

Outsourcing: United Kingdom Overview

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A Q&A guide to outsourcing in the United Kingdom.

This Q&A guide gives a high-level overview of legal and regulatory requirements on different types of outsourcing; commonly used legal structures; procurement processes; formalities required for transferring or leasing assets; data protection issues; supply chain compliance; specification, service levels and escalation; flexibility in volumes purchased; charging methods; customer remedies and protections; warranties and indemnities; term and notice period; termination and its consequences; liability, exclusions and caps; dispute resolution; and the tax issues arising on an outsourcing.

Regulation and Industry Requirements

National Regulations

1. To what extent does national law specifically regulate outsourcing transactions?

National law does not specifically regulate outsourcing transactions.

Sectoral Regulations

2. What additional regulations may be relevant for the following types of outsourcing?

Sector-specific Regulations

Financial services. The outsourcing rules applicable to financial services firms depend on the type of firm and whether the firm is regulated by the:

- Financial Conduct Authority (FCA).
- Prudential Regulation Authority (PRA).

The FCA and the PRA impose requirements on regulated firms entering into certain types of outsourcing arrangements. These can include requirements in respect of the terms of the outsourcing agreements and the firm's systems and controls for supervising and managing outsourcing arrangements and the associated risk.

As a general principle, a regulated firm cannot delegate or contract out of its regulatory obligations when outsourcing. It must also give advance notice to the FCA or PRA (as applicable) of any proposal to enter into a material outsourcing arrangement and of any material changes to arrangements (see [Question 3](#)).

The FCA and the PRA have various enforcement powers at their disposal in relation to firms which fail to manage their outsourcing arrangements, including the power to impose an unlimited fine.

The full impact of the UK's withdrawal from the European Union on outsourcing arrangements between UK and EU financial services firms and service providers remains unclear. However, it is common practice for financial services firms both in the UK and elsewhere in the EU to outsource certain services to businesses based in third countries and this practice is expected to continue to some extent.

See [Practice Note, Outsourcing in the UK financial services sector: Key regulatory requirements: Outsourcing by banks, building societies and investment firms](#).

Public sector. Depending on the nature of the contract and its value, a public-sector outsourcing can be subject to UK regulations on public procurement. If so, the awarding authority can be required to:

- Advertise the contract on the UK's "Find a Tender" service and follow special procedures.
- Ensure that all bidders are treated equally.

The UK public procurement rules are likely to have a significant effect on the:

- Timing of the pre-contract procedure.
- Award criteria adopted.
- Duration of the outsourcing contract (for example, framework agreements or concession contracts are subject to special rules which may lead awarding authorities to limit their duration to four or five years respectively).

In addition, UK private finance initiative (PFI) legislation applies to certain public sector outsourcing arrangements. Other laws and guidance can also be relevant; for example, local authority procurement is also subject to requirements under the Local Government Acts.

At the time of writing, the UK government had indicated that it plans to reform the UK's public procurement regime, although the majority of these changes are expected to be evolutionary rather than revolutionary. However, any new regime is unlikely to come into force until 2023 at the earliest. For further details, see www.gov.uk/government/consultations/green-paper-transforming-public-procurement/outcome/transforming-public-procurement-government-response-to-consultation.

Public sector workers are generally entitled to accrue defined benefit pensions. Contractors are expected to fund the continuing provision of those or, in some cases, broadly equivalent benefits.

In a central government outsourcing, the contractor will normally be required to participate in the relevant public sector scheme and pay contributions set by the Government Actuary.

In a local government outsourcing, the contractor will normally have a choice of participating in and contributing to the Local Government Pension Scheme or providing broadly comparable defined benefits under a scheme of its own.

In all cases, the cost of funding these valuable pension benefits is likely to be significantly higher and less predictable than would be the case if the contractor were free to offer pension arrangements of its own choosing.

Other Legal or Regulatory Requirements

There are relatively few UK regulatory requirements targeted specifically at outsourcing. However, many activities are subject to specific regulatory regimes which may have implications for outsourcing transactions. Given the limited scope of this Q&A, it is not possible to give a comprehensive overview. However, by way of example, sector-specific authorisations/requirements for licences may be required from the applicable authorities for outsourcings relating to sectors including (among many others):

- Aviation (Civil Aviation Authority).
- Consumer credit and financial services (FCA).
- Energy (Ofgem).
- Gambling (Gambling Commission).
- Telecommunications, broadcasting and postal services (Ofcom).

Licences, permits or approvals may also be required from numerous other bodies such as local authorities, the Health and Safety Executive (in respect of, for example, handling certain chemicals) or government departments (for example, Ministry of Defence approval can be required to carry out certain defence-related activities).

3. What industry sectors require (formally or informally) regulatory notification or approval for outsourcing transactions?

Financial Services

Firms regulated only by the FCA must give notice to the FCA before entering into, or significantly changing, a material outsourcing arrangement. Firms that are also regulated by the PRA must also notify the PRA. Although no period of notice is specified, the appropriate regulator expects firms to discuss matters with it at an early stage, before making any internal or external commitments.

Failure to give this notice to the appropriate regulator is likely to amount to a breach of the regulator's rules. Both the FCA and the PRA have various enforcement powers at their disposal, including the power to impose an unlimited fine.

UK Merger Control

UK merger control legislation (Enterprise Act 2002) can apply to outsourcings. This legislation is not sector-specific and applies where both:

- Two or more "enterprises" cease to be distinct.
- One of the two jurisdictional tests set out below is satisfied (in which case consideration should be given to whether the transaction should be notified to the Competition and Markets Authority (CMA)).

Notification is not compulsory but completion without the CMA's approval entails certain risks, including the possibility that the outsourcing supplier can subsequently be required to sell all or part of the business acquired, and the contract can be terminated.

According to CMA guidance, an outsourcing arrangement is likely to satisfy the first point above only if the arrangement involves the permanent (or long-term) transfer of assets, rights and/or employees to the outsourcing service supplier and where those transferred elements can be used to supply services other than to the original owner/employer.

The second point above will be satisfied where either:

- The UK turnover of the part of the customer's business being outsourced exceeds GBP70 million.
- As a result of the transaction, the supplier and the part of the customer's business being outsourced together supply 25% or more of all the goods or services of a particular description supplied in the UK (or in a substantial part of it). This test can be easily satisfied on the basis of a narrow description of services (it need not be a viable market in economic terms).

See [Practice Note, Overview: UK competition law: Mergers qualifying for investigation under the UK merger control regime](#).

