

PANORAMIC **OUTSOURCING**

United Kingdom



LEXOLOGY

Outsourcing

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JURISDICTION SNAPSHOT

Market

What is the extent of outsourcing in your jurisdiction, including the most common sectors for outsourcing activities?

Outsourcing is prevalent in the United Kingdom across most sectors, and arrangements typically cover IT (infrastructure, applications development and maintenance, and network services), cloud services (including managed cloud services), business processes (IT support, procurement and finance) and facilities management. The most common sectors for outsourcing activities in the United Kingdom include financial services, healthcare, manufacturing and retail. The trend towards outsourcing has been driven by cost-cutting measures, access to specialist skills and a desire for greater efficiency.

Law stated - 27 March 2024

Government approach

How would you describe the government's approach to outsourcing arrangements? Are there any government-sponsored incentives for outsourcing, or restrictions on outsourcing abroad?

The UK government has generally been supportive of outsourcing arrangements, particularly in the provision of public services. However, there have been concerns around transparency and accountability, and so in recent years there has been a shift towards greater scrutiny of public outsourcing arrangements and a recognition that they are not always the best option for delivering public services.

There are no general government incentives for outsourcing or general outsourcing-specific restrictions. There are a number of sector-specific requirements (eg, financial services) and general laws that have a broader application that can apply to outsourcing arrangements (eg, in relation to employee transfers and tax). Public-sector contracting and procurement rules are also applied to outsourcing arrangements.

Law stated - 27 March 2024

Offshoring

Are there any specific prohibitions or restrictions on outsourcing abroad?

There are no specific prohibitions or restrictions on outsourcing abroad. However, the [Transfer of Undertakings \(Protection of Employment\) Regulations 2006](#) (TUPE) apply to outsourcing arrangements in the United Kingdom, which are designed to protect employees in the event of a transfer of a business or undertaking or where there has been a service provision change (ie, in outsourcing situations). While TUPE does not prevent outsourcing abroad, in outsourcing situations, only staff located in England, Scotland or Wales will qualify for TUPE protection. Any offshoring will also need to take into account data privacy laws and restrictions on the transfer of personal data to overseas jurisdictions.

Law stated - 27 March 2024

REGULATION**Legislation****Is there any overarching domestic legislation governing outsourcing?**

No, there is no overarching legislation in the United Kingdom governing outsourcing. However, general laws applicable to the services and nature of the arrangements will apply (eg, laws in relation to data protection, employment transfers and taxation).

Law stated - 27 March 2024

Legislation**Are there any sector-specific laws or industry guidelines on outsourcing?**

There are several sector-specific laws and legally enforceable guidelines in the United Kingdom, in particular those issued by the [Financial Conduct Authority \(FCA\)](#) and the [Prudential Regulation Authority \(PRA\)](#) in the financial services sector (applying to regulated entities such as banks, investment businesses and insurers). They generally apply to all outsourcing arrangements, with specific requirements applicable to 'critical and important functions' and cloud-hosted services. Regulated entities must comply with these requirements in the selection, negotiation and management of the outsourcing arrangements. While not (yet) specifically applying to the outsourced service provider, many obligations require the regulated entity to ensure specific contractual protections are included in their outsourced contracts (eg, in relation to security, access to data, audit rights and controls over sub-sourcing). New legislation also gives the UK government the power to designate certain third party providers to the financial services sector as critical third parties. This designation would result in direct oversight of the third party providers by the UK's financial regulators.

In other sectors, there are specific non-statutory guidelines that should be followed, largely placing obligations on the procuring (customer) entity. For example, there are guidelines applicable to the outsourcing of the National Health Service services and general government policies for public sector organisations, largely imposing obligations to ensure transparency and value for money.

Law stated - 27 March 2024

Licences, permits and approvals**What licences, permits and/or approvals are required for outsourcing activities, if any? What are the penalties for non-compliance with these requirements?**

In general terms, there are no specific licences, permits or approvals required for outsourcing activities in the United Kingdom.

Reforms

Are any legislative or regulatory reforms envisaged or under way that will affect outsourcing arrangements in the foreseeable future?

There are no legislative or regulatory reforms envisaged or under way in the foreseeable future that are specific to general outsourcing arrangements. However, sector-specific reforms are undertaken from time to time.

The UK government has amended the Financial Services and Markets Act 2023 so that it can designate third party service providers to the financial services industry as critical third parties (CTPs) - this designation will only be made in respect of service providers who provide a service that, were it to fail or be disrupted, threaten the stability of, or confidence in, the UK financial system. The new legislation also gives UK regulators the ability to make rules with respect to such services, bringing CTPs within the purview of financial regulators. UK regulators are currently undertaking a consultation exercise with respect to the new rules that will apply to entities designated as a CTP.

The UK government has also proposed updating the [Network and Information Systems Regulations 2018](#) to increase the cybersecurity reporting requirements for essential service providers. If enacted, the updates would impose additional security and reporting requirements on critical digital service providers in the UK's economy, including some providers of managed IT and outsourced services, and cloud computing providers. On 31 May 2023, Ofcom published [revised statutory guidance under the regulations](#). As at the date of this publication, the UK government has not updated the Network and Information Systems Regulations 2018.

LEGAL STRUCTURES

Types available

What legal vehicles or structures are available for outsourcing arrangements, and which are the most commonly used? What are the key advantages and disadvantages of each?

There are a number of different structures that can be deployed for outsourcing arrangements. The most common include:

- Commercial contract: this is the most common vehicle for outsourcing arrangements, typically between the customer entity and the supplier entity (although multi-party and framework agreements can also be used). While they can be detailed and complex, the structure is typically straightforward and familiar to most commercial counterparties.
- Joint venture: while less common, multiple parties may set up a joint venture (JV) entity to provide outsourced services to a closed pool of recipients, or to the market generally. Customer entities may be a party to the JV arrangement, or the JV could be

a partnership between multiple suppliers to combine resources and expertise. These arrangements are typically very complicated and can be difficult to manage. Careful consideration needs to be given to competing interests and conflicts between the partners.

