SUPPLIER PERSPECTIVES:

STRATEGIES FOR A CHANGING WORLD

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COUNSELING SUPPLIERS: NEGOTIATE TO WIN

In a changing, intensely competitive marketplace, how should lawyers for suppliers serve their clients? This paper offers some suggestions from observation and experience. Some are general and even strategic; others are tactical and specific; some concern the effects and implications of the worldwide coronavirus pandemic.[1]

1 COUNSEL'S ROLE

Counsel for suppliers have the same professional obligations as other lawyers. As negotiators, lawyers seek results advantageous to their clients, consistent with requirements of honest dealing.[2] They act as counsellors (in private) and as advocates, facilitators and scribes during negotiations. Occasionally, they serve as lightning rods, asking inconvenient but necessary questions or taking firm positions that may make others present (sales executives especially) a trifle uneasy. During changing times and such emergencies such as the pandemic, they help clients to adapt.

Fundamentally, counsel for suppliers do three things:

- Help to set the right tone in negotiations by listening to customers' goals with sympathetic understanding, respecting their interests and building cordial, constructive relationships with everyone across the table. As always, the most important audience is the other lawyer's client and, in particular, the customer's business leaders and decision-makers.

- Help their clients to win good business on acceptable terms. What is 'good business'? Engagements that the client can

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[1] The views expressed, though rooted in experience, are not necessarily those of the author's firm or any of the supplier clients he has had the privilege and pleasure of representing over the years. The article is intended for professional education, rather than as legal advice. Suggested positions on issues discussed may vary for a variety of legal and other reasons, depending upon the client, transaction, applicable law and other circumstances.

[2] ABA Model Rules of Professional Conduct, Preamble [2].

deliver successfully and profitably, with reasonable prospects for growth in scale and scope, as well as favorable references.

- Support their clients' management when issues arise after signing, including operational and other difficulties in the normal course of business and such unexpected, unprecedented events as the coronavirus pandemic.

As counsellors to management, counsel help to assure good decisions, balancing opportunities and risks and acting prudently to contain risks through contract terms and mitigate risks in plans for transition and service delivery. Counsel who see all of the documents are well situated to offer overall perspective both to management and more narrowly focused business specialists. Lawyers are not financial analysts or subject matter experts in operational disciplines, but experience has a way of teaching what may go wrong, as well as the wisdom in Murphy's Law that what can go wrong will go wrong. Good counsel possess market knowledge and, if they are either inside counsel or regular outside counsel, may be repositories of institutional memory – of wins, losses, deals gone wrong, and experience with particular intermediaries. Experience also helps to distinguish the authentic voice of the potential customer from "deal noise" generated by their advisors and counsel. What is in their advisors' forms or carried forward from other deals may not necessarily match the situation or the potential customer's actual needs.

2 MARKET REALITIES

Good business lawyers must understand the clients they serve, their business, its risks and the markets in which they compete.

Competition – fierce competition – is a constant. Suppliers regard their competitors with a mixture of wariness, respect and fear. Most suppliers' teams include at least some alumni of their principal competitors. Established onshore companies fret about nimble, aggressive offshore competitors who have built market share at their expense. Offshore companies have wary respect for long-time industry leaders, their strengths and longstanding customer

relationships. In truth, all competitors have strengths and weaknesses.

Lawyers sometimes fret that the aroma of potential commissions may asphyxiate or intoxicate sales executives, leading to improvident concessions and, ultimately, uncertain or substandard margins and performance issues. Lawyers too easily forget that sales people live and die by commissions. Missing their numbers or losing a major contract may mean unemployment. (Few lawyers could live with such uncertainty.) They and their companies live or die according to their numbers, sales objectives, market guidance and growing backlogs and revenues. Contraction too easily becomes an almost irreversible spiral in businesses with large overheads that must spend heavily to chase new opportunities. The pressure to close new business is powerful, rests on serious grounds and often seems irresistible.

Competition and competitive bidding have tended to drive the market toward modest, commodity margins, unless suppliers differentiate themselves with novel or distinctive service offerings. Growing reliance on large-scale cloud technologies, often hosted by market leaders under subcontract to the customer's primary supplier, may reinforce these tendencies. However, few technology-enabled services are actual commodities, since they depend upon changing technologies, require skilled personnel and are offered in ever-changing combinations. True commodity services, such as laundry or catering, are stable, standard offerings furnished by more or less interchangeable suppliers using familiar methods.

Helping sales-led clients to make money and grow in these conditions is no easy thing; but effective, efficient counsel have never been more important.

As markets evolve, counsel must adapt. Reports of the mega-deal's demise are (like Mark Twain's death) exaggerated, but most of the action now involves smaller, more narrowly focused opportunities than were once common, with contract terms of three, five or perhaps seven years, plus options to renew for another year or two.

Only the largest organizations and opportunities will justify truly custom solutions, tailored for particular customers. Suppliers' solutions increasingly involve combinations of standard and often automated service elements. These may be cloud-based solutions, 'as a service' offerings, analytics or robotics; but they are standardized and offer customers efficiencies, savings and performance predicated on scale and automation. Increasingly, suppliers of outsourced services may begin to resemble carmakers who offer many models from a limited range of 'platforms,' engines, transmissions, subsystems and parts in order to offer customers both variety and economies of scale. Standard or package offerings are also offered independently, over the web, to anyone with a credit card willing to accept standard, non-negotiable terms.

The worldwide coronavirus pandemic seems not to have affected these long-term technical and competitive trends; but it has drawn attention to *force majeure* provisions, disaster recovery and related issues. Suppliers, like their customers, have responded to shelter-in-place orders, quarantines, travel restrictions and other emergency measures in a businesslike manner, working diligently to support their customers and maintain service. Many customers have received notice of *force majeure* conditions; but few have invoked termination rights or other drastic remedies, evidently because their suppliers continue to perform as well as conditions permit and there are, in any event, few (if any) alternatives at a time when outside suppliers and internal operations must cope with the same restrictions.

In the long run, after normality returns or a new normality arrives, experience with remote operations during the pandemic may make companies more willing than ever before to entrust critical operations to outside suppliers in remote locations. If, as seems likely, businesses increasingly shift toward remote work for reasons of convenience, efficiency and economy, suppliers' delivery models and solutions may also evolve.

We may also expect suppliers, customers, their advisors and counsel to take a fresh look at traditional terms and arrangements. *Force majeure*, excused performance and disaster recovery arrangements may change, based upon lessons learned from a worldwide

pandemic worse than any since the so-called (and mis-named) Spanish flu of 1918 – 1919. Traditional disaster recovery provisions and plans contemplated comparatively short-term, local emergencies — such as hurricanes, earthquakes or terror attacks — followed by temporary relocation of operations to alternate sites; not a worldwide emergency that has compelled countless millions of working people to work remotely and virtually for a year or more, without seeing colleagues or clients in the flesh, traveling or even commuting. Future planning is bound to draw upon this experience and include plans for prolonged remote operations in the event of a future pandemic.

3 METHODS, TOOLS AND PROCEDURES

For suppliers, consistency and efficiency matter. Legal budgets are tight. Bid and proposal dollars are scarce and must be allocated among numbers of potential opportunities. The pressure to do more with less is persistent and, at times, overwhelming. The market and the intermediaries who serve many customers must see consistency about contract terms and much else. Improvident concessions may otherwise become 'precedent' (at least in the eyes of some intermediaries). Consistency also matters to the supplier's own management in order to assure economies of scale, operational excellence, dependable margins and the company's position in and messages to the marketplace. The following kinds of tools and methods help suppliers to achieve these goals:

3.1 Policies, Playbooks, Forms and Guidelines

For lawyers and deal teams, there must be policies, 'playbooks' or other ground rules. These vary in their form, level of detail and underlying philosophy, even though most suppliers' positions on usual contentious issues are similar, as one would expect in a competitive market. Some playbooks resemble treatises or handbooks; others are elaborate charts; and some are now automated, at least an extent.

To what extent should such tools be comprehensive, rules-based and prescriptive rather than judgment-based? Prescriptive rules may help to assure better discipline and permit delegation to less

experienced lawyers and paraprofessionals. They also lend themselves to automation through software, which offers the advantages and hazards of fly-by-wire avionics. Alas, not all airmanship can be written into software. When pilots trained in simulators and dependent upon computers encounter unforeseen weather or turbulence, or systems misfire, the results may be disastrous. In somewhat the same way, no set of rules, however comprehensive and skillfully compiled, can foresee all combinations of risks, service offerings, contract terms and pricing. Choices and decisions require judgment. Terms that would be unacceptable for a novel solution may be acceptable when renewing existing contracts for proven solutions where delivery has been flawless, working relationships are excellent and actual operational risks are negligible. Comprehensive policies are useful, but ultimately, policies must be judgment-based in order to cope with kaleidoscopic variety and allow empowered negotiators expeditiously to craft agreements on acceptable, market-competitive terms. Few things create a worse impression during negotiations than perceptions that even minute variations from opening or "standard" positions must be cleared with headquarters.

Apart from policies and playbooks, other tools, training and guidance are useful, including:

- Standard forms for agreements and supporting documents, especially descriptions of standard services, service levels and pricing terms. These are more important than before, for at least two reasons. First, customers seem increasingly willing to work with suppliers' paper (especially when buying standard offerings) but even when (as on many large transactions) the customer reserves power of the pen, good forms are useful references and occasional sources for compromise language. Second, as business evolves toward standard solutions, or varying combinations of standard service elements, suppliers are well served by greater attention to well-crafted, reasonably balanced, modular forms for contracts, service descriptions, service levels and other supporting documents. Use of standard documents helps to assure consistency while reducing legal costs and saving time. Where services are automated and standard, documents can often be simplified and a surprising

number of conventional contract terms that made sense in a world of custom solutions and consumption-based charges may have to be revisited. Time taken to make these documents readable and congenial to customers (while still protecting the client) is time very well spent. When writing their own forms, suppliers may be tempted to write documents as lopsided as some they receive; but suppliers are better served by succinct, balanced documents written in plain English that sales people can explain, and sophisticated customers should be willing to accept essentially as written, because they offer what customers are entitled to expect.

- Standard markups for forms used by leading intermediaries. Major law firms advising customers tend to use the same forms (with variations) and to refine them over time. Having a common starting point for markups and negotiations helps to assure consistency, absorb lessons learned and avoid both oversights and constant re-invention of wheels, while saving time and money. Lawyers and firms advising customers keep track of "precedents" established with particular suppliers. Counsel for suppliers should do the same, tracking compromise positions and language agreed with leading counsel for their customers.

- Training for legal teams, sales executives and sales support staff in the company's usual positions, the underlying risks and rationale for those positions and negotiating skills. Just as lawyers must understand the operational and financial risks underneath the words; business people need to understand what the words say and why they matter. Even arcane "legal" terms affect costs, revenue, risks, margins and business outcomes. All concerned must sing from the same music.

- Where possible, suppliers do well to build teams who work together regularly, understand one another and become accustomed to collaboration. This is particularly true when suppliers engage negotiators (who may or may not have legal training and credentials) to lead discussions with customers. Messages, whatever they may be, are often better received from someone not identified in the customer's mind as an attorney;

but lawyer and negotiator must be well coordinated in their dealings with both internal and external audiences. The better they know one another, the better the results are likely to be.

Finally, to assure that usual positions remain competitive, periodic review is essential. Supplier organizations, especially large ones, tend to develop an inward focus. They see many RFPs and contracts, to be sure, but no one else's. Tunnel vision may result. Informal conversations with peers and trusted intermediaries are instructive. Occasional 'benchmark' reviews with outside lawyers may help to fine-tune positions and reassure management that those positions reflect market realities.

3.2 Process Disciplines

Successful suppliers have disciplined processes to evaluate opportunities, review bids and proposals, then vet the price, solution, contract terms and other particulars as negotiations proceed. These work best when review is entrusted to small, knowledgeable, accountable groups. Crucial internal constituencies must be engaged – not only sales, but finance, delivery and others, as appropriate – but without convening an entire grand jury. Process discipline need not be encrusted with barnacles. Not every lesson learned or pet peeve need be entombed in a policy, spreadsheet or Power Point slide. Review should focus on essentials, such as delivery, operational, financial and other risks; crucial contract terms; and relationship issues. If negotiating and sales teams cannot be trusted with *minutiae* they should be replaced.

3.3 Questions Suppliers Ask

Supplier processes invariably begin by qualifying opportunities and deciding which ones are worth pursuing. Suppliers examine customers' needs and requirements, their own portfolios, competitive considerations and the customer's credit (among other things) in order to determine whether the game is worth the candle. "Can we win?" they will ask. If so, is the opportunity good business that the supplier can successfully and profitably deliver? If not, bid and proposal dollars and the scarce time of talented sales teams are best expended elsewhere.

Counsel may be peripheral participants in initial discussions. After the decision to pursue, lawyers are closely engaged at each step, from the initial proposal through various rounds of review and negotiation. Throughout, they must be prepared to ask hard questions, and since they are likely to see potential business "in the round," rather than the narrow lens of their professional responsibility, their advice may carry particular weight.

What questions should suppliers ask?

3.3.1 What About the Client?

Lawyers who specialize in professional liability defense tell their clients that risk begins with client selection. The potential client with unrealistic expectations, an attitude and ongoing disputes with former counsel may be a poor risk. Better, they will say, to validate their parking and send them on their way. Much the same is true in sourcing. Clients may be sources of risk and not merely credit risk, although that is fundamental. No supplier relishes the prospect of joining other unsecured creditors at the bankruptcy trough while obliged to perform for a debtor in possession.

Not every client is ready to outsource or able to absorb or manage the change it entails. On both sides, participants must ask whether the customer has and is prepared to devote the time, attention and expertise necessary for successful launch and management of something as complex as a major outsourcing initiative. Has the customer identified a leader and team empowered to manage the relationship, give directions and make decisions? Have they the requisite experience, depth and clout? Have they sufficient time and attention to devote to the effort, or has this initiative simply been laid on top of full-time responsibilities? If not, challenges are likely.

First-time customers are often reluctant to relinquish operational control, as they must in order to achieve the benefits of scale, efficiency and consistency that outsourcing offers. Can they let go? Allow an outside supplier to manage operations, using its methods? For suppliers, contracts that subject everything to customer approval are cumbersome and may add cost and delay.

Some customers lack the organizational discipline and consensus necessary for outsourcing to succeed. It is challenging enough when all sing from the same music and almost impossible otherwise. When headquarters proposes, and business units oppose, success is unlikely. Wise customers use the months of preparation, selection and negotiation to build a strong consensus behind the outsourcing initiative, so that all concerned understand, accept and are fully committed. If not, prudent suppliers may decline to bid.

Realism is essential. Human nature can subtly lead parties to overreach by nurturing unrealistic expectations. The customer's negotiation team wants to deliver management the best possible contract. The lower the price, the more favorable the terms, the better the figures will appear in the business case and executive suite; and if those benefits come with superior technology sooner than expected, well so much the better. Customers and their advisors exploit competition, as they should, and press competing suppliers. Sales people may be congenital optimists and have, in any event, understandable incentives to win the business, recoup bid costs and, by meeting their targets, remain employed. They are anxious to please. Geeks are excited by the wonders technology might achieve. There is a natural inclination to propose what the customer is predisposed to hear, while trusting the delivery organization to sort out details later. Parties may commit themselves to ambitious goals, despite private reservations. All the more reason for early involvement of account executives, delivery managers and others with operational experience. Those accountable for delivery are less likely to inhale the vapors. Bringing them to the table is a best practice for both sides.

Finally, what about such crucial matters as attitude and culture? Will the customer team treat suppliers as partners and allies or do they prefer more contentious, adversarial relationships, imagining that gain necessarily comes at some else's expense? Are suppliers part of the team or just hired, expendable help? Partners or just vendors? Suppliers can and do serve the proverbial "hard-faced" men and women successfully and profitably, but with their own tough-minded teams, prepared to manage to the letter of the contract and an ample allowance for contingencies. Whether these

arrangements deliver the best value or the best the supplier might offer seems debatable.

