

Outsourcing

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GENERAL

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

The US legal system is a dual regime of federal and state laws. A combination of federal and state laws may apply to certain issues that relate to outsourcing transactions, including tax and labour law. Parties to an outsourcing transaction must have a clear understanding of the federal and state laws that apply to the particular transaction.

Federal law

Federal law applies in all jurisdictions in the US (and can preempt state law) in specific areas, for example:

- Patents.
- Trade marks and copyright.
- Immigration and insolvency.

As yet, there is no comprehensive federal law that regulates outsourcing transactions, although in 2004 a temporary ban was imposed on the offshore outsourcing of certain federal agency contracts (see *Question 2, Public sector*). More recent attempts to enact outsourcing-specific federal laws include the Notify Americans Before Outsourcing Personal Information Act (introduced in late 2007), which would prohibit a business from transferring personally identifiable information relating to a US citizen to any foreign affiliate or subcontractor in another country without providing notice to that citizen. No action has been taken on this bill since it was referred to a subcommittee in January 2008.

State law

State laws control other areas that federal law does not control (see *above, Federal law*). These include, in relation to outsourcing transactions, real property and general contract law.

In addition, many states have implemented laws relating to offshore outsourcing, and several have enacted laws in relation to state agency contracts (see *Question 2, Public sector*).

2. What additional regulations may be relevant on:

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

Financial services

The Financial Services Modernization Act 1999 (commonly known as the Gramm-Leach-Bliley Act (GLBA)) allows financial service providers (for example, banks, insurance companies and brokers) to become affiliated and offer a full range of financial services. It also introduced corresponding safeguards on the collection and disclosure of personal consumer information by financial institutions, including:

- Notice requirements.
- Security plans.
- An opt-out process.

The Fair Credit Reporting Act 1999 restricts the disclosure of a consumer's financial and other identifying information. It specifies the information that can be included in a consumer's credit report and the circumstances in which agencies or organisations can be provided with this information.

(See also *Question 14, Data protection rules*.)

In practice, financial service providers are also likely to be affected by both governmental regulation and non-governmental or self-regulatory rules specific to their industry. The following have either given formal regulations or issued informal guidance in relation to outsourcing by the entities that they regulate:

- The National Association of Securities Dealers (NASD).
- The Federal Deposit Insurance Corporation.
- The Board of Governors of the Federal Reserve.

The effect of the regulations on outsourcing transactions varies. For example, the NASD prohibits outsourcing certain classes of a broker-dealer's functions and heavily regulates a second class of specified activities, while other activities are affected minimally or not at all. Parties to an outsourcing transaction must consult and ensure compliance with the relevant regulations at the earliest planning stages.

Business process

There are no specific national regulations for business process outsourcing (BPO). BPOs can cover many different types of service and there may be industry-specific rules or regulations that affect particular industries (see *above*, *Financial services*). For example, BPOs that involve finance and accounting services or insurance underwriting services must comply with industry-specific regulatory requirements, such as:

- Rules on generally acceptable accounting principles.
- State regulations on how particular insurance policies are underwritten.

Engaging in a BPO does not relieve public companies from their obligation to ensure the accuracy and reliability of corporate disclosures and reporting of financial data (see *Question 14*, *Data protection rules*).

IT

The US Department of Commerce, Bureau of Information and Security has issued Export Administration Regulations (EAR) to control the export of certain items from the US, including:

- Tangible objects.
- Documents.
- Software.
- Technical information.

The EAR can significantly affect outsourcings when these items are exported, particularly in an IT outsourcing where the supplier provides some of its services from a location outside the US.

The EAR control actions that go beyond general export, including, for example:

- Releasing technology to a foreign national in the US through demonstrations or oral briefings.
- Electronically transmitting non-public data to a recipient abroad.

The EAR can impose special licensing requirements and prohibit particular exports based on the:

- Item being exported.
- Reason for export control.
- Country of destination.