- Captive outsourcing entity: large corporate groups may establish a subsidiary that is set up to provide specific outsourced services to the parent company and the wider group. This allows the parent company to control services across affiliates, typically with the aim to standardise services, reduce costs and ring-fence liability. The key disadvantages of captive entities include the high initial set-up costs, challenges of complying with fragmented requirements (and laws) applicable to multiple group entities, and access to specialist expertise (compared with third-party suppliers focused on providing specific services in specific jurisdictions). In addition, if captive entities in the regulated financial services sector deliver intra-group outsourcing services to other group companies, they will likely be subject to the financial services outsourcing regulations of the FCA and PRA. All on-, near- and offshore captive entities will still need to comply with, among others, UK data protection laws.

Overall, the choice of legal vehicle or structure will depend on a variety of factors, such as the level of control and protection required, the complexity of the arrangement, and the financial drivers of both parties.

Law stated - 27 March 2024

CONTRACTUAL RELATIONS

Contract forms

What are the most common contract forms for outsourcing arrangements, and what are the advantages and disadvantages of each?

There are a number of common structures.

Single-vendor contracts: The majority of outsourcing arrangements are governed by a bilateral contract between the customer and the outsourced supplier. In respect of these arrangements:

- Advantages include: simpler to negotiate and can be easily tailored to a specific service or category of similar or related services, and contract governance is typically easier.
- Disadvantages include: multiple contracts with multiple suppliers may be needed to cover broad outsourcing arrangements, leading to a fragmented approach. The customer is also typically responsible for managing interfaces between the service providers.

Framework contracts: Under a framework agreement, the parties may agree on a set of terms that apply to current and future services, providing an option for them to agree additional scopes of work at a later date. In respect of these arrangements:

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Advantages include: flexibility to easily add new outsourced services without the need to negotiate new terms.

- Disadvantages include: it can be challenging to identify all relevant terms, and not knowing what the future outsourced service might be (or time consuming to try and negotiate all possible requirements at the outset).

Framework call-off contracts: While less common for outsourcings (given the bespoke arrangements for most customers, suppliers and services), procuring bodies such as government departments or group entities, could establish a call-off contract under which multiple customers and multiple suppliers are able to enter into call-off arrangements for specific outsourced services. In respect of these arrangements:

- Advantages include: flexibility to contract with multiple parties on a set of standardised terms (with deviations negotiated in the 'call off' order document).
- Disadvantages include: it can be challenging to identify all relevant terms, not knowing what the future outsourced service might be, and to draft a set of framework terms that will be acceptable to multiple suppliers for differing outsourced services, and subject to local laws, if the framework applies across more than one jurisdiction.

Multi-vendor contracts: Under these arrangements, the customer contracts for multiple parties to deliver a number of related services. These can be structured so that the customer contracts with one 'prime' supplier, who is responsible for coordinating and managing the other suppliers, or the customer could contract with each supplier separately, and put in place an overarching cooperation framework in which each supplier signs up to follow. Managed service provision (MSP), including cloud MSP, fits within this form of contract. In respect of these arrangements:

- Advantages include: flexibility to select multiple suppliers, based on expertise and service delivery, and avoiding over-reliance on a single supplier.
- Disadvantages include: integration risks (eg, issues between suppliers falling to the customer, if one supplier is not 'priming' the services), and a potentially complex structure to manage.

These contracting forms may be based on several different service and pricing structures, including:

- Service structures: service and project-specific deliverables, output-based services, project-based deliverables and staff augmentation.
- Pricing structures: fixed price, time and materials, and cost-plus models.

Law stated - 27 March 2024

Due diligence

Before entering into an outsourcing contract, what due diligence is advised? Is any due diligence mandated by law?

Due diligence is not generally required, except for outsourcing arrangements in regulated sectors. For example, general and prescriptive due diligence obligations are included in the [European Banking Authority's guidelines on outsourcing arrangements](#) that are incorporated into the UK Financial Conduct Authority's [outsourcing requirements](#) (despite the United Kingdom leaving the European Union).

Notwithstanding any mandatory obligation, appropriate due diligence should form part of any assessment as to the suitability of an outsourcing partner. This should ideally be carried out prior to selecting a preferred supplier and prior to commencing detailed contract negotiations.

Typical customer due diligence includes:

- Security due diligence to assess the technical and organisational measures implemented by the supplier.
- Technical due diligence to assess the supplier's skills and resources to perform the services.
- Financial due diligence to assess the financial stability of the supplier, and its ability to stand behind its potential liabilities.
- Performance due diligence, such as through interviews with existing customers, to assess the supplier's track record and general suitability as an outsourced partner.
- Compliance and regulatory due diligence, to assess the supplier's competence to deliver or support the delivery of regulated services and processes (eg, in financial services outsourcing).
- All of the above, together with local HR, regulatory and legal, operational and broader geopolitical due diligence and site visits, where the supplier is based outside the customer's home jurisdiction (eg, in offshore outsourcing situations).

Typical supplier due diligence includes:

- requirements due diligence, to understand the current operations and services, and the scope of the new requirements (including in respect of any contracts, leases and licences that may need to be transferred or on which the services are dependent);
- employee due diligence if any employees (and their employment and pension arrangements) are intended to, or are at risk of, transferring to the supplier on commencement of the services; and
- compliance and regulatory due diligence as applicable to the customer as a regulated entity or specific regulated services or processes, to enable the supplier to meet its contractual obligations in that regard.

Law stated - 27 March 2024

Supplier selection

What procedures and criteria are commonly used to select suppliers?

