

*Effective and Efficient Contracting
Process*

Gregg Kirchhoefer, COP, Partner,
Kirkland & Ellis LLP

Matt Lovell, Partner, Kirkland & Ellis
LLP

Agenda

- The Issue
- Overview: Contracting and Negotiating Processes as Relationship-Builder
- Top Ten Tips for Negotiations
- Q&A

The Issue

The Issue

- The Outsourcing Contract Journey
 - At the end of the outsourcing journey the ultimate benefits realized can be significant
 - However, the path to that destination takes substantial effort and time
 - The challenge is to make the journey less arduous and time-consuming without sacrificing safety and security

The Issue

- The Outsourcing Contract Journey
 - Historically, the prevailing approach to outsourcing contracts was to heavily document and strongly bias agreements that were monolithic in scope and long in term
 - More recently, the approach has been to reduce scope (*e.g.*, best in breed or towers) and term (*e.g.*, three year term versus seven year term)
 - Currently, using the following contracting and negotiating processes can help make the journey less risky and demanding

Overview: Contracting and Negotiating Processes as Relationship-Builder

Overview: Contracting and Negotiating Processes as Relationship-Builder

The Relationship Mindset: Attitude Toward a Possible Relationship

- There is a tendency to think of sourcing as procurement; typically, it is not the same as commodity procurement
- It is helpful to think of outsourcing or other long-term sourcing transaction as a relationship akin to a marriage
 - Two parties making a long-term commitment to one another
 - The sourcing agreement as a “pre-nup”
- The sourcing relationship may create an exclusive (*de facto* or *de jure*) monopoly supplier to a certain degree

Overview: Contracting and Negotiating Processes as Relationship-Builder

Courtship: Getting to Know One Another (due diligence)

- From a customer standpoint, the provider selection process should be robust and thorough
 - Assess provider's track record of service and flexibility, ability to achieve objectives, financial viability, reputation, corporate structure (*e.g.*, for parent guarantee), litigation history, and other factors applicable to the specific services or service provider
 - Communicate thoroughly throughout the process
 - Include management, operational personnel, subject matter experts
 - Use regular meetings and broad access to keep process on-track
 - Consider internal sensitivities regarding communications
 - Consider privilege issues

Overview: Contracting and Negotiating Processes as Relationship-Builder

Courtship: Getting to Know One Another (due diligence) (cont.)

- Communicate thoroughly throughout the process (cont.)
 - Interview past/existing/current customers of provider; interview different business constituencies of customer
 - Consider the quality of infrastructure and personnel and long-term health of provider
 - Perform background checks – security measures, privacy, protection of confidential information, intellectual property, litigation history, media search, etc.
- From a provider standpoint, “know thy customer” is crucial to a successful engagement

Overview: Contracting and Negotiating Processes as Relationship-Builder

The Contract: A Prenuptial Agreement

- View the contract as an opportunity to improve understanding of the other party, the parties' respective interests, and the transaction – not as a hindrance or box to check
- Approach the contract as the last best chance to establish the relationship on a strong foundation
- Allocate time and resources sufficient to allow a comprehensive process and quality analysis and work product
- Involve counsel at inception
- Consider privilege issues when engaging and communicating with advisors

Overview: Contracting and Negotiating Processes as Relationship-Builder

The Contract: A Prenuptial Agreement

- Identify potential issues in the relationship
 - Issues related to fundamental commercial terms (*e.g.*, scope, price, and performance metrics/service levels)
 - Specific risks and concerns of each of the parties (*e.g.*, provider's concerns regarding revenue recognition, protection of IP, limitation of liability, data security)
 - Industry risks and dynamics
 - Extrinsic issues (*e.g.*, change in law, geopolitical risk)

Overview: Contracting and Negotiating Processes as Relationship-Builder

The Contract: A Prenuptial Agreement

- Build a foundation of trust and cooperation through the contract negotiation process – the living together
 - The provider will be taking over a critical function of the customer and potentially changing it in fundamental ways
 - The parties must establish a solid working relationship to address inevitable change and other issues in the future
 - One-sided contract with onerous burdens on the provider may be a Pyrrhic victory that creates a “breach-in-waiting” or work-to-rule approach
 - One-sided contract with insufficient protections and meaningful remedies for the customer may serve to jeopardize the relationship and may damage the perception of the provider in the marketplace

Overview: Contracting and Negotiating Processes as Relationship-Builder

The Marriage Contract: A Good Relationship Alone Is Necessary but not Sufficient ...

