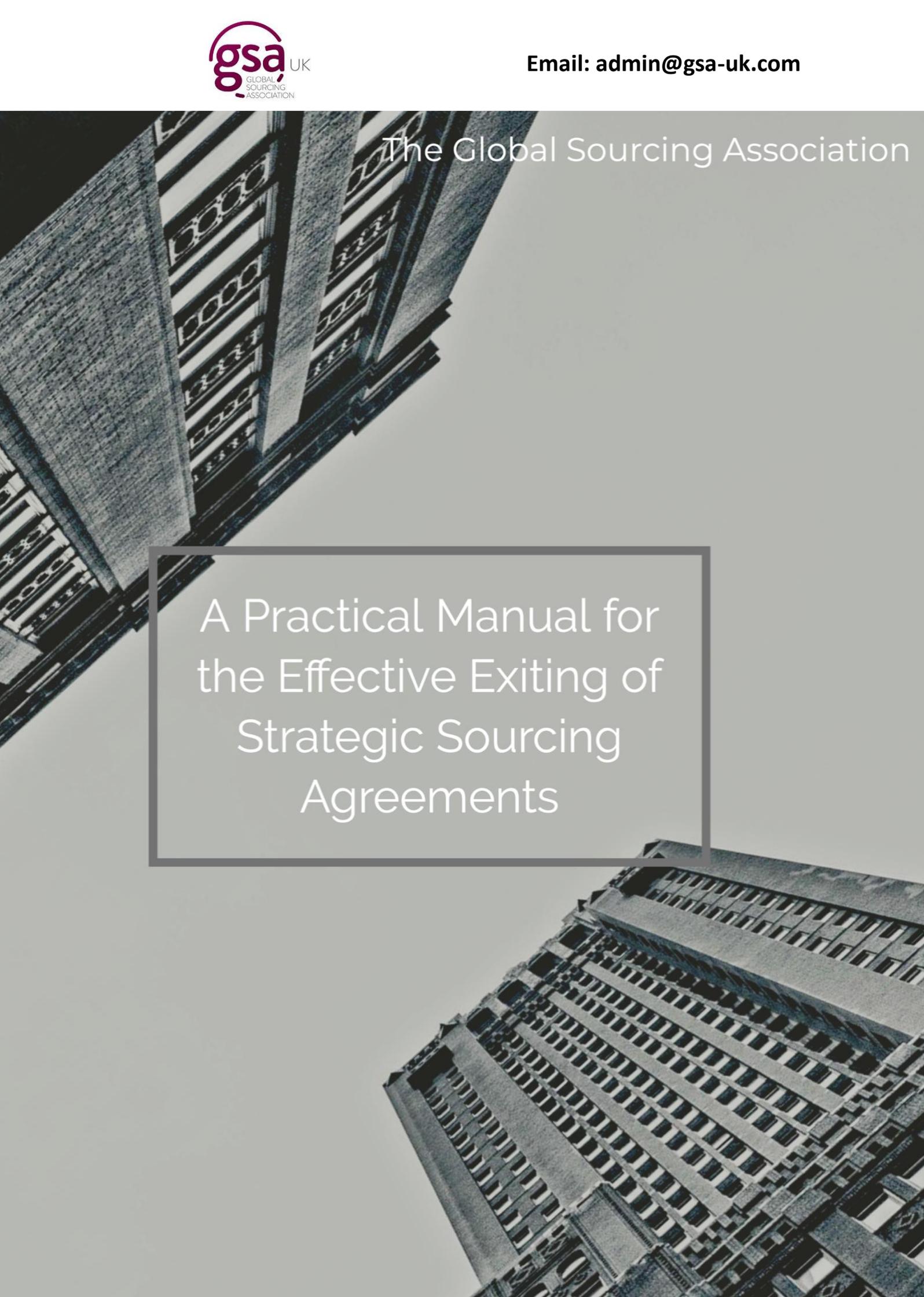


The Global Sourcing Association

The background of the entire page is a high-angle, black and white photograph of a modern skyscraper. The building's facade is composed of a grid of windows and structural elements, creating a strong geometric pattern. The perspective is from above, looking down at the building's structure.

A Practical Manual for
the Effective Exiting of
Strategic Sourcing
Agreements

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I have no idea how many contracts I have read that have no exit arrangements.

But these days I still find no exits and a high proportion that have a "do it later" paragraph or schedule saying something like "the parties will come together to develop a plan for exit six months before contract end". No! No, don't do it.

Here lies so much grief. Read this manual! It's by the world's leading proponents with a long history in helping their clients out of exit problems, and from their experience, learning hard knocks they have written this excellent guide.

Also remember that disaster recovery and business continuity are both forms of exit, all be it temporary, but great areas where all sides can learn and see how it really works. If you are starting out take this manual into consideration. If you already have a contract but you have a "do it later" schedule, then you can use this to develop the plans.

If you have a great exit plan - tell us about it! In fact tell us anyway. This is the second edition of the GSA's *A Practical Manual for the Effective Exiting of Strategic Sourcing Agreements*. Since the first issue the importance of being able to effectively exit a sourcing agreement has, regrettably, been brought into sharp relief by the COVID-19 crisis.

The effects of COVID-19 on the sourcing world will take some time to work through. One thing remains certain, however, and that is that if, in the difficult financial climate that looks like being with us for a while, there is a termination, whether through choice or circumstances, then the ability to exit with the minimum of delay and loss of service is more than ever a key component of a successful sourcing strategy.

A handwritten signature in black ink that reads 'Kerry'.

Kerry Hallard
CEO
Kerryh@gsa-uk.com



INTRODUCTION TO THIS MANUAL

Welcome to the second edition of the Global Sourcing Association's *Practical Manual for the Effective Exiting of Strategic Sourcing Agreements*. Following the issue of the first edition in 2014 sourcing has changed considerably. The rise of cloud computing and the advent of 'fintech' solutions have added new dimensions to the exiting of sourcing agreements. In addition, the uncertainty which will inevitably be created by the final separation from the European Union by Brexit increases the need for businesses to be as confident as they can be that they can exit a sourcing agreement as efficiently as possible. Finally, the COVID-19 crisis may force significant realignments of supply chains.

There is nothing certain in life except death and taxes. In the life of a strategic sourcing agreement there is nothing more certain than the fact that it will end at some point.

Remarkably, whilst there is a huge amount written about how to enter into an strategic sourcing agreement, there is not so much written about how to exit one. Anecdotal evidence and research indicate that the confidence of businesses in entering into an strategic sourcing agreement is much higher than their confidence in planning and managing its exit.

We have found that users are generally not inclined to comment on exit experiences (whether good or bad!) Strategic sourcing is becoming more complicated and, at the same time, shorter contract terms are supposed to encourage competition. If businesses cannot exit agreements easily or efficiently their ability to take advantage of new opportunities in the market is lost. As part of its transformational road map the *Global Sourcing Association* continues to champion the need for greater knowledge and expertise in the area of exit. This manual is in response to the ongoing need for guidance on the legal and practical aspects of exiting a strategic sourcing agreement.

This manual will continue to be updated on a regular basis. As mentioned above, there is a lack of published material. The GSA would like to be able to use real life examples (from customers and suppliers), on a named or anonymised basis, of how exits have worked for them. If you feel that you can contribute something in this area please do let us know.

ABOUT THE AUTHORS

PHILIP ALLERY - PRESCIENCE OUTSOURCING LIMITED AND GSA COUNCIL MEMBER



Philip Allery is a GSA Council Member and solicitor and has worked in the strategic sourcing space for many years. He remembers the days when it was called “contracting out”! He is the author of two books including *Tolley’s Effective Outsourcing: Practice and Procedure*. He has worked extensively in the post signature world of strategic sourcing spending six years as the head of a legal function in Phoenix Life working exclusively on outsourcing at each stage of the outsource lifecycle - from inception, through transformation, BAU, dispute resolution and finally to exit. He holds a GSA Diploma in Global Strategic Sourcing. He won the NOA Award for Academic Achievement in 2014. Through his company, Prescience Outsourcing Limited, he currently provides legal, logistical or consultancy support to strategic sourcing projects or disputes.

PAUL O’HARE – PARTNER AT DELOITTE LAW AND FORMER COUNCIL MEMBER OF THE GLOBAL SOURCING ASSOCIATION



Paul is a partner in the commercial technology practice, and former head of the outsourcing practice, at Kemp Little, one of the UK’s leading technology law firms. He has over 20 years’ experience advising service providers and customers on their IT and business process outsourcing transactions. Paul advises clients across a range of sectors, including financial services, legal and professional services, retail, technology and FMCG. Strategic sourcing Paul writes the outsourcing precedent contracts, and edits the outsourcing chapter, for *Practical Commercial Precedents*, one of the UK’s leading precedent text books.

HOW TO USE THIS MANUAL

Exit considerations feature throughout the lifecycle of the strategic sourcing agreement.

Each stage of the lifecycle is broken down into the legal and practical aspects that should be considered at each stage.

For convenience we have used the analogy of an aeroplane flight. At each stage of an aeroplane flight a number of things take place and a number of checks have to be made.

The annexes contain useful materials on governance structures, timescales and Exit and Transition Checklists.

KEY THEMES APPLICABLE TO EACH STAGE OF THE STRATEGIC SOURCING CONTRACT

KNOWLEDGE IS POWER

Outsourcing, by its very nature, means that you entrust an activity to a third party. The service provider then runs it. The service provider is often asked to transform the business. Whatever the degree of oversight, over time and with changes of personnel within the customer, the customer's knowledge of the activity and how it is run becomes less and less visible.

Harnessing the knowledge of the service provider is one of the most important features of being able to exit successfully.

EACH STAGE DEPENDS ON THE PREVIOUS STAGE

Using our flight analogy, successful arrival at the destination on time depends on the stage before. A good landing means a good approach to the runway and a good approach in turn depends on navigation and so on forever backwards. Each stage is dependent upon the previous stage. A failure to take sufficient action in one stage is very likely to impact on subsequent stages.

WHAT DOES A 'GOOD EXIT' LOOK LIKE?

A good exit should have the following elements:

- Is considered as a **key success criteria at the time of the contract**
- Is **considered and planned for during the relationship**

- When it happens **is brought about in a timely and informed way**
- Is properly **risk assessed**
- Is **delivered on time**
- Is **properly and fairly costed**
- Is **valued as a project**
- Is **well managed**
- Is **well resourced**
- Where the parties **part as friends**

The GSA strongly endorses the last item. An exit where either the customer or the service provider is unreasonable means that the potential for future business is lost.