3.3.2 Can We Deliver Successfully?

This seems obvious yet requires attention. Have we done this before? If so, with what financial and operational results? Was service delivered on time, within budgets? Were service levels and other performance requirements consistently achieved? If not, why not? What lessons have been learned and taken to heart? If the solution is unconventional, novel or one of a kind, what steps have been taken to mitigate risks by thorough technical and operational review? Adequate contingencies? Buffers in timetables? With novel, automated technologies, are assumed efficiencies from productivity realistic? To what extent do those efficiencies depend upon the customer, and if so, are the customer's obligations clear? Are dependencies explicit, so that the supplier may seek relief when the customer is late or remiss? Contract requirements must be realistic and achievable. These are not, of course, legal questions, but the answers matter, and sometimes lawyers have to ask inconvenient questions and, depending upon the answers, help to craft contractual and other mitigations.

3.3.3 Are Deal Elements Aligned?

Complex service engagements have many moving parts: customer requirements, supplier solutions, statements of work, service levels, financial models, pricing, adjustment and other terms of the master contract itself and many more. They should work together like whirring gears inside a car's gearbox. When they mesh smoothly, everything moves forward; and when they do not, there are unpleasant grinding noises and large costs. On large transactions, complexity is unavoidable. Risks of avoidable, expensive errors (on both sides) are greater when time and pains are not taken to get the details right, perform sensitivity analyses and confirm that as and when circumstances change – consumption, inflation, exchange rates and the rest – the charges and costs change predictably and acceptably. Risks are still greater when one side or the other – or more often, both, with winks and nods – "engineer" the figures in order to meet desired price points. Here again, inconvenient realities

are better faced than ignored. Involving those who must deliver and manage after signing is a best practice. Lawyers, who touch all of the documents and see virtually all aspects of the transaction can make important contributions because they can see the interconnections, warn their clients and are not confined to such specialized 'silos' as finance, operations, or particular service offerings.

At a higher level, are the business relationships, deal terms and contract terms properly aligned? Those who seek (or offer) custom solutions at a commodity price are likely to be disappointed. Outsourcing engagements commonly involve business relationships between organizations, a business deal and the contract documents that embody the deal. All matter. Often, the relationship matters most. If based on candor and a decent respect for both parties' interests and goals, difficulties can be addressed, and problems fixed — even if the deal is flawed, even in the face of novel challenges such as those presented by the pandemic. On the other hand, if suspicion, resentments and adversarial thinking taint the relationship, soluble issues may defy easy or perhaps any acceptable resolution. Among the pandemic's more important lessons has been the importance of good working relationships, built upon foundations of candor, collaboration and respect.

At the next level, the deal must make economic sense: meaning delivery of a good solution at reasonable cost to both sides, so that the customer receives value for money with anticipated financial and other benefits while the supplier earns respectable margins. Expectations must be aligned. No one gets state of the art innovation or radical transformation for a commodity price and without any technical risk. Solutions and terms may evolve during negotiations. Not all the glitter in preliminary studies and sales presentations may survive admonitions to sharpen pencils and reduce charges. Customers need to keep their users informed, and maintain a strong internal consensus, rather than position constituents for disappointment.

The contract must tie everything together on acceptable terms that permit both parties to succeed, motivate them to perform, deter nonperformance and deal sensibly with a range of (mainly remote)

contingencies. Much can go wrong, but so long as business relationships are sound, repairs or at least sensible disengagement are possible.

3.3.4 Have We Adequately Addressed Potential Risks?

Complex outsourced solutions necessarily involve a variety of practical, operational, compliance and other risks. These may be contained (to an extent) in the contract and mitigated after the contract is signed. Suppliers have well-considered positions, including fallback positions, on the usual contentious terms in contracts – liability limits, change control and the rest – but analysis does not stop there. No contract is free from risk, and negotiated resolutions inevitably require some compromise, meaning acceptance of terms that are less than ideal. What then? If transition and transformation plans are unusually ambitious, and unexcused delays may require payment of large credits ("penalties") have those plans been thoroughly vetted? Have operational plans for transition and delivery accounted for these risks, through "buffers" in schedules, contingency allowances and operational plans or other means? Where (for example) compliance and liability risks are large, the well-advised supplier will want to offer the customer robust security and document a thorough security program that holds the customer accountable for its responsibilities. Where risks are assumed, are there adequate plans to manage and mitigate those risks?

Contract documents may be complex. Likewise the grids and criteria suppliers apply to analyze opportunities and terms; but one way or another, almost all criteria come back to basic questions: Can we deliver? Do all elements align properly? Have we adequately contained or mitigated risks? How do particular terms or requirements affect costs, revenue and risks?

3.4 The 'Light Touch'

Rarely do suppliers win or lose on contract terms. Never mind what sales people may say in loss reviews ("our price was too high; our solution fell short; but we lost on the redlines"). Customers tend to

decide based on price, performance, solution and – if those are evenly matched – relationships and intangibles. At the margins, customers (like everyone else) favor those they trust and respect, with whom they prefer to work. Lawyers who set the right tone, listen well, choose their battles, respect the customer's interests and work constructively to find solutions that appeal to both sides — those lawyers will help their supplier clients to succeed. On the other hand, lawyers who seem cranky, remain mired in detail and take exception to unimportant *minutiae* are not helpful.

Historically, suppliers' lawyers, trained (like all lawyers) to spot all issues and pay attention to details, have tended to be meticulous — the more so when reviewing contracts replete with tough, over-reaching terms. Alas, some readers seem simply to count edits. "Too many redlines," they will lament, often for apparent tactical reasons, perhaps without reading or understanding the edits suggested. Suppliers' counsel once tended to respond to tough, over-reaching contracts in detail, spilling red ink throughout their markups then conceding ground incrementally through an iterative process of negotiation. In a perfect world, few fair-minded professionals would fault suppliers' lawyers for meticulous attention to detail. In the world suppliers' counsel now inhabit, there are persistent whispers and grumbles about numbers of redlines and invidious comparisons with the "other guys" who scarcely objected to anything (or so they would have one believe).

Are these criticisms fair? Rarely. Are they calculated? Almost certainly and all suppliers hear them; but this is the present competitive reality. Aggressive timetables and tight budgets leave little time for iterative negotiation. Competitors who limit objections to the most important issues and live with most of the customer's language are reckoned more flexible and cooperative. Selectivity – choosing which battles to fight – reinforces credibility on issues that matter most, for it is easier to insist that "no" means "no" when objections are limited to comparatively few essential issues. Standing firm is more difficult when many objections and edits fall away easily, as if "no" means "yes, eventually."

So what can be done? How best to minimize redlines and maximize prospects for success, yet protect the client?

To begin with, counsel must review proposed contract documents thoroughly, as always, noting *all* potential issues. Doing so protects the client, who can make informed decisions, and also the lawyer, should the client disregard the lawyers' advice and run imprudent risks.

Then winnow the list in consultation with business clients, based on the particular opportunity, service offering and the financial, operational and other risks. Not every issue matters to every client on every deal. Intellectual property issues that are crucial for applications development may be far simpler when customers buy self-contained, proprietary solutions.

Not every issue need be raised in the initial markup of the master agreement. Some drafting details can wait until after the price and other elements take shape. Many scope, financial and other issues are best addressed in statements of work or other contract documents, which may not be as intensely negotiated or attract as much attention from opposing counsel (especially outside counsel on tight budgets). Some arcane issues may be referred to experts and deferred. For example, customers' proposed audit and insurance requirements can usually be reconciled with suppliers' policies through discussion between audit and risk management professionals.

Where objections must be taken, be succinct without concealing actual differences. "Sand-bagging" real issues is poor practice and may prove hazardous, during competition and afterward. That said, change as little as possible. Where language can be lived with, *leave it alone* (though not when it is substantively incorrect, inconsistent with other terms or seriously objectionable). Where text is not especially well written, but adequate, *leave it alone*. Resist the temptation to offer opposing counsel a drafting seminar at your client's expense. Chances are that opposing counsel likes his or her forms about as well as you like your own. Few forms are technically flawless. Many (for example) confuse representations, warranties and performance obligations or characterize obligations as 'representations and warranties' to make them seem more robust. Rarely do such technicalities create actual issues or risks (although occasionally they do). Where unsettled issues require discussion,

note them in a footnote or marginal comment, explain the business concern and suggest sensible, constructive alternatives.

Where edits are essential, keep them brief. Better to alter a few words or insert a phrase here and there than to rewrite or, worse, substitute one's own preferred language. If time permits, iterative editing tends to reveal opportunities to prune new language, to say what must be said gracefully and in few words. So far as possible, avoid expanses of red, although there is more latitude to mark-up terms that are *always* contentious (e.g., benchmarks or liability limits) or onerous terms that depart from market standards (no, pledging one's first-born or flogging account executives are not standard – at least not yet).

Where extensive edits are unavoidable (as in such intricate provisions as intellectual property or taxation) brief marginal explanations or footnotes are useful. So, when appropriate, are cover messages or memoranda explaining business reasons and (where the answer is "no") proposing sensible alternatives. Businesslike explanations may dissipate fears and forestall criticism. ("Supplier welcomes an early discussion between tax experts and will work constructively to manage and minimize the parties' exposure, but cannot agree to absorb sales, use and other taxes upon the service or charges.")

How far to go? As far, or nearly as far, as the supplier is ultimately prepared to go, while leaving some room for negotiation. Surprises are bound to crop up during negotiations, so trade-offs will be necessary; and the customer and its counsel are unlikely to be satisfied unless they secure some concessions during negotiations. It is therefore wise to raise a few (*very* few) points that would be nice to have but could be conceded; and to propose thresholds – for amounts at risk, liability limits and such – that may not be quite the last word but are credible and competitive.

4 VARIETIES OF CUSTOMERS

Customers (and their advisors) run the gamut.

At one extreme are the innocent and credulous, who have never outsourced and lack sophisticated advice. These days, they are a rare, nearly extinct breed. Any supplier tempted to take advantage and prey upon inexperience should think again. The unfortunate customer who signs a contract without service levels, convenience termination rights and other usual protections will figure it out – guaranteed – foreclosing any future opportunities or favorable references. Suppliers' standard terms and contracts should respect customers' legitimate interests, provide usual protections and concede what a sophisticated, fair-minded customer would expect. Great wisdom resides in the Golden Rule: Do not unto others as you would not be done unto. To do otherwise is not only wrong, but foolish.

At the other extreme are the gladiators, for whom blood on the sand – the supplier's blood, naturally – actually *is* the point. For them, contracts are zero-sum, adversarial exercises, where gain comes only at the other side's expense. They will seek every advantage, care little for the supplier's interests and may not be entirely scrupulous in their methods or, crucially, disclosures. Supplier beware — rather than *caveat emptor* — is the sovereign principle. Healthy contingency allowances are essential.

In between these extremes lie two distinct, sophisticated and thoroughly respectable approaches to outsourcing engagements. Both are firm but fair. One is primarily adversarial and the other more collaborative. Both recognize that outsourcing contracts (like other business arrangements) generate value for participants.

Partisans of adversarial engagements aim to extract as much of that value as possible for their customer. Like the gladiators, they believe that gain comes primarily, though not exclusively, at the other party's expense. Their ideal contract would approach the limits of the supplier's indifference curve — that is, the point where the supplier would just as soon walk away as sign. Adherents to this philosophy seek tough, comprehensive remedies; elastic scope; limited (often, severely limited) rights for the supplier to obtain

additional compensation (even when circumstances change) and, in general, maximum leverage for all contingencies. If the supplier performs flawlessly, it will receive regular payments and (assuming good cost models) adequate returns. If difficulties arise, the customer will have the whip hand.

Collaborative contracts have essentially the same table of contents and captions, as well as the customer's usual protections and remedies, but a different underlying philosophy that recognizes the symbiotic, interdependent nature of the relationship and believes that success is most likely if it is mutual. Suppliers understand that satisfied customers who receive excellent service, value for money and achieve their operational, financial and other goals make the best references and are more likely to offer future opportunities. Wise customers understand that suppliers who earn decent margins perform better, are unlikely to skimp in order to save costs; and that successful engagements attract and retain the supplier's best talent. Recognition of these realities does not, of course, transform negotiations into a love feast or make complex issues vanish; but it will expedite compromise resolution of tough issues on a basis that is fair to both parties and consistent with prevailing market standards.

Interestingly, customers who negotiate collaboratively often obtain more favorable terms and larger concessions than those devoted to more 'hard-nosed' bargaining and 'tougher' positions. How so? It comes down to such intangibles as tone and trust. People are more likely to make concessions to those they trust, who treat them fairly, as opposed to those who squeeze – let alone bully. Leo Durocher had it wrong. Nice guys may and often do finish first.

How then should counsel approach the more formidable documents and customers – those who propose unacceptable or barely acceptable terms?

To begin with, understand that 'winning' bad business is no victory. Some indignities really are too great. If risks are excessive and margins elusive or nonexistent, walking away is best and may be the only possible way to achieve decent terms, if the customer reconsiders. Suppliers, eager as they are to sign new contracts, too

easily forget the leverage they possess. Customers' advisors and purchasing professionals are paid to offer choices to their management. If leading competitors walk away from unacceptable terms, management may wonder why. Remaining competitors will wonder just what their departed rival divined that they may have missed. It is not much of a horse race when leaders or favorites head for the barn. Organizers of the race meeting will face questions.

Short of such drastic steps – and walking away is the very last resort – what is a supplier to do?

- First, take firm positions on the crucial issues – positions that are consistent with market standards and permit the supplier to earn respectable returns from good performance without excessive risk. Infinitely elastic scope for a fixed price is not a sound business proposition (as those who propose this may actually understand, much as they wish your client would sign).

- Second, recognize that winning competitive business will require compromises. At least a few such compromises may fall near or beyond the limits of the supplier's usual "comfort zone." Therefore, consider where one may move on contentious issues that matter to the customer without taking excessive risks, jeopardizing margins, the financial integrity of cost models or delivery excellence. There may be room to negotiate about liability limits, for example, if the solution is proven, security is robust and actual access to sensitive data is restricted. When renewing a contract after years of flawless performance, larger service level exposure may reassure the customer without adding much risk.

- Third, consider how to mitigate the effects of stringent or unfavorable terms, perhaps in scope, pricing or other contract documents; perhaps through contingency allowances in cost models; perhaps through changes in the solution or plans for transition and operations. Occasionally, customer demands may present opportunities — if, for example, a supplier is prepared to risk larger liability exposure and the customer is prepared to pay for better security and with clear standards (rather than the usual catch-all provision for adherence to customer, supplier or

unspecified industry standards, whatever is most stringent and most tactically convenient after an incident).

5 PERENNIAL ISSUES

How then may a supplier address the more important and contentious issues concerning scope, performance, compliance, pricing and remedies?

To begin with, understand and explain to one's clients that the perennial issues, even when encrusted with legalisms, are actually business issues about cost, revenue, risks, margins and the rest. Moreover, the ultimate decisions are business decisions for both sides. However impressive and articulate the customer's counsel may be, rarely (if ever) will he or she have the final say.

Then, on each issue, take positions that are market-competitive, protect the supplier's essential interests, and are scrupulously fair to the customer. Treat the customer fairly — *always*. Readily concede and even offer (unasked) what customers need and fairly expect; then insist that they reciprocate. Insistence upon equity and common sense can be a disarming, effective tactic, especially with the customer's decision-makers. Principled positions, explained in business terms, can be very persuasive and at the end of the day, the customer has come to the table in order to do business.

5.1 Scope

Nothing else matters so much. What exactly does the supplier provide and the customer receive for its money? Customers, not surprisingly, prefer to pack as much as possible into scope; while suppliers are wary of "scope creep" (as they call it) meaning uncompensated expansion of scope.

5.1.1 'Sweep' Clauses

Most contracts include a 'sweep' clause obliging the supplier to perform a variety of lesser-included, incidental and related responsibilities — typically, (i) those inherent in or related to responsibilities laid out in a statement of work; or (ii) formerly

performed by displaced staff, even if unstated in the statement of work. Where suppliers take on whole operations or processes in their entirety, the principle is logical and acceptable, as it was when industry pioneers took over glass house data centers, including the operations, equipment and personnel. Sweep clauses make less sense for selective outsourcing (that is, bits and pieces of particular functions) or transformed operations (doing the same work with different methods and technologies); and none whatever for standard service offerings, offered remotely using cloud solutions or other novel technology. Where sweep clauses are appropriate, they should be closely tied to the solution actually proposed, avoid extravagance and never override express qualifications, limitations or exclusions in the scope documents.