EU Merger Control

As a result of the UK leaving the EU, the UK no longer participates in the so-called "one stop shop" regime provided by the Merger Regulation ((EC) 139/2004). This has two main impacts:

- Firstly, UK turnover is no longer relevant for the purposes of determining whether the jurisdictional thresholds in the Merger Regulation are met.
- Secondly, as of 1 January 2021, the UK CMA can scrutinise a transaction under UK merger control legislation even where the jurisdictional thresholds in the Merger Regulation are met. This contrasts with the position before 1 January 2021, where the CMA would in most circumstances have been unable to apply UK national control law to any transaction required to be notified under the Merger Regulation. As a result of this change, some outsourcing transactions which would previously have been dealt with solely under the "one stop shop" regime (as a result of the UK's membership of the EU) may need to be notified to the UK authorities in parallel.

Joint Ventures and Merger Control

In circumstances where the customer and supplier set up a joint venture (see [Question 5](#)), the analysis as to whether merger control applies can be different.

See [Practice Note, Transactions and practices: UK Mergers and Acquisitions](#) and [Practice Note, Transactions and practices: EU Mergers and acquisitions](#).

National Security Review

The UK Government has created an extensive regime to strengthen its powers to scrutinise certain transactions on grounds of national security. The National Security and Investment Act 2021 came into force on 4 January 2022, creating a hybrid mandatory and voluntary notification regime. It may therefore be compulsory or advisory to notify and obtain approval from the UK Government in respect of notifiable outsourcings.

See [Practice Note, National Security and Investment Act 2021: overview: Transactions within the scope of the NSI Act](#).

From an outsourcing perspective, the following points should be noted:

- National security is a broad concept capable of applying to a wide range of activities which may be outsourced. These extend well beyond the military/defence sector to encompass civil interests such as owners of critical infrastructure and advanced technology, together with (in certain cases) key suppliers to such businesses. For some sectors, notification is mandatory and failure to notify and obtain clearance ahead of completion will render the transaction void (civil and criminal penalties may also be imposed); for others, notification is voluntary but may be advisable to reduce the risk of the transaction being "called in" post-completion for investigation.
- The trigger for application of the legislation is a change or increase in the ownership of either a business, or particular assets deemed to be potentially important to national security. Outsourcing transactions which involve neither should generally not be caught (although a subsequent change in the ownership of either the customer or the outsourcing provider could act as a trigger (as could a restructuring involving transfer of assets used in outsourcing)). The minimum thresholds for changes to the ownership of businesses are also set very low: acquisitions of minority stakes of 15% or more (and sometimes even less, where "material influence" is acquired) may be caught under the voluntary regime, and of more than 25% under the mandatory regime.
- Even if an outsourced service provider is not itself subject to the legislation, its customer may be, which could have implications for an outsourcing. For example, in order to secure clearance for a change in ownership, the customer might have to give undertakings to the UK Government to address certain national security concerns, which could in turn necessitate changes to its outsourcing arrangements.

Structuring the Transaction

4. What transaction models are commonly used in an outsourcing in your jurisdiction? What are their respective advantages and disadvantages?

Direct Outsourcing

The simplest structure is a direct outsourcing (that is, an outsourcing contract between the customer and the supplier). This can comprise one or more separate contracts dealing with core issues (for example, price and duration) with detailed schedules that set out:

- The staff and assets transferred.
- The services provided.
- Service levels.
- The consequences of failing to meet service levels.

If the proposed supplier is not the main trading entity within its group, or does not have sufficient assets to meet its potential contractual liabilities, the customer can require a parent company guarantee.

The structure is more complex if the customer procures services on behalf of itself and its group companies. Generally, the customer either:

- Enters into the outsourcing contract as agent on behalf of its group companies.
- Includes a third-party rights clause to ensure its group companies have directly enforceable rights under the contract.

A supplier should consider including specific contract provisions that control multiple actions by the customer and its group companies, and ensure that its liability limitations and exclusions apply to each and all of them.

If the supplier intends to use subcontractors, the customer can require:

- That the supplier notifies it of the choice of subcontractor.
- That the supplier remains liable for its subcontractors' acts and omissions.
- A right to veto particular subcontractors.
- A right, if the supplier suffers a certain level of financial distress, to pay subcontractors directly and/or require contracts with key subcontractors to be assigned to the customer.

Direct outsourcing arrangements allow the customer to streamline its operations and take advantage of economies of scale achieved by a large supplier. By retaining a third party to take care of non-core operations, the customer will be better able to focus on the core areas of its business. Many of the potential issues associated with outsourcing are dependent on the sector in which the customer operates and the activities being outsourced. For example, quality control is vital to protect against reputational damage sustained as a result of poor service in call centres. The customer may also find additional obstacles presented by the costs associated with the physical transfer of the services and ongoing costs such as travel and cross-jurisdictional advice.

Multi-sourcing

The customer enters into contracts with different suppliers for separate elements of its requirements. The issues are generally similar to those experienced in a direct outsourcing (see above, *Direct Outsourcing*) but, in addition, the customer must ensure

interfaces between the different suppliers are carefully managed to encourage the seamless provision of an overall service (sometimes referred to as "Service Integration and Management" or SIAM). This will usually involve requiring suppliers to participate in a common governance process involving, for example, regular meetings of all parties and an escalation procedure designed to resolve differences/disputes. The customer may also wish to impose contractual obligations on suppliers to cooperate with one another.

The structure shares similar advantages and disadvantages to direct outsourcing, but the need for effective interfacing between the various suppliers can add layers of cost and complexity. One advantage can be avoiding over-reliance on a single supplier (but only where identical services are sourced from several different suppliers). Another advantage can be that individual contracts can be lower value and shorter (as compared with a contract with a single supplier, where the provider may insist on a longer minimum term and incorporate a premium for managing its own subcontractors).

Indirect Outsourcing

This is similar to a direct outsourcing (see above, *Direct Outsourcing*), except that the customer appoints a supplier that immediately subcontracts to a different supplier. Often, the second supplier is located outside the UK, and the first supplier is UK-based.

The structure shares similar advantages and disadvantages to direct outsourcing, but it is potentially harder for the customer to police the activities of, and enforce its rights against, the overseas supplier. The resulting level of management and risk-sharing can erode some of the potential cost savings.

Joint Venture or Partnership

The customer and the supplier set up a joint venture company, partnership or contractual joint venture, perhaps operating in an offshore jurisdiction.

Advantages of this structure include the following:

- Customer has a greater degree of control than in other models.
- Customer benefits from the supplier's knowledge and credibility.
- Customer shares in profits generated by third-party business that the joint venture conducts.
- Structure is easier than others to transfer to a new supplier or take back in-house on termination.

However, the joint venture structure is complicated and expensive to set up and maintain.

Captive Entity

The customer outsources its processes to a wholly-owned subsidiary, taking advice from local suppliers on a consultancy basis.

This gives the customer direct operational control and can have tax benefits in appropriate jurisdictions. However, there will be significant upfront set-up costs and risk cannot pass to a third-party supplier.

Build Operate Transfer

The customer contracts with a third-party supplier (perhaps overseas) to build and operate a facility. The supplier then transfers the facility to the customer.

