Partial IT Contract Termination to Realign the Services Platform

Gerardo Fernandez, Geofrey Master and Lynn McNeal

Introduction

Comprehensive IT services contracts contain provisions allowing the client to terminate services in whole or in part in a range of circumstances, including for convenience and without cause at any time. These provisions provide the client with powerful flexibility to identify and implement business strategy and decisions altering the delivery arrangements in their services environments.

Although many of the issues discussed in this article are fully applicable to *any* contract termination, the focus of this paper is on **partial, non-cause based terminations** undertaken for the purpose of making strategic modifications to supplier portfolios.

Benefits

Frequently the drive to terminate services involves material dissatisfaction with current performance or, at least, some re-evaluation of the cost-benefit relationship of the current services scope driving the change in the hope of ending an underperforming supplier. Increasingly however, the motivation for change within the ranks of suppliers involves a component of a 'move *to* positive' rather than 'move *from* negative.' Such drives are seen in the case of organizations developing multi-supplier services environments. Organizations in both the public and private sectors are recognizing that the pursuit of dynamic best-of-breed platforms justify partially jettisoning arrangements that in the past may have been viewed as being 'adequately' performed.

Opening the door to a multi-supplier services environment by introducing new suppliers to the platform can drive better aggregate service delivery in a variety of ways, including through creating a more constructively competitive setting that drives service improvement in other service areas. It is not hard to see how it could be significantly beneficial to remove a specific sub-set of services from an incumbent supplier in order to pursue better options for those services while also enhancing the mix of suppliers overall.

Contractual aspects – exercise of important rights

The tools available for an organization to "move to positive" transformation among its suppliers are largely tools that have been standard contract provisions in services contracts for many years. One of the most important of these standard provisions is the 'termination for convenience' right and, even more specifically, the right of 'partial termination for convenience.' Through exercise of this right, an organization can make strategic adjustments in its services delivery by unilaterally terminating a defined scope of services (or services sub-set) that it wants to place with an alternative supplier (or potentially even return to in-house delivery).

While termination for convenience rights may carry some costs and restrictions, such as requirements that certain service subsets be terminated together (typically due to delivery dependencies that render a partial termination of those services too risky for effective delivery by different parties), often the right is unfettered. Typically, the only restriction of significance on the exercise of the termination for convenience right is a stipulated time period required for the notice of termination.

Despite broad latitude in the exercise of termination for convenience rights, several ancillary issues must also be addressed in any such partial termination. Foremost of these relate to adjustment of ongoing charges for the diminished services scope. Ideally, the contract will include provisions pre-establishing the charges reduction or setting out guidelines through which the parties can work to establish changes to charges due to reduced scope of services following any partial termination.

Whatever the specific provisions, the obvious objective must be to minimize disputes in this area, as a defining element of a partial termination is the continuing involvement of the supplier that is being partially terminated. In fact, the incumbent's interest in remaining a supplier (albeit in a reduced capacity) rather than being entirely replaced and removed should encourage the incumbent to be reasonable in the inevitable business negotiation associated with the charges adjustment in a partial termination, even if the contract does not contain comprehensive guidance on the adjustment mechanism. In fact, the objective of a multi-supplier environment – where qualified suppliers have ongoing access to potential scope on an ongoing basis – should be one that itself encourages good behavior and cooperation through a desire to preserve the ability to participate. Despite some potential disappointment at 'suffering' a reduction in scope, the incumbent should see a longer term positive relationship benefit that encourages it to be cooperative through such adjustments.

Terminations for convenience often involve the payment of contractually mandated termination fees. Such fees are designed to allow the incumbent to recover costs such as hardware, software and personnel brought to the engagement by the supplier in anticipation of future performance that it will no longer be able to recover due to the partial termination. These termination-related fees should not include lost opportunity, in recognition of the principal that the customer's business operations cannot be allowed to be hostage to a supplier's future profits. Often unrecovered or 'stranded' costs can be reduced, and termination fees correspondingly reduced, through either the client's or successor supplier's acquisition or assumption of stranded resources (such as hardware, software and personnel) that are not re-deployable by the incumbent supplier.