When reviewing customers' proposed 'sweep' clauses, supplier's counsel should:

- Limit inherent services to those "reasonably related" to statements of work or outsourced functions.

- Be clear that 'sweep' clauses may supplement statements of work, but do not trump express qualifications, limitations and exclusions (e.g., concerning responsibilities retained by the customer or dependencies upon other suppliers).

- Exclude general references to services commonly performed in the customer's industry (which the supplier cannot know). Advisors to customers know perfectly well that this is over-reaching and inappropriate.

- Limit obligations concerning services formerly performed to those directly related to the outsourced functions, regularly performed (and not discontinued) during a discrete period (typically, 12 months) before the contract. If displaced personnel used to wash executives' cars or oversee the company basketball league, those activities fall outside of the supplier's scope.

- Ideally, require identification of undocumented responsibilities within a reasonable time, lest anyone pine for the "good old days" long after transition and transformation are complete.

Here is a sample markup of a typical 'sweep' clause:

> Throughout the Term, Supplier shall provide:
>
> (a) The services, functions and responsibilities described *as Supplier responsibilities* in the Statement(s) of Work, as they may be amended and supplemented from time to time;
>
> (b) The services, functions and responsibilities *related to those described as Supplier responsibilities by the Statement of Work (but not expressly excluded), regularly* performed during the twelve (12) months preceding the Effective Date by the personnel who were displaced or whose functions were displaced as a result of this Agreement, *not discontinued and identified to Supplier in writing within six (6) months after the Effective Date [or, alternatively] completion of the last Transition Milestone*;
>
> (c) The services, functions and responsibilities *related* to *the Statement(s) of Work* and performed by or for Customer under the base case dated [date] *for the [specify time period – e.g., current or most recent year]*;[3]
>
> (d) ~~The services, functions, processes and responsibilities that are of a nature and type that would ordinarily be performed by the organization or part of the organization performing services similar to the~~

[3] If there is no base case, or the base case is deficient, this should be stricken. Where base cases are included, suppliers often prefer to limit their application to current or near-current years. Future projections are uncertain and in any event, projected future costs of the customer's internal operation are irrelevant to the outsourced solution.

~~Services within a company in the [insert] industry, even if not specifically described in the Statement of Work~~; and

(e) Any services, functions or responsibilities not specifically described by *or excluded from* the Statement(s) of Work, but inherent in or necessary for the proper performance of the services, functions or responsibilities described ~~above~~ *by the Statement(s) of Work*.

(For convenience, the foregoing, ~~and any and all similar services performed by Customer prior to the Effective Date,~~ are collectively referred to as the "Services.")

5.1.2 Change Control

Few issues are more sensitive, contentious or important to both sides than changes.

Customers dislike "nickel and dime" changes for piddling adjustments. They fear blizzards of changes that might inflate costs and erode anticipated savings. They fret about suppliers tempted to "buy the business" with lowball bids, then "get well" with (shall we say) "therapeutic" change requests. Less commendably, they sometimes wish to fix prices for elastic scope through restrictions upon compensated changes.

Suppliers seek to maintain and, ideally, to improve margins through greater efficiency over time. Often, forward pricing commitments depend upon anticipated but by no means guaranteed improvements in productivity. Scope creep and margin erosion are hazards. The essential principle is easily stated: net additional service, if material, must be paid for. Suppliers may be good corporate citizens, but they are not philanthropies and have to make decent returns in order to survive. When circumstances change, and material additional effort is required for any number of reasons — regulatory changes, changes in the customer's own policies and operations, changes in the customer's systems, collaboration with and support for other

contractors — the supplier should be compensated for net additional service performed.

With change control (as with so much in life) the Devil is in the details rather than the essential structure, which commonly provides the following:

- Customers may request changes, and suppliers may propose them, on their own initiative (and, naturally, at their own cost). When change requests involve preparation of detailed requirements and hundreds of hours of effort, the supplier may (or may not) be able to charge for the preparatory work. When detailed requirements or designs are needed, customers may fairly require a preliminary, rough-order-of-magnitude estimate of likely scope, timing and cost, as well as a firm price for preparation of detailed requirements or specifications.

- Suppliers commonly enjoy considerable latitude to make operational changes, so long as those changes do not increase the customer's cost or adversely affect service levels or quality.

- There will be a formal process for submission, review, negotiation and (if approved) implementation of change requests and change proposals. Good change discipline protects both parties. Customers routinely insist that they need not pay for changes unless and until approved and authorized in writing. Conversely, suppliers should have no obligation to perform changes unless and until a change order or amendment has been signed.

- Although pricing for changes may be (and often is) negotiated on a case-by-case basis, customers (who fear the leverage of incumbency) commonly insist that, unless otherwise agreed, net additional service be priced at relevant contract rates. Where no such rate applies, because skills or resources never anticipated are required, things become a little more interesting. Suppliers routinely reject 'most-favored' pricing because of the practical difficulty of making comparisons among varied offerings and contracts across large organizations but may offer their standard

rates. Good customers who buy lots of service may press for a discount from 'standard' rates.

Some contracts distinguish various classes of changes, such as operational, technical and contractual changes; or between changes and amendments; but differences among these (inevitably abstract) labels may be uncertain and debatable. Virtually all changes, however labelled, amend the contract documents in at least some respects, although many changes have little or no financial impact and few are likely to require amendments to the master contract text (as opposed to service descriptions or other supporting documents). Contractually, a single procedure can work well, even if different levels of approval apply based upon scale, cost or similar criteria.

5.1.3 New Services

Then there are 'New Services,' often defined abstractly as services that are "materially different," involve changes in the means or manner of performance, different levels of effort or for which there are no rates or other charging metrics. What all this means is hard to discern – and that may be the point, for abstractions permit tactical games when paired with restrictive provisions that preclude adjustments unless the change involves a 'New Service,' whatever that may be. If the customer may plausibly contend that variations from or additions to basic service are not 'New' then nothing more need be paid; but if they are cheaper (on account of novel technologies, for example) then the customer may insist that they are 'New' and must be priced more aggressively. Few customers may be quite so calculating, but the potential for misunderstanding and even abuse is plain.

From the supplier's standpoint, clarity is needed. Are 'New Services' wholly new, unrelated kinds of service, as when a supplier of IT services also offers BPO solutions? If so, such services can be put out to bid in the usual way or, for that matter, negotiated on a sole-source basis. Rarely can such work be priced in the abstract, months or years ahead of time. Or might 'New Services' include (as some forms suggest) transitional support for acquisitions and divestitures? Implementation of operational changes required to meet emerging regulatory requirements? Transition or

implementation projects may be priced based on then-current contract rates. What about traditional service, delivered with new processes or technologies? One path to clarity is the use of examples, based upon the customer's intentions or anticipated needs, in order to supplement and clarify the usual abstract definition.

Suppliers should also make sure that cost and pricing models are aligned, and cover all direct and indirect costs, so that all costs, including future variations driven by changes in volumes and other circumstances are covered by both a base charge or rate and incremental charges or credits (commonly referred to as additional resource charges and reduced resource credits). All costs must have a home. If customers insist that base charges cover everything except authentically new services and specially authorized projects, then pricing metrics must be comprehensive and cover all underlying costs.

5.1.4 Restrictions on Changes

5.1.4.1 "At no additional cost"

Some forms sprinkle this phrase (or its equivalents) everywhere, like salt and pepper on scrambled eggs. This or that incremental activity – support for divestitures or other contractors, regulatory changes and so on – must be performed "at no additional cost to Customer." Occasional references of this kind may not matter, and sophisticated suppliers' cost models include some modest allowance for surprises, but at some point, a thousand cuts equal a hemorrhage. One good approach (after searching the document for such phrases as "no additional cost") is to insert equally simple language to the effect that "*material* incremental cost or service" must be authorized as a change or may bear additional cost at usual contract rates, measured by net additional hours, full-time equivalents (FTEs), transactions or other relevant criteria. The materiality threshold, whether or not quantified, provides the customer some protection against "nickel and dime" change requests and charges. Cooperation with other contractors is all very well, but it is one thing to attend occasional meetings, answer questions or provide access to systems; and quite another to devote

several additional staff to support for another contractor. The former are incidental and easily absorbed; the latter should fairly bear additional cost (perhaps captured by normal volume adjustments).

Since one may not catch all such terms or, in any event, win every point at the negotiating table, it is wise, when working with tough, restrictive forms (and customers partial to that approach) to make sure that cost models include an ample allowance for contingencies.

5.1.4.2 Obstacle Courses

Some forms restrict compensation for changes by transforming the process into a kind of steeplechase, where compensation depends upon clearing a series of hurdles or other obstacles. Thus changes may not be compensable unless various notice and other requirements are satisfied, a quantitative or other pricing adjustment applies, or the change is either a 'New Service' (discussed above) or a 'Project' (i.e., discrete, separately authorized initiatives unrelated to performance of basic service). If pricing metrics apply to all conceivable services and cover all costs (direct and indirect) this may be acceptable, provided 'New Services' and 'Projects' are clearly defined and well understood, based upon concrete examples rather than abstractions.

But suppliers must insist upon the essential principle that net additional work, if material, must be paid for, whether through a quantitative or equitable adjustment, a negotiated change or in some other way. Lawyers who craft such provisions are unlikely to be persuaded; nor, for that matter, their kindred souls in procurement; but business decision makers may be persuaded of the essential equity of the position (which cuts the other way when service volumes decline) and the additional cost to the customer of the larger contingency allowances prudent suppliers build into their cost models (which may exceed the cost of occasional *ad hoc* changes).

5.1.4.3 Mandatory and Disputed Changes

The parties may disagree about the scope, timing or cost of particular changes. In these situations, some customer-oriented forms would allow the customer simply to compel performance on

command. Suppliers naturally resist obligations to perform uncompensated work but will make some accommodation for a limited range of urgent changes, such as those a bank or regulated customer may be obliged to make in order to remain in compliance and its regulators' good graces, so long as there are sufficient payments to cover actual costs. A supplier may, for example, agree to undertake essential changes required by laws and regulations, so designated by the customer's management, so long as the customer makes substantial, partial payments, pending expedited resolution of the matter by the parties' senior management.

5.1.4.4 Current Technology

Customers want up-to-date solutions. No customer wants to inherit a museum when the contract expires or to pay large sums simply to keep up to date. On the other hand, the supplier's cost model and pricing cannot very well accommodate unlimited, unanticipated or accelerated changes, above and beyond (i) whatever refresh or upgrade commitments have been built into cost models and priced and (ii) normal, evolutionary changes offered to all customers in the normal course of business and without additional charge. Vague superlatives or references to unspecified best practices or standards in the customer's business (whatever they may be) should be avoided. Anticipated initiatives, such as transformation to cloud solutions or introductions of other novel technology should be separately addressed, to avoid misunderstandings. Here is a sample markup of a typical customer-oriented clause:

> Supplier will, without any additional Fee, cause the Services ~~as approved by Customer,~~ to evolve and to be modified, enhanced, supplemented and replaced as necessary for the Services to *meet the refresh and replacement schedule in . . . and* keep pace with *the normal evolution of* technological advances and advances in the methods of delivering *similar* services *to Supplier's commercial customers generally (and without additional charge)*. In particular, and without limiting the generality of the preceding sentence, Supplier's tools, utilities, methodologies, processes and other normal procedures for

performing Services will be upgraded and enhanced as, and when *and to the extent* upgraded or enhanced for ~~Supplier's own business and~~ the support of its *commercial* customers generally *(without additional charges)*. Adjustments in Services in accordance with this Section will be deemed to be included within the scope of the Services to the same extent and in the same manner as if expressly described in this Agreement. *Other adjustments shall be authorized as Changes.*

5.2 Performance Standards

Service levels and other performance standards matter to customers as measures and assurances of quality. General performance standards, committing supplier to meet acceptable standards, are rarely controversial (unless extravagantly worded or tied to uncertain superlative standards). Service levels are rarely agreed to unless suppliers are confident (indeed, virtually certain) that they can be consistently achieved. Few credits (universally and inaccurately referred to as 'penalties') are ever paid. Nonetheless, performance standards matter. Customers understandably expect to hold suppliers accountable. In the event of serious failures, it will not do to offer nothing more than a report and assurances of good behavior.

5.2.1 General Standards

Outsourcing contracts commonly require suppliers to agree that service quality will meet or exceed industry standards, the customer's past performance, or some similar form of words, often phrased in terms of professional or workmanlike service.

The customer's past performance may be problematic, unless well documented. Rosy recollections are as difficult to calibrate as to confirm. Some suppliers prefer to avoid unspecified, changeable "industry standards" (whatever they may be) although others agree, especially when providing services essentially similar to their competitors or the supplier considers itself an industry leader.

Well-advised suppliers reject grandiose commitments to provide superior, spectacular or (a particular favorite) "world class" service (whatever that may be). More neutral phrasing that refers to "good professional service" or the standards of other suppliers of similar services are generally accepted, since they measure suppliers against their competition and, often as not, leading competitors offer comparable quality at competitive rates. Some suppliers object to unavoidably vague references to unspecified "industry standards," but will agree to at least match their competitors — a more objective standard that could be proved by expert evidence, if ever the need arose.

Suppliers should and do insist that general standards should not override specific service level commitments, lest they be required to provide better, costlier service than the customer has agreed to pay for. The customer who contracts for bargain service is not entitled to superior service for which it is unwilling to pay. General standards should only apply where service levels do not.

Here is a sample markup:

> Supplier will perform the Services in accordance with (i) the Service Levels, as they may be modified or supplemented from time to time; or (ii) *where no Service Levels apply, (A)* the ~~highest~~ level of service *consistently* achieved by Customer *during the __ months* prior to the Effective Date *to the extent measured and documented*, or *otherwise* (ii) *(B) good professional* ~~the highest industry~~ standards for *similar services provided by first tier providers of* ~~for~~ similar services~~, whichever is higher~~.

5.2.2 Service Levels

Service levels are intensely negotiated, although detailed discussions of metrics, administrative arrangements, validation and other technicalities need not involve counsel (apart from editorial review of terminology, definitions, and calculations in particular). Suppliers have experts who work with customers and their advisors to iron out specifics.

The more contentious issues concern financial credits and, in the most serious cases, termination or other drastic remedies. Overall exposure is typically capped at a percentage figure (often called the "amount at risk") tied to monthly charges (excluding expense reimbursements and unusual items, such as charges for projects). Those percentages are negotiable but tend to be single or very low double-digit percentages of the monthly invoice and well within anticipated margins. Customers who press for higher figures should accept that suppliers' internal disciplines may require larger contingency allowances (raising overall costs) or prompt the supplier to press for earn-back opportunities that offset exposure.

Service level credits are commonly computed by multiplying the at-risk percentage times the amount of the invoice times a weighting percentage that reflects the metric's relative importance. The total of all percentages (the "pool") is negotiable but commonly capped at 175-250%. There may or may not be other parameters, such as ceilings upon individual weighting percentages, obligations to apportion exposure among services and metrics (lest a single metric bear disproportionate exposure) and others. Details are best left to the experts.

Customers occasionally propose larger than usual financial consequences for short lists of critical operations or systems. Sophisticated suppliers will work with their customers to craft a responsive solution – such as surcharges for especially serious or repeated incidents, or larger credits for prolonged failures of especially critical systems (such as those that could shut down production lines, shipments or web sites that accept customers' orders). Customers seeking these kinds of protection should be prepared to document excellent historical experience and invest in stable, robust, redundant infrastructure sufficient to support fail-safe performance. Abiding wisdom resides in such maxims as "fast, cheap, good — pick two" and "there is no free lunch."

For suppliers' counsel, the essential point is an overall or holistic assessment of risk and exposure. Where service levels are aggressive and solutions are novel, conservatism may be the order of the day. When customers buy proven, stable solutions, suppliers' confidence may allow greater flexibility and additional (but largely

theoretical) exposure. Both sides should beware of overly complex service level schemes, which are often written by advisors without deep operational experience and may be challenging for both sides to implement and administer.

