THE IMPORTANCE OF AN EXIT STRATEGY IN TECHNOLOGY CONTRACTS

SUMMARY

It is important to plan an exit strategy when engaging an enterprise-level technology services provider as part of best practice and to protect against risks in a relationship breakdown. Switching enterprise-level technology service providers is, more often than not, much more difficult and complex than switching telcos for your mobile phone or switching internet service providers. It is easy for decision makers in corporations of all sizes to mistakenly believe that switching enterprise-level technology services providers is just as convenient. The result is that too little time is invested in thinking through the end of the relationship with the service provider. Significant time and effort needs to be spent on carefully planning a thorough exit strategy as soon as a technology services provider is engaged and at a time when clear-headed parties are at peace, and not when there is a sudden urgent need to switch service providers in a panic. The issues to be considered include continuing service requirements, data security and privacy, knowledge and documentation transfer and the costs of transition.

INTRODUCTION

These days, as consumers, we are spoilt for choice when it comes to technological products and services. In many jurisdictions, telco regulation and consumer cloud services have made it easy for us to switch seamlessly from one service provider to another while retaining all essential information such as our phone number, documents and details of our contacts.

However, at the enterprise level, we should not believe that the same convenience applies. It is key for Chief Information Officers (“CIO”) to manage expectations of the business. Where there are gaps between expectations and reality, corporations often end up in scenarios where they experience serious difficulties ending their relationships with their technological service providers when they have committed to one platform, but subsequently plan to switch to another.

The problem becomes particularly acute where there is a relationship breakdown with their service provider. While it may seem counterintuitive, it is important to invest the time, thought and effort in preparing an exit strategy before you contract with a service provider. If you are regulated or the services you provide are regulated, then the need to prepare an exit strategy becomes all the more important to satisfy your regulators that you have complied with their requirements and best practices.

SERVICE PROVIDER OBLIGATIONS

Unless regulated, a service provider’s obligations are usually contractual. The extent of their obligations are therefore usually whatever is being commercially bargained for. Committing to a technology service provider and the platform offered is often a significant investment and the decision should not be made lightly. Communication between CIOs and the business is essential to bridge the gap between business needs and technological implementation. While CIOs do have to manage business expectations as to what the technology can do, the business will invariably look to them to ensure that the technology investment is exploited for the best possible benefits of the business and customized to business needs as far as possible.

In today’s technologically-driven world, businesses often entrust their technology services provider...
with their most guarded data and information. The business relies on the service provider to ensure that the data is secure, accessible and managed meaningfully for a fee.

Enterprise information stored in various formats could be stored off-premises by the service provider and held on behalf of the client as part of the suite of services provided. This means that important and confidential data and information is in the custody, care or control of the service provider.

Things are usually fine until there is a need, or a want, to terminate the engagement and to move to another service provider. This can happen for a variety of reasons. Factors such as better available technology, changes in reputational risk or changes in the regulatory environment or accreditation may all contribute to the reason for change.

The new service provider may require the enterprise data to be delivered in specific formats or in a specific structure so that the transition to the new platform can be as smooth as possible. It is quite common for the old service provider to then require additional fees to be paid (which can sometimes be very significant) before they undertake the effort to organize the enterprise data into the required format. Without being paid the additional fees, the old service provider has little incentive to assist with the transition. There may even be situations where disputes arise with the old service provider resulting in the old service provider holding the enterprise data at ransom until their requirements on fees or other issues are met.

From the service providers’ point of view, outside of contract, they have no general legal obligations to assist their soon-to-be former client in any transition of software or services. Indeed, it is a fallacy to think that preparing any data, software and services in a transition is simple task for the service provider. There are often many technological hurdles that their clients do not appreciate. The expectation is often that transitioning data is as simple as “copying and pasting”. In truth, the transitioning of data is often a much more complex process. Multiple safeguards often need to be put in place to ensure data integrity is not compromised for the clients during the transition and sometimes at significant expense for the service providers.

WHAT HAPPENS IF RELATIONSHIPS BREAKDOWN?

In situations where there is a relationship breakdown between the service provider and the soon-to-be former client, tensions may flare resulting in both parties entrenching their positions. This usually means that the service provider would require upfront payment of additional fees before they would go the extra mile to assist in any form of transition to the new service provider, while the soon-to-be former client would demand the immediate return of their data and information.

Proceedings may ensue with the client often having to argue that it was an implied term of the contract with the service provider that the service provider would assist the client with any form of transition to a new service provider. Depending on the facts, this may not be an easy case to make. Such contracts are no different from any other commercial contracts. In the absence of any statutory regulations providing otherwise, the Court will first examine the express terms agreed between the parties and it is then on the party alleging the existence of an implied term to persuade the Court of the parties’ unexpressed intentions.

The burden is on the parties alleging the implied term to prove it. This is usually not a desirous position to be in. What may seem obvious to one party based on personal experiences may be completely opaque to another.

EXIT STRATEGY

To guard against risks and define potential losses, as well as minimize disruption of services and ensure continuity, a comprehensive strategy should be developed at the time the client enters into a contract with the service provider. Conceiving an advance exit strategy has many benefits. First, it gives you an opportunity to think about the potential pitfalls in the contract – for example, does the contract include language ensuring that client data is returned in a neutral format, or in a format that would assist with the transition. The commercial considerations are no different from a big-picture procurement and supply strategy, but greater attention should be paid to the technological considerations in order to ensure a seamless transition.
From a technological perspective, a key factor would be whether the new service provider provides a platform that is interoperable with the previous platform, and if not, what steps need to be taken to ensure that data integrity is maintained in the migration exercise. It is often impossible to foresee whether there will be a switch in service provider in the future. As part of the exit strategy, care should thus be taken to consider if the enterprise data should be returned in a neutral format so make it easy to cut over to the new service provider. In the absence of an agreed exit mechanism, these are the steps which may sometimes require the assistance of the previous service provider, that can become a sticking point between the old service provider and the client.

It is often advisable to ensure that the contract with the service provider has a comprehensive exit mechanism governing the rights and obligations of both the client and the service provider, in the event the client subsequently decides to switch platforms. This is distinct from a termination mechanism in the contract which only provides for situations in which the contract is regarded as at an end, such as in the case of material breach, insolvency or termination of related agreements.

It is important to consider these matters at the time the service provider is engaged. It would be prudent for parties to agree upfront and prepare a detailed plan for the orderly transition of data and services to any new service providers and to provide for the cost, if any, of the same, including whether the client needs to purchase any software licenses (legacy or otherwise) and equipment from its existing service providers. Planning for exit early significantly mitigates the risk of any disputes and most importantly, safeguards a smooth transition from a technological and operational perspective which is now increasingly important in today’s technological age.

CONCLUSION

It is critical in today’s technology-driven world to ensure that we plan for difficult eventualities when we commit to technology platforms. Such planning demands constant communication between CIOs and the business to bridge gaps between needs, expectations and capabilities. It is also helpful to ensure that professionals with the right legal, commercial and technological acumen are engaged to assist with risk assessment and management.

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1. Chapter 1: The Importance of An Exit Strategy in Technology Contracts <6 March 2019>
2. Chapter 2: Employees, Technology and A Legal Hangover – Bring Your Own Problems? <4 June 2019>

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