Contract Services

Truth in Outsourcing

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Is that great deal too good to be true? Prudent users must refuse to be fooled by wishful expectations.

outsourcing attorneys help their clients realize legitimate commercial expectations in negotiating (and renegotiating) complex infrastructure service contracts. For end users, outsourcing contracts hold the promise of achieving multiple goals with various downside risks. Goals include partnering with a specialist to absorb the shocks of technological change, predictable service-level agreements that guarantee a particular quality of service, fixed prices for baseline services, and variable pricing for services beyond an agreed-upon baseline. The downside, however, frequently comes from a mismatch of end-user expectations and a vendor’s sales pitch. For that reason, both end users and prospective service providers should explore the concept of truth in outsourcing.

Fraud in outsourcing

There is no truth-in-outsourcing law. There are many laws and unwritten “common laws” relating to fraud, misrepresentation, consumer warranties, implied warranties, and the like. Such laws deal with the potential for disparity between a customer’s legitimate expectations and what that customer feels was actually provided. Once a contract is signed, the law imposes limits on claims of fraud when one party is merely in breach of contract.

Under New York law, for example, a breach-of-contract claim cannot be converted into a fraud claim simply because the other party could not or did not perform up to expectations. Measures of damages in fraud cases involve indemnifying the injured party for out-of-pocket losses, not including any lost profit. In a typical contract, the user’s lost profits are similarly excluded.

In fraud, the loss compensable by law is only what is caused by a rightful reliance on a misrepresentation by the other party. “Under New York law, a plaintiff must establish that his reliance on the other party’s misrepresentation was justifiable, both in the sense that the party claiming to have been defrauded was justified in believing the representation and that he was justified in acting upon it” (1).

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In any case of fraud, the person defrauded took the risk because the offer was “too good to be true.” To avoid making bad deals in outsourcing, end users must carefully examine whether each service offering is too good to be true.

Truth in outsourcing depends on both parties. Vendors must avoid knowingly making misleading statements. What is said or not said could lead users to unjustified expectations. Yet prudent users must refuse to be fooled by wishful expectations that are not solidly supported by experience in the outsourcing industry.

Risky business

Four areas in a typical outsourcing relationship pose the greatest risk of disappointment. They involve defining the scope of the outsourcing, identifying methods for keeping the relationship flexible, human resource planning, and managing the outsourcing process.

Scope. Truth in scope requires introspection by end users about the tasks to be outsourced and the ability to manage the process after the contract is signed. Outsourcing is most likely to be successful when clients understand both the scope of the work the vendor will perform and that which the end user will perform. Most clients understand the need to create a monitoring team of senior personnel that specifies tasks and provides guidance for future mission-critical activities the vendor can perform. The challenge in successfully defining the scope of work is to identify and plan for the interrelationship of both parties after the contract is signed.

Flexibility. Truth in flexibility requires an understanding of the vendor’s limitations relative to change. Typically, outsourcing is successful when the nature of the services provided is predictable, with economies of scale. Flexibility cannot be achieved through outsourcing when too many unpredictable changes occur because changes usually affect pricing and budgets. Flexibility should be built into both parties’ obligations, and end users should be realistic about the probability that external environmental changes could require restructuring of service levels, pricing, the scope of work, or even the terms of the contract.

Personnel. Truth in personnel requires a sober analysis of the staffing needs for the end user’s benefit. In some cases, the speed of technological change suggests that training is best handled by the outsourcing vendor. Frequently, however, it is to a client’s advantage to retain and retrain personnel or to give flexibility to certain personnel (especially government or union personnel) who wish to remain employed by the end user. Most companies are undoubtedly aware that change in the “knowledge capital” of human resources can be costly, whether it amounts to training, retraining, retaining, or reacquiring skilled and knowledgeable people. Human resources planning is a key driver for scoping and structuring any successful outsourcing effort.

Postcontract management. Truth in postcontract management requires an understanding of the change in roles once outsourcing has begun. After a contract is signed, the vendor will be responsible for providing contractually agreed-upon services. But clients accustomed to managing people must now measure work performed under contractual metrics. If such metrics fail to anticipate changes in the outputs required for running the user’s business, the contract will cause a mismatch of expectations.

End users should not be fooled by “hyper” sales pitches or by the desire to unload all problems on someone else. Outsourcing is no panacea for managing a poorly defined process. Vendors should ensure that their clients’ senior management personnel have properly aligned expectations and a willingness to manage toward metrics.

Truth in outsourcing can be achieved only in the context of mutual responsibility for success. Although outsourcing is not a traditional partnership with shared risks and rewards, it certainly depends on constantly working to align expectations and realities with respect and a shared commitment to efficiency and achievement.

Reference