Most selection procedures start with the customer requesting a number of potential suppliers to submit a detailed response to the customer's request for proposal (RFP). The RFP defines the customer requirements and objectives, and parameters for the outsourcing, sometimes with additional information on proposed models and remuneration, and detail on how the response will be assessed (eg, if there are weighted scores to certain requirements). The supplier responses to the RFP should include sufficient detail to allow the customer to properly understand how the supplier would provide the services and meet the requirements. Some customers use specialist sourcing consultants to assist with identifying which suppliers should be invited to respond to the RFP.

A typical procedure follows a process covering:

- defining requirements;
- identifying potential suppliers;
- sending out an RFP;
- evaluating responses (or supplier 'proposals');
- down selecting to narrow the supplier to take forward;
- site visits, interviews and references to substantiate responses and additional information;
- information sharing (including where the supplier needs additional information from the customer to refine its price);
- final down selection (which often includes asking a small number of suppliers (eg, three) to provide their 'best and final offer' on their proposal (a BAFO));
- obtaining commitment (or not) against key legal requirements and terms (or sometimes against the whole proposed contract terms); and
- negotiating and selecting a final preferred supplier.

While it often adds time and expense, many customers seek to negotiate with two or more bidders, in order to maintain a competitive process and incentivise concessions to 'win' the award.

Typical selection criteria include:

- referenced experience and expertise (backed up by case studies, testimonials and customer interviews);
- financial stability (assessed through financial due diligence);
- meeting minimum service or solution requirements and commitments to service levels;
- complying with industry standards, such as ISO standards;
- pricing;
- security and data protection measures and assurances;
- scalability and the commitment to innovate and add value;
- cultural fit, location and time zone compatibility; and
- accepting key legal terms.

Selecting the right outsourcing supplier is one of the most critical elements, and requires careful evaluation and management to ensure the selected supplier meets the customer's needs and objectives, and is a good cultural fit.

Law stated - 27 March 2024

Duration and renewal

What is the common duration of outsourcing contracts? How does the renewal process commonly play out?

The duration of an outsourcing contract varies, depending on the nature of the services, any period during which they are migrated away from the incumbent supplier, and the necessary time for the parties to embed the services and recognise the economic benefits of the arrangements.

Typically, large-scale outsourcing arrangements have five to seven-year minimum terms. In more complex, large-scale outsourcing arrangements, especially where there are substantial transition and transformation requirements, 10-year minimum terms are not uncommon. However, there has been a trend more recently for more simple arrangements to be on shorter terms of three to five years with options to renew.

Renewals for long-term outsourcing agreements typically require the agreement of each party, and subject to them agreeing on new pricing arrangements and any variations to the scope of delivery of the services (including where new technologies can be deployed to increase efficiencies and improve standards). For short-term arrangements, it is not uncommon for the customer to have a right to unilaterally extend for 12 to 24 months (eg, so the customer commits to three years, but with a unilateral right to extend for 12 to 14 months on notice prior to the expiry of the original term).

Law stated - 27 March 2024

Service specifications

How are the service specifications typically agreed, and what service terms and parameters are commonly applied? Can any flexibility be provided for in these terms?

Service specifications are typically agreed based on the requirements set out in the customer's proposal for the services and the supplier's response on how they will meet those requirements. They also typically incorporate the supplier's solution proposal and delivery model. For most outsourcings this will result in a partially output-based service specification, which will form an integral and key part of the outsourcing contract.

If the services require a transition or transformation process, this should be documented in a detailed plan setting out requirements, deliverables and milestones. It also needs to be clear at which point the services 'cut across' onto the new model.

Flexibility can be provided for in the outsourcing contract through a clear change management process. This should allow for adjustments to the scope of services, service

level agreements, and contractual terms in response to changing circumstances and requirements. Under English law, an agreement to agree is generally unenforceable, and so a customer may seek to include certain protections to ensure that an outsourced supplier does not unreasonably withhold consent to a required change (and at least where a change is required to ensure compliance with law) and that it is subject to pre-agreed pricing metrics. The contract may also include a more flexible process for agreeing operational changes in the delivery model (that do not need to go through the formal change control process).

Law stated - 27 March 2024

Performance metrics and protections

How is performance typically monitored, and how can customers be compensated for service level failures? Are service credits, liquidated damages or other penalties permitted?

Performance is typically monitored through service level agreements (SLAs), which outline the key performance indicators and service levels that the supplier is expected to meet. These SLAs typically include metrics such as response time and resolution time, and where applicable, uptime and availability of systems. If the supplier fails to meet these metrics, customers may be entitled to compensation for those failures in the form of service credits specified in the SLA.

Other performance requirements, in particular delivery and performance milestones, may be monitored against set dates, and the contract may provide that liquidated damages (set quantifiable amounts) are payable if they are not achieved.

Service performance can also be monitored in other ways, including through management information reporting, user scoring (including net promoter scores for certain kinds of outsourcing) and feedback processes. These should all form part of the wider contract governance process.

Both service credits and other forms of liquidated damages are permitted under English law, provided they are reasonable and proportionate to the actual loss. However, a penalty (an unreasonable or disproportionate sum in the context of the breach) is not generally enforceable.

Law stated - 27 March 2024

Charging methods

What charging methods are commonly used?

There are numerous different providing models and permutations, and different controls and incentives can be built into each. Common methods include the following.

Fixed price contracts: in this type of contract, the price for the outsourced services is agreed upfront and remains fixed for the term of the contract. The advantage of this contract is that it provides clarity in terms of overall cost. However, it may not be suitable for more complex outsourcing arrangements where changes may be required, or where a premium would need to be included to cater for unknown expenses.

Unit pricing: in this type of contract, the price is determined by the volume of services consumed against a fixed unit rate card. The advantage of this contract is that there is price certainty per unit, but flexibility as to what is used. However, it may result in inefficiencies and quality issues, as suppliers are remunerated based on units of services rather than the time and effort required. There can also be difficulties in predicting the total cost of the service over a given time.