Breaching the EAR can have significant consequences, including fines, penalties and the loss of export rights.

Telecommunications

There are no specific laws regulating telecommunications outsourcing arrangements, but parties must be aware of the general laws and regulations regulating the telecommunications industry.

The Federal Communications Commission is the primary telecommunications industry regulatory body.

Public sector

Federal law. In 2004, the Thomas-Voinovich Amendment (contained in the omnibus Consolidated Appropriations Act of 2004) prohibited offshore outsourcing of services provided under certain federal agency contracts. This ban only lasted for a year, although it still applies to federal agency contracts executed during that one-year period.

State law. Several states have enacted laws concerning the outsourcing of state agency contracts, by either:

- Restricting services from being provided offshore. One of the most stringent anti-outsourcing laws is New Jersey's S. 494, which prohibits certain state service contracts from being performed outside of the US. Generally, an exemption can be granted under the law when it is certified that either:
 - a service cannot be performed within the US; or
 - application of the law would violate the terms of any grant, funding or financial assistance from the federal government.
- Providing preferences to services provided on-shore. Some states, such as North Carolina and Tennessee, have adopted this system. For example, Tennessee permits its Commissioner of Finance and Administration to create rules that give a preference when awarding state data entry or call centre services contracts for companies that use US citizens or residents, or persons authorised to work in the US.

Other states, such as Alabama, encourage the use of local services but do not restrict state procurement decisions.

Regulation of outsourcing at the state level is not limited to the legislative branch of government. Since 2003, the governors (a state's highest governmental position) of at least nine states have issued executive branch directives or orders. These regulations range from mandates that establish a process to evaluate outsourcing proposals, to various prohibitions on the performance of work offshore.

Other

The Health Insurance Portability and Accountability Act 1996 (HIPAA) and its regulations regulate the use, storage, protection and privacy of personally identifiable health information. Outsourcing transactions involving the use or disclosure of personally identifiable health information, particularly outsourcings in the health-care industry, must comply with HIPAA and the rules for electronic medical records (see *also Question 14*, *Data protection rules*).

LEGAL STRUCTURES

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

There are various legal structures that can be used in outsourcing, which provide the customer with different benefits and levels of control. However, greater customer control can mean that the supplier is less willing to assume risk.

Traditional structure

The most traditional legal structure for an outsourcing arrangement is for the customer and the supplier to implement a services agreement, where the supplier provides a described set of services under a specified payment schedule. Customers that outsource a non-core function generally rely on the supplier's skill and experience to provide the services. Typically, the services agreement contains general governance and contingency procedures, but the supplier generally controls how the services are provided under the agreement (as long as it complies with the service descriptions, service levels and so on). This structure involves the customer giving up a degree of control. However, it gives the customer a predictable and stable pricing structure and can reduce start-up costs.

Joint venture

A customer and a supplier can set up a joint venture, where each party contributes certain assets, know-how and capital to a newly created entity that performs the services for the customer. The customer has a greater degree of control than in a traditional structure (see above, *Traditional structure*). However, the up-front costs are likely to be higher and the customer shares more of the outsourcing's risks with the supplier.

Wholly owned subsidiary

A customer can set up a wholly owned subsidiary to provide the outsourced services, commonly known as a captive entity. While this gives the customer significant control over the outsourced services, it must also bear greater costs and risk. When the captive entity matures, the customer can divest or spin off the captive entity (that is, separate the captive entity from itself) to achieve profit and recoup investment.

Build, operate and transfer (BOT)

Under a BOT structure, a customer enlists the supplier to build the infrastructure (including facilities, technology and people) necessary to provide the outsourced services. The supplier operates the infrastructure for a term (this is similar to the traditional structure (see above, *Traditional structure*)), and transfers ownership of the entire infrastructure to the customer. The customer then continues to provide the outsourced services (this is similar to the captive entity structure (see above, *Wholly owned subsidiary*)). Although the up-front set-up costs are greater, this structure allows a customer to ease into an outsourcing (with a level of control similar to that in a traditional structure), with the ultimate goal of taking back control of the outsourced service (as in a captive entity structure (see above, *Wholly owned subsidiary*)).