- Note that an effective sourcing agreement must have clear governance and dispute resolution processes and appropriate incentives and disincentives to keep the parties' interests aligned
- Do not underestimate the need for a solid agreement with detailed exhibits and schedules because as time passes, the individuals initially involved may move on
- Ultimately, even the best contract might not save an engagement if the parties are poorly matched or their respective interests are misaligned

Overview: Contracting and Negotiating Processes as Relationship-Builder

The Marriage Contract: A Good Relationship Alone Is Necessary but not Sufficient...

- Contract has many different functions/purposes
 - Memorializes the agreement and the intent of the parties at the time of entering into the agreement
 - May be necessary to satisfy legal requirements (*e.g.*, Statute of Frauds; assignment of IP rights)
 - Serves a prophylactic purpose (but note that in litigation, even if you win, you lose)
 - Allocates risks and responsibilities
 - Provides incentives and disincentives to shape behavior
 - Provides a roadmap for actions when things change or go wrong

Top Ten Tips for Negotiation

Top Ten Tips for Negotiations

Tip #1: Do Not Start Work before all Contract Documents Are Executed

- Beginning to engage a provider for work prior to executing the definitive contract documents can reduce flexibility
 - More difficult to walk away from an engagement if the provider has already started performing the engagement
- If the parties must commence work prior to executing the definitive contract documents:
 - Ensure that the work product has intrinsic value
 - Shape the engagement as a pilot that is not dependent on the ultimate engagement
 - Have alignment mechanism in place (*e.g.*, tie all or some portion of the payment to the provider to completion of the definitive documentation)
- Agree upon how any pre-definitive/interim agreement will be rolled into the definitive agreement and scope of work

Top Ten Tips for Negotiations

Tip #2: Recognize That Negotiation Is Not a Zero Sum Game

- Parties should not look at negotiation as a battle to be “won”
 - Final contract documents should be “fair and balanced” to reflect the appropriate risks and incentives for optimal outcomes and performance by both parties
 - “Winner take all” mentality is not conducive to building a strong foundation for an ongoing, long-term relationship
- However, parties need to understand that risk of failure often falls disproportionately on the customer – therefore, agreements must appropriately address the balance of risk

Top Ten Tips for Negotiations

Tip #3: Do Your Homework

- Understand the contracts to be negotiated and the background materials (*e.g.*, RFP response, customer's business case, etc.)
- Work from a term sheet if appropriate or helpful
- Research the other party's agreements – prior agreements and public domain sources (EDGAR, other regulatory filings, court documents, etc.)
- Prepare issues lists, document summaries, and potential compromise and fallback positions

Top Ten Tips for Negotiations

Tip #4: Develop a Good Working Relationship

- Strive for face-to-face meetings for key negotiating sessions
 - Read body language
 - Be sensitive to nuance, particularly when dealing with foreign counterparties
- Use a “partnering” approach – engage in give and take
- Maintain long-term focus
- Avoid extreme positions
 - Do not take false hard line positions
 - Consider loss of credibility when a party ultimately caves on an extreme position or line in the sand

Top Ten Tips for Negotiations

Tip #5: Have the Right People in the Room (or not)

- Negotiate during scheduled sessions, on home turf if possible
- Make sure each party has its decision-makers available
- Identify members of the deal team on both sides early on
- Even if not leading the negotiations, have business people present even when the lawyers are going through the terms and conditions (there is no such thing as a purely “legal issue”)
- Limit/control operations personnel’s involvement in negotiations
- Leave option open to bring in senior personnel to resolve thorny issues or to reinforce hardline positions

Top Ten Tips for Negotiations

Tip #5: Have the Right People in the Room (or not)(cont.)

- Lead negotiators likely should not be the individuals who will have direct, day-to-day responsibility with respect to the implementation and operation of the sourcing arrangement
 - Negotiations can become contentious
 - This helps avoid putting operations personnel in position of taking unreasonable positions with people with whom they will have to work
- On the other hand, it can be helpful to have present the representatives from both customer and provider who will have to live with the contract
 - Helps them understand the dynamics of the deal
 - Precludes future disclaimer of responsibility on basis they did not have input into the deal thereby improving accountability

Top Ten Tips for Negotiations

Tip #6: Check Your Ego/Emotions at the Door

- Remember, the negotiation is not about you or about whether you “win” or “lose” (see also Tip #2)
- Never lose sight of what is best for your organization as a whole
- Do not take a failure of the parties to agree, or the other party’s position, on an issue personally
 - Remember that at times, there will simply be disagreement
 - Remember that “no” is not a bad word
- Use posturing sparingly and judiciously
- Consider the degree of openness in communications but do not lie

Top Ten Tips for Negotiations

Tip #6: Check Your Ego/Emotions at the Door

(cont.)