Cost-plus contracts: in this type of contract, the cost of the outsourced services is based on the actual costs incurred by the outsourcing supplier, plus a fixed percentage or fee uplift. The advantage of this contract is that it provides transparency in terms of costs and greater flexibility. It can also encourage better quality of service, as fixed margins are not squeezed. However, it may result in higher costs as the supplier has less incentive to manage base costs and it can be difficult to set and predict a target price.

Time and materials contracts: in this type of contract, the cost of the outsourced services is based on the time and materials incurred by the supplier to complete the work. The advantage of this contract is that supplier will generally be more flexible to allow changes to the scope of work as needed. However, it can lead to higher costs as the supplier has less incentive to work efficiently.

Overall, typically a combination of these methods is used to provide a bespoke arrangement for the nature of the deal. Parties might also supplement these methods with other pricing methodologies, such as pain share or gain-share arrangements and methods to address efficiencies and cost-savings – suppliers will also seek reimbursement for particular expenses incurred while performing the services.

Law stated - 27 March 2024

Contract governance

What are the common approaches to contract governance, and how are they commonly addressed in outsourcing contracts (eg, governance procedures, obligations on continued improvement, KPIs, change control procedure, disputes process and escalations)?

Outsourcing contracts are typically long and detailed, setting out high-level and granular rights and obligations on how the success of the contracts is governed. These controls typically include:

- Governance structures and procedures that define roles and responsibilities, regular review meetings (including the composition and standing agendas for such meetings) and escalation processes.
- Management information to report on performance against SLAs and key performance indicators.
- Obligations to highlight, and potentially deliver, ongoing improvements and innovation in delivering the services.
- Periodic benchmarking procedures, to assure the customer that key outsourced services track or out-perform specified market metrics as to quality or efficiency, while remaining competitively priced. Benchmarking provisions are set out in specific

schedules and benchmarks are commonly conducted by specified, independent, benchmarking providers. Specified underperformance against the benchmark may result in an automatic, negotiated or mediated reduction in service charges.

- Change control procedures to allow for parties to suggest and agree necessary changes to the scope and delivery of services, and contract terms.
- Dispute resolution procedures to manage issues and disputes.

Law stated - 27 March 2024

Contract governance

What contractual provisions are commonly included to protect and mitigate against serious service continuity issues (eg, business continuity obligations; are step-in rights or oversight rights commonplace)?

Depending on the nature of the services and criticality to the business of the customer, outsourcing contracts typically include a number of protections to mitigate against service continuity issues:

- SLAs to define expected levels of services or responses, and monetary credits for non-compliance. After the event, the SLAs may require root cause analysis of the issue, and reporting on remediation steps to prevent similar failures.
- Business continuity obligations (sometimes included in detail plans) setting out the steps to be taken in the event of a service disruption, including backup requirements and restoration procedures.
- Step-in rights, to allow the customer (or a third party nominated by the customer) to temporarily take control of the outsourcing if the supplier is unable to perform its obligations or is in financial distress. Suppliers often resist these rights or make such rights subject to strict controls, and so 'oversight rights' (eg, to insert a management team to assist the supplier, rather than take over) are quite common.

Escalation procedures that define the levels of authority and operational responsibility for resolving issues.

Law stated - 27 March 2024

Warranties and indemnities

What warranties and indemnities are commonly stipulated in outsourcing contracts (for both the customer and the supplier)? Are there any mandatory or prohibited provisions in this regard?

Warranties

Outsourcing contracts typically include a standard suite of mutual warranties, including that each party has authority to enter into the contract and will comply with applicable laws. In addition, typical warranties cover:

- supplier performance commitments;
- non-infringement of intellectual property rights (mutual if both parties are providing intellectual property to the other);
- confirmation that the arrangements are not in breach of third-party commitments; and
- compliance with specific obligations, such as having appropriate anti-bribery policies in place, not using certain open-source software components, and other service-specific commitments.

Indemnities

Indemnities tend to be focused on specific risks and, unlike jurisdictions like the United States, do not tend to cover all contractual defaults. Generally, suppliers are becoming more reluctant to agree to multiple indemnities, so depending on their bargaining power typical indemnities cover:

- breach of confidentiality and data protection provisions (typically covering both supplier and customer);
- breach of the customer's contractually mandated information security arrangements, especially where the customer is in a regulated sector (eg, financial services or critical national infrastructure);
- third-party claims resulting from a breach by, or an act or omission of, the supplier;
- third-party intellectual property infringement (typically covering both supplier and customer); and
- employment-related risks (such as taxation, immigration and supplier personnel claims against the customer).

Law stated - 27 March 2024

Ending the agreement

What are acceptable grounds for terminating an outsourcing contract?

The specific grounds for termination vary depending on the nature of the arrangements, but common grounds for termination include:

- Fault-based termination rights:
- for both parties, material breach (not remedied within a stipulated time frame, if remediable) and, from a supplier's perspective, the customer's failure to pay undisputed charges by a specified, long-stop, due date;

- in favour of the customer, critical service level failures in accordance with defined thresholds, including persistent breaches of specified service levels or other significant contractual obligations;
- in favour of the customer, delays against critical defined milestones;
- usually in favour of the customer only, breaches of certain key provisions, such as data protection, security, anti-bribery and corruption; and
- usually in favour of the customer only, breaches resulting in regulatory issues, or failures to comply with specific legal requirements.
- For both parties, the insolvency of a party (or analogous events).
- A change in ownership of a party (often only as a right for the customer, who has a keen interest in the corporate control of the supplier).
- Where termination is directed by a regulator, or required to comply with a regulatory obligation.
- For convenience, typically to allow a customer to terminate a long-term commitment on paying set compensation to the supplier.

Regulators of certain sectors may specify mandatory termination rights to be included (such as the European Banking Authority's guidelines on outsourcing arrangements that are incorporated into the UK Financial Conduct Authority's (FCA) outsourcing requirements).