This is a relatively low-risk model but can be expensive. The customer can ask the supplier to operate the facility in the longer term.

Procuring the Supplier/Service Provider

5. What procurement processes are used to select a service provider or supplier of outsourced services?

The process is typically as follows:

- Initial due diligence.
- The customer (and/or its advisers) draws up a specification of the business to be outsourced and identifies potential suppliers. This usually involves the customer conducting due diligence on the function to be outsourced (and any relevant IT), which gives it a clear idea of its requirements, and reduces the potential for having to widen the scope during the tender exercise. It can also conduct some degree of due diligence on potential suppliers (for example, their probity and financial strength, and a review of reference sites).

Due diligence should include an assessment of the impact on the proposed outsourcing of changes arising from the UK's withdrawal from the EU (Brexit), bearing in mind that, at the time of writing, many businesses are still adapting to new trading conditions and some changes (such as those regarding UK imports, for example) are not expected to take effect until 2023. For further details, see <https://hansard.parliament.uk/commons/2022-04-28/debates/22042822000011/BrexitOpportunities>.

Request for Information

In the UK, a customer can send a request for information (RFI) (often called a request for proposal (RFP)) to potential suppliers. Generally, this briefly outlines the areas the customer is considering outsourcing and asks questions relating to the supplier's capabilities and competence.

Invitation to Tender

In addition, or as an alternative to an RFI, the customer can send out an invitation to tender (ITT) (often called a request for proposal (RFP)) and invite responses. The customer should include in the ITT:

- All information that it considers the supplier needs to make a bid.
- A clear and detailed statement of the service requirements.
- Preferably, a draft contract on which it invites the supplier to comment.

Shortlisting

The customer assesses the responses and shortlists a small number of possible suppliers. The customer should establish its evaluation criteria at an early stage. The supplier's capacity and ability are likely to be assessed at this stage.

Negotiation and Further Due Diligence

After shortlisting, more detailed negotiations begin. Generally, the potential supplier(s) carry out some degree of due diligence. Work streams are established to conduct commercial, technical and legal negotiation. It is important that these work streams are closely co-ordinated.

The customer can conduct negotiations with:

- Several short-listed parties (this can be complex and costly).
- One preferred bidder (which risks loss of competitive tension in negotiation).

Either party can carry out further due diligence after contract signature as part of the contract process to establish a baseline against which service provision can be measured.

Transferring or Leasing Assets

Formalities for Transfer

6. What formalities are required to transfer assets on an outsourcing transaction?

Immovable Property

Transfer of title to immovable property in England and Wales must be in writing (usually by deed), and, in most cases, requires registration at the Land Registry to transfer the legal title and, if this is the case, the transfer must be in one of the forms prescribed by the Land Registry. A plan will also be required if the transfer will result in first registration or if the transfer or lease is of part (as opposed to whole) of a title.

Where the asset is a lease or licence, the consent of the landlord or licensor may also be required. Where the property is charged to secure debt finance, the consent of the lender is usually required.

The transfer of title to immovable property outside England and Wales will be governed by the formalities of the relevant jurisdiction.

IP Rights and Licences

A transfer of UK IP rights generally must be in writing and can require registration of the transfer at the UK Intellectual Property Office, depending on the rights involved.

The transfer of IP licences should be by written consent (where the licence is expressed to be personal or there is an express restriction on assignment). Particular attention is needed where the licence is held in the name of another company within the customer's group. Where this is the case, approval should be obtained at an early stage.

Formalities for transferring non-UK IP rights tend to be similar, but important details may vary from the above and appropriate advice should be sought.

Movable Property

A written assignment is usually sufficient to transfer movable property for evidential purposes. Where assets are leased or charged, the transfer can require the counterparty's and/or lender's consent.

Key Contracts

The assignment of key contracts must be effected in writing. Any contract to be transferred should be identified at an early stage and its terms reviewed to identify whether assignment is possible without the counterparty's express consent. Alternatively, if the terms of the contract permit, the customer can retain ownership of the contract and allow the supplier to supply the services to the counterparty as agent of the customer on a "back-to-back" basis.

As with the transfer of any contract or licence, consideration should be given as to whether the burden of the contract should also transfer to the supplier, either by:

- Novation.
- Express indemnity (which leaves some residual risk with the transferor).

Offshoring

UK legislation imposes controls on the export of certain goods such as technology which can be used for military or paramilitary purposes. In such cases a licence may be required to facilitate the transfer of assets to a provider based outside the UK. However, in practice, it is unusual for outsourcing transactions to be affected by these controls.

Data and Information

There are no formalities as such for the transfer of data and information; instead contractual provisions are included for providing access to such data or information, and regulating how it is used. If there is copyright in the data or information which is transferred, then the copyright will have to be transferred in writing as referred to above. See also [Question 9](#).

Formalities for Leasing or Licensing



7. What formalities are required to lease or license assets on an outsourcing?

Immovable Property

All leases of immovable property in England and Wales for a term of up to three years may be in writing or oral, while those for more than three years must be by deed. It is advisable, although not a legal requirement, that licences of immovable property should also comply with these formalities. Leases of more than seven years must be registered at the Land Registry and must therefore contain prescribed clauses which set out the key details of the lease. The consent of any superior landlord or lender can be needed, which may require financial tests to be satisfied or a guarantee to be provided. Leases or licences of immovable property outside England and Wales will be governed by the formalities of the relevant jurisdiction.

IP Rights and Licences

Licences of registered trade marks must be in writing and signed by the licensor. In relation to other IP rights, a written agreement should be entered into as a matter of good practice. It is usually advisable (but not a legal requirement) for an exclusive licensee of registered IP rights (such as patents or registered trade marks) to register the exclusive licence with the UK Intellectual Property Office. For the leasing or licensing of existing licences, see below, [Key Contracts](#).

Movable Property

A written lease or licence should be entered into as a matter of good practice to record the terms agreed.

Key Contracts

The concept of a contract being leased or licensed is not generally recognised under English law. In practice:

- Rights under a contract can be assigned (subject to consent where necessary).
- Rights and obligations can be novated.
- A third party can exercise rights or perform obligations as an agent or subcontractor of the contracting party.

Therefore, good practice dictates that the customer should:

- Make a written contract that clearly categorises the basis on which it is "leasing" the contract to the supplier.
- Consider the need for counterparty consent.

Data and Information

There are no formalities as such for the licensing or leasing of data or information, except where there is IP in the data, such as copyright, in which case a written agreement should be entered into as a matter of good practice. Consideration should also be given to the inclusion of confidentiality obligations on the recipient of the data or information (see [Question 9](#)).

Transferring Employees on an Outsourcing

8. Are employees transferred by operation of law?

For information on transferring employees in an outsourcing transaction in the United Kingdom, including details of structuring employee arrangements, notice, information and consultation obligations and calculating redundancy pay, see [Country Q&A: Transferring Employees on an Outsourcing in the United Kingdom: Overview](#).