While strategic terminations for elective realignment of the supplier mix is most often effected through exercise of termination for convenience rights (if contract expirations are not available), services contracts contain a number of other termination rights that could be used in particular situations. These include termination rights based on supplier default and, frequently, due to the occurrence of certain events, such as significant changes in ownership of either the supplier or the client arising. Although a particular partial termination will typically be characterized as one identifiable type of termination, circumstances may allow alternative bases for termination that carry reduced (or no) termination charges that can be helpful in the negotiations of such termination changes. These negotiations are particularly relevant in the financial aspects of partial termination and set the stage for viable change or stand as an impediment to change, as discussed further below.

Strategy and Approach

Before making the decision to partially terminate an IT sourcing contract, an organization should analyze a few key aspects:

- Cost-benefit breakdown.
- Critical dependencies and gaps (defining the scope to be dissected and key demarcation points).
- Impacts on the organization (e.g. communications, public, internal).

Once the decision to partially terminate is made, the organization should assign a team (ideally including major stakeholders) to thoroughly prepare the environment before starting – including defining objectives of the termination and how to achieve the desired end-state.

Some top planning considerations include:

- Develop a Comprehensive Financial Model – For project success, a comprehensive financial viability model must be developed, validated and accepted. This critical step must account for *all* costs related to termination of incumbent scope and ongoing performance in the multi-supplier environment including costs (and savings) associated with engagement of services integration parties and practices.
- Build a Supplier Replacement Plan – A team of experts should be established to build a 'Supplier Replacement Plan,' which includes all the activities associated with the identification and selection of suitable suppliers. The plan should include steps to assess and decide if scope elimination is feasible and describe how the partial termination will be communicated to internal, incumbent and external audiences. The planning should be thorough, from beginning to the end of the project (including successor onboarding and implementation, and steady state arrangements), identifying contingencies, dependencies and timing. Careful consideration of issues before initiating change reduces the risk of surprises during the process and to makes it significantly easier for the organization to adjust as required, during project rolls out.
- Establish Clear Goals and Obtain Management Buy-in – There are frequently multiple drivers of change. It is important to document project objectives, plans and commitments (including financial model requirements) and establish executive / management support for core program goals.
- Define Scope separation – Dissecting or splitting scope in partial termination will include operational challenges, dependent on the way services have been broken up or implemented. It is essential to analyze the scope demarcation points, understand any potential issues or gaps, and clarify how the new contract will address them.
- Establish Project Leadership – Change programs require solid organizational support. It is important therefore to identify the project leader, sponsor, core team members and other key support (including legal, contract administrator, Finance and relevant SMEs) and clearly define their roles and commitment levels.
- Service Integration – All suppliers in a multi-sourcing environment must understand their respective roles in the different aspects of the integrated services. Integration Sessions allow suppliers and the customer to jointly review the establishment and implementation of processes and define how the interactions are going to work in the environment. These integration activities

involve things like: performing data handoffs, status and performance reporting, managing trouble tickets across towers and submitting requests. Integration Sessions become particularly important in coordinating potential changes in scope or responsibilities resulting from a partial contract termination.

- Set up a Steering Committee – With typically dozens of interrelated elements, it can be challenging for individuals to maintain a firm grasp of the big picture. Establishing a capable Steering Committee that oversees the execution of the project ensures that activities remain focused on the achievement of core objectives.

Contract Levers

To ensure a smooth termination, organizations must take the time to analyze and thoroughly understand all aspects of their current contract's terms associated with partial terminations, including costs, restrictions, limitations, levers and options. These contract terms should be reviewed and discussed with all key members of the team in the context of understanding of the full ramification of the provisions. For example, what are the incumbent's obligations related to termination assistance in effecting a smooth realignment? In general, suppliers should not be able to stop work for any reason during the disengagement process—in fact, most comprehensive services contracts include provisions giving the client special protections during this period to ensure continued support and cooperation during any termination periods.