Law stated - 27 March 2024

Ending the agreement

How do contracts commonly address exit from the outsourcing contract?

Given the transition from one supplier to another, or back to the customer, exits can be complex and require cooperation from the incumbent supplier. Contracts commonly include detailed provisions to cater for exit and migration. Such exit requirements may be mandated by regulatory rules (such as those required by the UK FCA).

Typical exit provisions include:

- Obligations to start exit planning within a short period of the services commencing (if not prior to commencement), with the supplier to provide a detailed exit plan setting out the steps and timelines for any exit from its services. Any exit plan should then be kept up to date during the term of the contract to reflect new developments (and the contract should include commitments to carry out such updates on a regular basis).
- Clear obligations on the supplier to provide access to customer data, or to provide assistance to extracting and migrating data as necessary to a new supplier. To the extent relevant, there may also be obligations to transfer operating procedure manuals (especially in business process outsourcing), sub-contracts and licences that relate to the services.
- An obligation on the supplier to continue to provide the services for a minimum period of time, even if the supplier has terminated the contract (eg, for the customer's

material breach). Such continuity commitments are often required in regulated outsourcing such as in the financial services sector.

- Mutual obligations on the delivery or destruction of confidential information and intellectual property over which that party has no continuing rights.
- Clear rights and obligations, and supporting indemnities, in relation to personnel of the supplier. In particular, whether they are expected to be retained on the services by the customer or a new supplier.
- The requirement for the exiting supplier to co-operate generally with an incoming supplier.
- The allocation and specification of costs for the provision of the exit arrangements, for example, requiring the incumbent supplier to perform some or all of the exit arrangements at no additional cost to the customer where the customer has terminated the outsourcing because of the supplier's material or other terminal breach.

Law stated - 27 March 2024

Ending the agreement

Is there a common or mandatory notice period for non-renewal of a contract?

There are no mandatory notice periods for termination or non-renewal. The parties are able to negotiate these mechanics as works best for the services and the commercial arrangements. Typically, a customer requires a significant notice period (sometimes nine to 18 months) for non-renewal, as the process to put in place a replacement service and contract with a new supplier can be time-consuming. Suppliers typically accept shorter notice from a customer of around six months.

Law stated - 27 March 2024

General tips

What can customers do to make their outsourcing contract more successful?

Outsourcing arrangements are put in place by customers to gain access to specialised skills, reduce costs, increase efficiency, and focus on core business activities. However, in handing over responsibility for business-critical services to a third party, competing interests can develop that make the outsourcing less successful. Customers should always take the following key steps:

- Detailed pre-contract due diligence on the supplier, including customer references and financial checks.
- Ensure the scope of the services is clear as to output and outcomes, and any specification is as detailed as possible. These should be backed up by robust service levels and key performance indicators.

- Ensure there are clear contractual processes to manage changing requirements, including on how such changes are scoped, agreed and charged for (and what restrictions can be placed on a long-term supplier to reject implementing necessary changes to the services).
- Maintain effective communication channels to ensure that any issues are notified to the customer and resolved promptly.
- Implement a contract governance process that facilitates regular interaction and points of escalation at different levels of seniority.
- Plan for how the customer will exit from the services at the outset, and include appropriate exit and migration commitments from the supplier.
- Above all, try to understand and, within reasonable and proportionate grounds, accommodate the supplier's positions throughout the negotiation of the outsourcing contract. One-sided outsourcing contracts hardly ever succeed in delivering the benefits which drove the customer to outsource in the first place.

Law stated - 27 March 2024

REMEDIES AND PROTECTIONS

Legal remedies

What legal remedies are available to the parties to an outsourcing contract in the event of contractual breach or unjust termination?

There are a number of legal remedies available, depending on the nature of the breach. These include a right to recover damages or of indemnification (or both, though not for the same losses), claim specific performance, or seek an injunction. These may be pursued through the exercise of contractual rights and processes (eg, in the case of indemnities), dispute resolution such as mediation, or in arbitration or litigation. In addition, a party may have grounds to exercise rights of termination.

The key remedy for contractual breach is a claim for damages to put the injured party in the position they would have been in had the contract been performed as agreed, and to recover wasted expenditure. While specific breaches may be subject to express 'liquidated damages' detailed in the contract (eg, specific sums for later delivery), damages are determined by the court or arbitrator(s) based on the losses suffered.

If a party terminates a contract contrary to its contractual rights, such as without valid grounds or without providing proper notice, that party may be in repudiatory breach. This would entitle the innocent party to claim damages or specific performance, and potentially the right to rescind the contract, which means the contract is treated as if it never existed, and the parties are returned to their pre-contractual position.

These legal remedies will be subject to the terms of the outsourcing contract, and in particular any negotiated caps or exclusions on liability, or restrictions on the kinds of loss and damage that may be claimed (eg, loss of profit, losses from third-party claims).

Law stated - 27 March 2024

Contractual protections

What contractual terms are typically included to protect a party from events outside its control?

Outsourcing contracts typically include force majeure provisions that specify that a party is not liable for any failure or delay in performing its obligations under the contract due to events beyond its control, such as acts of God, pandemics, natural disasters, war or government action. Suppliers sometimes try to broaden the definition of what would provide relief, and so customers need to carefully consider what is reasonable and who should bear the risk of such events arising (in particular where the impact should be mitigated by the supplier in its business continuity arrangements).

A relief clause may also be included to provide protection to the supplier if the customer is in breach or fails to meet specified dependencies. These typically specify that the supplier will not be liable for any failure or delay in performing its obligation, is entitled to an extension of time (relative to the customer failure), and in some cases a right to recover wasted costs and additional expenditure. A customer must ensure that these relief clauses are reasonable and include appropriate controls such as notification requirements and obligations to mitigate costs and expenses.

Law stated - 27 March 2024

Other remedies

What other remedies are available (eg, contractual)?