Data Protection and Secrecy

9. What legal or regulatory requirements and issues may arise on an outsourcing concerning data protection?

Following the UK's exit from the EU, the General Data Protection Regulation ((EU) 2016/679) (EU GDPR), together with parts of the UK Data Protection Act 2018 (DPA) became part of retained law in the UK. Additional UK legislation made amendments to both pieces of legislation, appropriate to the continued application of the GDPR and the DPA in the UK which became the UK GDPR (UK GDPR). While the UK GDPR has retained many of the EU GDPR's provisions, there are some differences.

See [Practice Note, UK GDPR and DPA 2018: quick guide](#).

Data Protection and Data Security

The two main legislative instruments governing the protection and processing of personal data in the UK are the UK GDPR and the Data Protection Act 2018 (UK Data Protection Regime). "Personal data" includes any data such as names, contact details, or other data which relates to an identified or identifiable natural person.

The UK GDPR applies to the processing of personal data in the context of the activities of an establishment of a controller or processor in the UK, regardless of whether the actual data processing takes place in the UK. It is therefore likely to apply to most outsourcings involving UK-based businesses, where the services involve processing personal data. The UK GDPR also applies even where the customer or supplier is established outside the UK, provided that the processing activity relates to offering goods and services, or monitoring behaviour, that target data subjects in the UK.

Under the UK Data Protection Regime, issues can arise:

- When an outsourcing contract is being negotiated/concluded or if later, when there is a TUPE transfer of employees (see [Question 8](#)).

- To the extent that the outsourced services require the supplier to process personal data in respect of which the customer is a controller, and that processing is within the scope of the UK Data Protection Regime.

Organisations may also be caught by the EU GDPR if they fall within its territorial scope, for example:

- Where they have an establishment in the EU and their processing of personal data is in the context of the activities of that establishment.
- Where they offer goods or services to data subjects in the EU (from a location outside the EU).

Therefore, an IT supplier based in the EU, providing outsourced IT services to a UK-based organisation, which require the supplier's processing of personal data about UK data subjects, will have to comply with EU GDPR with respect to that processing. This is because it is being done in the context of its EU establishment (even if the actual processing is done at the customer's site in the UK). It may also have to comply with UK GDPR as a result of obligations in its contract with the UK-based customer.

The Network and Information Systems Regulations is the main legislation in the UK which sets out security requirements in respect of non-personal data (see below).

Use of processors and sub-processors. The UK GDPR distinguishes between entities which are:

- Controllers, that is, the entity which determines the purposes and means of processing personal data.
- Processors, that is an entity which processes personal data on behalf of a controller.

For the purposes of many outsourcing arrangements (particularly business process outsourcings), the supplier is likely to be regarded as a processor of data on behalf of the customer. As a result, this section focusses primarily on controller-to-processor arrangements. However, the nature of some outsourced services may mean that in some cases, the supplier is regarded as a controller (or as a joint controller alongside the customer).

Where the supplier is regarded as a processor, the UK Data Protection Regime places certain obligations on controllers. For example, the controller must be satisfied that a processor will implement appropriate technical and organisational measures, particularly in relation to keeping the data safe and secure, and in a way which ensures the protection of the rights of those individuals to whom the personal data relates. The customer/controller must carry out due diligence on the supplier to be satisfied of this. In addition, the contract between the customer/controller and the supplier/processor must include certain mandatory requirements. For example, requiring the supplier to:

- Keep the data safe and secure.
- Only act on the lawful instructions of the customer/controller in respect of the personal data.
- Help the customer/controller to comply with its own obligations, for example in response to data subject access requests or a security breach resulting in loss of personal data.

If a supplier/processor wishes to sub-contract some of the outsourced services to a third-party, prior written authorisation from the controller is required. Any contract with such processor or sub processor must mirror the obligations as regards personal data in the contract with the controller. In addition, the lead processor will remain liable to the controller for the actions or inactions of any sub-processor.

Liability for breaches of personal data processing requirements (for both the customer and the supplier). The customer as controller is liable for ensuring that it only uses processors which meet the requirements of the UK Data Protection Regime (see above). Both controllers and processors are directly liable under the UK Data Protection Regime for complying with the obligation to implement appropriate technical and organisational measures to protect personal data which is processed pursuant to the provision of outsourced services. Processors also have direct liability to only process personal data in accordance with the controller's instructions, and to notify the controller of any breaches involving relevant personal data.

Security requirements. Both controllers and processors must implement appropriate technical and organisational measures to ensure a level of security appropriate to the risk to the personal data which is being processed. Appropriate measures are assessed by reference to a range of factors such as the business sector and established market practice. The UK regulator, the Information Commissioner's Office (ICO), has also avoided being overly prescriptive. However, the ICO has imposed significant fines on businesses for failure to meet this standard. Recent examples include penalties of GBP20 million and GBP18.4 million imposed on British Airways and Marriott International respectively. Industry information security standards such as ISO27001 are also helpful to follow, and it is common practice to ask suppliers whether they have this standard in place.

Mechanisms to ensure compliance. The UK Data Protection Regime is enforced by the ICO, which has extensive powers including the ability to impose significant fines (see below). As between the parties to any outsourcing transaction, the contract documentation will usually impose obligations relating to data protection, often including requirements that staff who are directly involved in handling personal data undertake to observe confidentiality (statutory or otherwise).

Direct liability on processors for certain breaches of the UK Data Protection Regime was a concept which was introduced by the GDPR. As a result, it is more common to see provisions in outsourcing contracts to protect suppliers' positions (to the extent that the customer's actions impact on the supplier's ability to meet regulatory requirements). Also, given the substantial penalties for breach, specific liability apportionment for losses resulting from breach of contractual provisions (and statutory obligations) is more common (with the contracting parties often settling on a special cap in respect of such losses).

Transfer of personal data to third countries. Where personal data is to be exported for processing to a supplier located outside the UK (as in the case of "offshoring") and no "adequacy regulations" (see below) or special derogations apply, additional safeguarding measures must normally be put in place. The most commonly-used safeguarding mechanism to ensure compliant transfers outside the UK is to incorporate a set of standard contractual clauses into the outsourcing arrangement. The ICO issued revised sets of standard contractual clauses, which came into effect on 21 March 2022, to replace the "old" EU model clauses on which businesses previously had to rely. Although there are arrangements in respect of the transition from the old to the new clauses, it is important to ensure that the correct standard contractual clauses are used. These clauses are designed to ensure that the supplier applies the same standards of security as would be applied if the data remained within the UK. As a result of the decision in *C-311/18 Data Protection Commissioner v Facebook Ireland and Maximilian Schrems*, the use of standard contractual clauses as a safeguarding mechanism must be accompanied by a transfer risk assessment. Among other things, this must take account of any local laws which may undermine the ability for the data to be protected to an equivalent standard as that provided in the UK and set out appropriate measures to address these risks.