COST APPRECIATION

An exit incurs costs for the supplier, be it the loss of the contract itself or the costs of migration. Over the years the authors have seen (and continue to see) contracts where the value of exit support provisions, retendering assistance or post termination use of intellectual property are degraded or lost altogether, because customers insist that the service provider has to absorb the cost or provide things free of charge. This often starts at the bid requirement stage and, due to the combined pressures of competitive tendering, and service providers naturally wishing to stay in the process, it is not resolved in the bidding stage or the Key Commercial Principles (KCP) stage. It then becomes a commercial issue during negotiations.

We believe that it is time that customers and service providers take a more mature position in these areas. As a result we have not pulled back from indicating where customers should consider their position accordingly.

STAGE ONE – “READY FOR TAKE OFF” – CONTRACTUAL ISSUES

The strategic sourcing journey begins with the work that is necessary to enter into the right agreement with the right service provider.

In aviation terms this is the stage for carrying out those all-important “pre-flight checks”. You would not take off without checking the route and that you have all the necessary safety equipment and so it is with outsourcing.

Mistakes at this stage of the strategic sourcing journey can be costly later on as, once a contract is entered into, trying to recover the situation can be difficult.

Due diligence is vital and questions about the supplier’s experience in exiting agreements on time and within budget should be asked and should form a key part of the service provider selection criteria. A set of sample due diligence questions appears in Annex 1. A site reference from a former customer on how their exit was managed

is very important. If the service provider has no relevant experience then a decision can be taken about how this risk can be dealt with (for example, a contractual obligation that the service provider employs a specialist in exit management if, at the time the exit take place, it still does not have a track record in this area).

Equally, at the down selection stage, the exit experience should feature as a key selection principle.

Our experience is that exit, not being a topic that interests people when they do a deal, is not heavily featured compared with other key principles. Therefore, at the KCP stage it is necessary to capitalise on this and ensure that all key exit principles are captured.

Given the importance placed on exit, the project benefits register should include the terms agreed on exit. If they are, then on a final review prior to signature, it can be seen whether exit rights have been “traded” in any way and if so, whether on an acceptable basis.

In terms of the strategic sourcing contract itself a number of things are important.

WHEN EXIT CAN BE TRIGGERED

An exit strategy is only effective if it is available to the customer at the right time; comprehensive exit management provisions are of little use if the customer is tied in for the long-term. The first issue to address, therefore, is the circumstances in which the strategic sourcing agreement can be brought to an end. These include:

- Termination for cause
- Termination for insolvency
- Termination for convenience
- Other termination rights
- Expiry.

TERMINATION FOR CAUSE

Whilst the strategic sourcing contract will normally allow the customer to terminate for material, unremedied breach, this provides limited protection in practice, as it can be very difficult (and time-consuming and costly) to assess, and determine, with certainty whether or not a particular contract failure is material in the context of the overall project.

For that reason, customers will often wish to specify in the contract the key service provider failures that will allow termination for cause. These areas will normally include:

- Transition and transformation – this is one of the highest risk phases of any strategic sourcing project, and customers will generally insist upon having the right to ‘pull the plug’ on the project where there are significant implementation delays that have been caused by the service provider.

- Service level failures – to ensure that customers are not locked into a contract where service provider performance is patchy, the contract should define the circumstances in which repeated service level failures will allow the customer to terminate for cause (whether or not those failures are rectified).

Regardless of which party is at fault, exit assistance is still needed; the only variable is whether exit assistance charges are payable to the service provider (see below, *Payment considerations*).

TERMINATION FOR INSOLVENCY

Similarly, both parties will want the right to terminate the agreement where the other party becomes insolvent. Since, in most jurisdictions, a contract will not, as a matter of law, automatically terminate on the other party's insolvency, each party needs to consider the circumstances in which it has the right to terminate where the other suffers financial difficulties.

From the customer's standpoint, if the contract survives the supplier's insolvency, the customer could find itself in a situation where it has ongoing obligations (for example, to make payment) but the liquidator or administrator of the service provider has chosen to decline performance of the service provider's obligations. The customer also needs to bear in mind that, in some jurisdictions, such as the UK, if the service provider is in liquidation, the liquidator has the power to disclaim "onerous property", which can include unprofitable contracts. If the liquidator disclaims a contract, the other party has an action for breach of contract but joins the list of unsecured creditors with its claim for damages.

Ideally, the contract should allow for the right to terminate before insolvency occurs (when there are warning signs that insolvency may follow). By the time the service provider becomes insolvent, it may have lost the ability to facilitate a smooth transition.

If it is the service provider that is in financial difficulty, the customer may also require "fast-track" provisions to exit quickly. Where the service provider terminates because the customer is in financial difficulty, the service provider is likely to insist that the provision of exit assistance is conditional on advance payment by the customer.

Finally in this respect, both parties should be aware of effect of the Insolvency (Protection of Essential Supplies) Order 2015 in a customer insolvency scenario. The Order extends the protection afforded to 'essential supplies' such as water, electricity and gas, to IT services and, in broad terms, restricts the circumstances in which a service provider of IT services may terminate the supply of those services in certain formal insolvency scenarios.

TERMINATION FOR CONVENIENCE

The customer may want to bring the agreement to an end for reasons other than material or repeated breach or service provider financial failure. The customer may be dissatisfied with the service provider or the service provider's performance (for reasons that do not amount to material or repeated breach), the market conditions may have changed, such that the customer wants access to more favourable pricing or better technology, or the customer's sourcing strategy or business requirements may simply have changed (see below *Reasons for Changing Suppliers*).

In any deal that is longer than a couple of years, it is important that the customer retains the right to terminate for convenience. The service provider will have legitimate concerns about this where it has agreed pricing on

the basis of a longer term deal. For example, the service provider may have made up front investments (in equipment, premises, transition activities and so on), the costs of which it is expecting to recover over the life of the contract, or the service provider may have agreed to reduce its margin in the early years of the contract.

In these circumstances, the service provider will, understandably, expect the customer to pay an early termination charge. The contract should be clear on how this charge is to be calculated and, where it the amount is pre-agreed, the service provider should (before contract signature) provide details of how it has arrived at that amount and what costs it is seeking to recover through the termination charge, so that the customer can validate that the early termination charge is reasonable. In addition, the contract should reflect that the early termination charge will reduce over time.

TERMINATION FOR FORCE MAJEURE

At the time of issuing the second edition of this manual in 2021 COVID-19 has been an issue for many customers and service providers and is likely to remain so for some time. From a commercial point of view a customer of significant services needs to think very hard about terminating in a force majeure situation. It would be a forced termination so quickly finding another service provider or the space and resources within your own organisation to take the service back would not be easy. Clearly it remains better to work with the current service provider if at all possible.

In significant sourcing agreements there will usually be business continuity and disaster recovery provisions and also a requirement on the service provider to perform to the extent reasonably possible. The sourcing of significant services to dedicated and hi-tech locations such as found in India for example have shown that such locations have been able to adapt and continue to work with little or no interruption in service.

Does the force majeure event affect the exit obligations? An exit obligation is like any other obligation. If the force majeure event means it cannot be performed then the service provider is entitled to relief. As stated above, a significant agreement usually requires the service provider to have a business continuity and disaster recovery regime and also to continue to perform its obligations to the extent it can. For these reasons and because exit is mainly about migration of data and processes, then provided that the service provider remains in business, it is unlikely that an exit could not happen at all - it would just have to be slower. As described below under *Extension Rights*, an exit clause should have the ability for the customer to extend the exit period.

Whether over the coming months we will see developments in force majeure clauses to take account of heightened awareness of force majeure generally and COVID-19 issues in particular remains to be seen.

OTHER TERMINATION RIGHTS

Other express termination rights that should be considered include a right to terminate where the parties have been unable to implement the recommendations made by a benchmarking adviser following a benchmark exercise, and termination for change of control. Where the customer already has a right to terminate for convenience, a right to terminate because the benchmarking recommendations have not been implemented, or on a service provider change of control is only advantageous if the customer does not have to pay a termination charge (or at least the full termination charge) in these circumstances. Ultimately this is a matter for negotiation.

EXPIRY

Finally, the contract should not overlook the fact that exit assistance is also needed where the agreement runs its full term and expires. In these circumstances, the trigger point for commencement of exit assistance activities and services will be different (in that they will not be triggered by a termination notice).

WHEN TO CONSIDER EXIT MANAGEMENT ISSUES

Frequently, the customer and service provider elect not to negotiate and agree a detailed exit management plan as part of the original negotiations. Indeed, it may not be possible to do this if, as is often the case, the service provider is implementing changes to the customer's service delivery model or solution (for example, as part of a transition or transformation programme).

In these circumstances, the exit provisions should not be ignored during contract negotiations. At the outset, the parties should negotiate and agree a detailed set of legally binding principles setting out the terms that apply during the exit phase. The service provider should then be required to prepare, after contract signing (normally during the transition phase), a detailed exit management plan (which addresses how a smooth exit is to be achieved from an operational standpoint).

The contract should specify a date by which the detailed exit management plan must be delivered (for customer review and approval) and, to guard against the possibility of delivery of the plan drifting, the customer should consider making part of the transition payments conditional on delivery and agreement of the detailed exit management plan. The contract should also require the service provider to update the exit plan on a regular basis (at least annually) and following (or as part of) any major change to the services.

KEY ISSUES TO BE ADDRESSED

There are a number of issues that should be addressed in the exit provisions of the contract. These include assets, people, intellectual property, knowledge transfer, re-tendering, change freezes, exit period extensions, and payment considerations, each of which are considered in further detail below. Until quite recently an exit schedule dealt with these items in a standardised and recognised format. Whilst that is still the case it must always be remembered that as the contract changes so may the exit requirements. Traditionally a service provider's use of IPR was confined to its own IPR plus standard licences (usually software) from providers of standard market available applications. More recently, we have seen the rise of more integrated solutions with third party IPRs which are provided by third party technology partners who do not provide standard applications to the market but partner with third party suppliers to use their services/software. A good example of this is in mortgage administration where a number of mortgage administrators use third party solutions as part of their services to customers. This can mean that the customer is receiving substantial functionality from a third party that it has no direct contract with. Even if the service is relatively standard, it can still be a barrier to exit if the customer is dependent upon obtaining something similar from a third party or relying on its new service provider to get a similar package from the third party. This raises the need for additional awareness of ownership or licence issues required by the customer on an exit.

ASSETS

The contract needs to address how each category of asset is to be dealt with on termination, including:

- Equipment and other physical assets.
- Contracts.
- Software.
- Personnel.

Equipment and other physical assets. Whether the equipment and other physical assets used to provide the services are to be transferred to the customer as part of the exit strategy depends on several factors. The most important of these is whether those assets are dedicated (used only in the provision of services to the customer), or shared (used for the benefit of multiple customers of the supplier).

For dedicated assets, the customer will generally wish to have the option to purchase those assets on termination. The contract should address how the purchase price is to be determined. Often, it is agreed that this is at net book value, in which case the contract should specify the depreciation and amortisation principles to be used for the purposes of calculating the net book value.