Contracts often legislate for additional or alternative, remedies in the event of non-performance. Typically, these include obligations on the supplier to issue service credits (as payments, or to offset charges) if it fails to meet specific service levels and key performance indicators. The contract may also specify other forms of liquidated damages, such as amounts payable if a service does not commence by a key milestone. The rationale behind some of these contractual remedies is to quantify and limit the remedy at the outset. These 'automatic' rights also often help preserve the working relationship between the parties as they remove the requirement for a customer to bring a formal legal claim to recover general damages or prove the damage they have suffered.

In addition to financial compensation the contract may also specify additional remedies, such as:

- step-in rights, to take control or management of the services;
- obligations on the supplier to undertake detailed analysis of the breach, and implement remediation plans to correct issues and mitigate against future failings; and
- enhanced reporting obligations, such as providing additional information and attending additional governance meetings.

Law stated - 27 March 2024

Liability

How can the parties to an outsourcing agreement limit or exclude their liability?

Subject to certain exceptions, business counterparties can agree to limit their liability to a certain amount and exclude certain types of loss and damage from the scope of liability. A typical outsourcing contract includes the following liability provisions:

- **Uncapped liability:** certain liability that the parties agree is uncapped, such as for breach of confidentiality obligations, indemnities for third-party intellectual property infringement claims, and wilful default or abandonment. Under English law, the parties cannot cap or exclude liability for their own fraud, or liability for death or personal injury caused by negligence.
- **Exclusions:** specific risks and liabilities that the parties agree are not recoverable. These typically include all indirect and consequential losses, and may specifically exclude loss of profit, business, revenue or goodwill (whether direct or indirect).
- **Recoverable losses:** specific risks and liabilities that the parties agree at the outset are not excluded. Such as procurement costs, wasted expenditure and other service-specific losses that a party wants to ensure are recoverable (and not subject to later disagreement as to whether they fall within a broad exclusion).
- **General caps:** specific caps on the general liability of one party to another, typically linked to contract value and the fees paid or payable during a specific period (eg, a multiple factor of 12 months' fees), with set minimum monetary amounts. Typically, a customer will expect to have a lower liability cap to the supplier, as the perceived risk to the supplier under the contract is often lower.
- **Super caps:** additional heads of liability for which higher caps apply. These often cover specific risks that the supplier may not accept as being uncapped, such as for damage to property or breach of data protection provisions or breach of information and physical security requirements.

Law stated - 27 March 2024

Insurance

Are insurance requirements typically specified in the outsourcing contract? If so, what are the common areas of cover?

Insurance requirements are typically specified, and while the specific insurance requirements will depend on the nature of the arrangements, common areas of cover include:

- Employers' liability insurance;
- public liability insurance;
- professional indemnity insurance; and
- cyber liability insurance.

ASSET TRANSFER AND ASSIGNMENT

Movable and immovable property

What rules, standards and procedures govern the transfer and assignment of movable and immovable property in the context of an outsourcing arrangement?

Where an outsourcing arrangement covers the transfer of, or right to use or occupy property, such as office space, such transfer needs to comply with formal legal requirements depending on whether it is a transfer of freehold property or leasehold property. Such transfers are less common in current outsourcing arrangements.

Outsourcing arrangements may also – though unusually these days – necessitate the supplier using some of the customer's assets (eg, information systems and computer hardware or peripherals) for an interim period after contract signature. Such arrangements will of course need to be carefully considered and documented, especially if there are third-party rights involved (eg, third-party proprietary software running on the hardware). Difficulties may arise where the supplier's contractual performance is prevented or delayed by defects in, or the state of, the customer's tangible assets or even real property. Such eventualities should be considered and provided for in the outsourcing contract.

Law stated - 27 March 2024

Rights transfer

How can a customer's rights and obligations under another contract be transferred or assigned to the supplier?

Contractual rights can be assigned in writing. However, the contract may include prohibitions or requirements for notice and/or consent of the other party. Under English law, contractual obligations cannot be assigned and must be transferred under a formal novation entered into by the relevant parties.

Law stated - 27 March 2024

INTELLECTUAL PROPERTY

Ownership

What rules, standards and procedures govern the transfer and assignment of intellectual property in the context of an outsourcing arrangement?

The licence or transfer and assignment of intellectual property should always be specifically addressed in the outsourcing contract. In particular, in the absence of a formal written contractual assignment of intellectual property (IP), the rights accrue to the author (eg,

supplier), even if paid for by the customer (ie, there is no 'works made for hire' concept under English law). The most common IP arrangements include:

- **Background IP:** typically, each party retains ownership of the IP that is pre-existing, or which is developed independently of the contract and services. It may also extend to cover developments and derivatives of such background IP, so these are retained by the original party. This IP is generally licensed for use during the term of the contract, but additional licence rights may be required if certain background IP is embedded into service deliverables that the customer may use after termination of the outsourcing arrangement.
- **Foreground IP:** the ownership of new IP created by the supplier (or its subcontractors) in the provision of the services is often subject to negotiation, and depends on the nature of the services, the charging structure, and how bespoke the IP is to the customer. Often a supplier wishes to retain this IP for itself (to exploit in other services), and provide the customer with a defined licence. However, if the customer feels that it has paid for the development of the IP, the IP is bespoke to its requirements, or will provide a competitive edge, it will often want to own it. This has to be carefully considered. Any licence must be broad enough to capture the customer's current and future use of the IP.
- **Third-party IP:** if the services involve the use of third-party IP (such as one party providing access to third-party software), this needs to be carefully considered at the start of the outsourcing project to ensure that such IP can indeed be licensed (or sub-licensed) as required, and then reflected in contract drafting to comply with third-party requirements and so that the licensed rights granted are not broader than the rights in the underlying licence.
- **Artificial intelligence (AI) in outsourcing services:** the deployment of AI requires special consideration and documentation in outsourcing, depending on, among others, the AI technologies, models and processes concerned, the rights to training datasets for machine learning, the rights to AI outputs and inputted data and information, the increasing risk of infringing third-party IP rights in large language model (LLM) datasets that may be deployed, and the increased vulnerability of AI-enabled processes to cyber attacks and data breaches.

