customer for the particular failure concerned, but this should be without prejudice to the customer's wider rights in relation to more serious breaches of the agreement or persistent failures in performance, both of which should also be dealt with (*see Question 26*). Service credits are generally enforceable provided that they are a genuine pre-estimate of the customer's loss rather than a contractual penalty.

Establishing a baseline against which the service credits will be measured can form part of a due diligence exercise which precedes or follows contract signature.

CHARGING

17. Please describe the charging methods that are commonly used on an outsourcing (for example, risk or reward, fixed price, cost or cost plus, pay as you go, resourced-based charges, use of minimum charges and so on).

The parties will adopt different approaches to charging depending on, among other things:

- The type of services being provided.
- Whether the supplier is appointed on an exclusive basis.
- Risk allocation between the parties.

A typical outsourcing contract adopts one, or a combination, of cost plus, fixed price and pay as you go.

Cost plus

The customer pays the supplier both:

- The actual cost of providing the services.
- An agreed profit margin.

There are usually additional provisions to ensure that:

- Costs are assessed on an agreed and transparent basis, which the customer can review (open book).
- Indirect costs (such as overheads, or the cost of investment in new assets, amortised over a specified period) are included on an agreed basis.

In addition, the customer usually includes measures to control costs, such as:

- An external third party review to establish typical market prices (benchmarking).
- A pre-agreed inflation adjuster to regulate price increases or decreases (indexation).
- Measures to share cost savings between the parties and provide an incentive to the supplier to achieve these.
- A mechanism to assess and agree the cost impact of changes in the scope or level of services (charge variation mechanisms).
- A mechanism for agreeing annual budgets, which must then be adhered to, subject to permitted variances.

Fixed price

A fixed price is often used where there will be a regular and predictable volume and scope of services (for example, payroll) and the customer wants certainty for budgeting purposes.

Pay as you go

The customer pays a pre-agreed unit price for specific items of service (such as volumes of data processed or deliveries made). The supplier may want to add a minimum fee. It is often used where the level and volume of services is less predictable.

Particular consideration may be needed as to how (if at all) the supplier will be allowed to recover implementation costs (for example, as a specific item of charge, linked to the achievement of measurable milestones or targets, or in an agreed manner over the life of the agreement).

18. Please briefly describe any other key terms used in relation to costs, such as charge variation mechanisms and indexation.

The principal terms used in relation to costs are:

- Charge variation mechanisms.
- Indexation.
- Benchmarking.
- KPIs.

(*See Questions 16 and 17.*)

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CUSTOMER ISSUES

19. If the supplier fails to perform its obligations, what relief is available to the customer under general law?

The customer has a number of remedies, including:

- Damages.
- Specific performance (available at the discretion of the court).
- Termination.

20. What customer protections are typically included in the contract documentation to supplement relief available under general law?

Customer protections typically include:

- A detailed measurement of service performance (often by reference to KPIs (*see Question 16*)) and reporting of actual and foreseeable problems, usually combined with audit rights.
- Service credits or similar (*see Question 16*).
- Indemnity from the supplier for loss suffered by the customer in specified circumstances.
- Other forms of financial penalty, such as loss of exclusivity or a reduction in the minimum price payable to the supplier.
- Step-in rights.
- Specific provision for termination in defined circumstances (for example, material breach and insolvency) (see *Question 26*).
- A requirement for the supplier to hold insurance (for example, for damage to persons or property) and note the customer's interest on its insurance policy.
- A parent company guarantee (*see Question 3*).
- Warranties (*see Question 21*).
- An appropriate governance or escalation structure under which each party appoints specified relationship managers to manage problem areas and to escalate them to higher levels if solutions cannot be easily found.

WARRANTIES AND INDEMNITIES

21. What warranties and/or indemnities are typically included in the contract documentation?

Typical supplier obligations are to:

- Confirm that it is entitled to enter into the agreement and perform its obligations.
- Perform the services with reasonable skill and care, in a timely and professional manner and in accordance with all applicable laws and negotiations.
- Indemnify the customer against harm suffered due to the supplier's actions. This may be limited to harm suffered due to default (for example, wilful misconduct, negligence or breach of contract) or may extend to situations where the supplier's liability is not based solely on fault (for example, if performance of the services infringes third party IP rights).
- Indemnify the customer against future liability in respect of employees transferred to the supplier as part of the outsourcing.
- Confirm that material information provided in the pre-tender and tender stages was and remains accurate, complete and not misleading (for example, that the statements made about its services or its financial resources are true).
- Make other assurances specifically related to the project or type of services (for example, that the supplier has particular accreditations or operates in accordance with a particular quality assurance system). Many of these can be covered by specific contract terms (for example, in the SLA) instead of in the warranties section.