Supplier models

In addition, several different supplier models can be used in combination with the above structures, including the following examples:

- A customer can multi-source the work, spreading the services across multiple suppliers so that:
 - one supplier's failure is limited to a portion of the total services;
 - the customer has greater freedom to move or add services between suppliers.

Under this model, a customer must have additional internal resources and processes in place to manage multiple supplier relationships (including to address issues of responsibility among suppliers in the event of a performance failure).

- A customer can enter into a services agreement with one supplier as the general contractor. The supplier can subcontract the services to other suppliers. Under this arrangement, the prime contractor is primarily liable for all services, including subcontracted services.

This model creates a single point of accountability. However, since the customer does not have a contractual relationship with the subcontractors, it must rely on the prime contractor to enforce any rights or remedies against them.

PROCUREMENT

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

The procurement process generally involves the following stages:

- **Request for information (RFI).** Usually, a customer sends an RFI to potential suppliers. This is a fact-finding document intended to gather general information from each supplier as to its capabilities.
- **Request for proposal (RFP).** If the results of the RFI are satisfactory, the customer can create and distribute an RFP to each prospective supplier. This contains relevant information about the outsourcing to allow each supplier to submit a proposal to the customer. It is usually a very complex document and many customers employ a consultant or lawyers to assist in its drafting.
- **Proposals.** The suppliers then submit proposals and the customer reviews them to decide which suppliers to consider. Typically, the customer meets with each prospective supplier to obtain clarification on its proposal.
- **Supplier selection.** The customer selects one or two suppliers and performs due diligence. This further assists the customer in making its decision. In addition, the supplier can use this to clarify any assumptions that it made when preparing its proposal.

- **Negotiations.** The customer then starts contract negotiations. Often, the customer selects two suppliers and enters into parallel negotiations. This forces the suppliers to actively compete against one another to provide the most favourable terms to the customer.

TRANSFERRING OR LEASING ASSETS

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

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

Immovable property

The transfer of immovable property should be in writing and signed by both parties. Applicable state law can require that the transfer be in writing, for example, for real property transfers. The transfer of immovable property can be publicly recorded in the appropriate governmental office. This recording serves as public notice of the transfer so as to avoid any disputes over subsequent transfers.

IP rights and licences

The transfer of IP rights must be in writing. The transfer of IP licences should be in writing (this may be required for exclusive licences) and may require the consent of the owner of the IP rights. The transfer of both IP rights and licences can be publicly recorded in the appropriate governmental office. This recording, when made within statutory time frames, serves as public notice of the transfer so as to avoid any disputes over subsequent transfers.

Movable property

The transfer of movable property (other than of nominal value) should be in writing and signed by the transferring party. If movable property is leased, a transfer of the leased property usually requires the owner's consent along with written confirmation that the transferee accepts the terms of the lease.

Key contracts

Transfers of key contracts should be in writing and signed by the transferor and transferee. However, the contract can contain restrictions on its assignment, which requires the other contracting party's consent or notice to be given. The transferor can remain responsible for certain obligations under the contract after it is transferred, depending on the contract's terms.

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

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

Immovable property

Leases or licences of immovable property should be in writing and signed by both parties. Applicable state law may require that leases or licences be in writing, for example, for real property leases. If the property is under a lease or licence, the owner's consent may be required. Some leases or licences may prohibit subletting or sublicensing.

IP rights and licences

Licences of IP rights should be in writing and may require the owner's consent. Failure to use a written agreement may create an implied licence and lead to the terms of the licence being unenforceable or ambiguous. Some IP licences prohibit sublicensing without the owner's consent, or limit the parties' rights to access or use the IP.