Ensuring cooperation on an ongoing basis as a participant in a multi-supplier environment is also critical. While long-term participation in a multi-supplier environment often involves sophisticated contractual arrangements, such as shared service levels and inter-supplier operating level agreements, transitional involvement of incumbent suppliers require clear commitments to be a team player and work with the client's other suppliers, even if viewed as competitors. Solid services contracts contain provisions committing suppliers to cooperate and these must be understood and operationalized as part of the overall environmental realignment.

In all cases, it is critical to carefully define and document decisions, assigned responsibilities and expected actions and contributions of all parties. At its core, the service relationship between the client and service supplier is based on contract and the contractual provisions provide the opportunities and limitations, which must be evaluated and assessed. The approach must be comprehensive, addressing each component of delivery (including hardware, software, personnel and third-party services) for responsibility for provision and the charges associated with the provisions.

Financials and Due Diligence

Before the partial termination decision is made a thorough financial model should be built including the current state, future state, and costs associated with transition (such as early termination costs, disengagement support costs, asset purchase) and ongoing operation. This must be undertaken in combination with the costs and benefits of the new (successor supplier) contract, including implementation costs. The financial model should be able to re-model scenarios, identify issues, predict outcomes, highlight decision alternatives and produce summary financial reports.

For due diligence, it is important to define the process and identify the key documentation necessary to fully describe the environment, prepare clarification meetings with subject matter experts and tours that will need assistance from the incumbent. As with any due diligence, comprehensive project information should be completed and analyzed and should include detailed budgets, detailed description of termination costs in the contract and any other additional support contract cost (e.g., disengagement support) as well as costs of ongoing operations.

Finally, due diligence materials should encompass all information any services engagement involves, notably including comprehensive listings of assets associated with the terminated services, third party contracts involved in the services, and architectural diagrams and strategic technology plans.

Project Planning

Successful transfer of services from an incumbent to a new supplier is heavily dependent on transition and implementation activities involving the incumbent, the new supplier and the client organization. This is equally true in a partial termination and replacement as it is in a re-sourcing of full incumbent scope. As such, it is important to develop a comprehensive project implementation and transition plan that includes activities from early preparation of the contract termination to complete closure with the new contract's services in place. The plan should include and account for items such as:

- Anchor dates and milestones throughout the project.
- Preparation of documentation and knowledge.
- Deliverables and obligations.
- Key management assignments and decisions.
- Regular recurring meetings and governance activities.
- Knowledge transfers and job shadowing.
- Program communications with stakeholders.
- Tools installation, processes integration and operational verification.
- Service levels and performance indicators to be implemented.
- Organizational changes and impacts.
- Overall readiness and confirmation.

The project must have a clear list of owners, roles and responsibilities from the incumbent and successor supplier teams covering project leaders and support teams, such as operational, legal, finance, and subject matter experts.

The project plan will necessarily address parallel implementation activities and should simultaneously account for both the process of bringing in the successor supplier and the process of disengaging the old one as well as establishing their ongoing operational interdependencies and deliverables. The relationships and interrelated processes should be carefully reviewed and implemented to promote a successful transition and ongoing multi-supplier environment.

Communications

One of the final steps is to make certain the incumbent supplier's team understands the reasons and motivations for the partial termination, including its continuing role as a (critical) player in the client's multi-supplier environment. A professional approach to this level of communication will achieve more satisfactory benefits for the organization and smooth out the transfer of responsibilities to the successor supplier – and integration of both into the multi-supplier environment.

Carefully building a comprehensive communications plan and executing it can be a critical element to success. Leaving stakeholders in the dark increases the risk of unpleasant surprises late in the project and general dissatisfaction or suspicion that can be difficult to overcome.
The owner of the communications plan should communicate clearly and robustly with all stakeholders on all information impacting or otherwise relevant to them.

Conclusions

- Partial contract terminations are useful tools in the effort to improve the IT environment and allow for the introduction of new suppliers to enhance technology or capabilities or to obtain a better financial cost structure.
- Thorough analysis of the key aspects impacting the environment is essential to understand where the opportunities lay, what advantages these alternatives may offer, and what risks of change must be avoided.
- Careful planning and implementation will provide a safe path to changes in the supplier environment. Frequent communication and complete involvement of all stakeholders in the change will promote a positive outcome in the project.