Law stated - 27 March 2024

DATA PROTECTION

Regulation

What rules, standards and procedures govern the protection and transfer of data in the context of an outsourcing arrangement? Are there any sector-specific regulations in this regard? What are the penalties for non-compliance?

Data protection in the United Kingdom is governed by the UK GDPR (the EU General Data Protection Regulation 2016/679, as it currently forms part of UK domestic law) and the Data Protection Act 2018. The Privacy and Electronic Communications (EC Directive) Regulation 2003 may also apply, depending on the nature of the services. These rules set out specific

requirements for the processing and transfer of personal data applicable to outsourcing arrangements, including prescribed clauses that need to be imposed on the supplier (as the processor) and specific requirements on security and international transfers of personal data outside the UK and European Economic Area, which is an especially important consideration in offshore outsourcing transactions. Penalties for non-compliance include maximum fines of (the greater of) 4 per cent of worldwide turnover or £17.5 million. UK data protection law is currently under reform, with the Data Protection and Digital Information Bill in the legislative process at the time of this publication. The Bill aims to simplify some of requirements on businesses.

There are also numerous sector-specific laws and regulatory requirements, including under the Network and Information Systems Regulations 2018 (applicable to operators of essential services and certain digital service providers). The government is currently proposing amendments to these Regulations specifically to apply to providers of managed IT and outsourced services, but, as at the date of this publication, those amendments have yet to be made.

When entering into an outsourcing arrangement, it is important to ensure that these rules, standards, and procedures are taken into account and that appropriate measures are put in place to ensure that personal data is adequately protected. This may involve carrying out a data protection impact assessment, ensuring that appropriate contractual clauses are included in the outsourcing contract, providing specifically for compliant transfers of personal data to, and the compliant processing of such data by, offshore suppliers, and ensuring robust technical and organisational measures are implemented to protect personal data.

Law stated - 27 March 2024

EMPLOYMENT AND LABOUR

Employee transfers

What rules, obligations and liabilities apply to the transfer of employees to and from the customer and supplier (including with regard to offshoring arrangements and termination of the outsourcing contract)?

The Transfer of Undertakings (Protection of Employment) Regulations 2006, commonly referred to as TUPE, apply when a business or part of a business is transferred from one owner to another, or where a service moves from one supplier to another (including first-generation outsourcings from the customer, if a service is in-sourced back to the customer at a later date, or second- or later - generation outsourcings from an outgoing supplier to an incoming supplier). TUPE provides protection to employees who are affected by such transfers or service changes, ensuring their employment terms and conditions are preserved (including benefits and certain contractual pension liabilities), and their jobs are not lost as a result of the transfer. In the context of an outsourcing, this typically means that individuals performing the services move with those services if there is a change in service provider (a 'service provision change'). The regulations also require the outgoing and incoming employer to inform and consult with employees affected by the transfer. In most outsourcings, the parties agree contractual protections to address these risks, which can include rights for the new employer to dismiss individuals whose employment transfers to

them, and recover any liability from the previous employer, as well as (more generally) the allocation of liability between the customer and supplier for the costs of redundancies, and suitable indemnification for pre- and post-transfer situations.

The rights and obligations under TUPE technically apply to offshore arrangements, but for service provision changes (ie, in outsourcing situations) only where the staff are located in England, Wales or Scotland. However, in most cases' employees transfer to the new employer or provider but their role is immediately redundant.

TUPE often has significant implications for both the outsourcing supplier and the customer. Whether and how TUPE applies is complex, and contractual protections and indemnities are often negotiated at length.

Law stated - 27 March 2024

Definition of 'employer'

How is 'employer' defined in the context of an outsourcing arrangement, and how does this affect the parties' responsibilities and liabilities?

From a UK perspective, the employer of the relevant personnel providing outsourced services will be the supplier (there is no concept of joint employment under English law). Notwithstanding this, as the roles and responsibilities between the parties can sometimes blur the employment relationship (eg, if the customer has recourse to direct the personnel of the service provider, and if they may work in the customer's facilities), it is common for the outsourcing contract to specify certain obligations on the supplier to ensure it maintains and is responsible for the employment relationship. These typically cover management and supervision, controls on replacing key individuals, and impose all taxation and immigration responsibilities on the service provider. Customers typically seek an indemnity to cover situations where they may unintentionally become liable for employment risks of the personnel providing the services.

Law stated - 27 March 2024

Organised labour issues

To what extent are labour unions and works councils involved in outsourcing arrangements?

Labour unions are common in many public and quasi-public sector industries, as well as in industries like financial services and utilities, and they may become involved in outsourcing arrangements to varying degrees depending on the specific circumstances.

Employers have a legal obligation to consult with employee representatives when they are proposing to make significant changes that may affect their employment, such as outsourcing arrangements. In practice, this means that employers may need to involve labour unions in the outsourcing process. This may include negotiating redundancy packages (if the outsourcing will make certain roles redundant) or ensuring that employees are transferred to the new supplier on equivalent terms and conditions.

Work councils are much less common in the United Kingdom, although if there is one it will also need to be consulted in relation to any outsourcing arrangements impacting the employees it represents.

Law stated - 27 March 2024

Immigration

What immigration schemes and rules are pertinent in the context of outsourcing arrangements?

There are no outsourcing-specific immigration rules in the United Kingdom, and so the parties must comply with the ordinary immigration rules as they relate to the specific outsourcing arrangements. This could include the UK's Skilled Worker visa scheme, which allows individuals to come to or stay in the United Kingdom to do an eligible job with an approved employer.

