COM-14-3506
R. Terdiman

Research Note
17 September 2001

Commentary

IT Services Contracts — Exit Strategy Plan

An exit strategy plan is a critical part of today's outsourcing agreement. It defines the framework for planned or early termination, the parties' roles and responsibilities, associated service assistance and contract buyout fees.

All outsourcing contracts — IT outsourcing (ITO), business process outsourcing, applications outsourcing and application service provider (ASP) contracts — must anticipate the eventual termination at the end of the contract and plan for an orderly in-house transition or to another service provider (SP). However, sourcing agreements often end early for a variety of reasons (e.g., cause, convenience, bankruptcy, unusual business changes and change of control), and contracts must provide for these events as well. Therefore, both parties to an outsourcing agreement must carefully consider how to ensure a successful transition if and when termination occurs. (Exit plans are generally not applicable to consulting deals and many systems integration agreements).

Purpose

An exit strategy plan:

- Describes the circumstances and notification process under which termination may occur
- Preestablishes how the transition will be handled and in what time frame
- Identifies and defines the processes required to successfully transfer the contracts' operational and organizational components from the SP back to the service recipient (SR) or another SP — including provisions for recovering data, licenses, hardware and hiring staff
- Includes a buyout schedule for early termination; in the case of large outsourcing deals, these fees are subject to intense negotiation and can be quite high, particularly for termination in the early years

Importance

Termination of the SR/SP relationship is almost always guaranteed, prematurely or on a predetermined schedule. When a long-term IT outsourcing deal is signed, the SP and SR leave the table with the impression of having established a long-term solution. However, Gartner research shows that ITO contracts terminate early more frequently than expected and under circumstances that were not anticipated. Early termination is a distinct possibility for unstable or immature IT service offerings (such

Entire contents © 2001 Gartner, Inc. All rights reserved. Reproduction of this publication in any form without prior written permission is forbidden. The information contained herein has been obtained from sources believed to be reliable. Gartner disclaims all warranties as to the accuracy, completeness or adequacy of such information. Gartner shall have no liability for errors, omissions or inadequacies in the information contained herein or for interpretations thereof. The reader assumes sole responsibility for the selection of these materials to achieve its intended results. The opinions expressed herein are subject to change without notice.

as some current ASP offerings). Enterprises must plan for early, unanticipated terminations, as well as for planned changes.

Both sides must jointly develop an exit strategy that defines the key resources, assets and process requirements for continued, effective delivery of the services formerly provided by the SP. The SP is obligated to ensure that the transition happens smoothly and that the continued successful execution of services is assured. However, the SP does not always provide the appropriate level of services to make this happen, and the SR does not always live up to its end of the bargain.

Structure

The exit plan is composed of the following elements:

- Conditions under which termination may occur
- Business and technology impact of early termination
- Hierarchy of critical processes, assets and resources
- Contingency plans (e.g., data, backup data, software licenses and hardware)
- Exit scenarios such as a market scan of alternative SPs (including internal resources)
- Early termination cost/benefit analysis and payout schedule
- Statement of exit roles and responsibilities
- SP rates for performing additional termination services or the basis of estimates that will be used (because it is difficult to forecast rates several years out)

Examples

- *Outsourcing Contract:* An exit strategy plan for standard sourcing contracts (e.g., ITO and ASP) should include conditions for termination and focus in detail on the exact transition assistance provided by the SP at specified rates — including premigration, migration and post-migration assistance. Service-transition assistance should be provided until the effective date of expiration or termination and may be extended for additional months to ensure a smooth transfer. Important items include procedures for providing access to and transfer of the customer data, hardware, software, licenses and disaster recovery procedures, as well as stated rules regarding the transfer or hiring of personnel from and to any of the parties.

- *ASP Contract:* Given the immaturity and fast-changing nature of newer segments of today's SP market, as well as today's unstable marketplace conditions where vendors have been exiting the business, an exit strategy plan for these contracts (e.g., ASP) is particularly important. Because most ASP contracts do not involve a transfer of personnel or hardware, exit clauses do not have to address these elements. Prime areas of consideration are related to the enterprise's ability to retain the software licenses (directly from the ASP or third-party providers) and the customer's proprietary rights to data submitted to the ASP or produced by the ASP, access to and destruction of backup files, and the recovery of data. Innovative contracts may also specifically address whether and how the initial SP will provide for the transition to another SP in the case of supplier bankruptcy.

Bottom Line: Termination provisions and processes must be outlined clearly and in detail in the outsourcing contract. Although neither party in an outsourcing deal would like to terminate early, it is essential for both sides that an exit plan is agreed to upfront.