For obvious reasons, it is rarely practical for the service provider to offer the customer an option to purchase the shared assets.

This has implications for the contract:

- First, the contract should clearly identify from the outset any assets (or asset types) that should be used exclusively for the customer's benefit. This may have an impact on the service provider's costs (and therefore the charges payable by the customer) and this needs to be factored into the price and pricing terms.
- Second, the contract should require the service provider to provide the customer with details of all assets used to provide the services to the customer, including age, location, condition, refresh profile, and whether the asset is dedicated or shared. Among other things, this enables the customer to identify any equipment or other assets that can be purchased from the service provider on termination, and those that will have to be replaced. This information is also important to enable other prospective service providers to prepare their bids as part of any re-tendering exercise (see below, *Re-tendering*).

To address these points, the contract normally requires the service provider to create and maintain a database of all key assets used to provide the services. The service provider should be required to update this regularly throughout the life of the contract (including following any major changes to the services or to the service provider's service delivery model), and to provide the customer with access to this database. This helps ensure that an up to date asset register is available to the customer when needed as part of the exit strategy.

In addition, the contract should address the terms on which any assets are to be transferred: in particular, whether the service provider is required to provide any warranties as to the quality or suitability of the assets, or whether these are to be transferred on an "as is" basis. Ultimately, this is a matter for negotiation. As a minimum, the service provider should be required to assign any manufacturer warranties (to the extent these are capable of assignment), and to warrant that the assets will be transferred with full title guarantee (or equivalent) and free from any liens and other encumbrances.

Contracts. Similar issues apply in relation to any contracts to which the service provider is a party that are relevant to the provision of the services. These contracts may include key subcontractor agreements, supply agreements, services agreements, software licences, and hardware and software maintenance agreements.

The strategic sourcing contract should distinguish between third party contracts that are relevant solely to the provision of the services to the customer, and those that are relevant to multiple customers of the service provider. The former category may include contracts that were novated from the customer to the service provider at the start of the strategic sourcing arrangement, as well as contracts subsequently entered into by the service provider. The customer will normally require the option to have some or all of the contracts in this category assigned or novated to it on termination.

To facilitate this, the contract should contain a provision requiring the service provider to ensure that, where possible, appropriate assignment or novation rights are included in those contracts. The service provider should ensure that all contracts in this category can be terminated at the same time as the strategic sourcing agreement, so that it is able to terminate these if they are no longer required by the customer.

The service provider is also likely to have in place contracts with third parties that are relevant to its customer base generally, and clearly these are not appropriate for transfer to the customer on termination. The customer should ensure that the service provider is required to provide details of these contracts upon request, as this information can then be used to identify and source an alternative means of supply of the relevant products or services. The service provider is unlikely to be willing to provide commercially sensitive information relating to these contracts (such as pricing), but should be prepared to give sufficient information to enable the customer to understand the products and services being provided under these contracts.

As with the transfer of physical assets, the contract needs to address the terms on which any contracts are to be assigned or novated. For example, the customer needs to know that:

- It has been provided with all terms of the contract (and that there have been no material variations of which it is not aware).
- There are no material disputes between the service provider and the contract counterparty.
- Neither party has served notice of termination.
- The service provider is not in material breach of that contract.
- The service provider has no grounds for believing that the counterparty is in material breach.

In addition, the contract needs to address and apportion responsibility for any liabilities that arise in connection with any third party contracts. Frequently, this is dealt with by way of reciprocal cross-indemnities for liabilities arising before and after transfer of the contract.

Finally, the contract should deal with who bears the cost of any charges imposed by the counterparty in connection with the transfer or assignment. Historically, some third party suppliers (particularly in the software industry) have used any proposed transfer or assignment of its contract to the service provider as an opportunity to extract additional charges from the customer. Whilst the imposition of assignment charges is less common than it used to be, the customer can avoid this financial risk by negotiating appropriate terms, allowing for assignment to a service provider and/or including a right for any service provider to use the software or other

underlying contract assets, at the time the third party contract is originally entered into. Customers should ensure that these rights are sufficiently wide to enable it to re-assign the contract/transfer the right to use to a replacement service provider in the event of a subsequent transfer of the outsourced services. If the contract does not have these rights at the outset then upon the customer's first strategic sourcing there is the opportunity to obtain assignments or novations upon express terms that allows what is often termed as 'an End Service Transfer' i.e. the transfer of the contract to a new service provider or a transfer back to the customer. Upon an End Service Transfer, the contract can be assigned or novated at the customer's discretion and without cost. There is a judgement required here in that the original service provider may not need the contract ultimately (e.g. due to a transformation by the supplier) and thus it may be better to negotiate a 'Right to Use' for the service provider instead rather than pay for an assignment or novation that might only have a limited life.

SOFTWARE

Particular thought should be given, at the outset, to the position on software licences and maintenance contracts (especially relevant to IT services, but increasingly important for many business services as well). The parties need to agree whether software licences and maintenance contracts are to be bought in the service provider's or customer's name. While there may be a commercial benefit in these licences being bought in the service provider's name (the service provider may have more favourable pricing terms with the software vendor, for example), this can create complications on exit, unless the parties have managed to include an assignment or transfer right in the relevant licences and contracts. As discussed above, the increasing use of third party specialist solutions may mean that the customer is beholden to the third party for significant functionality which may not be easy to replicate. The customer therefore should contract for the service provider to be able to obtain a new licence for the customer or its new service provider on an exit or the customer should contract directly with the third party for this right.

These points are relevant to licences and maintenance contracts for application software, but the customer is also likely to want to ensure either that any software licences relating to equipment used exclusively to provide services to the customer (operating system licences and firmware for example) are in the customer's name or that they are capable of transfer to the customer.

PEOPLE

Regardless of what is stated in the contract, the employees of the service provider may transfer to the customer or a replacement service provider on termination by operation of law. In the EU, for example, this may happen pursuant to Directive 2001/23/EC on safeguarding employees' rights on transfers of undertakings, businesses or parts of businesses (Acquired Rights Directive) (ARD).

The ARD is implemented into English law by the *Transfer of Undertakings (Protection of Employment) Regulations 2006* (TUPE). TUPE goes beyond or 'gold plates' the ARD by introducing the concept of a 'service provision change'. There can be a service provision change when there is an initial outsourcing, a second-generation outsourcing or when a client takes services back in-house from a service provider. The intention was to provide certainty that TUPE would always apply in an outsourcing context (although subsequent case law has eroded that principle).

Under TUPE, employees automatically transfer on their existing terms and conditions of employment, with continuity of service, along with all accrued rights and liabilities in connection with their contracts of employment, except those rights and liabilities relating to provisions of occupational pension schemes regarding old age, invalidity and survivors.

Depending on the nature of the services being provided, the manner in which they are supplied and the bargaining power of the parties, the customer may be able to negotiate a requirement that the service provider reassigns its employees to other duties immediately before the transfer, to avoid the transfer under the TUPE. This may be particularly important where a customer wishes to change service provider because it is dissatisfied with the service standards or service levels being achieved by the incumbent service provider's employees.

However, where the service provider's employees are assigned to the services and the service provider does not have other duties to which its employees can be reassigned, the employees automatically transfer under TUPE, unless they object to the transfer.

Where it is anticipated that employees will transfer on termination, the contract should cover a number of matters, such as identifying those employees who will transfer, and providing relevant indemnity protection against transferring liabilities.

From a practical point of view, people issues are likely to figure largely in any exit. The key is identification of people so that any TUPE or redundancy issues following TUPE are clearly identified well in advance.

IP

In many strategic sourcing contracts, the service provider and its subcontractors will create documentation (in the form of process manuals and help desk scripts for example), software code and other deliverables. It is important that the contract addresses ownership of these deliverables, bearing in mind that in many jurisdictions, the default position is that the service provider (as author) retains ownership and, where ownership is not transferred to the customer, whether and if so the terms on which the customer is permitted to use those deliverables following termination.

Where items are created as part of a discrete project for the customer (for example, the development of a new software application), for which the customer has paid separate project fees, the customer normally insists that ownership of those items is assigned to it. If this is agreed to, the service provider should consider whether it should have a licence to use the IP rights in those items for the benefit of its other customers (possibly after a period of exclusivity for the customer).

The customer will often expect any such licence back to be reflected in more favourable pricing terms for the development project concerned, and ultimately these are commercial issues to be negotiated case by case. Where the service provider retains ownership in this scenario, the customer should ensure that it has a perpetual and irrevocable licence to use the items (essentially a licence that gives broadly the same rights as ownership would).

In addition to items created as part of a discrete project, the service provider may also create other IP rights in the ordinary day-to-day provision of the services. This might, for example, include software code allowing different parts of the customer's system or network to interface with each other. Again, the parties need to address, at the outset, who will own this IP and, if the service provider retains ownership, whether the customer

is likely to need to use that IP following termination. If there is a possibility that this IP will be needed, the contract should again address the scope of the post-termination licence. As discussed above under *Software*, significant functionality may belong to a service provider's licensor.

Among other things, the customer should ensure that:

- The licence permits modification of the IP (to allow continued use as the customer's business and operations change).
- The licence permits use by replacement service providers to provide services to the customer.
- The licence permits use by successors in title to the business and their service providers (so that the customer can sell the business).

For the position on procedures manuals and other documentation created by the service provider in the course of service delivery see below, *Knowledge transfer*.

Finally, customers need to be realistic about their expectations in relation to the post-termination use of any commercial off-the-shelf software (COTS) products owned by the service provider. Historically, there has been an expectation among some customers that they should have a right to continue using the service provider's COTS products used in the provision of the outsourced services, free of charge, following termination of the strategic sourcing contract. In most cases, this is generally an unrealistic expectation, and an approach that will cause significant tensions during contract negotiations. Increasingly, customers are adopting a more reasonable and realistic approach to usage rights over service provider IPR, and accepting that any post-termination use of COTS products is likely to be on the basis of normal commercial terms.

DATA

The ability to access and migrate data has been brought into sharp focus as a result of cloud computing and Fintech offerings. The *Information Commissioner's Office* and the *Financial Conduct Authority* have both published its concerns on the use of cloud computing.

The Information Commissioner has expressed concerns around

"Can you [the data controller] guarantee that you will be able to access the data or services when you need them"?