In some cases, an alternative legal basis for exporting data may be available, which avoids the need for additional safeguarding mechanisms. For example, certain countries are regarded by the UK ICO as "safe destinations" for personal data because their own national law offers an equivalent level of protection to that available in the UK. The countries that benefit from "adequacy regulations" include Member States of the EEA, and those countries in respect of which the EU had granted adequacy decisions prior to 31 December 2020. Alternatively, suppliers may have obtained approval from the UK ICO for binding corporate rules which allow them to export data to other group companies outside the UK, without the need for specific contractual arrangements governing the transfer. See [Practice Note, Cross-border transfers of personal data \(GDPR and DPA 2018\) \(UK\): Schrems II – Binding Corporate Rules](#).

Brexit also has the potential to affect personal data flows out of the EEA to the UK. The adequacy decision adopted by the European Commission in June 2021 in respect of the UK means that the status quo in respect of data transfers from the EEA to the UK has been maintained for the time being. However, the decision is due to expire in 2025 and its long-term future may depend on how the EU reacts to proposed reforms of the UK Data Protection Regime. Without an adequacy decision, organisations within the scope of EU GDPR would have to put in place additional measures in order to continue to transfer personal data to the UK.

Sanctions for non-compliance. The UK ICO can impose civil fines of up to GBP17.5 million, or 4% of the breaching undertaking's annual worldwide turnover in the preceding year, for the most serious breaches under the UK Data Protection Regime. In the case of breach, the ICO can also issue an enforcement notice against a business requiring it to take (or refrain from taking) specified steps to comply with the UK Data Protection Regime.

Under the UK Data Protection Regime, there are a number of criminal offences, notably offences relating to the unlawful obtaining of personal data and selling or offering to sell it.

Individuals can lodge complaints with the ICO in respect of alleged breaches of the UK Data Protection Regime and bring an action for damages against the relevant business, including in some cases, class actions with other affected individuals. Fines can also be imposed for data breaches under sectoral regulatory regimes, for example, financial services firms have been fined substantial amounts for failure to keep customer data secure.

TUPE transfers. Even where the actual services being outsourced do not involve personal data, the UK Data Protection Regime may have implications in respect of employees who are transferring from the customer to the supplier. Care should be taken to ensure that personal data relating to such employees is shared and transferred in a lawful manner, with a clear legal basis under the UK Data Protection Regime for the transfer. Any personal data transferred outside the UK will need to be transferred using one of the safeguarding mechanisms outlined above (see above, Transfer of personal data to third countries).

Network and Information Systems Regulations. These regulations apply to organisations which supply national infrastructure (for example, in sectors such as electricity supply, oil and gas, water, transportation, healthcare and digital infrastructure, including cloud storage providers) and meet certain thresholds, together with relevant digital service providers. In brief, the regulations require such organisations to take appropriate technical and organisational measures to manage the security risks posed to them (for example, by taking appropriate measures to protect against cyber-attacks). The regulations apply, indirectly, to any data that an organisation holds (including non-personal data) and which may be affected by the obligation to take appropriate technical and organisational measures.

Where an outsourcing relates to an activity covered by the regulations, it will be important to ensure that the outsourced activities continue to meet the relevant standards, for example, by mirroring the requirements on the customer by the regulations in obligations imposed on the supplier in the outsourcing contract.

The maximum penalty for breach of the regulations is GBP17 million. As with the UK Data Protection Regime, competent authorities under the regulations can issue enforcement notices, and have powers to investigate and audit compliance of organisations which fall within their scope.

Banking Secrecy

General requirements. Case law has long established that banks owe their customers a duty of confidentiality under English law, subject to certain qualifications, namely, they can disclose information about a customer where:

- They are required to do so by law.

- It is in the public interest.
- It is in the interests of the bank (for example, in the course of instituting proceedings to recover loans).
- They have the client's express or implied consent (for example, under an agreement permitting disclosure or setting out exceptions to the duty of confidentiality).

In any event, UK banks are dual-regulated by the FCA and the PRA (see [Question 2](#) and below, [Confidentiality of Customer Data](#)).

While the common law and the constraints of the data protection legislation impose obligations on banks to keep information confidential, tensions arise by virtue of:

- The commercial aspirations on the part of banks (that is, to transfer information to networks of bankers and affiliates and to outsource functions, to trade and transfer their debt and to share information on defaulting customers).
- Increasing legal and regulatory initiatives requiring disclosure to counter tax avoidance and evasion (such as the US Foreign Account Tax Compliance Act and the UK regulations promulgated under the UK/US intergovernmental agreement).
- Obligations under anti-money laundering and terrorist financing legislation.

Sanctions for non-compliance. Breach of a banker's duty of confidentiality can give rise to:

- Damages claims.
- Injunctions preventing further unauthorised use of the relevant information.
- Where the relationship between the bank and its customer is, by virtue of special or exceptional circumstances, determined to be a fiduciary relationship, the bank may be obliged to account to the customer for profits made by virtue of confidential information.

Confidentiality of Customer Data

General requirements. In addition to being subject to the UK Data Protection Regime, and potentially other data protection laws as well, such as the EU GDPR, (see above, [Data Protection and Data Security](#)), most outsourcing firms handling data on their customers' behalf are likely to be subject to a duty of confidence towards their customers and potentially also to third parties (for example, their customers' clients).

Financial services. Financial services firms can also be in a fiduciary relationship with their clients, in which case they will be subject to a fiduciary's duty of confidence under English law.

In addition, a duty of confidentiality may arise under FCA and/or PRA rules. For example, SYSC 8 includes a requirement that an outsourcing firm must ensure that the supplier protects any confidential information relating to the firm and its clients.

Mechanisms to ensure compliance. A firm engaging in an outsourcing must ensure that the supplier protects any confidential information relating to the firm and its clients. Generally, firms must ensure that their terms include adequate contractual provisions (including rights of redress and termination) and that their due diligence, oversight and ongoing monitoring procedures are robust. Amongst other measures, firms should consider the following:

- Conducting assessments of the risks associated with any data-processing outsourcing arrangements (including due diligence on security measures and IT systems).
- Carrying out ongoing monitoring of their supplier.
- Instituting procedures to ensure that adequate management information is received relating to monitoring and due diligence procedures.
- Setting up reporting lines with their supplier.
- Appointing a single manager with overall responsibility for data security.
- Properly training staff.

Sanctions for non-compliance. Breach of confidence in relation to customer data can give rise to:

- Damages claims.
- Injunctions preventing further authorised use of the relevant information.

Businesses may also face enforcement action by the ICO, including fines (see above, General Requirements). Firms in the financial services sector may be exposed to enforcement action by the FCA and/or PRA (as applicable) for failing to protect customer data (based on financial services legislation rather than data protection law).