Movable property

A lease or licence of movable property should be in writing, signed by the owner, and the transferee must agree to the lease or licence's terms. Some leases of movable property coincide with the licensing of IP rights, for example, the transfer of computer hardware that has installed software (*see above, IP rights and licences*).

Key contracts

The formalities are the same as for transfers (*see Question 5, Key contracts*). In addition, contracts may prohibit sublicensing or require the owner's prior written consent to grant a sublicense or effect a transfer.

TRANSFERRING EMPLOYEES

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

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

Initial outsourcing

There are no circumstances in which employees are transferred by operation of law. The employment contracts with the customer are terminated and the supplier re-hires the employees.

Change of supplier

See above, *Initial outsourcing*.

Termination

See above, *Initial outsourcing*.

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

General terms

Not applicable (see *Question 7, Initial outsourcing*). The customer must terminate the employment of employees who will perform services for the supplier and the supplier must re-hire them.

Pensions

Employees' participation in the customer's health, welfare and pension plans ends on termination of their employment with the customer.

Employee benefits

See above, *Pensions*.

Other

If the supplier hires all or substantially all of the members of a bargaining unit that is subject to a collective bargaining agreement (CBA), the supplier may have a duty to bargain with the unit and/or honour the CBA.

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

There are no legal requirements for either the customer or the supplier to provide any particular information to the other party in relation to its employees.

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

Customers with 100 or more employees must, under the Worker Adjustment Retraining and Notification Act 1988 (WARN Act), provide employees with 60 days' prior written notice of termination if the outsourcing will result in either:

- A plant closure resulting in employment loss for 50 or more employees at any single site of employment.
- A mass lay-off resulting in employment loss, at a single site of employment, for either:

- 50 or more employees constituting at least one-third of the workforce; or
- 500 employees.

Some states have also enacted their own WARN Act-type statutes with which customers must comply.

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

There is no legal requirement to provide any particular terms and conditions of employment to the transferring employees in the absence of a CBA or other pre-existing contractual provision to this effect. Therefore, the supplier can harmonise the terms and conditions of the transferring employees with its existing workforce. This is generally the subject of negotiation of the outsourcing agreement between the parties.

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

Employment in the US is generally "at will" (that is, either the employer or the employee can terminate the employment relationship without liability at any time or for any reason, including before or after an outsourcing), in the absence of a CBA or employment agreement. It may be necessary for the customer and supplier to issue WARN Act notices (see *Question 10*).

In addition, when employees are dismissed, the customer and supplier must comply with federal, state and local discrimination laws that prohibit dismissals based on an employee's membership in a protected class, including:

- Race.
- Colour.
- Gender.
- Age.
- National origin.
- Religion.
- Disability.

Employees may also be protected from dismissal if they are on a leave of absence, such as:

- Medical leave under the Family and Medical Leave Act 1993.
- Military leave under the Uniformed Services Employment and Reemployment Rights Act 1994.

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

There are no legal prohibitions on structuring the employee arrangements of an outsourcing as a secondment. The customer and supplier may, however, be deemed to be co-employers of the employees and, therefore, share potential liability for violations of employment laws.

DATA PROTECTION

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

Data protection rules

There is no comprehensive US data protection law. The federal and state laws, and specific industry regulations, impose various data protection obligations in a piecemeal way:

- **Federal law.** There are several laws, which each apply to different types of industries, activities and information:
 - **Consumer information.** The privacy and security of consumer information is protected, for example, in the areas of:
 - financial services, under the GLBA and the Fair Credit Reporting Act (*see Question 2, Financial services*);
 - healthcare, under the HIPAA (*see Question 2, Other*).
 - **Public companies.** Public companies must ensure the accuracy and reliability of corporate disclosures and reporting of financial data (*Sarbanes-Oxley Act 2002*). This applies even if the company engages in a BPO (for example, HR management) either within the US or overseas (*see Question 2, Business process*);
 - **Consumer protection.** Under its consumer protection authority, the US Federal Trade Commission has imposed privacy and data security obligations on entities that collect or process consumer data.
- **State law.** Individual states also have data security laws. Most states require entities that collect or process sensitive consumer data to give notice to consumers of breaches in the security of this data in certain circumstances. Under some data security laws, data licensees must report breaches in the security of the data to the licensor within specified time periods. Other state data security laws require companies to protect the sensitive consumer information that they possess, and in particular to restrict their use of, and protect, social security numbers.