Source: Information Commissioners Office' *"Guidance on the use of cloud computing 1 20121002 Version: 1.1"*

The Financial Conduct Authority has expressed the following:

"Using the cloud can provide more flexibility to the service that firms receive, enabling innovation and bringing benefits to firms, their consumers, and the wider market. However, it can also introduce risks that need to be identified, monitored and mitigated. *These risks primarily affect the degree of control exercised by the firm and specific issues such as data security. Cloud customers may have less control of the supplier, for example the degree to which they can tailor the service provided, and of the data, such as where data are stored.*" (GSA' Emphasis)

“If the regulated firm does not directly contract with the service provider, it should review sub-contracting arrangements relevant to the provision of the regulated activity to determine whether these enable the regulated firm to continue to comply with its regulatory requirements. Firms should consider, for example, security requirements *and effective access to data and business premises*. (GSA’ Emphasis) The regulated firm must be able to comply with these regulatory requirements even if it does not directly contract with the service provider

Source: “FCA Finalised Guidance 16/5 – Guidance for firms outsourcing to the ‘cloud’ and other third-party IT services” July 2016 (updated September 2019)

More recently, again in relation to financial services, the European Banking Authority has made clear that customers should always know where their data is held. *Final Report On The Guidelines On Outsourcing* European Banking Authority 25th February 2019.

In traditional strategic sourcing the service provider’s data typically resides on the service provider’s own servers or those of a sub-contractor that has been approved by the customer. The customer will know where data is held or at least it is fairly easy to find out. In cloud computing (especially public cloud) the position is rather different as the cloud provider typically buys processing or storage capacity as a commodity as and when available. The customer’s lack of visibility of where data is and can it be accessed or migrated is a key concern of both these regulators. This becomes a very serious issue in the event of an exit due to a service provider’s insolvency.

In terms of exiting the customer must therefore:

1. Know where its data is kept
2. Be able to get access to that data
3. Have the data migrated in an acceptable format.

Contractually, the following provisions are important.

1. A requirement on the service provider to provide information on where data is, and restrictions on the service provider’s ability to transfer the data to other locations/regions without the customer’s consent. This area is arguably neglected in modern strategic sourcing practice due to the inbuilt limits of the traditional model. However, even in the traditional model the customer needs to be assured that the service provider is fully aware of where data is at any one time. It is recommended that all contracts require the service provider to log where data is hosted and that all relevant sub-contractors should supply details, and be subject to the same restrictions on transfer as the service provider.
2. In order to get access the customer will need rights of access from its service provider and most importantly from sub-suppliers. Given the criticality of data access it is recommended that the customer considers obtaining a direct access right from sub-suppliers. This can be done via a direct agreement or by the service provider ensuring such a right is given by law via the Contracts (Rights of Third Parties) Act 1999 or an overseas equivalent. The UK Government’s standard model form contract contemplates both having third party rights and the service provider ensuring in its sub-contract that the customer has a direct enforcement right against the sub-contractor as if it were the service provider.

3. The service provider must not have and no sub-supplier may obtain any form of lien over the data. The sub-supplier must contract to that effect.
4. Data may not be disposed of until migrated. One risk that cloud computing has highlighted is that the service provider's or sub-supplier's terms may reserve a right of disposal unless data is migrated in a short time frame. In one US example a few years ago customers were given just two weeks to remove their data!
5. Data must be in a migratable format. Even in traditional outsourcing there should be clear limits on how data is migrated. The key requirement is that the data must come back in a 'readily migratable format' or 'be capable of being migrated into a commercially available format' and not be dependent upon a service provider's or sub-contractors' proprietary software.

KNOWLEDGE TRANSFER

One of the most important areas to be addressed as part of any exit strategy (and one that is frequently overlooked) is knowledge transfer.

The customer is unlikely to have retained much internal knowledge of the processes involved in the delivery of the services, which in any event are likely to have changed significantly over the life of a long-term deal. The contract needs to address how this knowledge can be transferred to the customer or a replacement service provider during exit.

This can be achieved in a number of ways:

- Some of the service provider's employees may transfer to the customer or replacement service provider on termination, automatically transferring to the customer or replacement service provider much of the requisite knowledge as to process and service provision. Such a transfer may happen by operation of law (TUPE in Europe for example) or by agreement between the customer and the relevant employees. In this context, the customer needs to consider carefully before contract signing the scope and duration of any non-solicitation or non-poach provisions that it is being asked to sign up to by the service provider.

In many jurisdictions, there are no legal restrictions on the service provider's ability to change the employees involved in the delivery of the services during the exit period. This can lead to 'social dumping' behaviour, where the service provider 'dumps' its underperforming employees on the customer shortly before the contract comes to an end. To guard against this, the contract should include provisions preventing the service provider from making any changes to the employees engaged in the service provision (except for reasons outside its control) from the point at which a termination notice has been given by either party (or during the last six months of the contract where the contract runs its full course). These provisions should be in addition to any key personnel terms that apply during the life of the contract.

- The contract should include terms requiring the service provider to prepare a procedures manual, describing how the services are delivered by the supplier, including the processes used. This manual is an important tool in ensuring that the customer can run an effective re-tendering process. The service provider is normally required to prepare the manual, for customer acceptance, during the transition phase. The service provider should also be required to maintain and update the manual during the life of the contract, to take account of service delivery and process changes, so that the customer knows that the manual it receives as part

of exit is up to date and current. The service provider may have concerns about including in the manual any of its proprietary processes that are confidential or commercially sensitive, in which case the parties need to agree terms that achieve a balance between ensuring that the customer has the knowledge needed to take over (or hand over) the services on termination, without unduly prejudicing any competitive advantage that the service provider's processes may give it in the market.

- The customer should consider whether other mechanisms are needed to ensure an effective knowledge transfer. These mechanisms might include training programmes and workshops, and access rights to service provider employees (these might need to apply not only during exit, but for a reasonable period post-termination). In some cases, the customer may want to have the ability to implement a more formal 'work-shadow' process, where the customer's, or a replacement supplier's, employees are permitted to shadow the service provider's employees in their day-to-day operational activities. Service providers will normally wish to put some limits around any work-shadowing arrangements, among other reasons, to ensure that they do not interfere with the service provider's ability to provide services (to the customer and its other customers), and to ensure that the customer's, or replacement supplier's, employees do not have access to commercially sensitive information of the service provider or its other customers.

RE-TENDERING

Related to the customer's exit strategy is the process of re-tendering the services. Unlike a first-generation outsourcing, where the customer holds (or is in control of) all the information needed to tender the contract on a competitive basis, in a second- or subsequent generation outsourcing most, if not all of the information that other prospective bidders may need to prepare and submit a meaningful bid, will be in the hands of the incumbent service provider. For obvious reasons, the incumbent service provider may not be motivated to readily hand over all this information to enable its competitors to bid for the services.

Unless other prospective service providers can be satisfied that there will be a level playing field between them and the incumbent service provider (if that service provider has been asked to re-tender), it can be difficult to attract those service providers to bid on second- and subsequent-generation outsourcings. This scenario can significantly undermine the customer's ability to exit a strategic sourcing arrangement.

To avoid this lock-in scenario, it is important that the contract contains terms that redress the imbalance, and allow for a level playing field between all bidders. The contract should describe in detail the information that the service provider must provide to the customer and other prospective service providers as part of any re-tender exercise. The contract should also specify when this information must be provided. It is not sufficient that it be provided during exit: the customer needs to have access to it well in advance of exit, to enable it to prepare for and run a proper re-tendering exercise. For this reason, the customer should ideally be able to obtain the information at any point during the contract term.

Service providers will, understandably, be concerned about an open-ended commitment to assist in any re-tendering exercise carried out by the customer, as this could result in significant financial exposure on the service provider's part. For this reason, service providers will often seek to impose a limit on the number of re-tendering exercises that can be carried out by the customer during the contract term (for example, by allowing for one such re-tendering exercise in its pricing), or alternatively, by having the ability to charge for any assistance it provides in relation to re-tendering of the services.

The information in question may include:

- Details of the services, including service levels attained. In all probability, the customer will already have this information (in the form of service level and management information reports). It is important that the contract makes clear that the customer either owns those reports or has the ability to disclose them to third parties, including as part of any re-tender exercise.
- Details of work volumes and staffing requirements in the preceding 12-month period (including details of roles and responsibilities), broken down by location and by whether those staff are dedicated to the customer account or part-time. An additional useful question to be able to ask is around the skill sets of the employees in scope.
- Full details of each employee who is assigned to the services, including their terms and conditions of employment, date of birth, length of service, remuneration and any associated liabilities (including claims brought against the service provider and grievances raised).
- Details of the assets (hardware, software and any other equipment) used in the delivery of the services, including technical specifications and condition of those assets (where appropriate and relevant), age and refresh profiles.
- Organisation charts including details of key subcontractors used.

As a general rule, prospective bidders are likely to need the same information and assistance that the incumbent service provider had access to when it bid for the services at the start of the contract. This is an important principle that should be enshrined by customers in the exit provisions of the contract (and included in any key commercial principles relating to exit that are included in the RFP).

CHANGE FREEZES

The contract should also consider whether a 'change freeze' needs to be imposed following notice of termination, preventing the service provider from making material changes to the manner in which the services are delivered (or to the assets used to deliver the services) without customer approval. The reason for this is to ensure stability and minimise the risk of disruption during exit, and to ensure that the assets and service delivery components that the other bidders have used as the basis for their bids do not change significantly.

Note that this is different to the contract change control process (intended to manage and control changes to the service scope), in that it is possible for the service provider to make changes to the assets and/or processes used to deliver the services, without necessarily triggering the contract change control process. The change freeze is intended to address this.

EXTENSION RIGHTS

The exit phase of a strategic sourcing contract, and transition to a replacement supplier, rarely run exactly to plan. The re-tendering process, and negotiations with the replacement supplier, can take longer than anticipated, as can many of the operational activities required to facilitate transition to a replacement service provider. For these reasons, it is important that customers include in their strategic sourcing contracts, an

unfettered ability to extend the exit phase beyond the original planned termination date. In practice, service providers will generally be amenable to this approach provided that (i) the customer is required to provide sufficient notice to the service provider of any extension (to enable the service provider to plan its resourcing), and (ii) there is an overall limit on the extension period (again to provide the service provider with some certainty around its resourcing needs).

PAYMENT CONSIDERATIONS

Payment considerations relating to exit should also be considered upfront and addressed in the contract. There are a number of different approaches here.

First, customers may seek to have exit and termination assistance included as part of the charges, so that the customer does not have to make a significant additional payment during exit. While this has some obvious attractions in principle, the reality is that, often the parties do not know what level of input and assistance will be required from the service provider on termination.

For this reason, this approach means that one party or the other is taking a potentially unnecessary risk on the costs of exit assistance. If the customer does require this approach then the service provider will almost certainly price in an element of contingency to cover that risk. This will be factored in over the initial term. However, it is possible that the agreement will extend in which case the customer will have added to the service provider's profits when that money could have been in the customer's hands. If the exit is for cause then the customer will have to sue for a refund of the built in exit costs which may not be an easy matter.