Supply Chain Compliance

10. What (if any) compliance provisions should an outsourcing customer include in the contract?

There are no specific requirements which must by law be passed onto service providers (other than in the context of a service provider that is acting as a data processor (see [Question 9](#)) and, potentially, the sectoral legislation discussed in [Question 2](#)). However, there are several areas where it would be recommended for the customer to guard against supply chain risks.

Slavery and Human Trafficking

If the applicable thresholds are met (the key one being an annual turnover of GBP36 million or more), the Modern Slavery Act 2015 requires the customer to report on its due diligence processes in relation to slavery and human trafficking in its business and supply chain. As well as satisfying itself at the outset of a relationship that a potential business partner is not engaged in any such conduct, the customer may ask suppliers to adhere to its own modern slavery policy or at the very least warrant to act in compliance with the Act and avoid commission of the slavery and trafficking offences. The company would in all likelihood want to report on measures of this kind in its compulsory modern slavery statement.

Anti-bribery and Corruption

Similarly, many companies have anti-bribery and corruption policies which assist in proving compliance with the UK's Bribery Act 2010 and in particular in proving the defence that a company had "adequate procedures" to prevent bribery. Although there is no legal requirement to include them, the official guidance suggests that contractual provisions are a key way of managing bribery risks. Many outsourcing contracts would require suppliers to adhere to the company's Anti-Bribery and Corruption (ABC) policy or provide evidence of its own policy, to contain no less stringent provisions.

Anti-tax Evasion

Less frequently, an anti-tax evasion provision will also be included, to prove that the company had reasonable prevention procedures in place, but such a clause in isolation is unlikely to be enough to protect a company from prosecution.

Data Processing Provisions

Where the supplier is acting as a data processor, the UK GDPR requires certain mandatory terms to be included in the contract (or in a separate data processing agreement). For further details, see [Question 9](#).

Broader Supply Chain Due Diligence

In the context of a strong focus on environmental, social and governance (ESG) matters, it is increasingly common to find contractual provisions which require counterparties to adhere to high standards of ESG conduct. These may reference specific international norms (for example, applying the UN Guiding Principles on Business and Human Rights). Legislation is in development that will require certain organisations to conduct due diligence on their supply chain. In this context, organisations are likely to use contractual terms to ensure that suppliers act accordingly, particularly to avoid environmental damage.

Other

Depending on the nature of the contract, the contracting party and the service provided, it may also be advisable to include provisions which require the service provider (and any subcontractors):

- To obtain all necessary permits, consents and licences required for delivery of the service (which may cover everything from planning permission to environmental permits to export licences).
- Not to do anything to cause the customer to lose or breach any permit, consent or licence on which it relies.

A catch-all "compliance with laws" provision could ultimately be relied on if the contract contains no more stringent or specific protections.

Services: Specification, Service Levels and Escalation

11. How is the service specification typically drawn up and by whom?

The parties usually draft the services specification together, although the supplier often takes the lead, based on its previous experience of similar projects.

Where, after contract signature, the parties agree to develop a detailed specification of the services, the customer's requirements can be attached to the contract as a separate schedule. Usually in these circumstances:

- There is an obligation on the supplier to ensure that the service description or specification is developed to reflect the customer's requirements.
- The customer's requirements are stated to take precedence over the service description.

With longer-term contracts in particular, parties may also wish to provide for enhanced termination rights or break clauses if changes in circumstances may undermine key commercial assumptions on which the contract is based. As the services specification may need to change over time, parties should include a change control procedure making clear (among other things) how the extra costs of any changes should be allocated.

12. How are the service levels and the service credits scheme typically dealt with in the contract?

The parties usually identify and agree a set of objective, measurable criteria to measure performance (key performance indicators (KPIs) or service levels). These could be that deliveries of products in a logistics contract will be made within specific time periods or that telephone calls to a call centre will be answered within a defined period. These service levels are combined with a:

- Process for recording and reporting on success or failure in achieving the targets.
- Formula under which financial compensation is paid to the customer if targets are not met (for example, variance from the required level of performance by a specified percentage). These are referred to as service credits or liquidated damages.

The service levels and service credits can form part of the services specification or are laid out in a separate schedule to the main agreement (service level agreement (SLA)).

Generally, the service credits are offset against the fees otherwise payable to the supplier and are usually relatively modest. The aim is to compensate the customer for poor service without the need to pursue a claim for damages or terminate the contract, and to motivate the supplier to meet the performance targets.

The service credits should be expressed to be the sole remedy of the customer for the particular failure concerned, but this should be without prejudice to the customer's wider rights in relation to more serious breaches of the contract or persistent failures in performance, both of which should also be dealt with (see [Question 19](#), and [Question 24](#)). Service credits are generally enforceable, provided they do not amount to a contractual penalty (i.e. their effect on the contract breaker is not out of all proportion to the legitimate interest which they are designed to protect).

Establishing a baseline against which the service credits will be measured can form part of a due diligence exercise which precedes or follows contract signature. For longer term contracts, it is common to include a change of control procedure designed to allow service levels to be reviewed and modified to reflect changing circumstances.

If Brexit is considered likely to undermine key commercial assumptions on which the contract is based, parties may also wish to provide for enhanced termination rights/break clauses (see [Question 24](#)) or rights to re-negotiate certain aspects of the contract (see [Question 31](#)).

13. Are there any service escalation mechanisms that are usually included in the contract? How often are these exercised and how effective are they in restoring the services to the required levels?

Escalation mechanisms are commonly included in contact documentation. However, it is not recommended that the parties should rely on them as the sole means of addressing issues with service provision. They should instead be viewed as part of a "package" of measures designed to promote resolution of problems with service provision. The precise content of that "package" is a matter for negotiation but will typically include at least some of the mechanisms discussed in [Question 20](#).

Transaction Management

Organisational Structures and Change Management

14. What types of organisational structures are commonly used to govern outsourcing transactions?

It is common for each party to appoint one or more contract representatives to deal with operational issues. The level of formality surrounding this process varies, often depending on the scale and complexity of the outsourcing. For example, some contracts may simply provide for the contract representative to be a "first point of contact" if issues arise, whereas others may impose extensive reporting requirements on the supplier, provide for regular meetings to review progress and require input from a variety of staff with responsibility for different aspects of the contract (similar to an operational committee).

These governance mechanisms can be helpful in overcoming operational problems where the contract representatives co-operate and are able to agree a way forward. However, it is important to ensure that, if changes are proposed, they are dealt with in accordance with the change management procedures of the contract (see [Question 15](#)). There should also be a clear procedure for escalating any issues in cases when agreement cannot be reached (see [Question 13](#)).

15. What change management models are commonly used to govern outsourcing transactions?

Most outsourcing contracts contain a "change control" procedure, which allows either party to request a change. Certain changes, such as those required to comply with changes in the law, may be classified as mandatory (and in such scenarios the non-requesting party will be obliged to implement the change). For these situations, it is important to specify which party will bear the cost of the change.