- **Industry rules.** In addition to these federal and state data security laws, the Payment Card Industry (through an independent council originally formed by the major credit card companies) has established its own comprehensive requirements to contractually protect customer cardholder data through its Data Security Standards. These require that companies that store, process or transmit payment card data comply with specific security requirements.

Contract documentation

Contract documentation varies based on the type of industry, business activities and information involved, and the risks that the outsourcing poses. An outsourcing contract typically includes requirements that:

- Data is protected from unauthorised access.
- Reporting obligations are complied with.
- The risk allocation between the supplier and customer in relation to data security breaches is addressed.

Specific security requirements are often imposed, such as technological limitations on the supplier's access to data.

SERVICES

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

The customer typically draws up an initial services specification itself or with a third party consultant's assistance. Third party consultants or lawyers can assist the customer to:

- Develop an outsourcing strategy.
- Create preliminary services specifications in greater detail.
- Confirm the historical service levels that the customer achieved.

The services specification is a significant contract document that must address various stages in the outsourcing of services, particularly if the outsourcing involves significant changes to the customer's processes or infrastructure. Ideally, the initial services specification is created before the RFP process starts (*see Question 4*).

The parties work together throughout the negotiation process to refine the initial services specification as more details about the supplier's capabilities and customer's needs emerge.

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

Contracts typically contain a mutually agreed set of measurable service levels and specified remedies, including service credits. The contract should also contain a process for determining the supplier's performance in relation to the service levels.

Service levels can be included in the main agreement or included in a schedule (a service level agreement). Service levels and credits generally apply to the aspects of performance that are most important to the customer and are often weighted to reflect this.

CHARGING

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

Outsourcing contracts may have multiple charging mechanisms to address the differences in services in a single agreement. As outsourcing has become more common, various new (and sometimes complex) charging methods are used. The methods below are the most commonly used.

Fixed price

Fixed price methods used to be the most common pricing arrangement. The customer pays a fixed fee to the supplier, usually on a monthly basis (a monthly recurring charge), for providing the agreed service. This is an appropriate structure in situations where the scope and amount of work is well defined and unlikely to fluctuate.

Pay as you go

In situations where the scope or amount of work is not fixed or more difficult to define, suppliers typically use time and materials, or pay as you go, charging mechanisms. Under these structures, services performed by the supplier are charged at time-based rates (such as hourly, daily, weekly and so on) and materials are charged with a mark-up.

Cost plus

In a cost plus outsourcing, the customer is charged the supplier's actual costs to perform services, plus a mark-up that is intended to represent a reasonable profit for the supplier. Cost plus depends on what is included in the supplier's costs, such as overhead and assets depreciated over time.

Resource-based charges

A common approach is an up-front fixed recurring charge (based on an assumed service volume), plus a resource-based charging mechanism to adjust the fixed charge up or down incrementally depending on the actual volume of resources used.

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

The following key terms in relation to costs may be used:

- Resource-based charges (*see Question 17*).
- Benchmarking, to ensure that the charges (and other key terms of the agreement) are competitive when compared with similar charges in the relevant industry.

- "Most favoured customer clauses". These require suppliers to ensure that their charges to the customer are equivalent or more favourable than those charged to its other customers.
- Gain-sharing. In certain agreements, it may be appropriate for the parties to share in certain cost savings achieved. It is often difficult for the parties to agree on the details about when this applies and how the specific terms of gain-sharing operate.