Typical customer obligations are to:

- Confirm that it is entitled to enter into the agreement and perform its obligations.
- Confirm that the information provided during the pre-tender and tender stages is accurate, complete and not misleading.
- Make assurances as to title, condition and maintenance of assets transferred to the supplier, including the absence of outstanding liabilities under contracts transferred (although there may be negotiation over exactly how the customer will transfer these).
- Indemnify the supplier against historic liability in respect of employees transferred to the supplier as part of the outsourcing.

22. What limitations are imposed by national law on fitness for purpose and quality of service warranties?

English law implies contractual terms that goods are fit for purpose and of satisfactory quality and that services will be performed with reasonable skill and care.

The agreement often specifically excludes these terms and replaces them with specific wording, with the intention that the agreement set out all relevant obligations. In relation to limits on the right to exclude these terms, see *Question 29*.

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TERM AND NOTICE PERIOD

23. Does national law impose any maximum or minimum term on an outsourcing? If so, can the parties vary this by agreement?

Generally, English law does not impose any maximum or minimum term on outsourcing. The duration of the arrangement is left to negotiation between the parties. An outsourcing arrangement is typically for a fixed term of between three and ten years (although there may be provision for automatic renewal on a rolling annual basis if a party does not give notice of termination, and assuming inclusion of a mechanism for reviewing charges).

In public procurement processes (*see Question 2, Public sector* and *Question 4*), the contract term is affected by the initial tender statements in the *Official Journal* and can only be extended in accordance with the public procurement rules. If the arrangement is a framework agreement (that is, an agreement under which specific purchases can be made throughout the term of the agreement), the maximum duration is four years (except in exceptional circumstances). Local authorities are required to carry out best value reviews every five years.

In certain circumstances, long-term supply agreements that include exclusive or minimum purchase and supply obligations can infringe EC or UK competition law. For certain vertical agreements, Regulation (EC) No. 2790/99 on the application of Article 81(3) of the EC Treaty to categories of vertical agreements and concerted practices provides a safe harbour, but this does not apply to exclusive purchasing obligations, and certain minimum purchasing obligations, if that obligation is for a term that exceeds five years.

24. Does national law regulate the length of notice period required (maximum or minimum)? If so, can the parties vary this by agreement?

English law does not regulate the notice period required to terminate an outsourcing agreement. This is left to the parties to specify in the agreement. The length of notice can vary according to the grounds for termination. In the case of a material breach or insolvency, a short notice period is likely to be the only practical solution, although it is subject to a cure period for breaches of contract.

Generally, the nature of an outsourcing arrangement means that an extended notice period is often desirable for the customer to make alternative arrangements. Mechanisms should be included in the agreement that oblige the supplier to:

- Continue to perform services during the notice period.
- Co-operate with the transfer to a replacement supplier (or to bring the services back in-house).

TERMINATION AND TERMINATION CONSEQUENCES

25. What events are considered sufficient under national law to justify termination of an outsourcing rather than a claim in damages (for example, fundamental breach, repudiatory breach, insolvency events and so on)?

The following events are generally considered sufficiently serious to justify immediate termination:

- A particularly severe breach.
- A breach that indicates that the counterparty no longer wishes to continue with the agreement.
- The other party's insolvency, so that it is unable to perform its duties under the agreement.

However, parties typically specifically provide termination events in the agreement (*see Question 26*).

26. In what circumstances can the parties exclude or agree additional termination rights (for example, for breach, change of control, convenience and so on)?

The parties are free to agree specific termination rights, which can block or extend rights implied by general law, for example, termination for:

- Breach of the agreement. Typically, the breach must be material and it is usual to include a cure period in which the injured party gives written notice of the breach and allows the counterparty a reasonable period to remedy it (often 60 days or more).
- Minor but persistent breaches (with the type of breach and number of breaches needed to trigger the termination right defined in the agreement).
- Insolvency (with the definition of insolvency set out in the agreement).
- Change of control (ultimate ownership) of the supplier.
- Termination for convenience by the customer on notice. This allows the customer to switch suppliers without having to give a reason (for example, if it is generally dissatisfied but unable to demonstrate any clear breach). This is usually an expensive option since the supplier often requires compensation for early termination.

27. What implied rights are there for the supplier to continue to use licensed IP rights post-termination? To what extent can these be excluded or included by contract?

Where the customer licenses IP rights to the supplier in connection with the outsourcing, the licence terms generally govern the continued use of those rights by the supplier post-termina-

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tion (either in the main agreement or a separate document). The customer is usually reluctant to agree a continuation unless it receives some benefit.

Where there is no specific agreement and a licence has been implied, it is generally implied that the licence ends post-termination. The parties can (and should) make specific provision to regulate how far either will remain entitled to use the other's IP rights post-termination.

28. To what extent can the customer gain access to the supplier's know-how post-termination and what use can it make of it?

To the extent that specific IP rights cover the supplier's know-how, see *Question 27*.