There should also be a clear procedure, ideally with timescales attached, for the agreement of requested changes and their documentation and incorporation into the contract. Typically, this will require the supplier to provide estimates of the cost and impact on the services and a timetable for their implementation. There should also be an escalation procedure if agreement cannot be reached (see [Question 13](#)).

The customer may wish to specify that it is entitled to request additional services. Although it would be unusual for these to be mandatory changes, the supplier may be obliged to respond reasonably and in good faith to such a request and to adopt the same pricing models as those which apply in relation to the existing services.

Flexibility in Volumes Purchased

16. What mechanisms are commonly used to manage adjustments in the volume of services?

If the customer's needs change so that it requires higher or lower volumes from the supplier, this would normally be addressed by making a request under the change control provisions of the contract (see [Question 15](#)). The extent to which the supplier can be obliged to accept the change will depend on the terms of the contract. For example, where the customer anticipates an increase in volumes, it will generally be advisable for it to negotiate a commitment from the supplier to meet such additional demand, should the customer require it. In the absence of such a contractual commitment, the level of flexibility which the supplier can offer is likely to depend on the extent to which it will need to make additional investments and how long it will take to bring those investments "on stream". Conversely, where the supplier is investing on the basis of an assumed level of volume purchases by the customer, it is likely to resist any attempt by the customer to reduce the fees due based on lower volumes.

Typically, most change control provisions only permit material changes where required by law or when both parties can reach agreement; it follows that (in the absence of any provisions specifically addressing the issues) the level of flexibility in practice will be heavily dependent on the approach to charging (see [Question 17](#)) and the ability and willingness of the supplier to accommodate any changes requested by the customer.

Charging Methods and Key Terms

17. What charging methods are commonly used on an outsourcing?

The parties will adopt different approaches to charging depending on, among other things:

- The type of services being provided.
- Whether the supplier is appointed on an exclusive basis.
- Risk allocation between the parties.

A typical outsourcing contract adopts one, or a combination, of cost plus, fixed price and/or pay as you go.

Cost Plus

The customer pays the supplier both:

- The actual cost of providing the services.
- An agreed profit margin.

There are usually additional provisions to ensure that:

- Costs are assessed on an agreed and transparent basis, which the customer can review (open book).
- Indirect costs (such as overheads, or the cost of investment in new assets, amortised over a specified period) are included on an agreed basis.

In addition, the customer usually includes measures to control costs, such as:

- An external third-party review to establish typical market prices (benchmarking).
- A pre-agreed inflation adjuster to regulate price increases or decreases (indexation).
- Measures to share cost savings between the parties and provide an incentive to the supplier to achieve these.
- A mechanism to assess and agree the cost impact of changes in the scope or level of services (charge variation mechanisms).
- A mechanism for agreeing annual budgets, which must then be adhered to, subject to permitted variances.

Fixed Price

A fixed price is often used where there will be a regular and predictable volume and scope of services (for example, payroll), and the customer wants certainty for budgeting purposes.

Pay as you Go

The customer pays a pre-agreed unit price for specific items of service (such as volumes of data processed or deliveries made), often based on a rate card (that is, a schedule of fees for each item of service). The supplier may want to add a minimum fee. It is often used where the level and volume of services is less predictable.

Particular consideration can be needed concerning how (if at all) the supplier will be allowed to recover implementation costs (for example, as a specific item of charge, linked to the achievement of measurable milestones or targets, or in an agreed manner over the life of the contract).

18. What other key terms are used in relation to costs, including auditing and benchmarking mechanisms?

The principal terms used in relation to costs are:

- Charge variation mechanisms.
- Payment terms/interest on late payment.
- Indexation.
- Benchmarking.
- KPIs.

(See [Question 11](#) and [Question 12](#)).

Customers can seek a right to suspend payment in the event of a genuine dispute over costs, but for obvious reasons many suppliers will be reluctant to agree to this. Disputes as to costs would generally be dealt with through the normal dispute resolution provisions of the contract; where the dispute as to costs is of a technical nature, the contract may provide for resolution by means of expert determination (see [Question 31](#)).

Customer Remedies and Protections

19. If the service provider fails to perform its obligations, what remedies and relief are available to the customer under general law?

The customer has a number of remedies, including:

- Damages.

- Specific performance/injunction (available at the discretion of the court).
- Termination.

20. What customer protections are typically included in the contract to supplement relief available under general law?

Customer protections typically include:

- A detailed measurement of service performance (often by reference to KPIs (see [Question 12](#))) and reporting of actual and foreseeable problems usually combined with audit rights.
- Service credits or similar (see [Question 12](#)).
- Indemnity from the supplier for loss suffered by the customer in specified circumstances.
- Other forms of financial penalty, such as loss of exclusivity, a reduction in the minimum price payable to the supplier or the right to withhold payment.
- Step-in rights allowing the customer to take over the management of an under-performing service or to appoint a third party to manage the service on its behalf.
- Specific provision for termination in defined circumstances (for example, material breach and insolvency) (see [Question 24](#) and [Question 26](#)).
- A requirement for the supplier to hold insurance (for example, for damage to persons or property) and note the customer's interest on its insurance policy (see [Question 23](#)).
- A parent company guarantee
- Warranties (see [Question 21](#)).
- An appropriate governance or escalation structure under which each party appoints specified relationship managers to manage problem areas and to escalate them to higher levels if solutions cannot easily be found (see [Question 13](#)).

Warranties and Indemnities

21. What express warranties and/or indemnities are typically included in the contract documentation?

Typical supplier obligations are to:

- Confirm that it is entitled to enter into the contract and perform its obligations.
- Perform the services with reasonable skill and care in accordance with good industry practice, in a timely and professional manner and in accordance with all applicable laws and regulations.
- Indemnify the customer against harm suffered due to the supplier's actions. This can be limited to harm suffered due to default (for example, wilful misconduct, negligence or breach of contract) or can extend to situations where the supplier's liability is not based solely on fault (for example, if performance of the services infringes third-party IP rights).
- Indemnify the customer against future liability in respect of employees transferred to the supplier as part of the outsourcing.
- Indemnify the customer and any replacement supplier against employees transferring to the customer/replacement supplier upon termination of the outsourcing contract under TUPE (see [Question 8](#)).
- Confirm that material information provided in the pre-tender and tender stages was and remains accurate, complete and not misleading (for example that the statements made about its services or its financial resources are true).
- Make other assurances specifically related to the project or type of services (for example, that the supplier has particular accreditations or operates in accordance with a particular quality assurance system). Many of these can be covered by specific contract terms (for example, in the Service Level Agreement (SLA)) instead of in the warranties section.