5.2.3 Excused Performance

When, if at all, should service level failures or other failures or delays be excused? For suppliers, as for most people, liability without fault — strict liability — is anathema. Suppliers expect to be held accountable, but only to the extent that they are at fault. If *force majeure* conditions, the customer's acts or omissions or other circumstances outside their control delay, disrupt or prevent performance, they expect to be excused.

Excused performance or so-called 'savings' clauses embody these principles, but many customer-oriented forms are written so restrictively that a supplier is only excused in the event of war, terrorism or natural disasters; or if the customer either breaks the law, commits an intentional tort or breaches express obligations. Even then, relief from performance obligations may be the supplier's only remedy. In reality, a variety of other acts or omissions by customers, their employees or other contractors might interfere with or prevent performance, short of breaking the law, committing actionable torts or breaching one of the customer's comparatively few express obligations.

From a supplier's standpoint, excused performance should:

- Excuse failures caused by circumstances outside the supplier's control, including not only the usual litany of *force majeure* conditions, but also failures caused, directly or indirectly, by the customer, its employees, agents and other contractors.

- Not be limited to tortious acts, violations of law or breaches of the customer's express obligations. Many acts and omissions, even lawful and legitimate action or inaction, may delay, disrupt, interfere with or prevent performance. If so, and to that extent, the supplier should be excused. Moreover, outsourcing customers' obligations are rarely limited to payment of monthly

invoices. Successful performance depends upon customers' fulfillment of their obligations to provide facilities, technology, staffing and other resources — especially when operations are transformed to novel, automated solutions, and forward pricing depends upon aggressive productivity assumptions and timely completion of projects.

- Permit recovery of reasonable costs of mitigation, including net additional service performed, generally after notice, consultation and consent. Without notice, the customer's management may not know that issues exist; and even then, they prefer not to spend for remedial action. That is their prerogative, so long as the supplier is excused and adequately protected through schedule or other relief from unavoidable consequences of the situation. Some customer forms make notice a pre-condition for any excuse from performance. This is not desirable, but may be acceptable, so long as the clause is sufficiently broad. Those managing operations should inform the customer as a matter of course.

Excused performance or other clauses often waive suppliers' rights to terminate contracts (so long as bills are paid) but a surprising number of customer-oriented forms go farther – too far, from the supplier's standpoint — and waive claims of breach so that the supplier can neither terminate nor recover its damages. In other words, the supplier has no remedy. Limiting remedies for breach is one thing; denying any remedy is quite another.

Here is a sample markup of a typical provision:

> Excused Performance. Supplier will be excused from failures to perform the Services or to meet Service Levels ~~only if~~ *to the extent* that (i) Customer fails to perform the retained services identified in the Service Description or breaches other express provisions of this Agreement and (ii) such failure, or breach *or other acts or omissions of Customer or its Affiliates, employees, agents or other contractors* (not undertaken at Supplier's direction or with Supplier's consent) directly *or indirectly* causes~~s~~ Supplier's

failure to perform; provided that Supplier (a) gives Customer prompt notice of Customer's failure to perform such retained services *or other acts or omissions* resulting in such performance failure, (b) uses reasonable efforts to continue to perform despite Customer's failure to perform retained services *or other acts or omissions* and (c) uses its reasonable efforts to mitigate the adverse consequences of Customer's failure to perform such retained services *or other acts or omissions*.

When negotiating service levels, supplier teams sometimes suggest detailed lists of circumstances that should excuse failures to achieve service levels (such as deficiencies in customer systems, unexpected surges in demand and a variety of others). Most, sometimes all, of these examples may be fairly characterized as customer acts and omissions that need no specific mention (although specific concerns may be accommodated, so long as they are not misconstrued to negate the protection afforded by 'excused performance' and *force majeure* clauses). In general, broad provisions for *force majeure* and excused performance should provide better protection than any laundry list of specific causes for service level failures (in the same way that opinion practice has shifted away from long lists of exceptions toward general exceptions for bankruptcy, equitable remedies and the like).

There are, however, two larger points.

First, regarding *force majeure* clauses: as discussed below, usual litanies of *force majeure* events and conditions should be reviewed to consider whether conventional language covers emerging risks — not only war and terrorism, but, for example, undeclared hostilities; hostile acts of insurgents and other irregular forces; surveillance and other operations of governments' military, intelligence and security agencies; catastrophic failures of public networks on which so much depends; epidemics, pandemics and related emergency measures (in addition to the familiar mention of quarantines); and many more. *Force majeure* clauses may be narrowly construed, and unidentified risks may be deemed to have been assumed, especially if risks are foreseeable. State law varies,

and in some states the case law is surprisingly restrictive. General references to circumstances beyond the parties' control may be insufficiently specific to cover many (or perhaps any) risks, and familiar 'laundry lists' may not necessarily cover contemporary risks of greatest concern. Raising these issues during negotiations may prompt energetic discussion; but better to speak frankly and allocate risks prudently than leave matters to chance or unfavorable case law dating from long before the Internet era. From the suppliers' standpoint, the essential principle is clear: commercial solutions and recovery plans are not designed to protect against extraordinary risks, such as espionage or military operations – albeit operations conducted in cyberspace rather than with kinetic weapons.

Second, regarding excused performance: rarely will one party or the other bear sole responsibility when outsourcing engagements go badly wrong. Many know the familiar "first rule of holes": if you are in one, stop digging. The corollary is not as well known: the deepest holes are usually joint ventures. Without the protection of an appropriate excused performance clause, the supplier may have little or no protection and little or no basis for counterclaims or defenses predicated upon customer acts or omissions that contributed to the difficulties at issue.

Might the common law afford some protection? Are suppliers better off relying upon the common law and dispensing with whatever meager protection the customer's proposed 'savings clause' may afford?[4] Possibly, at least in theory, depending upon applicable law, and especially to the extent the other party's breach, prevented, delayed or disrupted performance; but apart from payment, the outsourcing customer may have few, if any, obligations that affect the supplier's performance. Moreover, in some states, the common law's protection may be limited to circumstances where performance is impossible or nearly so, at least without extreme measures and prodigious cost. In any event, can one depend upon a trial judge and twelve registered voters to sort this out? Suppose the

[4] Where the customer's express obligations are few, it is often helpful to add an express, innocuous obligation to cooperate with the supplier – a principle that may cover a multitude of sins.

restrictive savings clause was stricken during negotiations? Might clever counsel then claim that the supplier waived all protection? Suppose it remains? Has the supplier waived whatever other protection the common law may provide? Dubious arguments sometimes prevail.

More important, few such cases ever reach the courtroom. During settlement negotiations, having an adequate provision for excused performance (even if less than ideal) can provide crucial leverage, compelling both sides to face reality, own up to their responsibility and compromise. For these reasons, explicit language of reasonable breadth is recommended. So are detailed, specific *force majeure* clauses that cover contemporary risks.

5.3 Force Majeure

Force majeure – the French expression for overwhelming, irresistible force – may excuse delays and failures to perform, but under the common law, only to the extent contracts so provide. Otherwise, a supplier risks liability for breach, unless it can prove frustration of the contract's essential purpose, impracticability, or impossibility. These doctrines offer scant protection for suppliers, since little is impractical or impossible for a company prepared to spend itself into ruin.

5.3.1 Force Majeure Events and Conditions

Definitions of *force majeure* commonly list familiar examples: not only fire, flood, earthquakes and inclement weather, but war, riots, epidemics, quarantines and a host of other dire conditions beyond the parties' control. Often, there is a catch-all reference to circumstances beyond the parties' control; or the clause may simply define *force majeure* as circumstances beyond the parties' control.

Over time, usual lists of *force majeure* conditions have grown. Oil shocks during the 1970s (such as the oil embargo that followed the October 1973 Mideast war) introduced references to embargoes and commodity shortages. Then came revolution (as in Iran), terrorism and computer viruses. But what of novel, contemporary risks — surveillance, data thefts by criminal gangs, insurgencies and other irregular warfare, cyber-attacks by intelligence agencies, their

obscure proxies or what diplomats call "non-state actors" (those insurgencies again)? Do usual litanies cover these risks? Perhaps, depending upon applicable law and the interpretation of contract language that may have been written before these risks took on their present form.

Governing law varies. In some states, notably New York, protection may be limited to listed, unforeseeable causes so that general exclusions have little or value, apart from risks of the kind listed. Unlisted risks are deemed assumed.[5] In California, a statute excuses nonperformance when "prevented or delayed by an irresistible, superhuman cause, or by the act of public enemies" of the state or the U.S.[6] But in California, as elsewhere, *force majeure* clauses tend to be construed in accordance with usual rules of contract interpretation, and risks not called out with reasonable specificity may be deemed to have been assumed, especially if they are foreseeable (as earthquakes are in the Golden State). Michigan statutes and common law offer little or no protection against *force majeure* conditions, but Michigan's courts will apply general rules of contract interpretation and persuasive authority from other states to interpret *force majeure* clauses, construing them narrowly to cover causes that have been "specifically identified."[7]

To reduce uncertainty, counsel for suppliers may succinctly enlarge usual language to embrace contemporary risks. Risks of particular concern should be called out and phrased as broadly as possible.

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[5] Glen Banks, *New York Contract Law* (2015) p. 340; *Rochester Gas & Elec. Corp. v. Delta Star, Inc.*, No. 06-CV-6155-CJS-MWP, 2009 WL 368508 at *7 (W.D.N.Y. 2009)

[6] Cal. Civ. Code § 1511(2).

[7] *Kyocera Corporation v. Hemlock Semiconductor*, 886 N.W.2d 445 (Mich. Ct. App. 2015) (citing *In re Cablevision Consumer Litig.*, 864 F.Supp.2d 258, 264 (E.D.N.Y., 2012).

For instance,

- "Storms and inclement weather of all kinds" should cover Atlantic hurricanes, Pacific typhoons and Midwestern tornadoes, among other things.

- In Florida or along the Gulf Coast, call out storm surges as well as flooding and hurricanes. Californians and their West Coast neighbors should mention tsunamis as well as earthquakes, even though they go together like salt and pepper.

- Declared wars have gone out of style, so one might refer instead to "war, revolution, insurgencies and other hostilities." Hostilities may include not only bullets, bombs and artillery but "hostile acts of governments, their security and intelligence agencies and other agents" such as "espionage and surveillance." Given the prevalence of irregular warfare, one might usefully refer to hostile acts of insurgent and terrorist groups, as well as governments.

- With protectionism in the air, conventional references to embargoes might refer also to sanctions and other trade restrictions. And after covid, public health measures taken by government should include lock-downs, travel restrictions and other restrictions that have lately become familiar.

Litanies merit scrutiny in order to be sure that they cover evolving risks and risks of greatest concern, given the underlying business, its geographic footprint, relevant risks and other considerations. Wise drafting should call out the full range of foreseeable risks, phrase those risks broadly, and be clear that the list includes but is not limited to listed risks. Catch-all references to circumstances beyond the parties' control may be helpful but cannot be relied upon to cover unidentified risks, let alone all risks. Breadth and reasonable specificity are virtues in *force majeure* clauses.

When reviewing lists of *force majeure* events and conditions, consider the extent to which some such circumstances may be foreseeable or within the parties' control. Foreseeable risks may be deemed assumed, unless identified as *force majeure* conditions.

Consider, for instance, strikes and other labor disputes, which are often listed among *force majeure* conditions; but may not apply when management locks out a union or the dispute is limited to the contracting party, rather than its industry as a whole. On the other hand, general strikes against all employers (which sometimes occur in India) are beyond any company's control. In much the same way, *force majeure* clauses in outsourcing contracts carve out interruptions that might have been avoided through use of normal precautions required by contract, such as emergency generators, or performance of a required disaster recovery plan.[8] Customers' payment obligations, however, should not be excused. Customers have continued to pay their bills throughout the coronavirus emergency.

5.3.2 Pandemic — a Force Majeure Event?

If a worldwide pandemic is not a *force majeure* event, one may wonder what might qualify. If the worst pandemic in 100 years is not a *force majeure* event, what could be? It is a fair, if rhetorical, question. Epidemics and quarantines have long been listed among *force majeure* conditions — though not always — and litigation arising from the present emergency may establish whether general references to "acts of God" or other circumstances outside the parties' control" encompass the coronavirus pandemic, gubernatorial shelter-in-place proclamations and related measures.[9] Plainly, *force majeure* clauses should routinely specify these possibilities, including not only the contagion itself but the now-familiar emergency measures that curtail or prevent normal operations.

Of course, contracts negotiated during an ongoing pandemic may fairly treat today's world of remote work, Zoom conferences and minimal travel as the current, if temporary, 'normal' rather than a *force majeure* condition. Solutions and performance standards must

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[8] Many businesses have detailed plans for recovery of critical systems and operations, often through use of backup or remote facilities and equipment.

[9] See, e.g., *JN Contemporary Art LLC v. Phillips Auctioneers LLC* No. 1:20-cv-04370-DLC (S.D.N.Y. Dec.2020) WL 7405262 (holding covid a natural disaster).

be crafted accordingly, recognizing new realities. Scattered staff working remotely will not be protected like a data center, with floodlights, security guards and a perimeter fence. After normality returns, any future epidemic or pandemic should be treated as a *force majeure* event, perhaps subject to disaster recovery obligations based upon current experience. Likewise unexpected future developments in the current pandemic, which has yet to run its course as this written, and may offer further unpleasant surprises, such as the exceptionally contagious Delta variant.

5.3.3 Force Majeure — Scope of Protection

Force majeure clauses should be broadly phrased to excuse not only cessation of performance when calamities prevent performance; but delays, partial performance and reductions in service or quality, each to the extent attributable to *force majeure* conditions. Language should be phrased broadly, to cover calamities that delay, disrupt, hinder and interfere with performance, as well as those that preclude performance.

5.3.4 Giving Notice — When, Whether and How?

Force majeure clauses in outsourcing contracts commonly require suppliers to give prompt notice, as customers fairly expect, and common sense requires – to say nothing of good account management and customer relations. Doing so quickly may be a condition for any relief from performance obligations on account of *force majeure* events. Suppliers naturally prefer to manage issues as they arise, relying upon account teams' skill to meet operational challenges and satisfy even the most demanding customers. They may hesitate to call attention to contract terms that could permit termination or other remedies if service deteriorates or cannot be restored within an agreed (often short) time after disaster strikes.

These inclinations are understandable, but few, if any, customers have invoked the coronavirus emergency as grounds for termination. Might customers do so at some future time, after the threat subsides and emergency measures lapse? Perhaps. Might customers waive termination rights by long delay exercising contractual remedies? Perhaps. However, giving notice should

preclude later suggestions that the supplier was remiss, or forfeited protection by failing to give notice. During a worldwide emergency that curtails internal as well as outsourced operations and compels most businesses to operate remotely, few customers have good alternatives – particularly when suppliers continue to perform as well as any impartial observer (an arbitrator, for instance) might reasonably expect in these exceptional circumstances.

Notice need not be an ominous, 'lawyerly' missive, admonishing the customer to "be advised that subject to such-and-such a clause of the master service agreement dated thus-and-such a date, the supplier, acting by and through its legal counsel, hereby notifies ABC Company (hereinafter, "Customer") that the sky is falling and requests waiver of the following obligations, pending further written notice." Such a notice, bound to be forwarded to the customer's legal department, fairly invites a defensive, equally 'lawyerly' response.

Rather than transform a business challenge into a legal matter, the customer's account executive might pick up the phone or schedule a Zoom conference to explain what the supplier is doing to meet the emergency, serve customers, and perform as well as circumstances permit. Conversations should be accompanied by businesslike letters to the same effect in order to satisfy contract requirements and acknowledge existence of *force majeure* conditions, but communications serve primarily to inform and reassure the customer. Proceeding in this way may tend to reinforce business relationships and prevent these issues becoming what many business people dread almost as much as viral infections — a legal matter.

5.3.5 Customer Remedies

Outsourcing contracts have commonly permitted customers to terminate affected services (or, if substantially all services are affected) entire contracts if suppliers are unable to restore service within a reasonable, negotiated time after *force majeure* events affecting the supplier's facilities and operations (not, importantly, those affecting the customer's facilities and operations). Many contracts also provide for substitute or alternate service for some

weeks afterward, while awaiting either resumption of service or engagement of another supplier. So long as the customer continues to pay usual charges, the supplier may agree to cover the additional cost, up to a negotiated ceiling for a limited time; or the customer may suspend payment and make its own arrangements for temporary service. Provisions like these may now be reconsidered in light of current experience with a prolonged emergency where there may be few alternatives (or none) since all competitors and internal operations are subject to the same risks and restrictions. The logical solution, most likely to make practical and economic sense, is to treat comparable emergencies as a kind of disaster that invokes plans for remote operation so long as the emergency and related restrictions continue.