CUSTOMER ISSUES

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

The customer can bring an action for damages resulting from the supplier's failure to perform its obligations (including seeking recovery of the expense incurred to replace the services), and if the breach is material, it can terminate the agreement. While the customer may have the right to seek specific performance by the supplier, this type of remedy is difficult to obtain. If the contract is silent on these issues, applicable state law may provide particular remedies for contract breaches.

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

Protections that can be included in the contract documentation to supplement relief available under the law include:

- Service level agreements for measuring and reporting the supplier's performance against specified levels with credits and other remedies if service levels are not met (*see Question 16*).
- The right for the customer to step in or terminate the agreement or the affected services, and receive a refund in certain circumstances (*see Questions 25 and 26*).
- A requirement for the supplier to provide post-termination assistance to the customer when transferring outsourced functions back in-house (or to another supplier in the case of termination).
- A governance structure requiring the supplier to appoint a relationship manager to act as a primary liaison between the parties, and informal dispute resolution procedures to expedite any escalation of problems to higher levels of authority within the parties' organisations.
- A requirement for the supplier to maintain specified types and levels of insurance coverage and to identify the customer as an additional insured party on its policies.
- A parent company guarantee to ensure supplier performance and reduce risks related to the supplier's financial problems or insolvency (this can increase the chances of enforcing the agreement if the contracting supplier is not a US entity).
- Provisions requiring the supplier to indemnify the customer for its losses in specified circumstances.

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

The warranties and indemnities included in an outsourcing agreement depend on the nature of the transaction and negotiations between the parties. Usually, each party warrants that it has the authority to enter into and perform the agreement.

In addition, the customer typically requests the supplier to warrant that it will:

- Perform the services in a professional manner.
- Ensure that the services and any resulting deliverables (that is, the items promised under the contract) meet the contractually required specifications.
- Comply with all applicable laws and regulations.
- Ensure that the services and deliverables do not infringe a third party's IP rights.
- Not introduce any viruses, disabling procedures, trojan horses or other disabling codes into the customer's computer systems.

Suppliers may also be required to make warranties in relation to the types of services being supplied or the customer's industry.

Each party usually indemnifies the other party against claims of personal injury or property damage. The supplier usually also indemnifies the customer in relation to:

- Claims that the services or deliverables breach third party IP rights.
- Claims by transferred employees in relation to the period before the transfer.
- Claims based on the supplier's failure to comply with federal or state law.

Other indemnities may be appropriate depending on the types of services being supplied or the customer's industry.

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

Generally, state contract law recognises implied warranties of fitness for a particular purpose and merchantability. However, the supplier can exclude these through an explicit provision in the outsourcing agreement.

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

There is no national law imposing a maximum or minimum term on outsourcing agreements, so parties can negotiate term limits specific to their arrangement. Generally, an outsourcing arrangement is for a fixed term of between three and ten years.

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

National law does not regulate the notice period required to terminate an outsourcing agreement. The parties can agree on termination rights and notice periods. Generally, the customer requires an extended notice period to transfer the services back in-house or to another supplier.

Usually, the contract contains terms requiring the supplier to continue to provide services during the transfer, and to provide other services necessary for a smooth transition. The notice period varies depending on the type of termination.

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

Usually, the customer and supplier include specific termination rights in an outsourcing agreement. However, state law (including case law) generally grants a party certain rights to terminate a contract, including an outsourcing agreement.

While the law differs between states, the following are generally considered sufficient to justify termination:

- A material breach of the agreement by a party.
- An anticipatory repudiation (that is, breaking the contract before the required performance time).

Under national bankruptcy law, a party's insolvency does not, by itself, necessarily give rise to a termination right. While many agreements include such a provision, this right may not be enforceable under bankruptcy law.