An alternative approach that is sometimes adopted is to distinguish between the reasons for termination. If, for example, the customer has terminated for cause (poor performance, service provider financial difficulties and so on), it may expect that the exit assistance be provided at no additional cost. The supplier, on the other hand, may resist this position on the grounds that, had the contract run its course, the customer would still have required termination and exit assistance, and the only difference is that the requirement for exit assistance (and the customer's payment obligation), has been accelerated.

In practice, many customers are prepared to pay for exit assistance services (regardless of the reasons for termination), on the grounds that the quality of the assistance services will be better where the service provider is being remunerated. The customer should, however, ensure that it has agreed a rate card with the service provider in advance, to be used to calculate the exit assistance charges. In addition, the customer will probably want the ability to pay for exit assistance either on a time and materials basis or on a fixed-price basis. The contract should give the customer the right to choose either of these options. As described below, (*What can be done to reduce exit costs?*) the customer should have the ability to pay for exit assistance on the basis of milestone achievement.

The customer should also consider building into the contract the right to redeploy existing resources (that is, resources that it is already paying for as part of the monthly service charges) from their day-to-day activities to focus on exit activities. This may have a knock-on effect on the service provider's ability to meet other contractual obligations (for example, service levels), and the service provider should ensure that, where existing resources are redeployed with a knock-on effect on performance, it is not penalised for this (whether in the form of service credits or otherwise). Any suspension or relaxation of the service levels as a result of resource redeployment during exit should be agreed before the redeployment and clearly documented to avoid disputes arising at a later date.

A final point here is that customers should ensure they have the ability to obtain assistance and information (on a paid for basis), for a reasonable period following migration of the outsourced services, about the IT environment (for example, information about the operating system versions used) or the service delivery processes deployed to provide the outsourced services before termination.

STAGE 2 – “WE ARE IN THE CRUISE” - STEADY STATE REVIEW AND MONITORING

At this stage of our journey the captain is checking progress along the route, the en route weather and is preparing to consider alternative destinations if problems or a change of destination is required.

Similarly, during the steady state stage of a strategic sourcing agreement the customer should be keeping an eye on the contract’s progress and considering whether other options should be looked at.

BAU REVIEW

From a governance and business planning point of view a number of reviews should be happening within the customer organisation, with the key questions being:

- Contractually - is the agreement delivering what we contracted for?
- Strategically – is it going to deliver what we need over the whole term of the agreement?

If it is not, does the customer need to consider changing the agreement or changing the supplier? It is a fact that the needs of the customer change over the lifecycle of the agreement. Equally, it is not always possible for the service provider to be able to deliver what the customer wants as the customer’s business changes.

Strategic sourcing strategy is beyond the scope of this manual but if the agreement is not delivering what the customer needs and cannot realistically be changed, or if the services are not what the particular service provider can supply either now or in the future, then the customer needs to consider an exit of some kind.

A wise customer therefore should, on a regular basis review where its own business, the service provider’s business and the operation of the agreement are going.

REASONS FOR CHANGING SERVICE PROVIDERS

There are many reasons for changing service provider whether at the end of the term or mid term

- poor performance
- more sophisticated contract procurement and sourcing strategies
- rapid changes in technology
- customer related changes in what it wants
- service provider related changes in what it can supply both in terms of service and cost
- ‘culture changes’ within the customer or supplier
- relationship issues
- customers are less inclined to accept ‘second best’ until the contract expires
- customer organisations having to be ‘upper quartile’ so their key service providers have to be the same
- getting the best from your incumbent supplier

- consolidation of services into an existing supplier

Core areas for consideration are:

- Cost/price
- Service received
- Ability of service provider to meet future needs
- Relationship
- Best or better options in the market

The fundamental questions that need to be asked to get a clear picture are:

The Services

- are we getting what we are entitled to/paid for?
- are the service levels holding up?

The Supplier

- performance within the contract – is the service provider performing within the contract parameters?
- is the service provider generally competitive in its own market?
- can the service provider improve the performance or service offering to match the market?
- is the service provider performing for its other customers?
- is the current contract competitive in terms of what the service provider offers for similar services – and in particular to the customer’s competitors?
- could we benchmark?
- should we partially terminate and move part of the service elsewhere e.g. to a more specialised service provider who can provide that part of the service better?’

The Market

- where is the market going? Where is the technology going? Where are service improvements and cost improvements going to come from?
- would we be better to terminate now and take advantage of some improvements already in the market?
- Alternatively, would we be better to hold off terminating for the moment or consider extending for a shorter period until some market development is in a more mature state?
- is there an advantage in combining with a service provider and being part of a service provider’s development in new thinking?

But in long term strategic sourcing arrangements these questions are often not asked for a number of reasons:

- Culturally, few organisations keep a sufficiently resourced retained organisation to run analysis. This is particularly an issue for SME companies. Use of consultants should be considered.
- There is no driver to conduct such reviews. An attitude of “we have done a deal for x years” often prevails.
- The service provider is supposed to remain competitive (simply because the contract says so).
- The contract was expensive to set up and the costs have not been fully amortized/written off.
- There are termination penalties to the service provider tied into an early exit for convenience.

Customers also need to ask themselves questions in relation to its total strategic sourcing model. Businesses with a number of strategic sourcing relationships should ask questions such as:

- can we consolidate into fewer outsourcers?
- if we did, would there be a concentration risk?
- could our current service providers take on the additional business and in particular what is their track record for delivering inward migration and/or transformation?

Conversely businesses with few strategic sourcing relationships may need to ask themselves questions such as:

- we have only one or two service providers - is there a case for looking at becoming less dependent on a few suppliers?
- are we better to take some services to another more specialised supplier?
- can we invigorate our external services by using more suppliers?

During this stage of the strategic sourcing journey a business may need an external consultant to help in this exercise.

EXIT TIMING ISSUES

Depending upon the nature of the outsource, the potential timing of a possible exit is an important consideration. The business should ask whether it is possible or desirable to exit within any given time window. The very nature of strategic sourcing means that businesses are highly dependent on their outsourcers at all times. During a time of expansion or acquisition or divestment exiting an strategic sourcing agreement might have to take a lower priority.

In any organisation changes of significant service provider arrangements is likely to be highly disruptive to a company's planning cycle. The higher the commitment to strategic sourcing the greater the potential impact. Strategic sourcing strategy during this stage therefore needs be aware of and in synchronisation with the company's overall strategy objectives.

The other side of the timing debate is available capacity in the market. If the sector has little capacity or has just taken on a number of new contracts it might not be possible to readily migrate. Consequently further questions involve analysis of:

- new or leaving market entrants
- exits and deals going on in the market.

AVOIDING AN EXIT BY RENEGOTIATING

It is during this stage that there is the time to start looking at what possibilities there are for changing the agreement. Approaching the service provider and saying that you are considering exiting is not an easy thing to do, and the temptation to let things ride along is strong. However, it is essential to be prepared to discuss with the service provider the possibility of exit and exit planning.

There could be mutual benefit in discussing such matters. If the agreement is one where the service provider is losing money or making little margin then it may want to consider an early exit as well. The service may well not be part of its current operation and this is so particularly with service providers who have entered into long term agreements and where the market has changed or the service provider's focus has changed. Needless to say, a

service provider should be prepared to provide some incentives to the customer thus making the business case easier.

The opposite position is that the service provider, faced with losing business, is prepared to rethink the arrangement and renegotiate a new deal. Few service providers are prepared to just give in to losing business so a threatened exit is a spur to ensure that revenue is preserved and the service provider does not lose face in the market.

All things being equal, it is clearly far better, as well as cheaper and easier, to renegotiate a current contract and make it work better than do a new deal altogether.

As we have seen earlier, one of the most common mid-term exit negotiation strategies is to part terminate and migrate some services to another service provider – usually one who is more skilled (and therefore more profitable) in that area.

HOUSEKEEPING

There are a number of housekeeping items that the service provider should regularly undertake.

If the Exit Plan has not been completed or fully completed within the post service start date transition period – usually three to six months – then it should be completed now. If there is a transformation exercise the plan will need to be updated on an interim basis.

Remember that the exit plan is required to operate in all scenarios. Using our flight analogy, if there is a very serious service provider issue e.g. insolvency then this forms an immediate emergency checklist. If there is a fundamental service provider failure then lack of an exit plan will have serious implications. For financial services companies the ability to be able to manage an exit is a regulatory requirement and not having a proper exit plan in place will be a regulatory breach.

It is now common practice to regularly test an exit plan. Indeed, financial service regulators expect some form of testing for an emergency exit (i.e. insolvency of the service provider or abandonment by the service provider of the strategic sourcing agreement) to ensure there is a plan that can be immediately brought into action.

In Stage One we saw that the exit schedule included a number of obligations on the service provider to maintain information. An exit cannot proceed if the customer or the service provider does not know how the services are made up and how they are supported.

The customer must be able to obtain without delay or hindrance necessary information. As described in Stage One, the service provider should be keeping vital information in an organised manner such as:

- registers of support contracts and licences
- registers of assets
- systems profiles and architecture maps
- procedure manuals

If any of these are not maintained, then any exit decision process will be delayed. The benefits of tender assistance and/or termination for convenience provisions will be severely compromised if at the point they are activated the service provider cannot provide this information. This is a real issue and one which may not be solved easily once discovered. One of the authors has seen an exit delayed by several months (with potential

impacts to timing of the benefits supporting the business case) whilst the service provider rectified this situation. We are now seeing that customers are imposing a service level, reporting and service credit regime in these areas.

Some organisations include reviewing these registers as part of the audit cycle whilst others operate some form of 'obligations database' which enables a customer's governance function to make checks on the supplier.

STAKEHOLDER ENGAGEMENT

During this stage stakeholder engagement is important as to what any potential exit/change of service provider thinking is. Depending upon the organisation, the customer's retained organisation may or may not have the ability to change service providers without approval or consultation involving the end user. The usual scenario (which accords with good practice in the *GSA Lifecycle Model*) is for key end users of the service output to be involved in new strategic sourcing initiatives.

Since timing of an exit can be critical it is important that account is taken of the internal decision-making process. This is often forgotten about which can lead to rushed decisions, trying to catch up on a compromised timetable (usually involving additional cost) and possible loss of leverage with the supplier.

CHECKLIST AND KEY ACTIONS FOR STAGE 2

- Review regularly whether the contract is delivering the contracted services
- Review whether the service provider can meet the changing requirements of the customer
- Consider strategic sourcing options as part of the customer's planning cycle and whether a change of service provider is a constraint on other activities
- Exit plans must be kept up to date
- Exit plans should be tested on a regular basis
- Asset and contract registers and systems profiles and procedure manuals etc. must be kept up to date
- Stakeholder engagement at an early stage is necessary to ensure that decisions are neither delayed nor rushed to meet contractual notice requirements.