5.3.6 Financial Adjustments

Suppliers accept that customers need not pay for services they do not receive. Most contracts so provide and will continue to do so.

More difficult issues arise if emergencies reduce service quality or require net additional effort. Customers question why they should continue to pay for normal service if, for whatever reason, they receive something less. Suppliers may seek additional compensation for net additional work required to support customers during an emergency. One obvious, if imperfect, solution is to invoke equitable adjustment provisions, adjusting charges based on net changes in levels of effort, resource consumption and other measures (though not internal costs that suppliers must keep confidential) with due regard to one-time investments or savings. Often these clauses refer to 'extraordinary events' such as mergers, acquisitions or sudden surges or contraction in service volumes. If ever there were an 'extraordinary event' surely a global pandemic qualifies. Equitable adjustment clauses are not formulae, but furnish an objective, useful framework for negotiated adjustments — one that might be useful in reconciling pandemic-related concerns about changes in solutions and related costs.

5.3.7 *Drafting Tips*

- Counsel for suppliers who might invoke *force majeure* clauses should phrase them broadly, so that their clients are protected against a wide range of emergencies that might prevent, delay, disrupt, hinder and interfere with performance.

- Customers fairly expect prompt notice and regular reports upon the supplier's efforts to mitigate a calamity's effects. Suppliers do these things as a matter of course, as part of good account management and customer relations. They may not object if (as many customer-oriented forms provide) notice is required as a condition for relief from performance obligations on account of *force majeure* conditions. But what level of effort is required — 'reasonable efforts', 'commercially reasonable efforts', or 'best efforts' — whatever those phrases may mean? Practitioners suppose that 'best efforts' requires more than ordinary performance, but case law tends to muddle and confuse any distinction. It is therefore wise to (i) define 'best efforts' as something more than ordinary performance, using the facilities, personnel and other resources ordinarily available; (ii) reserve the right to charge for net additional performance (the 'SWAT team' flown in is not free); and (iii) make clear that 'best efforts' commitments do not require disregard of contract obligations to other customers or the financial condition and operational integrity of the supplier's own business.

- *Force majeure* conditions do not (and should not) excuse failures to provide disaster recovery services, *except* to the extent that calamities prevent or disrupt performance of recovery obligations, as they may during a worldwide emergency such as the coronavirus pandemic. However, recovery plans sometimes cover selected, critical services rather than all of the supplier's services. Where customer-specific plans do not apply, customers may not expect more than a supplier's performance of the supplier's plans for recovery of its own operations. Contract language should leave no doubt on this point.

- *Force majeure* clauses may exclude a handful of obligations unlikely to be affected by emergencies, such as the customer's obligation to pay invoices — just as borrowers and tenants are commonly required to make loan and rent payments during emergencies, since even then, checkbooks can be found and electronic payments authorized. Customers may fairly require that rigorous security continue during emergencies, while allowing adjustments to security protocols and procedures consistent with remote operations. The guards and alarms that protect data and service centers will not be available to hundreds of personnel sheltering at home under quarantine orders. During the pandemic, special protocols for remote work have become common, with security measures that resemble those implemented by law firms and legal departments for attorneys compelled to work remotely during the emergency.

- When calamities strike, customers expect their suppliers to allocate scarce resources fairly among affected customers, rather than play favorites. This is appropriate, so long as the contract respects the supplier's right obligations to customers who have contracted (and paid) for more robust recovery solutions. Obligations to act impartially do not guarantee Cadillac service to those who purchased minimal or 'bargain basement' recovery solutions.

5.3.8 Looking Ahead

No one can now know just how customers, suppliers and their counsel may now adapt conventional contract terms based on experience with this worldwide emergency. Some customer-side counsel now recommend lopsided terms that effectively shift all risk from any future pandemic to the supplier.

Some recent customer-oriented *force majeure* clauses omit any reference either to epidemics or to quarantines and other emergency restrictions that curtail or even prevent performance — as if suppliers should cheerfully assume all risks and take their chances. Few are likely to do so. Suppliers willing to run this risk might get lucky; but in a future worldwide calamity, ruinous exposure might leave customers as unsecured creditors in a messy reorganization or

liquidation under the bankruptcy laws. This hardly seems an optimal outcome.

Other customer-oriented forms now propose to (i) exclude the present emergency from operation of *force majeure* and excused performance clauses while (ii) authorizing suspension of services and contract termination and (iii) the supplier waives all defenses and relief "to the fullest extent possible." 'It's all yours' is the apparent principle for allocating extraordinary risk beyond either party's control. It is difficult to imagine any well-advised supplier accepting such terms and risks.

To be fair, draconian terms shifting all risk seem intended mainly to assert leverage during negotiations and afterward. Starting with aggressive terms may tilt negotiated outcomes in the customer's favor. Should dire contingencies occur, threats to take drastic action may help to assure attention and priority. In practice, such patently unacceptable provisions are rarely, if ever, accepted as written. Negotiated compromises tend to recognize reality. Prudent business people cannot accept unlimited (and effectively strict) liability for exceptional risks that they cannot predict, prevent or control. Suppliers can and do assume large (but not unlimited) exposure for risks they can manage and mitigate, including operational failures and security lapses. But they cannot prudently accept infinite liability for once-in-a-century plagues.

Rather than deny reality by attempting to shift all responsibility, suppliers, customers and their counsel should use the same businesslike common sense now apparent during the emergency, as sensible people on both sides collaborate to make the best of things during trying times.

Should contracts negotiated before the emergency concludes carve out the ongoing pandemic? No, because of the uncertain course of future events — uncertainty illustrated by the recent, persistent Delta variant of the virus, as well as remarkable vaccines and reports of promising new treatments for actual infections. All these are in flux as this is written; and although everyone hopes that the crisis will soon abate, little is certain. Prudence therefore suggests that contracts now in negotiation should accommodate present

conditions, such as remote work with related security and operational protocols; but allow leeway and protection for an uncertain future, including future variants of the present virus, future pandemics and restrictive measures and policies imposed by public authorities. All are circumstances beyond the contracting parties' control; confident as we may be of our clients' ability to cope with a combination of goodwill, common sense and business judgment.

5.3.9 Force Majeure and Disaster Recovery

Now, more than ever, *force majeure* clauses should be drafted and negotiated alongside disaster recovery commitments; and those commitments must now cover situations like the pandemic. Conventional disaster recovery terms and plans address calamities of limited scope and duration — such as recovery after damage to a supplier's service center by fire or natural disaster. The pandemic has often required prolonged performance on a remote basis, not merely from alternate sites for few weeks or months. The kinds of protocols put in place for remote performance during the pandemic seem sure to become routine parts of recovery plans. Performance standards and operating procedures must reflect the realities of remote operation, such as relief from service level or other requirements that cannot be measured or achieved during remote operations; and adjustments to security protocols that protect customers' systems and data without measures relevant only to large facilities, such as retinal scans or security cameras. Customer access to workers' homes for audit or other purposes is inappropriate.

5.4 Price Protection

Both sides care passionately about pricing. No surprise there. Customers seek some assurance that pricing will remain competitive throughout the contract term. Suppliers, whose cost models and productivity commitments involve calculated risk, are concerned to preserve margins and wary of provisions designed to reduce revenues. Small wonder that benchmark provisions generate lively discussion.

Many customers propose both 'most-favored' pricing and rigorous benchmarks. The former is rarely, if ever, agreed, given the practical

difficulty of comparisons among varied offerings and contracts across large organizations. Even if the supplier were to agree, annual certifications that charges are the best available have little value to the customer. Advisors to customers understand this perfectly well, and no supplier lawyer need fret when applying a red pen to provisions for 'most favored' pricing.

Customer-oriented forms universally permit benchmarks of some or all services at the customer's initiative and often with drastic remedies, including compulsory retroactive price reductions or termination rights. Benchmark provisions are rarely invoked, but their existence affords leverage (which is the point) and details are vigorously negotiated. Whatever the form, key negotiating points include the following:

- *By whom?* Generally, one of the "usual suspects" among independent benchmark firms, often chosen from an agreed list and never by the supplier's competitors. This much is rarely controversial.

- *At whose cost?* Some forms call for engagement of benchmark firms by the customer at the customer's expense; others propose that suppliers share the cost. Suppliers are of two minds about these possibilities. Since benchmarking can only reduce charges, some suppliers prefer not, as they see it, to pay their tormentors. Others believe that their interests may be better protected by joint engagements in which costs are shared. Benchmark firms who justify their existence by finding savings for customers may, it is thought, be less likely to act as mere 'hired guns' when engaged and paid by both sides. Joint engagements may also assure a voice in the conversation when terms of reference are written and the process unfolds — a process whose outcomes may largely depend upon the skill of the benchmark professionals and the information available to them. Errors and aberrations are best headed off through collaboration and discussion, rather than debated when written into findings (even draft findings).

- *Scope and procedures*. Suppliers fear what they call "cherry-picking" – that is, comparisons of isolated elements or line

items, rather than all services or at least whole categories of service – in somewhat the same way that restaurant guides classify restaurants based upon the price of a meal, rather than *à la carte* items. Most customers accept the logic of this position. Many clauses contemplate benchmarks of both price and service levels. In practice, this may be problematic, since the two are interdependent, although the usual focus of benchmark exercises is (unsurprisingly) price, rather than service levels. More stringent service levels with superior technology, added redundancy and the rest will cost more. Benchmark firms follow their usual methods, but must also adhere to the contract, which may require such useful protections as written terms of reference, developed collaboratively, and an opportunity for both parties to review and comment upon draft findings before any final report issues. Suppliers can live with fair and objective findings, even if unfavorable, but fear errors, anomalies and aberrations.

- *Comparisons* are the essence of benchmarking. They should be based upon a reasonable, near-current sample of competitive contracts (not extrapolations from companies' internal costs) and normalized for scale, volumes, service levels, financial engineering and other variables. That much is rarely controversial. Standards for comparison or competitive ranges are something else again. Many customer-oriented forms would require suppliers to match the top quartile of the sample for quality and the cheapest quartile in price – in other words, premium quality for a bargain-basement price. Suppliers cannot accept this and require that comparisons be tied to the average or median of the sample (sometimes disregarding outliers) and with some reasonable margin for error, given the uncertainties of a process that involves judgments, adjustments and scarce market data. Nor is it quite fair to guarantee customers bargain rates for which they did not contract. Most rates and charges, after all, tend toward medians and averages, as one would expect in any competitive market.

- *Consequences and remedies?* Customers sometimes propose that suppliers be compelled to match benchmark findings, and even to reduce charges retroactively. Suppliers cannot accept

provisions that might compel them to lose money (if benchmark estimates fall below actual costs to perform) and pay refunds with unfavorable implications for revenue recognition and margins. Price, moreover, is not an independent variable. Suppliers have greater latitude to adjust charges if scope, service levels, staffing and other aspects of their solutions are open for discussion. The usual negotiated resolution involves an opportunity to meet, confer and propose adjustments not only to charges but also solutions and operations and thus, the supplier's cost to perform. If the parties do not then agree within a reasonable time, measured in weeks, not months, the customer may terminate affected services, often for a reduced termination charge. Occasionally, suppliers agree to modest, mandatory adjustments, within a narrow collar and spread over time, but this is much less common.

5.5 Remedies — Default Termination

Customers commonly have many termination rights, for cause and for their convenience; but suppliers can rarely terminate for any reason other than nonpayment and perhaps a handful of dire circumstances, such as intentional infringement or misappropriation of the supplier's intellectual property. Suppliers accept that payment is the customer's principal obligation and other breaches may be adequately addressed through payment of damages or equitable remedies. Customers fear that suppliers would have and might abuse excessive leverage if they could threaten to cut off service and disrupt the customer's business, on account of routine disputes. Although bullying customers would be bad business, the point is a fair one, which suppliers accept.

Suppliers also accept that customers may terminate in the event of an uncured material breach and various other serious failures (each, an example of material breach) such as excessive service level failures (measured by numbers of incidents or total liability for credits), material failures to execute disaster recovery plans, serious improprieties (such as bribery) and epidemic failures that, taken together, are material (so long as there has been a final notice or warning, and an opportunity to cure the causes for such a pervasive

failure). Little of this is controversial, though there may be quibbles about wording, cure periods and other specifics.

For suppliers, the crucial issue is materiality, an elusive term reminiscent of Justice Potter Stewart's reference to pornography as something he could not quite define but knew when he saw.[10] Like their customers, suppliers fear threats of termination on account of minor issues, even pretexts. Suppliers object to 'hair-trigger' termination rights that would permit termination for trivial reasons (in effect, for the customer's convenience) without paying termination charges. Neither side should have overweening leverage that might be abused. Default termination, contract law's analogue to the death penalty, should not apply to misdemeanors.

5.6 Remedies — Indemnification

Indemnities are undertakings to pay another's damages or losses. In outsourcing contracts (and many others) they are generally commitments to defend and, if necessary, pay third party claims. Since defense costs may be the largest single exposure, few customers accept simple indemnities against final judgment liability. For similar reasons, customers prefer conventional commitments to indemnify, defend and hold indemnitees harmless to narrower commitments to "defend and settle" claims. From the supplier's standpoint, either formulation can work, if the indemnity is well-drafted, precise and liabilities are contained (sometimes through a negotiated definition of the types of 'Losses' that are subject to indemnification as well as contractual limits on liability).

5.6.1 Mutual Indemnities

Since indemnities concern potentially large (though remote) risks, they are intensely negotiated. Forms offered up by one side or the other are studies in contrast. With indemnities, many people seem to believe that it is nobler to receive than to give (inverting the old maxim). Customers may seek many yet offer few (or none). Those they request from suppliers may be spaciously phrased to encompass a wide variety of potential claims related to the

[10] *Jacobellis v. Ohio,* 378 U.S. 184, 197 (1964) (Stewart, J., concurring).

supplier's acts, omissions and performance. Suppliers prefer to be abstemious, so that indemnities are few, specific, well-focused, and limited to third party claims – with liability limited proportionally to the extent of fault and (like most other liabilities) capped at an amount tied to revenues (typically, twelve months' worth of charges) subject to narrow exceptions for infringements and some exceptional or egregious claims. In cases of infringement, an indemnitor should not be liable for claims related to an indemnitee's plans, specifications, modifications, misuse of the indemnitor's technology or failure to use available upgrades.

Negotiated resolutions vary, for all the usual reasons, but often boil down to a longer or shorter list of more or less reciprocal indemnities for various potential claims, such as bodily injury, damage to tangible property, infringements, breaches of third party contracts, various employment claims, tax liabilities and violations of law. Since suppliers have more extensive performance obligations, suppliers are at greater risk for indemnified claims, although customers may be responsible for customer-provided materials and facilities as well as obligations to displaced or transferred employees. Customers and their advisors are not bashful about requesting supplier indemnities (not all of them by any means reciprocal). Supplier-oriented forms typically offer fewer, narrower indemnities than appear in the usual customer-oriented forms. Suppliers prefer to limit indemnities for injury to *bodily* (rather than personal) injury, and so avoid liability for damage to reputation, which is a kind of business loss (and ordinarily excluded, as discussed below). For similar reasons, suppliers should limit indemnities concerning property damage to *tangible* property.

Customers sometimes propose that indemnities embrace bilateral claims between the parties, in addition to the usual (and more typical) obligation to indemnify, defend and hold the other party harmless from and against third party claims. This approach is thought to offer tactical advantages and perhaps larger recovery, as indemnified losses, broadly defined, may encompass more than contract damages. Suppliers resist such breadth, contending that damages for breach, termination rights, and other usual remedies suffice for performance issues. If the customer can recover damages for breach and be made whole, it needs no indemnity.

Moreover, indemnification for bilateral claims could largely defeat limitations on liability, which may exclude at least some indemnified claims (or in many customer-oriented forms, *all* indemnified claims). If routine performance disputes were covered by indemnities, and liability for *all* indemnified claims were unlimited (as many customer forms propose), then contractual ceilings on bilateral liability would mean little. Suppliers therefore prefer to limit indemnities to third party claims – a point most customers accept if the indemnities and related terms are otherwise acceptable.