- Note that each party should air all issues in the negotiations and trust the other party to escalate issues internally as appropriate
 - Going over the head of the other party's negotiating team to bring an issue or concern directly to that other party's senior management poisons the well going forward
 - Trust and transparency are lost, potentially leading to drawn out negotiations and a greater likelihood that the negotiation becomes an emotional issue for some

Top Ten Tips for Negotiations

Tip #7: Document Everything You Can; Do Not “Agree to Agree”

- Document entire transaction to the greatest extent possible for execution with the master agreement so as to minimize loss of interrelatedness of terms and to avoid loss of leverage
- Do not assume that schedules and exhibits are business or technical documents that can be detailed at a later date
 - Do not leave schedules and exhibits to the last minute
 - Note that these are where the performance requirements, scope of services, pricing, and many of the most important details are going to be addressed
- Where details must be provided at a later date, include default approach (for when parties are unable to agree)

Top Ten Tips for Negotiations

Tip #7: Document Everything You Can; Do Not “Agree to Agree” (cont.)

- Get agreement on the principle, then on the language
 - Prepare business people for this approach so they understand why the parties may not trade drafts after each negotiation session
- Agree on the issue and make sure each party understands what has been agreed
 - Do not rely on ambiguity (usually)
 - Clarify where the agreement is unclear (and do not be afraid to restate the conclusion for clarity)

Top Ten Tips for Negotiations

Tip #8: Understand the Totality of Issues

- Tendency to want to try to resolve issues as they are identified
 - Better approach to negotiations is to walk through agreement from beginning to end rather than a hierarchy of issues
 - Some negotiators and many stakeholders are inclined to try to minimize the number of issues or the appearance of there being a lot of issues as the parties proceed through the agreement
- However, issues are often interrelated, or come up in multiple places throughout a document
 - Parties should be careful about agreeing to a change or making a concession in one place where that might be inconsistent with treatment of a similar issue elsewhere
 - More productive to “trade” on issues when they can be grouped and handled on a global basis

Top Ten Tips for Negotiations

Tip #9: Shut up

- Remember, silence is golden
 - Listen – the less said, the better
 - Once your position is stated, stop talking
 - Do not be afraid to let the other party talk itself into making your point
 - Once an issue is closed, stop talking
- Try to understand specifically what is motivating the other party
- Let the other party make the first move/offer
- Do not bid against yourself

Top Ten Tips for Negotiations

Tip #10: Know When to Fold ‘Em

- Be willing to walk away from a bad deal (and do not be afraid to communicate that)
- Drive the process with a sense of urgency but be patient
 - Do not let other party “run the clock” against you
 - Note that a stated deadline can operate as a disincentive to completion and result in overall longer duration – unless you are willing and able to walk away

Thank You

Q & A

Gregg Kirchhoefer, P.C.

gregg.kirchhoefer@kirkland.com

312-862-2177

Matt Lovell

matthew.lovell@kirkland.com

312-862-2355

KIRKLAND & ELLIS LLP

Offices

Beijing

Kirkland & Ellis International LLP
29th Floor, China World Office 2
No. 1 Jian Guo Men Wai Avenue
Beijing 100004
P.R. China
+8610 5737 9300
+8610 5737 9301 fax

Chicago

Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL 60654
+1 (312) 862-2000
+1 (312) 862-2200 fax

Hong Kong

Kirkland & Ellis
26th Floor, Gloucester Tower
The Landmark
15 Queen's Road Central
Hong Kong
+852 3761 3300
+852 3761 3301 fax

Houston

Kirkland & Ellis LLP
600 Travis Street
Suite 2400
Houston, TX 77002
+1 (713) 835-3600
+1 (713) 835-3601 fax

London

Kirkland & Ellis International LLP
30 St Mary Axe
London EC3A 8AF
+44 20 7469 2000
+44 20 7469 2001 fax

Los Angeles

Kirkland & Ellis LLP
333 South Hope Street
Los Angeles, CA 90071
+1 (213) 680-8400
+1 (213) 680-8500 fax

Munich

Kirkland & Ellis International LLP
Maximilianstrasse 11
80539 Munich
+49 89 2030 6000
+49 89 2030 6100 fax

New York

Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
+1 (212) 446-4800
+1 (212) 446-4900 fax

Palo Alto

Kirkland & Ellis LLP
3330 Hillview Avenue
Palo Alto, CA 94304
+1 (650) 859-7000
+1 (650) 859-7500 fax

San Francisco

Kirkland & Ellis LLP
555 California Street
San Francisco, CA 94104
+1 (415) 439-1400
+1 (415) 439-1500 fax

Shanghai

Kirkland & Ellis International LLP
11th Floor, HSBC Building
Shanghai IFC
8 Century Avenue
Pudong New District
Shanghai 200120
P.R. China
+8621 3857 6300
+8621 3857 6301 fax

Washington, D.C.

Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005
+1 (202) 879-5000
+1 (202) 879-5200 fax