STAGE 3 – “STARTING THE DESCENT” - APPROACHING EXIT – GETTING THE FUNDAMENTALS RIGHT AND AGREED – LEVERAGE POINTS – DRIVERS FOR A TIMELY EXIT

So we are now about to start our descent and so we are now talking in terms of ensuring that our descent profile is going to take our exit at the right pace and that we can get into the final approach at the right time.

UNDERSTANDING THE COMPLEXITY

Having taken a decision to change service providers/take services back in house – not necessarily a final decision – then the entirety of the exit implications need to be addressed at this point. It is vital that the exit implications are understood before any final decision is taken or any negotiations, even preliminary ones, start with a new service provider.

Anecdotal experience indicates that the true cost in terms of time, money, resource and process is not adequately considered and planned for. The consequences of this are:



- ***There is an inadequate understanding of the exit process.*** In most customer organisations this is understandable because of the infrequency of exits. Anecdotal evidence suggests that late into the decision process questions are asked which indicate a uninformed process within the organisation. A good example is TUPE. TUPE is often considered (wrongly of course – see Stage One) not to be an issue in a second generation outsource so that, amongst other things, the possibility of having to indemnify a new service provider for post migration redundancies is not considered at the appropriate time and not included in the business case. Another example is not understanding the exit implications so that wrong information is conveyed to the potential new service provider which, when discovered, may undermine the basis of negotiations to date.

A good practice, common in financial services for regulatory reasons, is to develop contract guides outlining the termination and exit provisions, likely cost areas and areas of potential negotiation so that the relevant functions can input into an exit review and preliminary budgeting. This practice has particular benefits in relation to older agreements where the exit provisions may not be so comprehensive and where there are more potential uncertainties that need to be budgeted for as part of the decision process.

- ***There is an inadequate understanding of the time required:***
 - notice that must be given and the ensuing exit assistance period must be activated or mapped. As described in Stage 1, a well drafted outsource contract usually has an ability to extend the term or the exit assistance in order to allow for an orderly, well planned exit.
 - there is inadequate understanding of the time that it takes to do an exit. In particular, it can take longer to do a second generation outsource than a first generation outsource. This leads back to our key requirement - ***information***. In theory a second generation outsource should be less time consuming than a first generation outsource. However, this may not always be the case because, as we saw in stage one, in a first generation outsource the customer has the information about processes, third party contracts etc. In a second generation outsource the supplier service provider is the custodian of the information and the customer is entirely dependent upon the service provider to provide this information.
 - Validation and Risk Assurance - Annex 3 is a typical timeline diagram showing how an exit is arrived at. The key feature of this diagram is the “Assembly Line”. This emphasises that the new service provider will, from an operational point of view, need to validate its understanding of how the service works and the resources required so that it can demonstrate to the customer at the “Go-No Go” point that it can safely take the service over.
- ***There is an inadequate understanding of the cost - it is important to understand the potential service provider costs of exit at the same time as you build your business case for the new service provider contract.*** This is the time when it is important to use the information provisions, audit/information provisions if necessary, governance etc. to understand what those might be. There are two reasons for this. First, the costs of exit and new service provider entry are likely to be high. What a customer must not do is to underestimate exit costs (or worse still assume that he can force a deal with the outgoing

service provider at a later stage) and then further into the process find it has to try and recapture this by forcing unrealistic pricing with the new service provider to balance the business case. It is not usually expressed in such open terms but a plea to the potential incoming service provider in terms of *“This deal won’t happen unless you help us on the project cost”* is not uncommon. The new agreement must self-sustain so squeezing the pricing on a new agreement to find funds for the exit costs of the old agreement is not a good idea.

The two largest areas of cost:

- Staff costs
- Third party contracts

As described in Stage 1, these areas are particularly difficult to judge accurately in the absence of specific rights to get an understanding of those costs.

WHAT CAN BE DONE TO REDUCE EXIT COSTS?

As a general rule, if an exit is timed properly the customer should pay less in terms of the service provider’s exit project charges.

Secondly, the more information you have and can get through the contract then the less you might have to pay later on once the exit has started.

These are some specific areas that can be looked at in terms of reducing the exit cost particularly on a potential mid-term exit.

- ‘checking the ammunition locker’

If there is a substantial breach and compensation claim then rather than fight it, it might be more beneficial for the service provider to forego some of the costs of exit e.g. a termination for convenience penalty or the exit assistance cost.

- Service provider’s Business Position
 - Service not core to the provider/provider not making much money – essentially saying you help us with our business case to help us take the problem away.
 - Part termination – it may well be the case that the service provider is good at one area and less good at another.

Offering to take away an area that is non-core to the service provider has a number of advantages and the customer should be able to extract a favorable exit arrangement. It might also hasten a discussion about the other services and could well be the basis of renegotiating the remainder of the agreement. A typical scenario is then agreeing better terms and an extension of the agreement.

- Timing

Pointing out that continuing would involve the service provider having to undertake future actions e.g. a forthcoming hardware refresh or having to adhere to some of the “continuous improvement” provisions.

- Benchmarking
 - The potential to invoke a benchmarking exercise.

- Phased Transfer
Phased transfer is one way of shortening the exit period for key services. This can soften the pain to the service provider by perhaps leaving some services with him for an extended period.

Finally, it is during this stage that the customer should consider whether any financial drivers could be agreed to ensure the exit proceeds efficiently?

- Incentive payments
- Agree a fixed price for the exit assistance
- Payment by results and on milestone delivery
- Retention payment – this is useful if some post cut over assistance could still be required
- Offering to be a reference site

Incentive payments are used in other areas of commerce to drive complex projects but for some reason it is not commonly used in exiting from outsource agreements. Serious consideration should be given to this. If an exit is completed on time and efficiently there can be many benefits for the customer in terms of its general business operations, such as a saving in resources particularly of external contractors. In addition, a wise customer may also consider requiring the service provider to incentivise its staff, particularly transferring staff.

The reality of course is that modern strategic sourcing is often on a shared service platform of some kind where the service provider maximizes its profits from sharing the costs of resources - licences, systems etc. with its other customers. As a result, migrating the service is not always a simple operation.

Agreeing a fixed price, as opposed to day rates, has the advantage that the service provider is encouraged to be efficient.

Payment by results or on milestones again encourages the service provider to be efficient.

Retention payments are a common feature of many contracts e.g. in the construction sector and is a well-trying method of ensuring that items are completed in a timely manner.

KEY ACTIONS AND CONCLUSIONS FOR STAGE 3

- Get the right people involved at this stage. Any decision to look at exiting should be done with the benefit of information and expertise. Involve all relevant functions - legal, HR, finance and risk departments at an early stage.
- The customer must start considering the exit side of things *in some depth* before any new service provider negotiations start.
- The earlier there is consideration of all exit issues then the better should be any leverage available. Leaving exit negotiations too late means that the service provider is in a better position than the customer.
- Budget adequately for the service provider's exit costs and don't under estimate the time, cost and resources required. Don't try and pass any under budget or unexpected exit costs to the new supplier.
- Actively consider incentives on the basis that if you want something done you generally have to pay for it. Incentives may well save time and money in the long run.

STAGE 4 - "APPROACH AND LANDING" - MANAGING THE EXIT ACTIVITY SUCCESSFULLY

Having reached the stage that an exit is going to happen and with the runway in sight this section looks at the ingredients of a successful exit exercise. These include:

- Recognition of the exit as a project
- Aligning the exit with the incoming provider's transition model
- The needs for executive sponsorship
- Adequate resourcing
- Recognising and managing the changing relationship
- Control of the process
- Escalation
- Management of the process
- Difficult exits
- Governance and Issue Resolution
- Risk management
- Communications
- Parting as friends

RECOGNITION OF THE EXIT EXERCISE AS A PROJECT

The exit project needs to be recognised as a project in its own right and not merely as a by-product of a new negotiation. The key point is that there is recognition that the exit workstream is just as important as the new service provider workstream.

ALIGNING THE EXIT WITH THE INCOMING PROVIDER'S TRANSITION MODEL

The exit plan which the customer has agreed with the outgoing service provider will often not align with the transition plan agreed with the incoming service provider. The incoming service provider tends to 'have the ear of the customer'. This can create difficulties in execution of the outgoing service provider's exit plan. It is important for the success of the exit and the transition that these two plans are properly aligned.

Some of the approaches used in multi-sourcing models (e.g. operating level agreements or OLAs) could be used for an exit project to ensure that all hand-offs and interfaces between outgoing service provider, incoming service provider and customer, are properly identified.

THE NEED FOR EXECUTIVE SPONSORSHIP

Given the importance of exit the customer should appoint an exit *sponsor*. An exit sponsor has to be a business executive having accountability for the overall delivery of the exit. Ideally, this person should not be part of a new service provider workstream. This avoids he or she having their focus diverted. The sponsor, for reasons described below, must be 'empowered'.

ADEQUATE RESOURCING

Ideally, there should be a team dedicated to the exit. What this looks like will vary according to the nature, size and length of the exit.

Like the exit sponsor, the exit team should, if at all possible, be dedicated to the exit and not subject to conflicting priorities by having to support a new service provider workstream. Not all companies have the ability to have dedicated teams for both the exit and the new service provider workstreams. Therefore, roles and responsibilities need to be clearly understood.

Few customer companies have the ability to maintain experts in the field of exiting strategic sourcing agreements and the use of consultants should be considered.

Once an exit is invoked the service provider will need to nominate its team and establish the governance arrangements. It makes good sense for the customer to reserve the right to interview and approve the outgoing service provider's exit manager and the new service provider's transition manager.

RECOGNISING AND MANAGING THE CHANGING RELATIONSHIP

During the exit stage the customer has to take a different view of the relationship. The changed relationship during an exit is an area that deserves research in its own right. For the purposes of this manual the customer needs to recognise that the relationship has changed. Therefore, during the exit there has to be positive management of the relationship. The exit relationship is not the same as the BAU relationship. Both the customer and the service provider need to manage the relationship in a different way. The customer has to recognise that the service provider is losing business; it is potentially losing employees and may well be losing them in a situation where redundancies are going to follow so, as already mentioned, staff motivation may not be high. Much is said about relationship in strategic sourcing agreements and not relying on the contract all the time etc. Exit is one situation where this applies.

Whatever the reason for the exit, from the outgoing staff's point of view they are facing an uncertain future. Incentives here may go some way to mitigating lethargy. For key people involved in the transfer it is useful to consider a retention payment to encourage them not to leave until the exit is completed.

The customer in particular needs to have in mind some sensitivity in the way it deals with the outgoing service provider and its staff. Whilst it is only right and proper to enforce the contract terms the language used and attitudes shown should be considered.

CONTROL OF THE PROCESS

The key consideration is that during an exit the customer is essentially in control. Many customers try to shift the burden of responsibility onto the incumbent service provider. This is unfair. The service provider will not be privy to all the decisions of the customer nor the relationship with the new service provider. The new service provider is not – despite what many customers and their legal advisers say – in the incumbent service provider's control. The service provider will therefore, quite rightly, expect the customer to take a positive interest in the process and control it and be responsible for the actions or inactions of the new service provider.