5.6.2 Indemnities for Noncompliance

The parties may indemnify one another against claims concerning violations of applicable laws and regulations. Suppliers typically commit to comply with laws applicable to their businesses, without assuming responsibility for the customer's compliance with laws applicable to the customer's business — responsibilities that customers generally cannot delegate. However, suppliers will be accountable for compliance with procedures that incorporate the customer's interpretation of regulatory requirements. When complex allocations of responsibility are negotiated, they should be reflected in the indemnities. For example, a supplier adhering to its customer's approved process for regulated transactions will: (i) decline responsibility for violations attributable to that process; and (ii) expect indemnification for the customer's misinterpretation of regulatory requirements. This allocation may vary if the supplier offers special expertise in compliance with particular regulatory restrictions. If compliance is an inherent part of the services, the customer will necessarily expect the supplier to take responsibility. Payroll services, for example, should include accurate calculation of withholding taxes from data feeds including wages and salaries, but without the supplier assuming responsibility for the employer's compliance with statutes governing wages, hours, leave or other benefits.

5.6.3 *Indemnities for Data Incidents*

Statutes in all 50 states and the District of Columbia require notice to individuals when personal data are compromised. Individual

statutes vary, but in general, they require to notice state residents when breaches of security expose personal information. Outsourcers must inform their clients immediately after a security breach, but the statutory obligation to give notice to affected consumers and public authorities belongs to the owner of the data – that is, the customer, or in EU parlance, the controller, who collects the information. In these circumstances, not surprisingly, customers seek indemnification and other protection from their suppliers. Suppliers may and do seek reciprocal indemnification from their customers, to the extent that fault lies in acts and omissions of the customer's users or deficiencies in the infrastructure and environments customers often provide for the supplier's use. As always, the parties' potential liabilities should be limited to the extent of their actual fault. Neither party insures the other nor accepts strict liability.

Sophisticated suppliers readily agree to inform their customers, cooperate in the investigation, take corrective action (within the supplier's scope of responsibility) and (to the extent they are at fault) pay reasonable costs of notice and other appropriate remedial support (such as credit monitoring), subject to applicable limits upon the supplier's liability. Within this general framework, of course, much room remains open for energetic negotiation.

- Which incidents must be reported? Statutory definitions of reportable incidents and security breaches vary and are less than ideally clear. Few CIOs want to receive telephone calls about every unsuccessful intrusion detected by the supplier's systems; and suppliers prefer not to be required to report suspicion or likelihood, which seems to them like a kind of glorified speculation.

- When and to what extent is the supplier responsible? For all incidents, however caused or only for incidents attributable to the supplier's failures to perform its express obligations? What if each party is partly responsible — should there be a proportional allocation of financial and other responsibility? No points for guessing the contrasting views of suppliers and customers on these questions.

- Who determines what action to take? Whether or not notice must be given? Customers contend, persuasively, that since the statutory notice obligation is theirs and the data subjects are their employees or customers, theirs should be the final say. However, specific legal notice obligations are not always clear, and because of the public relations impact of a data security incident, companies may be tempted to provide more than statutes strictly require. Suppliers also have reputations and prefer not to write blank checks, so tend to require that they be consulted, and that reimbursement and indemnification obligations be limited to reasonable measures and amounts (such as costs of notice, credit monitoring and approved settlements), subject to an overall limitation upon the supplier's liability – yet another contentious issue. In practice, when incidents occur, security professionals on both sides tend to collaborate, not only because they must (like two scorpions in a bottle) but because it is sensible and prudent to do so. Wherever ultimate responsibility lies (and it may be shared) supplier and customer share common interests in satisfying legal obligations, finding causes, mitigating effects, preventing recurrence and protecting reputations.

5.6.4 Indemnification Procedures

Procedures for indemnification resemble those in other contracts, and commonly include provisions for notice, collaboration in the investigation and defense of indemnified claims, payment of defense costs by the indemnitor, approval of settlements and the rest. In cases of infringement, the indemnitor will want reasonable flexibility to defend, procure a license or provide a substitute. All this is straightforward. Suppliers also insist (appropriately) that their liability be limited proportionally to the extent they are at fault. For suppliers, fault-based liability (as opposed to strict liability) is a fundamental, walk-away issue — the more so in a world of increasingly sophisticated attacks upon personal and other valuable data. Suppliers are not insurers. Their solutions and security measures may improve security for customers' data and reduce risk; but they neither eliminate those risks nor provide ironclad guarantees – any more than sellers of sprinklers or fire extinguishers provide fire insurance.

5.7 Limitations on Liability

No issues are more contentious or intensely negotiated than liability limits, including various exceptions to or exclusions from whatever limits may be agreed. Suppliers are not insurers, and therefore limit potential liability for breach, with exceptions for a few, egregious or exceptional situations. Here again, the Devil lurks in the details, but for suppliers the essential distinction is one between ordinary errors and malfunctions that may occur (for which liability should be limited) and those exceptional circumstances (such as wrongdoing) where limits may not apply.

5.7.1 Varieties of Damages

When contracts are breached, money damages are supposed to compensate the innocent party for its direct losses and provide a kind of rough financial equivalent to performance. Contract damages may be loosely classified in three categories:

- *General*, *actual* or *direct* damages compensate the non-breaching party for the reasonably foreseeable consequences of breach, based upon circumstances known to both parties at the time of the contract. These may include costs of corrective action and substitute service ('cover'), among others, if foreseeable.

- *Consequential*, *indirect* or *special* damages compensate the non-breaching party for secondary consequences of breach that would not be reasonably foreseen unless special or unusual circumstances are communicated at the time of the contract. Many lawyers suppose that lost profits, lost revenues, unrealized savings, reputational injury and reductions in goodwill or the value of the customer's business are necessarily consequential damages, but these business losses may be direct damages if they are foreseeable. They should therefore be clearly and separately addressed. Merely excluding consequential damages may not necessarily exclude business losses, which should be expressly excluded.

- *Incidental damages* are, as the label suggests, incidental costs related to the breach, such as costs of inspecting and returning defective goods, expenses and commissions paid to obtain substitute products and services, and costs related to delays.

In outsourcing, virtually all contracts: (i) preclude recovery of indirect or consequential damages, incidental damages, and such business losses as lost profits; and (ii) limit recovery of actual damages with either a fixed ceiling or a formula tied to revenue. Usually, there are some limited, intensely negotiated exceptions for which liability may be unlimited or subject to different limits (such as intentional wrongdoing and indemnified claims of infringement).

Suppliers uniformly reject unlimited liability (with narrow, limited exceptions), especially if they are to deliver service at lower cost than a customer's own internal operations. Supplier cost models contain no premium to insure the customer against business interruptions and similar contingencies. They could not do so and still offer savings to customers, who rarely insure their own operations similar risks. Suppliers are unwilling to assume risks that customers already bear or to bet their companies upon individual contracts. They provide a service (for which they expect to be held accountable) but do not write insurance for their customers' businesses.

5.7.2 Consequential Damages and Business Losses

Outsourcing contracts restrict and usually prohibit recovery of lost profits, lost revenues, unrealized savings, lost goodwill or share value, reputational injury and consequential damages. Since lost profits and other business losses may be recoverable as direct damages, if they might have been foreseen, it is good practice to exclude *both* consequential damages and business losses, which should be enumerated so that they are expressly excluded. Sophisticated customers with sufficient bargaining leverage sometimes secure limited rights to recover consequential damages, up to a negotiated ceiling for certain claims. This is most common in situations where any damages are likely to be consequential, such as misappropriations of confidential information and intellectual property; and even then, business losses, or at least the more far-

fetched business losses (such as reputational injury, lost goodwill or reductions in share prices or business value) should be excluded.

Contracts more frequently:

- Permit recovery (as indemnified losses) of consequential damages actually paid to third parties under contractual indemnities (subject to applicable limits, with certain exceptions, discussed below).

- Classify certain costs related to corrective action as direct, rather than indirect or consequential damages, and so foreclose any contention that costs of legitimate corrective action are unrecoverable as 'consequential damages.' Typical examples include corrective work, substitute service (or 'cover'), workarounds, fines or penalties owed to public agencies within the US (though not the EU, where the recently revised European regulation permits fines equal to as much as 4% of an offender's worldwide revenue).[11] and recovery of lost or corrupted data. Suppliers may question particular items on long laundry-lists of potential damages, but rarely object to reasonable costs associated with likely consequences of unacceptable performance.

5.7.3 Limitations on Actual Damages

Ceilings on actual damages may be fixed sums (as in an insurance policy). More often, ceilings equal total fees charged during an agreed number of months — often, twelve months — excluding expense reimbursements; but rules of thumb are not substitutes for thought, and conventional wisdom is not necessarily wise.

For the customer (and, in practice, both sides) the questions resemble those surrounding limits upon insurance coverage. How much is sufficient to cover dire contingencies: breakdowns in service or project failures, related corrective work or "cover," and costs of unwinding the relationship by engaging another supplier or bringing the functions back in-house? From the customer's

[11] Regulation (EU) 2016/679, Article 83(4) and (5).

standpoint, large exposure also helps to assure the supplier's full attention and engagement to prevent and, if ever necessary, recover from 'worst cases.' Suppliers understand this, although from their standpoint, the risk to their reputation in the marketplace and with the public is so large that they could not (even if so inclined) easily walk away from, for example, a catastrophic data incident — whatever the contractual limit upon their financial liability.

Suppliers consider the scale of the relationship, anticipated margins, and potential risks. If the parties conclude that twelve months' worth of charges is an appropriate overall limit, the contract usually will limit actual damages to (i) charges during the twelve months before the claim arose, or (ii) for claims arising before twelve months elapse, estimated charges for those first twelve months.

Although twelve months' revenue remains a common standard, it is by no means universal and seems less common that it once was. Why? Reliable market data are scanty, 'worst case' events are rare, contract terms are confidential (especially the most sensitive, heavily negotiated terms) and negotiated outcomes depend upon bargaining leverage, competitive pressures, the quality or risk associated with particular services and solutions and negotiated trade-offs with unrelated issues.

To the extent that suppliers occasionally accept larger limits, they may do so, in part, because (i) many customers now have or are willing to pay for superior security; (ii) suppliers now build robust security into service offerings; and (iii) all participants feel competitive pressure (even if they doubt claims by customers' procurement departments or consultants that the proverbial "other guys" have signed up for astronomical and even unlimited liability). Suppliers' flexibility on limits naturally depends upon their customers' willingness to limit suppliers' liability to the extent of fault and accept practical and financial responsibility for their own security, including the acts and omissions of their users.

Formulaic limits are often supported by a floor, so that the basic limit may be *x* months' worth of charges, or at least $*y*. Customers understandably seek some assured level of protection during the first weeks and months of a contract's term; but it does not follow that

the supplier's exposure should always equal an entire year's anticipated charges, even during the first few weeks, or at some future time when the relationship shrinks for any number of reasons, including possible customers' desire to reduce the scale and scope of the relationship. Rules of thumb have their uses, but are not substitutes for judgment, or the essential principle behind formulaic limits that tie the supplier's exposure and the customer's potential recovery to the scale of the relationship.

Some customers propose waiver and replenishment clauses to the effect that if claims or recoveries ever exceed a substantial percentage of the agreed limit, the supplier must increase the limit — that is, open itself up to additional liability — or risk termination of the contract without any termination charge. These clauses have little charm for suppliers, who perceive them as potential levers to increase pressure or exposure (or both) during any future difficulties. In practice, this right could be academic, as claims large enough to meet the threshold may well trigger termination, whatever the limit. If serious difficulties are resolved (as often they are) the customer may, of course, propose to refresh the liability limit as a condition of any overall resolution. Various compromise positions are possible — in particular, concerning the percentage sufficient to invoke the clause — but customers seriously concerned about insufficient remedies are often better advised to face the issue squarely and press for a higher overall limit in the first place or to seek larger limits for particular risks. Suppliers prefer to tie any increase in exposure to amounts actually awarded as damages or paid in settlements, rather than claims asserted, which may be limited only by the imagination of an unhappy customer's attorneys.

What about credits paid for missed service levels or transition milestones — should they count toward liability limits? Suppliers argue that they should, since amounts paid represent partial (if modest) compensation for inadequate performance; and amounts paid should reduce awards of damages, dollar for dollar, in order to prevent excessive recoveries. Customers, on the other hand, argue that the purpose of service level credits is deterrent, rather than compensatory. Credits, and the prospect of having to pay, help to assure the supplier pays attention, and in the event of an outage, promptly corrects and complies with the contracted service levels.

In practice, many suppliers concede this point, since credit amounts are generally limited to modest percentages of the supplier's monthly charges and probabilities of actual payment are (both parties hope) low.

5.7.4 Exceptions – Greater or Unlimited Liability

Certain claims are at least partly exempt from overall limits on liability. These exceptions are intensely negotiated, and resolutions vary for all the usual reasons, including bargaining leverage, competitive pressures, risk tolerance and context — particularly the kind of service, quality of the solution and perceived risk.

Not all exceptions mean liability without any limits. Sometimes liability for actual damages is unlimited, or subject to a higher ceiling, but consequential damages remain barred. Sometimes consequential damages are recoverable, up to an agreed limit, where the likely damages are consequential; but liability for actual damages is unlimited. Recovery of lost profits and other business losses is generally precluded, except in cases of fraud, wrongdoing or other egregious situations to which limits cannot apply.

Separate or enlarged liability caps are sometimes agreed for particular kinds of claims, such as information security and privacy claims arising from security incidents. The supplier willing to put 12 months' revenue at risk for operational miscues may agree to enlarge the limit for selected information security and privacy claims, if related security, compliance and indemnity obligations are acceptable. Even then, lost profits, unrealized savings, share price reductions, reputational injury and other business losses should be excluded.

Exceptions to liability limits and special limits for particular risks give the parties and their counsel opportunities for creativity and compromise.

The following exceptions are, if not typical, at least common:

- *Indemnified Claims of Infringement.* To the extent the supplier provides software or other forms of intellectual property,

infringement claims are often "life or death" cases, where no expense will be spared, so this exception may be readily agreed. Typically, an indemnitor has reasonable flexibility to defend indemnified claims by procuring a license, providing a non-infringing substitute, or taking other, reasonable measures. In the worst case – where no license, substitute or other solution is available at reasonable cost — the infringing matter may be withdrawn and scope, service levels and charges equitably adjusted. Sometimes refunds are agreed, and if substantially all services are affected, there may be a termination (without cause, and for a reduced termination charge, if any). Where suppliers work with the customer's proprietary systems and processes, they expect reciprocal indemnities against infringements. Suppliers' indemnities disclaim responsibility for infringement claims arising from the customer's infringing specifications and other acts or omissions, such as misuse, unauthorized modifications or failure to use non-infringing updates. For similar reasons, customers' indemnities concerning their own intellectual property disclaim responsibility for infringing modifications created by the supplier.

- *Other Indemnities.* Indemnitees can often recover consequential damages actually paid to third parties, despite the usual prohibition upon recovery of consequential damages for a party's breach of the contract. Suppliers naturally prefer that liability for indemnified claims be limited, just like general damages for breach. Customers often argue that a limitation on indemnified claims is unfair — if the supplier's acts or omissions expose the customer to liability above the basic limit, the supplier's liability should be unlimited. Suppliers may entertain additional or even unlimited liability for indemnified claims that involve bodily injury or damage to tangible property (insurable, low probability risks) and perhaps some other situations that rarely, if ever, arise in well-managed companies and involve only modest or moderate exposure (for example, certain employment claims by transferred employees or failures to pay required taxes). However, suppliers rarely accept unlimited exposure for risks arising from ordinary errors or malfunctions associated with performance, as doing so could

effectively defeat the fundamental purpose of liability limits, which is to limit damages arising from performance disputes.

- *Wrongdoing*, such as fraud, other intentional torts, intentional violations of law and other willful misconduct. Few attempt to defend the indefensible or contend that liability limits should shift costs of wrongdoing to an innocent party. Any such limitation would almost certainly be invalid as against public policy.

