

# Outsourcing Contracts: Step-in Rights

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This article focuses on one aspect of outsourcing arrangements which can be quite contentious – namely ‘Step-in’ rights.

‘Step-in’ rights are often seen by a customer as a necessity to offset the risk of an outsourcing arrangement, whilst a supplier will be reluctant to offer such a right, due to the implications and consequences associated with it.

We therefore look at the right, and the associated issues in outsourcing arrangements.

## Step-In Rights – What are they?

Step-in rights are rights granted in a contract to allow a customer or its representatives to step-into the ‘shoes’ of the service provider in certain circumstances.

As is evident from the above description of such a right, it is clearly a right which must not be taken lightly in contract negotiations.

## Why Have Step-in?

Usually, step-in rights are exercised to allow the customer or its representative to take over the whole or part of the services being provided by the service provider, due to certain trigger events such as:

- Breach of service levels;
- Complaints received by the customer from end users of the service (eg in a contact centre outsourcing, where callers have escalated service issues);

- Material breach of the contract;
- ‘Emergency’ situations – this is usually a subjective trigger event.

The objective of the customer in exercising a step-in would be to address the above types of shortcomings.

## Let’s Get Real!

There are many law firms that seem to almost as a knee-jerk reaction, include ‘step-in’ rights into their outsourcing contracts without giving any real thought as to the suitability of such rights, nor with any consideration of the fact that the inclusion of such rights in a transaction where the rights are not warranted, will unnecessarily cause friction between the customer and the supplier in the contractual negotiations.

In reality, true step-in (ie a wholesale assumption of the supplier’s service obligations using the supplier’s premises and facilities) is not only extremely likely to be rejected by the supplier, but also, the reality is that the customer will probably never exercise such a right in any event.

Let’s therefore analyse the issues associated with step-in rights:

- Expertise & Resource: Imagine a large customer company outsourcing its entire in-house contact centre requirements to a third party service provider. Following such outsourcing, the customer is

unlikely to have any staff remaining to provide any contact centre services. Consequently, if there is an issue with service delivery, the customer will not have the resource or the expertise to actually undertake a wholesale step-in to address the relevant issues – consequently, the step-in right is of no value.

- **Third Party Representative:** In the above scenario, the customer may require a third party representative appointed by the customer, to exercise the step-in on the customer's behalf. Such a step-in by a third party will only be possible, if rights have been reserved to this effect in the contract, which expressly refer to the third party being able to exercise such rights. Depending upon the nature of the outsourcing, it would be likely (especially if the outsourcing relates to an area which requires specialist skills) that the only type of third party which would have the requisite level of expertise and resource to effectively undertake the step-in, would be a competitor of the service provider – so what the customer is asking in the contract, is for the service provider's competitor to have free reign to enter and use the service provider's premises and facilities !
- **Confidentiality:** In many outsourcing arrangements, the customer's data and services might be provided from a facility used by the service provider to service a number of its clients. Consequently, the exercise of step-in might give rise to possible breach of confidentiality issues, if the customer or its third party is granted such access.
- **Costs:** A step-in will have cost implications from a number of perspectives. Firstly, there is the issue of the service provider's ongoing charges – usually, a customer will request that the step-in results in the waiving of the service provider's charges for the duration of the step-in. Secondly, the customer may look to recover its costs associated with exercising the step-in.

Let's look at the cost issue from the service provider's perspective – (1) the service provider is being asked to let the customer use the service provider's premises and facilities at no charge; (2) the service provider is being informed that even though the customer is receiving ongoing services through a third party using the service provider's premises and facilities, the service provider will receive no remuneration for this; (3) the service provider is being informed that it will have to pay the third party's costs for exercising the step-in, together with possibly additional costs; (4) to top it all off, the customer may contend that all of this is without prejudice to the customer's additional rights and remedies – namely termination rights coupled with the right to claim service credits and possibly damages !

- **Duration:** Commonly, customers attempt to have step-in rights exercised indefinitely, until the customer is comfortable that the shortcoming is addressed. From a service provider's perspective this is unrealistic, as it means that it will have to retain a workforce and facilities for the customer, with the associated overheads which may not be recoverable from the customer during the step-in, without knowing when service delivery will be resumed, if at all, in view of the possibility of the customer wishing to subsequently exercise its termination right.

### The Pragmatic Approach

Having considered the above, it should be evident that true step-in should be a rare event – and in fact it will usually be mission-critical outsourcing arrangements, where anything close to true wholesale step-in will ever be entertained by a service provider, and even then, the service provider would be looking for some reasonable caveats to the exercise of the right.

Instead, the parties should attempt to see if there are alternatives available to step-in rights, such as:

- Escalation meetings between the customer and the service provider to discuss the situation together with a remedial action plan;
- Service credits/liquidated damages;
- Right to sue for damages;
- Right to terminate the contract and seek damages – as after all, if the situation is so severe that the ‘expert’ service provider can not resolve the issue, what chance would the non-expert customer have in resolving the issue if it was permitted to step-in;
- Suspension of performance of services for a short finite time, whilst any issues are being resolved by the service provider itself. This could be coupled with some form of financial redress during that period to the customer.

If due to the nature of the services, and the particular trigger event, it is felt that some form of physical presence by the customer at the service provider’s premises is necessary, then a compromise might be for the customer to provide one of its employees to oversee jointly with the service provider, the manner in which certain services are being provided for a certain period of time, with the customer then being able to exercise a degree of management influence in to how the services are being performed.

### Final Thoughts

Although we have referred to the ‘customer’ in this Technology Column, as seeking various step-in rights or remedies, the reality is, that it will not usually be the customer itself which is seeking the onerous, and unrealistic positions, but the customer’s legal representative.

The prudent approach is always to assess whether step-in rights are really required, and if so, in which ‘real’ circumstances are they going to be exercised and why, together with consideration of the practical way in which step-in will be performed. Only after such internal consideration, should the issue of step-in be raised with a service provider and their legal representatives – ie ensuring that there is a real justification for the right, rather than a knee-jerk reaction which will do little more than prolong the negotiations and antagonise the working relationship between the parties.

At the end of the day, a customer seeking step-in rights, should consider how much it would welcome a competitor coming into its premises and accessing its facilities, and keep this in mind when it comes across resistance from the service provider against such onerous rights.

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