ESCALATION

It follows that in an exit situation speedy escalation of issues is crucial. In particular, this includes BAU issues. A BAU issue is not only important in its own right but, if not resolved, it can carry on into the exit process and new service negotiations.

PERFORMANCE OF SERVICES

Despite what the best practice says and despite what the exit schedule will say about all services being maintained to the same standards without deterioration etc., during the exit period there has to be a willingness to compromise here.

Few service provider organisations are staffed to the extent that exit and BAU can be run at the same time without some resource or performance issues arising. This is particularly so with smaller providers.

A well-drawn exit schedule should make provision for some of these things e.g. the customer has the ability (at its discretion) to prioritise any particular services or SLAs and to discuss service quality and achievement. In the absence of such a provision a sensible service provider, having reviewed the exit proposal, should sensibly approach the customer about what is achievable. The customer should listen to the service provider not least because if the customer is adamant about maintaining everything to the highest level the chances are the service provider will need more resource which will cost more. Since this right is discretionary the customer should as part of such discussions consider asking for some return from the service provider in lower service charges or exit costs.

Despite best endeavours some service levels, particularly high targeted ones, may well be missed. To take a simple example - if a service level is missed due to a resource constraint within the service provider the customer should at least consider *“Do I really need that service credit?”*

This is the time for the customer to have the character to be prepared to actively help the service provider and at the same time help the process for everyone’s benefit. It follows that the sponsor has to have buy-in from the end users to be able to make compromises of this kind.

In BAU it perhaps does not matter too much that there is not a quick process for agreement and compromise. However, in an exit situation the reverse is true, particularly as the process moves towards its final stages.

DIFFICULT EXITS

If the exit arises because of fundamental relationship or legal issues then a degree of rigour is required. This will depend on the circumstances. If there are on-going issues between the parties then both the customer and service provider should ideally try and agree that persons involved in the wider dispute are not involved in the exit process. If they happen to be then there should be a protocol that these issues are kept away from their exit teams and that the exit teams are not to engage in such issues.

Particular problems arise where there is actual or potential litigation. This is probably the most difficult area since there are clearly going to be problems relating to confidentiality, privilege and whether anything that is said during the exit process is capable of being used by the other party. The legal management of such a situation

is complex. However some agreement has to be reached between the parties to isolate the issue from the operational teams and impose some rules of engagement.

GOVERNANCE AND ISSUE RESOLUTION

An exit should have its own governance. Typically new contract negotiations are the subject of a steering group of some kind with emphasis on ensuring that issues are aired and resolved. Exit should also have a Steering Committee with clear terms of reference to manage these types of issues.

At Main Sponsor Level

- Customer Exit Project Sponsor
- Outgoing OSP Project Sponsor
- Incoming OSP Project Sponsor
- Customer Legal

At Working Steering Group

- Legal
- Operational & Technical
- Risk
- others

Annex 2 shows full details of such a structure.

Having the Exit Steering Committee meeting on the same day as a new service provider procurement steering committee is advantageous and there should be some cross membership of these two committees. Their minutes should also be shared recognising of course that certain things relevant to the new service provider cannot be shared with the incumbent provider.

A three way relationship is always difficult to manage. The inability of one party to make a decision to resolve issues quickly can be a problem. Some of these may not be capable of resolution by each party's project manager. The ability of a project manager to be able to refer to a sponsor is very important. The use of a three way steering group governance process tends to ensure that people who are decision makers make the decisions that are necessary and things are not allowed to drift.

RISK MANAGEMENT

Risk management should be a key feature of any exit planning. A risk assessment of the capabilities and resources required on the part of the outgoing supplier, the new service provider and of course the customer, who is ultimately responsible, is important. In long and involved exits this should be an ongoing exercise.

COMMUNICATIONS

Communications covers a wide variety of areas. Stage 3 looked at communications with the end users. Staff communications within the customer indicating what the exit is going to entail and the impact on the customer's retained organisation is of course vital. Other areas include communications with the market, regulators etc.

PARTING AS FRIENDS

Last but not least, the parties should try to 'part as friends' to quote this often used phrase. Who knows what relationships may develop in the future? To do this techniques such as:

- active protocols about achieving a professional outcome;
- respect for the other's organisation; and
- a ban on personality clashes

should be employed.

CHECKLIST STAGE 4

Managing the Exit

- The exit and the incoming transition have to be aligned
- The customer should have a say in the appointment of both the incumbent's exit manager and the new service provider's transition manager
- Have a dedicated exit governance model
- Sponsorship
 - Customer and service provider should employ exit sponsors who are empowered
 - Customer sponsor will need the authority and support of end user stakeholders to be empowered to compromise service standards in a sensible way where necessary.
- Employ where necessary a dedicated sponsor and exit team
 - Ensure that the exit team and the new contract team deal with their own responsibilities
 - The exit negotiations/work must have equal rigour/resource/sponsorship etc. with the new service provider negotiations/work
- Customer Responsibilities
 - Customer must manage the exit – the outgoing service provider is entitled to expect that
 - Customer must expect some disruption and ensure it is planned for
 - Customer must be prepared to compromise
- Relationship Management
 - Keep relationship issues or legal disputes away from the exit implementation teams
- Risk Management
 - Carry out a risk assessment so potential problems are identified
- Resource
 - Ensure that you have enough resource/budget for the exit. Don't let an underestimate contaminate any new supply negotiations/pricing
- Governance
 - Have a robust governance structure
 - Ensure that the exit steering group and new contract steering group sit on the same day

ANNEX 1 SAMPLE DUE DILIGENCE QUESTIONS

<p>Please indicate the number of exits that your organisation has carried out in the last 5 years</p>	
<p>Please provide details of your standard methodology for carrying out an exit detailing:</p> <ul style="list-style-type: none"> • Planning • Cost estimation • Cost control • Governance • Implementation • Problem solving 	
<p>Please describe a scenario where an exit went well and the reasons why it went well.</p>	
<p>Please describe a scenario where an exit or elements thereof did not go well and what actions you took to manage the situation.</p>	
<p>Please give examples of your ability to problem solve an issue that arose during an exit.</p>	
<p>Please provide two site references of customers that have exited from you in the last three years who can validate your exit experience and management. If none within the last three years please provide referees for any period up to date.</p>	

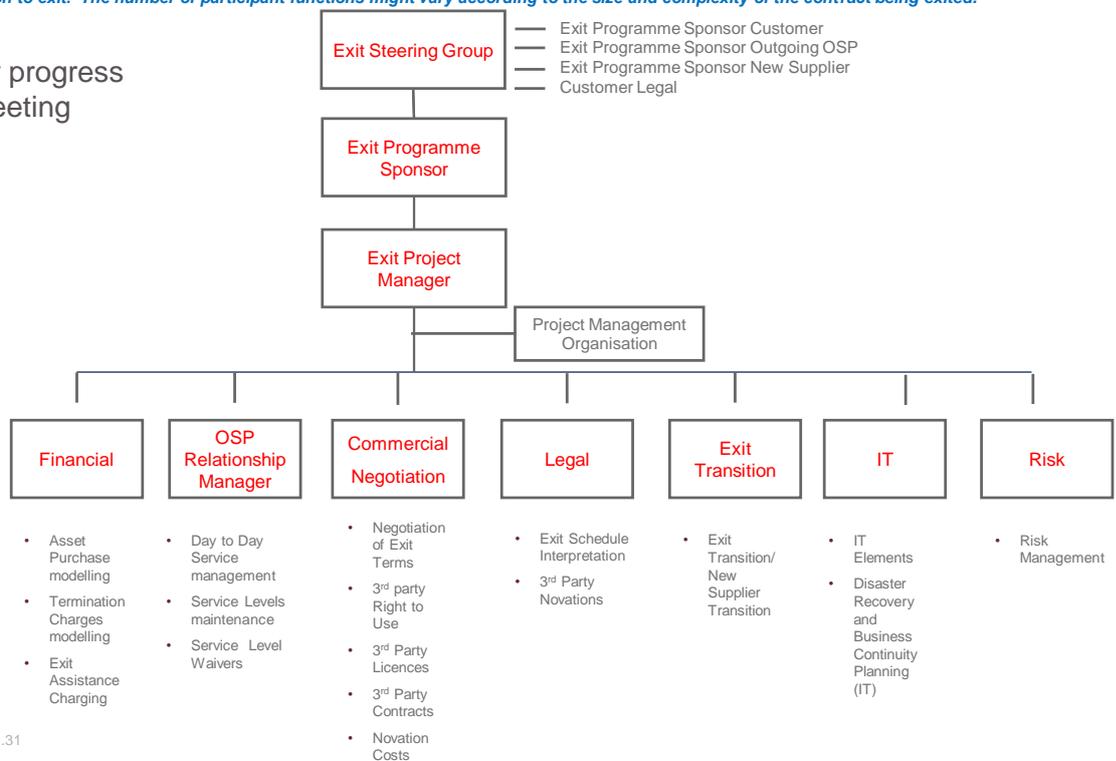
ANNEX 2 EXIT GOVERNANCE MODEL

Example Of Exit Governance Based On A Small Steering Group And Clear Project Structure And Workstream Leaders

NOTE: This basic structure will vary at different times of the exit process e.g. OSP and New Supplier would not be in the Exit Steering Group prior to the Customer's decision to exit. The number of participant functions might vary according to the size and complexity of the contract being exited.