- *Gross Negligence, Recklessness*. Customers sometimes propose that liability be unlimited for gross negligence and recklessness as well as intentional wrongdoing. It is hard to quibble with the principle; and here again, few attempt to defend the indefensible. However, the terms 'gross negligence' and 'recklessness' are neither universally recognized nor precise. Judicial formulations from accident cases may not fit commercial situations. The threshold for liability is lower than for intentional wrongdoing, since intention need not be proved, but how much lower is far from clear. Suppliers fret that judges or jurors might stretch the definition of ordinary negligence so far that they erase negotiated limitations on liability. To limit any such exception to extreme cases, one may: (i) adopt a statutory definition (if available) or define the terms in the contract — rather than rely upon changeable, sometimes obscure judicial pronouncements — so that unlimited liability is available only where there are blatant violations of legal duties, conscious disregard for the rights of others and other extreme circumstances that involve far more than a duty of ordinary care and (ii) impose a higher burden of proof, such as proof by clear and convincing evidence.

- *Abandonment.* Customers argue that abandonment by the supplier should be subject to unlimited liability in order to deter an "economically efficient breach" by walking away (or threatening to walk away) from a troubled deal for the price of the liability limit. Few, if any, reputable suppliers would imperil their reputations by doing so but the fear is understandable and easily accommodated through an appropriate exception. However, abandonment (sometimes described as "wrongful

termination") is an imprecise term that could mean exercise of the supplier's termination rights in bad faith or good faith exercise that is later determined to have been unjustified. Imprecision on this point and the risk of unlimited liability, could easily deter a supplier from exercising its remedies, even when warranted, because of the risk that a judge might disagree and open the floodgates. To protect their remedies, suppliers often propose to carve out good faith exercise of their rights to (i) terminate for nonpayment, and (ii) condition any further performance upon prepayment of charges.

- *Payment.* Liability limits should never apply to the customer's payment obligations. This exception is not controversial, and, in any event, few suppliers are likely to sit idly while a customer falls far behind.

5.7.5 Privacy and Security

Often, the most sensitive exceptions proposed are those that embrace privacy and data protection issues, such as exceptions for breaches of confidence and violations of law. Some years ago, unlimited liability for these risks was often agreed; but now, amid ever-growing concern about identity theft, the increasing complexity of statutory obligations and ever greater exposure, suppliers are unwilling to risk unlimited liability. Customers and suppliers fear claims related to security breaches that may release sensitive personal data about individuals and expose consumers to identity theft. No clear consensus has emerged, or seems likely to emerge anytime soon, given potential liabilities, the law's evolution, and the possibility that statutory and common law liabilities may expand in the years ahead. Compromise resolutions vary considerably, depending upon bargaining leverage, competitive pressures, and perceived risks associated with particular services, solutions and uses of personal and other sensitive data.

Ideally, many customers would prefer that suppliers' liability be strict and unlimited. If personal data are compromised, customers would prefer that someone else pay — especially if the outsourcer has erred or the outsourced solutions have (or are perceived to have) increased the risks.

Suppliers, naturally, see things differently. They too have reputations to protect, but prefer to contain their liability in some fashion, through absolute (if often enlarged) limitations on liability for privacy, data protection, and related statutory claims. Suppliers are willing to be accountable (within limits) for their own performance and the solutions they sell but are not willing to assume risks associated with inherent limitations in their solutions or the customer's acts and omissions (they too can compromise sensitive data). Security involves collaboration and not all customers need (or are willing to pay for) the kind of "fail-safe" security that an outsourcer might be able to provide (for a price) to intelligence and law enforcement agencies, the armed forces, regulated industries or especially demanding commercial customers. Risk also depends upon the degree of control — the more the supplier is empowered to make decisions and control the security architecture, the more risk the supplier may be willing to take. Conversely, suppliers are unlikely to take large risks in implementation or operation of solutions engineered by others or for the customer's retained functions.

No solution can provide absolute protection against ever-increasing risks, which now include organized crime, industrial strength espionage and quasi-military operations conducted by governments, their intelligence or security agencies and military forces, even irregular or insurgent forces answerable to no government. Suppliers commonly insist that liability be fault-based: in other words, they may be liable if, when and only to the extent that damages arise from breach of their obligations. Risks inherent in the solution, customer or user errors, deficiencies in the customer's internal security measures, war risks and sovereign acts, are not, as they see it, within their responsibility.

How then to square the circle and reconcile these competing perspectives? To begin with, the risks that most concern customers, such as consumer privacy and identity theft, exist before customers decide to outsource. Engaging an outsourcer may actually improve security, depending upon the circumstances and solution, but perceptions of risk may change — along with the number of potential points of failure. On the other hand, good security – even the very best security — can only reduce and not eliminate all risk.

Too often, 'worst case' risks and contract language are discussed abstractly, without practical discussion of risks, mitigation measures or related costs. Rather than simply debate legal theories and contract language in the abstract based on a 'parade of horribles' limited only by the participants' imagination, the parties are well advised to examine underlying realities and risks before they negotiate language.

Key questions include the following:

- What kinds of data are at risk? Personal data of customers and employees (including or excluding especially sensitive data, such as medical records or financial information)? Business secrets, such as business plans and product designs? Miscellaneous customer data entrusted to the supplier for processing? Conventional definitions of 'confidential information' and 'customer data' may not differentiate among different kinds of data, which may be processed separately and subject to different standards of care, security policies, regulatory requirements or liability limits. Clear, separate definitions are recommended, each with appropriate standards of care and security measures.

- How will that data be used? Will the supplier possess or have access to sensitive or personal data (and does the supplier really need access to that data)? Sensitive or personal data should not be more widely accessible than necessary to deliver the service. Suppliers of software development and maintenance services can sometimes work remotely with masked or 'blind' data, without access to actual personal data. In such cases, real risk may fall to near the vanishing point. Processing credit card statements or medical insurance claims is not so simple and special regulatory requirements apply to banking, health care, and some other industries. Security requirements may therefore be more stringent, detailed and specific.

- Are there clear, mutually agreed standards of care and security procedures? Who is responsible, practically and financially, for monitoring changes in security obligations and then recommending or implementing changes in security

procedures? Suppliers may be more willing to accept risk when their responsibilities are clear, and costs of accommodating change are compensated appropriately. It is in any event good practice to adopt comprehensive standards for security, rather than rely upon loose, debatable references to "best practices" (whatever they may be, however they may evolve) or potentially conflicting standards (e.g., customer, supplier or industry standards, whichever may be most stringent). Accountability is best measured against clear, objective standards.

- How robust are agreed security arrangements? Suppliers offer a range of capabilities, depending upon customer requirements, budgets, and the risks inherent in the underlying service and solution. Better security reduces risk and, not coincidentally, may increase costs as well as the supplier's willingness to accept additional exposure. Regulated customers processing sensitive or personal data need more robust security than most other companies. Few commercial customers need (or are prepared to pay for) military-grade security.

- Are each party's responsibilities clear and specific? How robust are the customer's existing arrangements (which the supplier will inherit and live with at least initially)? How robust is the customer's internal security program? Will the customer be accountable for performance of its responsibilities? Are those responsibilities clearly articulated? Security is, invariably, a joint responsibility. Suppliers are more likely to entertain expanded liability for their own performance when the customer's own house is in order, and the customer is liable for matters within its responsibility.

- Above all, what risks are of greatest concern? What hazards keep the customer's executives awake at night? What kinds of data just have to be protected? Consumers' account numbers and PINs? Product formulae or recipes? Answers will vary. So will solutions and negotiated outcomes.

From discussion of these realities, agreement should emerge upon practical measures to meet customer concerns at acceptable cost, as well as a common assessment of actual rather than theoretical risks.

Then and only then are the parties likely to agree upon some compromise positions for these vexing, complicated issues. Abstract discussions of contract language, 'worst cases,' and theoretical liability for bizarre hypotheticals are rarely productive.

Generalizations are hazardous, as privacy law is changeable and these issues are intensely negotiated; but it seems fair to say that the better the solution, standards, and the customer's own security, the more willing suppliers will be to entertain additional risk. Suppliers are uniformly unwilling to agree to unlimited liability for these risks; but they will make some additional provision for these risks, above and beyond the basic liability limitations, after thorough consideration of practical arrangements and risks, and with an absolute ceiling upon potential liability.

Occasionally, suppliers may entertain unlimited liability for narrow, well-defined risks, such as disclosure of the most sensitive confidential business information. Sophisticated customers protect their crown jewels — secret product formulae, for instance, or unannounced mergers — with great rigor, rarely disclosing anything outside of senior management, encrypting data and keeping paper copies under lock and key. Suppliers are unlikely ever to be privy to any of this, except perhaps account executives and other management who can be trusted (and to whose misconduct no limit could apply). However, to the extent such information is stored on systems managed by the supplier (e.g., e-mails that may contain such information), suppliers will typically resist taking on additional risk unless the information or systems are segregated and identified by the Customer as requiring additional security measures — measures built into requirements, solutions and charges.

However, few, if any, suppliers will accept unlimited liability for data incidents that compromise personal data or — whatever the circumstances (apart from intentional wrongdoing) — entertain any recovery of such business losses as lost profits and revenues, unrealized savings, damage to reputation or reductions in the value of the customer's business or its goodwill. To the extent that suppliers are at fault, they will be responsible for direct damages associated with security incidents, such as costs of investigations, remedial measures, and notices.

One possible resolution is creation of a second, separate liability cap for specific categories of information security, privacy and related claims (e.g., *x* months' worth of charges for performance and other claims generally, and *y* months' worth of charges for claims concerning breaches of confidentiality, security incidents and breaches of obligations related to personal data). When this approach is taken, the drafting should make clear that amounts awarded for any particular claim or group of related claims count toward one but not both limits. Where separate caps are agreed, and a security incident occurs, the customer should not be able to exhaust both by separating claims related to the incident (such as settlement of class litigation with data subjects) from underlying performance issues (such as failures of equipment or human errors). Drafting must make clear that claims arising from the same incident or situation count toward one limit or the other, but not both.

Another widely used approach is the so-called "supercap" or "enhanced cap" which might be *x* months' revenue for most performance issues but $x + y$ months' revenue for selected information security and privacy claims. This avoids the risk that clever counsel will attempt to drain both "buckets" (that is, exhaust two liability caps meant to be separate) but in the worst case, $x + y$ may be a very large number.

There may be no clear consensus regarding the choice between these approaches — either enlarging the liability limit or making some wholly separate provision for information security, privacy and similar claims. One or the other may be more or less attractive, depending upon the situation, particular risks and potential exposure. In all cases, whatever the approach taken, lost profits and other business losses should be excluded.

One thing *is* certain, however: there are no easy answers.

6 NEW TECHNOLOGIES — NEW CHALLENGES

The pace of change has accelerated during the present decade, first with cloud-based solutions, then analytics to manage and mine exploding masses of data and now robotic and other automated solutions. Suppliers seek to transform manual into automated

processes and convert process excellence into software, robotic and other tools that can be offered 'as a service' and thereby share with customers the savings and efficiencies that these technologies promise.

As before, the value proposition for outsourcing evolves. First came economies of scale from consolidation of operations in suppliers' data centers, using standard methods, processes and tools, master licenses and large-scale infrastructure. Then came arbitrage from offshore operations, partly inspired by the Year 2000 scare that revealed the quality and efficiency available in India and elsewhere, at lower cost. Scale and arbitrage remain relevant, but customers increasingly look to outside suppliers for superior technology and efficiency, in order to manage information, keep it secure and their operations compliant and up-to-date.

Often these novel technologies are sold on a stand-alone basis, under relatively simple contracts that bear more than a passing resemblance to traditional systems integration or development contracts. Integrating these technologies into larger-scale, more complex outsourcing engagements presents greater challenges, the more so with existing contracts and forms crafted with traditional technologies and 'build-to-suit' solutions in mind.

Many lawyers for customers approach these issues by extrapolating from their familiar forms, so that: (i) implementation is the supplier's sole responsibility (as if their client, the customer, were along for the ride); (ii) all technology must be licensed or sublicensed to the customer (which may not be possible or appropriate for third party solutions); and (iii) scope includes whatever used to be done (whether or not capable of automation or included in the automated service). Support is presumed to be comprehensive and lavish – ideally, round the clock, 24 by 7 by 365 (perhaps with a day off for maintenance during leap years).

To obtain desired efficiencies and savings, all must acknowledge reality.

- There are bound to be differences among and between (i) authentically custom solutions, crafted for individual

customers, tailored to their needs, with corresponding costs; (ii) implementation and operation of third party solutions, each with its own capabilities, performance standards and standard (that is, non-negotiable) support program; and (iii) the supplier's own standard solutions, which have similar limitations, but might (or might not) be tailored to an individual customer's needs.

- Standard offerings' performance may be fixed, designed into the technology and limited accordingly. Engineering may dictate capabilities and performance. Continuous improvement requirements, 'ratchet' increases in service levels tied to reported performance may be beside the point. Engineering dictates capabilities and performance, just as in aviation.

- Support programs for standard solutions have to be standard, perhaps with some options for premium service, especially rapid responses or after-hours support. But suppliers of such services have a business to run and cannot necessarily cater to each and every customer's desires or whims, any more than a Chinese restaurant is likely to serve lasagna simply because a particular diner fancies Italian food.

- Standard offerings will be upgraded, replaced or even discontinued based upon the emerging state of the art, market conditions and other factors outside the scope of a particular engagement, no matter what the contract says. The contract may provide for replacements and substitutions or rights to disengage but cannot require a supplier to offer an obsolete or uneconomic solution indefinitely.

- Implementation of novel solutions is a collaborative process, rather like initial transitions to outsourced solutions or eventual disengagement. Some forms feign ignorance of these realities, purporting to assign sole responsibility to the supplier. But there is no escaping reality. Transformation of existing operations and solutions to novel technologies requires collaboration in order to be successful, so reference to customer obligations, written dependencies, and adjustments when those dependencies are (for whatever reason) unfulfilled is appropriate. Where forward pricing depends upon timely

implementation of novel technologies, both parties and their counsel must consider dependencies, and possible consequences and adjustments, should implementation be delayed or deferred, whether because of either party's performance or circumstances outside the parties' control. Transformation projects require extensive collaboration between supplier and customer, and depend upon both sides' performance of their responsibilities.

Customers seek their suppliers' assistance in exploiting the data they amass from their customers and operations, seeking efficiencies, superior understanding of their customers' needs and preference, and opportunities to grow customer relationships. Suppliers who manage data for many customers may offer insights based on data they collect and may seek rights to exploit that data (suitably anonymized) for their clientele. Customers have misgivings, and perhaps antitrust worries, to the extent that their data reveal competition sensitive information. Nobody minds when suppliers collect and share information about security threats against all customers. Indeed, that is one reason to engage sophisticated suppliers, because of their breadth of experience and insight. An airline is unlikely to object to sharing data that might improve flight safety. On the other hand, data about fuel consumption, on-time arrivals, load factors and a host of other business metrics is unlikely to be shared. Procurement solutions are often based upon mass buying for many customers in order to obtain volume discounts and other favorable terms, but a customer would not want its competitors to know how many spare parts it buys, or how much raw material they intend to purchase for the coming year. There are no easy answers here, only issues and sensibilities of which suppliers and their counsel must be aware, cautioning their clients about legal and other risks that may arise.

7 PET PEEVES AND WORST PRACTICES

Customers and their advisors have their lists of pet peeves and worst practices — attitudes, practices and terms that do not contribute to good outcomes. Suppliers have similar lists. Here are some examples:

7.1 Suppliers as Adversaries

Outsourcing relationships are not, strictly speaking, partnerships. Most lawyers deplore that term because of its legal implications (agency, unlimited liability and the rest) and the parties' distinct, and to some extent competing, interests. Nonetheless, it is helpful to think, as partners should, of mutual interests; to respect the other side's legitimate concerns; and to maintain candid, cordial working relationships. Negotiations are not contests, so much as opportunities to identify contingencies and decide ahead of time how best to allocate and manage risks consistent with both sides' interest in long run, mutual success. In so doing, they may lay good foundations for success and build working relationships between individuals and organizations. Bruising, contentious negotiations forego this opportunity in favor of short-term advantage and may sow mistrust or suspicion in place of trust. There are no second opportunities to make first impressions or to set the right tone in business relationships. Acrimony may deter both creativity and concessions. Cordiality often yields larger concessions than self-consciously tough-minded techniques. People are less willing to compromise when they feel squeezed or bullied; and more flexible when discussions rest on foundations of trust and respect. The point of the exercise is to build a successful, long-term business relationship, rather than score points.