In practice, most (if not all) of the offshore outsource suppliers depend on the senior or specialist worker visa to bring staff into the United Kingdom to work on customer outsourcing assignments from their UK operations.

Law stated - 27 March 2024

TAX

Liability

What tax liabilities arise in the context of an outsourcing arrangement? Can these be mitigated in any way?

Various tax liabilities may arise for both the customer and the supplier, depending on the nature of the outsourcing and the contractual arrangements between the parties. Some of the key tax liabilities that may arise are:

- Value added tax (VAT): VAT and similar sales taxes may be applicable on the services provided by the supplier, depending on the nature of the services and the location of the service provider.
- Withholding tax: If the supplier is based overseas, the customer may need to withhold tax on any payments made to the supplier under the UK's withholding tax rules.
- Transfer pricing: If the outsourcing arrangement involves related parties, such as a parent company and a subsidiary, transfer pricing rules may apply to ensure that the terms of the outsourcing arrangement are consistent with arm's-length pricing.
- Capital gains tax: If assets or property are transferred between the parties, capital gains tax may be applicable. In some cases, stamp duty land tax may also be payable.

There may be ways to mitigate these tax liabilities, depending on the specifics of the outsourcing arrangements, such as VAT exemptions or zero-rated supplies.

Law stated - 27 March 2024

DISPUTE RESOLUTION

Common disputes and resolution forms

What are the most common types of dispute arising from an outsourcing agreement and how are they typically resolved? Is alternative dispute resolution (ADR) common and effective?

The most common types of disputes involve:

- **Delays:** complicated outsourcing arrangements are frequently delayed, in particular where the service provider has to build up bespoke IT systems and resources. This can lead to disputes as to whether the delay was caused or contributed to by the customer, and whether the supplier is entitled to certain relief from liability (and if the customer is liable for additional costs). Delays may also trigger the payment of liquidated damages, which the supplier may contest.
- **Scope:** these typically relate to disagreements over what services are included for the agreed price (in particular if the specification for the services is not sufficiently clear), scope creep (where a supplier may agree to provide additional services, but the parties do not properly document the implications, such as on pricing), and scope changes when there is a change in business requirements of the customer.
- **Service failures:** these disputes may include issues related to quality, timeliness or completeness of the services provided.
- **Payment:** payment disputes often arise where there is some form of variable pricing mechanics, such as charges based on service volumes or time and materials.

Many disputes are resolved through commercial negotiations, often facilitated by each party's legal advisers. This may involve invoking the formal dispute escalation process in the contract, by which the issues may be referred up to senior executives. If an acceptable solution is not found, the parties may seek to mediate the dispute or pursue litigation.

Law stated - 27 March 2024

Common disputes and resolution forms

Is alternative dispute resolution (ADR) common and effective?

ADR is a common and effective way to resolve disputes. In particular, it allows the parties to maintain an ongoing business relationship, because the process is typically less adversarial than litigation, and the parties have more control over the process.

Arbitration is becoming more common for the forum of disputes (over court litigation) as it can help to maintain confidentiality and keep sensitive business information (including the dispute) out of the public domain. Accordingly, arbitration may be more desirable for the supplier than the customer.

Law stated - 27 March 2024

Recent case law

Has there been any notable recent case law that may affect the resolution of outsourcing disputes in the future?

The resolution of outsourcing disputes is subject to the general body of case law developed by the English courts over a significant period of time, in particular that relating to contract interpretation. However, there have been a number of recent cases that are particularly relevant to outsourcing arrangements.

Wasted costs: [Soteria Insurance Ltd v IBM United Kingdom Ltd \[2022\] EWCA Civ 440](#)

In this case, the Court of Appeal clarified the approach to interpreting exclusion clauses, and found that a claim for wasted expenditure did not fall within an exclusion of liability clause that excluded claims for 'loss of profit, revenue savings... (in all cases whether direct or indirect)'. The court determined that the natural and ordinary meaning of the words used did not exclude wasted expenditure. When analysing an exclusion clause, the more valuable the right, the clearer the language of the clause must be. The court concluded that had the parties intended the contract-breaker to avoid liability for a 'catastrophic non-performance', clear and obvious exclusionary words to that effect would have been required. Finally, the court determined that there were a number of good reasons for distinguishing wasted expenditure from loss of profits generally, and as a result, Soteria's award of damages was increased by some £80 million.

Application of good faith to termination: [Optimares S.p.A v Qatar Airways Group Q.C.S.C \[2022\] EWHC 2461 \(Comm\)](#)

In this case, the High Court considered a number of issues, including whether an express obligation of good faith prevented a party from exercising its right to terminate the contract when the relationship between the parties had broken down. In his decision, the judge found that the express duty of good faith in the contracts applied to the performance of the parties' 'responsibilities and obligations' and not to the exercise of a right to terminate.

Application of the Unfair Contract Terms Act: [Last Bus Ltd v Dawsongroup Bus and Coach Ltd \[2023\] EWCA Civ 1297](#)

In this case, Last Bus Ltd claimed that a number of buses supplied by Dawsongroup were defective and did not meet the implied term requiring goods to be of a satisfactory quality under the Supply of Goods (Implied Terms) Act 1973. Dawsongroup argued that the implied term was excluded stating that 'conditions and warranties whether express or implied by law are excluded'. Under section 6 of the Unfair Contract Terms Act 1977 (UCTA), the exclusion of such an implied term could only be valid if it is reasonable. In assessing this, courts will consider the 'strength of the bargaining positions of the parties relative to each other' (pursuant to Schedule 2 of UCTA). In this case, although both parties were large commercial organisations with equal strength to negotiate on price, the court considered that this did not automatically mean that they had equal strength to negotiate on terms. Therefore, if it is common market practice not to negotiate on terms, or limit negotiation of terms, then

an exclusion clause is more likely to be found to be unreasonable and vulnerable to being found invalid even in the context of an agreement between large commercial entities who are legally advised.

Law stated - 27 March 2024