Fortnightly progress report / meeting

Weekly progress report / meeting



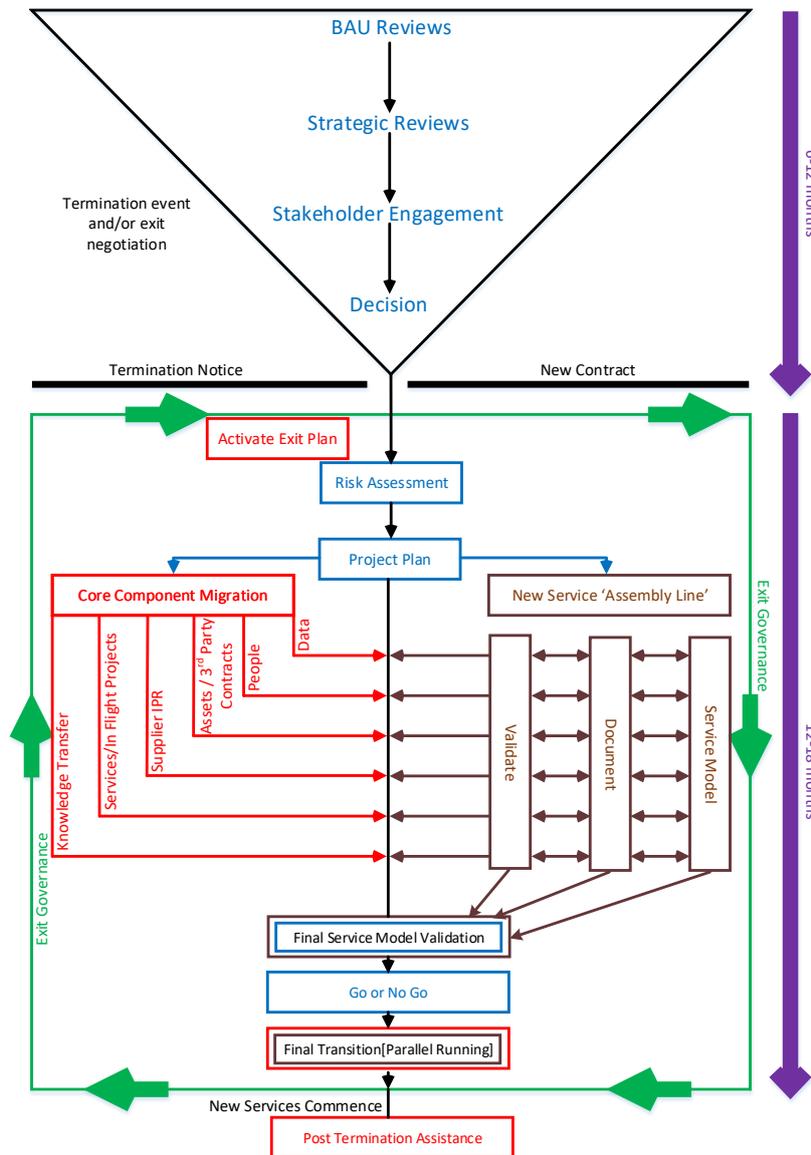
ANNEX 3 TYPICAL EXIT TIMELINE AND ACTIVITY

Key Decisions or Responsibilities:

Blue = Customer

Red = Incumbent Supplier

Brown = New Supplier



ANNEX 4

EXIT MANAGEMENT AND TRANSITION CHECKLIST

Exit Management

Exit Governance

- ✓ Establish exit management governance; agree meeting attendees, agendas & frequency
- ✓ Define and acquire resources to carry out customer obligations within the exit plan
- ✓ Identify risks and issues associated with each workstream and track within an agreed management tool
- ✓ Educate all parties of security, confidentiality, audit and exit / transition governance of which they must comply
- ✓ Monitor (via regular exit governance meetings and offshore presence) the behaviour of the outbound service provider and their adherence to the exit agreement

Exit Agreement

- ✓ Legal documentation / agreement
- ✓ Understand contractual obligations for providing notice and construct a day-by-day diary of activities to be followed to ensure obligations are met and the outbound service provider is treated fairly
- ✓ Construct an exit agreement framework that will have the capacity to define the exit obligations to be fulfilled by the outbound service provider, and the mechanism to be used to measure completion

Prepare requirements for agreement

Iteration 1

- ✓ Identify risks and issues associated with each work stream and track within an agreed management tool
- ✓ Provide list of outbound service provider staff authorised to access customer locations

- ✓ Construct a list of software, scripts, tools or command procedures required by the outbound service provider to perform the services being terminated
- ✓ Construct a list of processes, standards, procedures, manuals and any associated reference material that are employed by the outbound service provider to provide services being terminated
- ✓ Construct a list of all in-flight projects and changes scheduled during the termination period
- ✓ Construct a list of resolver groups in operation to provide the services being terminated.
- ✓ Construct a list of existing known errors
- ✓ Construct a list of open problems pertaining to the services being terminated
- ✓ Construct a full list of assets wholly owned by the customer in the possession of the outbound service provider
- ✓ Identify all third party contracts and licences owned or operated by the outbound service provider group them into those that are transferable (with associated costs) and those that are not. For those that are not, the outbound service provider MUST provide an alternative
- ✓ Plan for removal all outbound service provider external interfaces with customer systems according to risk and service provisions
- ✓ LOI

Iteration 2

- ✓ Commence transition planning with the inbound service provider
- ✓ Identify customer roles and activities to be performed and delivered by the inbound service provider (consider the possible application of TUPE)
- ✓ Provide any relevant documentation pertaining to transferable contracts/licences as required by the inbound service provider
- ✓ Agree permitted levels of access to inbound service provider office space by all other parties
- ✓ Discuss inbound service providers anticipated resource requirements from the outbound service provider
- ✓ Agree knowledge transfer and education mechanisms between inbound and outbound service provider
- ✓ Ensure the outgoing service provider is informed

Iteration 3

- ✓ Customer and outbound service provider agree the scope of termination (which services) and agree objectives, timescale & contractual obligations
- ✓ Agree permitted levels of access to outbound service provider office space by all other parties
- ✓ Identify geographic locations that are acceptable by both outbound and inbound service providers to perform KT transition task
- ✓ If required, agree location of neutral territory and negotiate procurement of temporary office space
- ✓ Define and agree process to transition transferable contracts/licences to Incoming service provider
- ✓ Define and agree resource requirements from the outbound service provider (assuming inbound service provider resource requirements are already agreed as part of the contract negotiations). These must, at a minimum, meet the outbound service provider's contractual obligations for termination
- ✓ Define and agree the data/information exchange process between all parties
- ✓ Define and agree terms for the transfer of in-house developed software, scripts, tools or command procedures required by the outbound service provider to perform the services being terminated that are not covered by the customer's IP rights
- ✓ Agree date and time for the outbound service provider to cease providing in-scope services
- ✓ Agree date and time for the outbound service provider to vacate occupied space in customer offices
- ✓ Agree suspension or relaxation of SLAs with the outbound service provider (if applicable, use this as a negotiation tool to reduce outbound service provider's costs)
- ✓ Agree with the outbound supplier, the mechanism to remove or archive customer documents & data held on assets that do not belong to the customer and are not transitioning to the customer
- ✓ Agree the knowledge transfer and education mechanisms between the outbound service provider and the inbound service provider
- ✓ Agree the transfer mechanism for in-house developed software, scripts, tools or command procedures required by the outbound service provider to perform the services being terminated either owned or not owned by the customer
- ✓ Customer, outbound and inbound service provider commercial groups to agree any transferable asset values
- ✓ Customer and outbound service provider to agree the contents of an exit agreement and intellectual property rights licences agreed between the parties
- ✓ Agree costs to customer and outbound service provider (assuming inbound service provider costs have been negotiated into the tender price)

- ✓ Agree payment schedule with outbound service provider for all exit costs and outstanding service invoices
- ✓ Review access rights for the outbound service provider's staff and arrange for these to be removed during the appropriate exit phase
- ✓ Once scope for exit management has been agreed, plan out the activities agreeing timelines, deliverables and measurement of success / completion – transition planning
- ✓ Populate framework exit agreement with agreed / negotiated position
- ✓ Outbound service provider and customer to sign exit agreement

Exit Agreement Complete

- ✓ Joint agreement that exit planning is complete

Service Closure

- ✓ Execute transition plan as agreed with all parties during exit planning
- ✓ Transfer privileged and shared user IDs and passwords where they are still required to support operations of the customer environment from the outbound service provider to the inbound service provider
- ✓ Outbound service provider to return all secure access encryption devices at the appropriate exit phase without impacting the continuing delivery of terminating services
- ✓ Organise the correct disposal of any hardcopies of customer documents
- ✓ Outbound service provider staff to return all access permits / passes issued by the customer for access to customer locations
- ✓ Vacate customer's offices
- ✓ Remove access for outbound service provider staff to customer locations
- ✓ Verify that all outbound service provider accesses (both physical and logical) has been removed.
- ✓ Full and final settlement of any outstanding disputes between customer and outbound service provider
- ✓ Outbound service provider ceases to provide service

Transition

Transition programme

- ✓ Prepare scope for transition planning

Transition Planning

- ✓ Provide customer with a detailed organisation chart of the inbound service provider's facilities / operations model for service delivery
- ✓ Agree the main accountable owners for each transition work stream
- ✓ Provide customer and inbound service provider with access to outbound service provider personnel to enable inbound service provider to undertake detailed due diligence
- ✓ Agree plan and timelines to transition in-flight projects including planned projects to commence during transition period or after the outbound service provider has stopped providing services
- ✓ Agree timelines to transfer in-house developed software, scripts, tools or command procedures required by the outbound service provider to perform the services being terminated either owned or not owned by the customer
- ✓ Agree plan with timelines and success measures to transition all in-scope services from outbound service provider to inbound provider, utilising artefacts and agreements provided during the exit planning phases
- ✓ Define dependencies between inbound service provider transition plan and outbound service provider exit activities
- ✓ Acquire resources to carry out outbound service provider obligations in accordance with the exit plan
- ✓ Conduct workshop between customer, inbound and outbound service providers ensuring all parties understand agree to the exit / transition plan and the governance of the exit / transition plan

Knowledge Transfer (KT)

- ✓ Review all documentation being transitioned to inbound service provider. This should be checked for accuracy, relevance
- ✓ Inbound service provider review of outbound service provider processes and procedures. Outbound service provider to answer all questions resulting from review
- ✓ Inbound service provider to confirm that outbound service provider processes, procedures are complete and up-to-date
- ✓ Confirm suitability of existing procedures post transfer. Propose any transformation plans

- ✓ Execute knowledge transfer phase as defined in the transition plan agreed between all parties
- ✓ Joint agreement of completion of knowledge transfer phase of the transition plan

Shadow KT

- ✓ Execute shadow KT phase plan as agreed between all parties during the transition planning and exit planning phases
- ✓ Joint agreement that shadow KT is complete

Primary KT

- ✓ Execute primary KT phase as defined in the transition plan agreed between all parties during the transition planning and exit planning phases
- ✓ Joint agreement that primary KT is complete

Service Activation

- ✓ Review inbound service provider ability to commence steady state
- ✓ 'Go' and 'No-go' discussions and decision between all parties
- ✓ Send notification of intentions to all affected third parties
- ✓ Novation and transfer of contracts
- ✓ Service transferred to inbound service provider
- ✓ Notice of termination communicated to outbound service provider by customer
- ✓ Outbound service provider to complete and execute its own internal communications plan
- ✓ Conduct workshop between customer, inbound and outbound service providers ensuring all parties understand agree to the exit / transition plan and the governance of such
- ✓ Outbound service provider to complete (with agreement from all parties) and execute external communications plan
- ✓ Inbound service provider to complete (with agreement from all parties) and execute external communications plan
- ✓ Customer to complete (with agreement from all parties) and execute external communications plan

The Global Sourcing Association



A Practical Manual for the Effective
Exiting of Strategic Sourcing Agreements

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