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

Parties have the discretion to include or exclude particular termination rights. Typical termination rights include:

- A material breach of the agreement that is neither waived nor remedied within a reasonable period of time after notice by the non-breaching party (the remedy period can vary according to the parties' agreement). This termination right can also address minor but recurring breaches.
- A party's insolvency, including, without limitation:
 - a petition or proceeding in:
 - bankruptcy;
 - receivership;
 - liquidation.
 - assignment for the benefit of creditors.

The parties can define the particular qualifying events in the agreement. They can also include termination rights based on a significant adverse change in the supplier's financial condition.

- A change of control of the supplier, particularly to a competitor of the customer.
- Termination for convenience, which typically requires significant advance notice and/or significant termination fees. This allows the customer to change suppliers at its discretion.

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

The outsourcing agreement (or a separate licence) typically addresses the rights of the supplier to use licensed IP rights, including the period of permitted use. In the absence of specific contract terms addressing this issue, the rights to use the customer's IP are based on implied rights that are likely to end on termination of the outsourcing agreement (and completion of transition services (see Question 24)).

The parties must address specific licence rights in the outsourcing agreement to avoid disputes over implied rights.

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

Supplier know-how that exists before the outsourcing is confidential information belonging to the supplier. Confidentiality terms in the agreement regulate this information; there is usually an express requirement that the customer maintain confidentiality post-termination, which may be limited to a specified term.

However, the parties can agree that the customer be licensed to use the supplier's know-how, particularly in relation to the items delivered under the outsourcing agreement that incorporate or are based on the supplier's pre-existing know-how. Ownership and licence rights in relation to know-how that the supplier develops during the provision of services must be addressed in the agreement's proprietary rights provisions.

LIABILITY

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

The general rule under state law is that damages, including incidental and consequential damages and loss of business, profit or revenue, can be limited or excluded entirely if the limitations or exclusions are not unconscionable or otherwise violate public policy.

However, state laws vary and may have specific conditions or limitations on this general rule. For example, state law may examine:

- The parties' relative bargaining power.
- Whether the limitation or exclusion of liability allows for recovery of damages sufficient to protect the contracting parties against unreasonable risk or harm.

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

The parties are free to agree on a liability cap subject to certain limitations (see Question 29). The factors that should be taken into consideration when setting the liability cap include the:

- Fee structure.
- Length of the agreement.
- Supplier's profit margin.
- Relative risks of the parties.

In many cases, the liability cap is set at either:

- A multiple of the monthly fees (if there is a fixed monthly fee).
- The total fees over a previous period.

TAX

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

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

Transfers of assets to the supplier

If the supplier purchases assets from the customer for less than the assets' fair market value, the supplier recognises ordinary

income equal to the fair market value of the assets minus the purchase price. Sales tax or other transfer tax may also be imposed. However, the transfer of assets from a customer to a supplier rarely occurs in an outsourcing transaction.

Transfers of employees to the supplier

If employees are transferred to a supplier, the supplier is generally responsible for withholding and paying certain payroll taxes from the compensation paid to the employees, as well as paying other taxes from its own funds with respect to such employees. For US federal tax purposes, the payroll taxes include:

- Federal income taxes.
- Federal Insurance Contributions Act taxes.
- Federal Unemployment Taxes.

Additionally, individual states and certain local jurisdictions within a state have different employer tax responsibilities, including withholding obligations.

VAT or sales tax

The US does not have a national sales tax. However, the individual states and certain local jurisdictions within a state impose their own sales taxes. Transfers in jurisdictions outside of the US may be subject to VAT or other similar tax.

Other

Before entering into an outsourcing relationship with a supplier, a customer that is not otherwise subject to income taxation in the jurisdiction where the supplier is located should review the income tax laws of that jurisdiction to determine:

- Whether the nature of the proposed relationship can result in the customer becoming subject to income tax in the supplier's jurisdiction.
- How the proposed relationship might affect the customer's overall tax liability.

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