This is not simply a matter of style and tone (although they matter and may affect long-term relations after signing, for good or ill) but also of philosophy. Many lawyers and purchasing professionals regard contracts and contracting as essentially adversarial — a kind of gladiatorial combat in which gain comes only at the other side's expense and the customer's interests are best protected by robust controls and draconian remedies. Reality is more complicated. Companies perform contracts because it is in their interests to perform and not merely for fear of ugly consequences if they do not. Fear alone rarely yields excellence. Wise suppliers understand that satisfied customers who receive value for money and good service make good references and may award them additional business. Wise customers understand that if the supplier struggles to break even, performance will be affected (to say nothing of the careers of account executives and others on whom the customer depends).

Account executives whose contracts perform well can attract better talent and command their management's attention for the right reasons.

7.2 Beware of Rigidity

Requests for Proposals often admonish bidders to follow instructions and propose precisely what the customer requested, or else risk disqualification. Alternatives may or may not be considered if submitted, but tend to receive little attention from either side, since they are unlikely to be scored. This kind of rigidity is unfortunate, for it precludes variations that might, in fact, be attractive to the customer.

7.3 Use and Abuse of Back-Channels

Competitive processes usually involve a good deal of private discussion, often in the form of discreet "coaching" from outside advisors about strengths and weaknesses in bids. Suppliers welcome this advice, which can be very constructive and serves both sides' interests by aligning solutions and proposals more closely with client needs.

However,

- The process must (and generally does) respect normal confidentiality obligations. Lawyers in particular cannot tell their customer clients what a particular supplier has accepted or conceded in confidential negotiations with the lawyer's other clients. They can, of course, advise their clients about market standards and trends; and they may discuss those other contracts privately with the particular supplier's representatives. Compromises reached on other occasions can be dusted off; but fears that any concession will be disclosed and "come back to bite" at another time inhibits suppliers' flexibility at the negotiating table.

- Consultants and lawyers who deal regularly with particular suppliers keep good records and draw upon prior experience when advising their clients. This is as it should be, so long as

confidences are respected. Prior experience often helps both parties quickly to identify acceptable compromises. However, the tendency to treat any accommodation from a supplier as "precedent" for future transactions with other clients may deter creativity or unusual compromise resolutions to accommodate exceptional circumstances. There are patterns and trends, as in any business, and adjustments in prevailing views, but most relationships have some distinctive features or uniqueness that, if respected, may give both sides useful flexibility. Customers' counsel should remember that eagerness to treat concessions and compromises as "precedent" tends to deter concessions that might be in the client's interests.

- Customers' advisors often drop hints about what the proverbial "other guys" have accepted. Often, for reasons of discretion, this may be stated in discreet code ("your position is not competitive"). Here again, it is fair and appropriate for advisors to press suppliers on particular issues and to share common industry knowledge with their clients, including usual negotiated resolutions, so long as they are truthful and respect their obligations to keep specifics confidential. Customers should keep in mind that suppliers also have a fair idea of industry custom, practice and standards, including institutional memory and impressions of their competitors' strengths and proclivities. It is their business to know such things. Not every concession made in a particular situation, in exchange for some corresponding customer concession, instantly becomes "standard." In practice, each side makes some concessions in order to close the deal; and suppliers understand that if the "other guys" agreed to this or that, they may well have obtained something else (unmentioned in "coaching sessions") in return.

7.4 "Too Many Comments"

Consultants, procurement departments, even customers' counsel often discourage extensive comments on proposed terms, suggesting that extensive objections or commentary may imperil the bid. Suppliers have heard loud and clear the widespread desire for a "light touch" that focuses upon essentials and keeps edits to a minimum. Nonetheless, customers and their advisors should respect

their counterparts' professionalism. Suppressing actual issues may have perverse consequences if objections are buried in cryptic phrases or pass unmentioned. Real commercial or operational issues do not disappear merely because they are ignored. Suppliers understand perfectly well that pettifogging objections to *minutiae* are no way to win friends and influence people. At the same time, no supplier should be scolded or punished for thoughtful, if extended, explanations of its concerns or suggested alternatives. A fair number of issues (intellectual property, for instance) are unavoidably complex. Markups of intricate provisions can be complicated. The words matter and cannot necessarily be confined a footnote, smartphone screen or Power Point slide. Thoughtful customers and their advisors should respect sophistication and discipline in prospective suppliers, and sometimes pause to consider whether the supplier who just smiles and says yes to everything can actually perform. Supplier resistance to particular terms sometimes reflects lessons learned from painful experience that the customer will prefer to avoid. Punishing professionals for thoroughness or attention to detail is not necessarily in the *customer's* interest.

7.5 Partial or Selective Disclosure

Disclosures and diligence findings are the foundations for suppliers' cost models and solutions. Without adequate, accurate information suppliers are bound to miscalculate. Perfection is not, of course, achievable. Archives, individual and institutional memories are imperfect — the more so when churned by mergers, acquisitions, divestitures, relocations and other such events. There is also a subtler danger if customers succumb to the temptation to 'game' disclosure, whether they oppose outsourcing, favor some internal or other alternative, or simply prefer to look good – better, perhaps, than the facts warrant. Anything less than full disclosure increases the risk of error. Reality will out, eventually, often in the least convenient circumstances. Prudent customers (and their counsel) appreciate that full disclosure serves both parties' interests. Where known gaps exist (as sometimes they do) discrete, narrowly focused post-closing adjustments that align assumed baselines with reality may serve both sides' interests.

7.6 Abdication and Disengagement

Some customers, having engaged counsel, sourcing consultants and procurement, effectively disengage and "turn it over to the experts," leaving them to lead the process and make decisions with which the customer's business (and not the hired help or purchasing department) will have to live. This is unfortunate and counterproductive. No one engaged temporarily, however skilled and experienced, can possibly know the customer's existing operations and future needs as well as those who have that responsibility today. Those who participate in development of requirements, selection and negotiation will understand the outcome better for having participated and are likely to have a sense of responsibility for the end result. When the going gets tough, as it may, they cannot be heard to say, "I had nothing to do with this."

Effective disengagement also occurs when customers do not take time to study proposals and review the suppliers' answers to all questions and requirements. Usually, time is short, documents are thick and both sides have prolix tendencies, but too often suppliers find that important points have passed unread. "Asked and answered" may not be a valid objection under the usual rules of evidence but does sometimes apply in the sales cycle.

Worse, perhaps, are the passive-aggressive responses: mute stares followed much later by statements that begin "we never really liked . . . ." Suppliers are anxious to please and welcome feedback, even critical feedback. When they miss the mark, tell them. Explain why and specify what is needed. Only then can they deliver what the customer wants and needs.

7.7 Evaluation by Scorecard

How customers, their consultants and counsel evaluate competing proposals is, of course, for them to decide. Suppliers are frequently warned that this or that response (often, anything less than unqualified acceptance) will reduce their overall score and chances for selection. Scorecards are useful tools, but numeric scores assigned to various criteria may mask subjective judgment and suggest false precision. On both sides, they encourage tactical

(rather than holistic) thinking in order to tick the right boxes, maximize scores and minimize both redlines and deductions — in much the same way that "teaching to the test" may improve scores without students ever mastering the subject. Suppliers' strengths and weaknesses differ. All suppliers have some of both. Finding the right supplier and solution at the right price is not necessarily a matter of arithmetic. Who among us would use a scorecard to pick a surgeon? Trial counsel for a crucial case? How many points should be assigned for billing rates, Chambers rankings, membership in the American College of Trial Lawyers, numbers of verdicts or membership in the Order of the Coif? Sounds silly, doesn't it? Indeed.

7.8 Over-reaching terms

Many customers' term sheets and form contracts propose terms that, from the suppliers' standpoint, make little commercial sense because they (i) disregard or deny realities in the supplier's business; (ii) shift excessive and inappropriate risks to the supplier — particularly for unknown, future contingencies or (iii) threaten the supplier's ability to earn acceptable returns, even when it is otherwise performing well. Suppliers recognize, of course, that the parties' interests sometimes diverge, and negotiation involves reconciliation of competing interests; but some over-reaching terms appear to reflect little more than a desire to score points and tighten screws, while leverage remains before selection and signing. In long-term, interdependent business relationships, rarely is it wise to impose terms one would regard as unconscionable if positions were reversed. The Golden Rule is, among other things, sound business advice.

7.9 Theatrics and Gamesmanship

Perhaps the single worst practice involves a combination of the foregoing techniques, woven together. Here is how the game appears from the supplier's side of the table.

Start with a tough contract. Throw in some lopsided, over-reaching, wish-list terms — punitive service credits, draconian remedies, indeed, everything in the form book. Never mind that no supplier

with competent counsel and an IQ above room temperature would sign.

Require, and quickly, a comprehensive markup. Explain in the instructions that anything left unmarked is deemed accepted. Never mind that they would never agree that deliverable items are deemed accepted unless swiftly rejected. *They* are the customer, and *they* have the leverage.

Then stage a formal meeting and scold the supplier about the sheer number of redines. Have business people frown on cue and pronounce a few words of mournful reproach. Privately, whisper to the sales people that their lawyers and company are "hard to work with." Never mind that the terms proposed are neither essential to the transaction nor market-standard. Never mind that no sane customer would accept similar terms, were they reciprocal.

These methods, when orchestrated, have predictable (and surely intended) effects.

They may mortify sales teams, who imagine writing loss reviews that blame the lawyers for excessive redlines when they could be spending their commission checks. Driving a wedge between sales and legal may stir dissension, while time pressures increase the risk that something important may be missed in the rush to complete massive submissions on time. Too many details in too little time is an excellent recipe for error. Pressure to minimize redlines may mean that issues worth raising, that might be resolved by accommodation, just fall to the cutting room floor (although they may not go away).

These methods are clever and can be effective — but are they wise? Suppose a bad deal is signed? Bad deals rarely end well for either party. Tough terms that help to assure better outcomes in litigation may not do much to help achieve good business outcomes *for the customer*.

These methods also have a number of unfortunate, unintended consequences. They set precisely the wrong tone – one of wary suspicion, where everyone is on guard and hesitant to make

concessions. The posturing and theatrics are, of course, transparent. Can anyone imagine that no one has seen the routine before? That no one will notice, or suppliers do not, in fact, have a good idea what terms are (and are not) market-standard?

Customers' counsel who play these games, or play along with procurement departments who do, reinforce widespread suspicions about our profession: That lawyers cannot be trusted or believed, so cannot persuade, except through crude exercises of leverage. That processes so time-consuming and documents so intricate and full of snares must have been designed to rack up chargeable hours. None of this facilitates intelligent, creative accommodation of competing interests. None of this encourages the supplier's decision-makers to allow their own counsel latitude to craft acceptable compromises in cooperation with opposing counsel — not when opposing counsel are distrusted and prone to bullying.

The most effective counsel for customers eschew these methods. They represent their clients vigorously and seek terms advantageous to their clients; but they play fair, skip the theatrics and may secure more favorable terms and better business outcomes than the gladiators, precisely because they are not only firm, but fair, credible and trustworthy. Suppliers understand and respect the crucial role that good counsel play on their customers' behalf; and suppliers' counsel welcome lively discussion of important, occasionally contentious issues (such as those discussed above) with their peers and counterparts; but experience suggests that gamesmanship does not contribute to good business relationships or business outcomes for either side.

7.10 Be Careful What You Wish For

Outsourcing engagements rarely succeed unless both parties succeed. Dissatisfied customers who do not receive good service and value for money are unlikely to renew or to provide favorable references. Suppliers struggling to break even rarely delight their customers. Suppliers who roll over and accept uneconomic terms or imprudent risks are likely to struggle. No legal artistry can avoid these awkward realities. Bad deals may not end well for either party.

Especially in competitive pursuits, the drumbeat to accept harsh terms is continual and sometimes deafening, particularly around liability for security incidents and privacy. Most suppliers remain unwilling to "bet the company" and none write insurance. Often there are whispers that the "other guys" have supposedly agreed. Suppose they did. Suppose that eager sales people, hungry executives, energetic procurement departments and their counsel prevail, and the transaction implodes. Both sides would do well to remember that good deals are necessarily good for both sides. Suppliers would do well to remember that sometimes, in order to make a good deal, one must be prepared to walk away. Willingness to walk may beget leverage in competitive processes designed to provide buyers with choices.

8 COLLABORATION TO MANAGE RISK

Suppliers understand very well why customers seek and heed sophisticated outside advice. They accept, embrace, even relish competition and respect the important, constructive role played by capable consultants and lawyers, even though they may press suppliers for lower prices, more ambitious service levels and more favorable terms. The best advisors are vigilant and vigorous in pursuit of the customer's interests; but they also help to set a cordial, candid and constructive tone; explain supplier interests and concerns to their clients; and serve as creative facilitators, seeking solutions that lay foundations for long-run success.

Fundamentally, counsel on both sides help their clients to identify and mitigate risks through contract terms that allocate and contain risk and provide for effective governance and management after signing. But for the supplier, the calculus of risk differs. Some risks are mirror images of the customer's — operational risks, for example. Each side must be confident that milestones can be met, and service levels achieved. Customers fret about charges and savings; suppliers worry about costs to deliver, revenue and margins. Both sides worry about ugly (if improbable) contingencies and related liabilities. Both sides must comply with laws and manage change while preserving deal economics. Both sides must be sure that contract terms align with expectations and estimates. Customers should ask whether negotiated statements of work and

service levels match changing requirements. Will projected charges deliver promised savings if consumption or other circumstances change? Suppliers ask themselves similar questions. Does the statement of work match the proposed solution? Have all costs been identified and modeled? Are cost and pricing models consistent with the documents and solution? Do they allow for inevitable if unpredictable change? Do the words on paper accurately capture the scope, solution and economics — particularly adjustments? In these respects, and others, the supplier's concerns are the other side of the same coin.

But there are differences. Perhaps the most important is that for the supplier, mistakes endure. Since the supplier can neither terminate (so long as bills are paid) nor adjust charges (apart from any agreed adjustments for volumes, changes, inflation and exchange rates) there may be no tourniquet if the contract bleeds red ink. Customers, by contrast, may reduce scope, send work elsewhere or take it in-house or, in an extreme case, terminate the contract. Doing so may be painful, expensive and disruptive (even "termination for convenience" is never convenient) but it is possible. Not so for the supplier. A bad deal may last the full term, measured in years, plus any extension options.

9 FRESH THINKING

Too many forms, clauses and methods remain rooted in the now-distant past of mammoth 'soup to nuts' contracts that once entrusted data centers, networks, end user computing and almost everything else to a single supplier for ten years. Gestation periods were long and solutions were heavily tailored to individual customers' needs— often, to relocate and then duplicate the customer's existing operations. "Mess for less" was the name of the game. Scale, cost and perceived risks of handing off internal operations were thought to warrant a protracted, iterative and heavily 'lawyered' process with massive documents.

Today, the risks that worry executives have to do with security, data breaches, cybercrime, the coronavirus and other such possibilities, rather than engagement of an outsider to conduct and manage key operations. Most contracts are smaller in scale, narrower in scope

and shorter in duration. Budgets and time schedules no longer permit months of effort or many hundreds of hours of professional time. In other words, the business world seems to have concluded that contract risks no longer warrant the time and cost formerly expended.

Yet lawyers are persistent folk, averse to risk and accustomed to familiar ways and forms. Many remain wedded to elaborate, exhaustive master agreements that, if printed, would be as thick as telephone directories once were. It is worth pausing to ask whether this makes sense, or whether clients would be better served by fresh thinking, with a proverbial clean sheet of paper, and simpler, less cumbersome terms. Risks must still be managed, contained and allocated, along with operational and other responsibilities, and arrangements must be documented with clear, consistent enforceable language. But perhaps the lawyers could dispense with belts, suspenders and handcuffs, eschew over-reaching or oppressive terms that only the desperate will knowingly accept and focus more limited time and attention on contemporary risks that matter to both sides.