Where the know-how is in the supplier's confidential information, the customer usually expressly undertakes to maintain the information in confidence and use it only in connection with the agreement. However, to the extent that the know-how is the skill and experience of employees engaged in performing the services, and the employees transfer to a new supplier (or back to the customer) under TUPE (*see Question 7*), the customer can benefit from such skills, except for specific confidential information.

Where the supplier develops know-how (or IP rights) during the term of the agreement for use in the performance of the services, or otherwise embeds its IP into the assets and systems of the customer, the customer usually requires a written licence to continue using the know-how or IP.

LIABILITY

29. What liability can be excluded? In particular, is it possible for the supplier to exclude liability for indirect and consequential loss and also any loss of business, profit or revenue?

The parties are generally free to exclude most forms of liability, subject to a number of important provisions outlined below:

- An exclusion of liability for fraud is unenforceable and should be carved out from any general exclusion of liability.
- Exclusions or restrictions of liability for misrepresentation must satisfy the requirement of reasonableness in the Unfair Contract Terms Act 1977 (UCTA).
- Under UCTA, it is not possible to exclude or restrict liability for death or personal injury resulting from negligence. In the case of other loss or damage, the exclusion or restriction of liability for negligence must satisfy UCTA's reasonableness requirement.
- If the parties are dealing on written standard terms of business, any exclusion or restriction of liability must satisfy UCTA's reasonableness requirement. However, in an outsourcing agreement, there is likely to be considerable debate as to whether a liability provision (which will usually have been negotiated) is part of the written standard terms.
- Implied terms as to title to assets cannot be excluded or restricted, while those relating to satisfactory quality, fitness for purpose and certain other matters can only be restricted where this meets UCTA's reasonableness requirement.

Subject to the above, a supplier (and usually the customer) will aim to exclude liability for:

- Indirect and consequential loss.
- Loss of business, profit or revenue, where these constitute a direct loss.

In contrast, the customer will usually try to ensure that it is able, under the agreement, to recover all its direct loss (including direct loss of profit, business and revenue). It may also specify particular heads of loss that are recoverable to put beyond doubt that these are agreed to constitute direct loss. In practice, these will be subject to negotiation.

30. Are the parties free to agree a cap on liability? If so, how is this usually fixed?

The parties can agree a financial limit on liability, subject to the limitations set out in *Question 29*. This may be a fixed amount, or a percentage or multiple of the contract value (for example, 125%).

The extent to which this formula will be held reasonable under UCTA (in cases where it is required to be reasonable) is uncertain. Current practice suggests that a percentage is better than a fixed sum, and that anything under 100% of the contract value may be held to be unreasonable, where the liability covered is significant. When using this approach, it is important to:

- Define contract value.
- Identify any areas where the liability should not be subject to a cap (for example, the supplier's indemnity in relation to IP rights and/or TUPE is often unlimited).

The supplier should take care that the drafting of the cap does not restrict its right to recover for non-payment of charges that are properly due to it from the customer.

TAX

31. What are the main tax issues that arise on an outsourcing in relation to:

- **Transfers of assets to the supplier?**
- **Transfers of employees to the supplier?**
- **Value added tax (VAT) or the equivalent sales tax on the service being supplied?**
- **Other significant tax issues?**

Transfers of assets to the supplier

Where the customer transfers assets to the supplier, there is an actual or deemed sale. The actual price or deemed market value

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(as appropriate) is treated as disposal proceeds for tax purposes and so may give rise to either a profit (on which tax is due) or a loss (which can be relievable against other tax charges of the customer). In practice, this is not usually a significant concern in outsourcings as typically very few assets of value are transferred. Since the outsourced business will generally have been run as a cost centre within the customer's business, it cannot typically be argued to have any goodwill associated with it. Moreover, assets transferred are often IT equipment or similar, which has minimal second-hand value.

The question also arises of whether the customer is required to charge VAT on the transfer of the assets. In some circumstances, the customer can argue that it is transferring part of its business as a going concern, and VAT need not be charged. However, even when VAT is chargeable, it is not usually a significant issue, as any price for the assets is often nil or minimal.

Stamp taxes can arise on:

- Transfers of real property at a rate of up to 4%.
- Transfers of UK shares in companies at a rate of 0.5% (although this is rarely relevant to an outsourcing).

Transfers of employees to the supplier

From the date of the transfer, the supplier becomes responsible for the calculation and payment of:

- PAYE income tax.
- National insurance.

Exceptions apply where the:

- Supplier makes payments to the customer's employees before the business is transferred to it.
- Customer makes payments to the employees that the supplier acquires after the business has been transferred.

VAT or sales tax

In most cases, the supplier must charge VAT to the customer on its fees for the outsourced services (because of the nature of the services).

Where the customer's business is fully taxable for VAT purposes, the customer can recover VAT in full. However, where the customer's business is not fully taxable, the outsourcing may give rise to a real additional tax cost (because by using a third party, irrecoverable VAT arises). This has become a significant issue in the financial services sector.

Other

There are no other significant tax issues on an outsourcing.

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