Typical customer obligations are to:

- Confirm that it is entitled to enter into the agreement and perform its obligations.
- Confirm that the information provided during the pre-tender and tender stages is accurate, complete and not misleading.
- Make assurances as to title, condition and maintenance of assets transferred to the supplier, including the absence of outstanding liabilities under contracts transferred (although there can be negotiation over exactly how the customer will transfer these).
- Indemnify the supplier against historic liability relating to employees transferred to the supplier as part of the outsourcing.
- Indemnify the supplier against any employees claiming unexpectedly that they should have transferred to the supplier as part of the outsourcing.

22. What requirements are imposed by national or local law on fitness for purpose and quality of service, or similar implied warranties?

English law implies contractual terms that goods are fit for purpose and of satisfactory quality, and that services will be performed with reasonable skill and care.

The contract often specifically excludes these terms and replaces them with specific wording, with the intention that all relevant obligations are set out expressly in the parties' written agreement. In relation to limits on the right to exclude these terms, see [Question 28](#).

23. What types of insurance are available in your jurisdiction concerning outsourcing? Are there any types of insurance required by law?

The business insurance market in England and Wales is well developed and numerous different types of policy are available. The following are probably most relevant to outsourcing arrangements:

- Employer's liability insurance (in the UK, businesses must obtain this cover).
- Professional indemnity insurance (for example, to provide cover against claims for negligence in the performance of outsourced services).
- Business interruption insurance.
- Fidelity or Employee Dishonesty Insurance (to provide cover against fraud committed by employees).
- Public liability insurance.
- Land and buildings insurance.
- Directors' and officers' insurance (to cover directors and officers of a company against claims brought against them in that capacity).
- Cyber-liability insurance (to cover against a range of IT-related risks, such as loss of digital assets or data breaches).

Termination and Termination Consequences

Events Justifying Termination

24. What events justify termination of an outsourcing without giving rise to a claim in damages against the terminating party?

The following events are generally considered sufficiently serious to justify immediate termination:

- A particularly severe breach.
- A breach that indicates that the counterparty no longer wishes to continue with the contract.
- The other party's insolvency, so that it is unable to perform its duties under the contract.

However, parties generally specifically provide termination events in the contract.

Repudiatory Breach and Material Breach

English law provides that the innocent party will normally have the right to terminate and claim damages if the counterparty breaches a condition of the contract. This is known as a "repudiatory breach". A term is likely to be regarded as a condition where its breach would deprive the innocent party of "substantially the whole benefit of the contract". The right to terminate for breach of a condition normally exists alongside any express contractual termination rights. Most outsourcing contracts also permit termination in the event of "material breach" (which would potentially include breaches which are less severe than a breach of condition). However, termination for such lesser breaches requires an express provision in the contract. It is usual to include a cure period in which the injured party gives written notice of any material breach (provided it is remediable) and allows the counterparty a reasonable period (often 30 to 60 days) in which to remedy it. If the breach is irremediable, the contract may provide for it to be terminated immediately (since any cure period will be irrelevant).

Insolvency Events

Commercial contracts normally contain provisions allowing either party to terminate immediately if the other is the subject of some form of insolvency proceedings (although in some cases, a party can be prevented from doing so, see below). If either party enters into an insolvency process, an administrator may decide not to honour existing contracts. If the administrator wishes the contract to continue (and the solvent party agrees not to exercise any contractual right to terminate), the debts due under the contract are classified as an expense of the administration and rank higher than unsecured debts on the final distribution of assets. If the administrator elects not to perform as originally agreed, the innocent party can terminate, but the right to sue for breach of condition (see above) will be of little value. On liquidation, the liquidator has the right to disclaim obligations under contracts which he/she considers to be onerous.

Termination for Convenience

English law allows the parties considerable freedom to decide in what circumstances the contract should be terminable. For example, a customer may seek a right to terminate a long-term outsourcing contract on notice, prior to expiry of the full term, without payment of compensation. However, where the supplier is making significant investments in the service, it may not be prepared to accept such a provision at all, or may insist on provision of compensation in the event of early termination (which will be enforceable provided that the level of compensation is a genuine pre-estimate of the supplier's loss arising from early termination, rather than a contractual penalty).

It is also possible to draft termination provisions in a way which would potentially allow termination where insolvency proceedings appear to be imminent but have not actually begun. For example, suppliers may wish to consider this if they are concerned about constraints on their ability to terminate in response to insolvency events (see below). However, as such clauses tend to be mutual, the party seeking a right to terminate for "near insolvency" needs to be prepared to accept that the same termination rights may be invoked against it.

The following restrict the ability of the parties to terminate in reliance on an insolvency event:

- **Special Administration Regime for investment banks.** Under this, providers of certain key utilities and other services cannot terminate their agreements until the insolvent customer has found alternative suppliers.
- **Section 233 of the Insolvency Act 1986 (as amended).** Similarly, this provides that suppliers of essential services (such as utilities and certain IT services) cannot terminate contracts with an insolvent customer unless certain conditions are met.
- **Corporate Insolvency and Governance Act 2020.** This prevents suppliers of goods or services (other than those covered by the section 233 of the Insolvency Act 1986) relying on any contractual provision which would allow the supplier to terminate or to do "any other thing" as a result of its customer becoming subject to a "relevant insolvency procedure" (which is broadly defined and includes administration, liquidation and entry into a Creditors' Voluntary Arrangement or CVA).

Other

In addition, the contract may contain provisions for termination where:

- An event of *force majeure* (as defined in the contract) has occurred.
- Minor but persistent breaches have occurred (with the type of breach and number of breaches needed to trigger the termination right defined in the contract).
- There has been a change of control (ultimate ownership) of the supplier.

25. What remedies are available to the contracting parties?

As outlined in [Question 19](#), the main remedies available to the parties under the general law in response to a breach are damages, termination and (exceptionally) specific performance or injunction (available at the discretion of the court). However, many outsourcing contracts modify and/or supplement the remedies available under the general law with some or all of the following:

- Liquidated damages and/or service credits, entitling the customer to recover specified amounts for delays or poor performance.
- Indemnities in respect of specific types of loss.
- The ability (in relation to a complex services outsourcing) for the customer to terminate the provision of some services, but not others.
- Where services have not been provided in accordance with the contract, a right of the customer to require the supplier to re-provide the relevant services to the appropriate standard.

- Step-in rights, allowing the customer to take over the management of an under-performing service or appoint a third party to manage the service on its behalf.

Exit Arrangements

26. What mechanisms are commonly used to address exit and post-termination transition issues?

Customers will often wish to include provisions requiring the supplier to:

- Prepare an exit plan in advance (to be approved by the customer).
- Provide reasonable assistance with any migration to a new service provider and co-operate with that provider.
- Continue to provide some or all services for a certain period following termination, ideally sufficient time to allow migration to a new service provider to be completed.
- Return any property of the customer and delete copies of customer data (but only after the latter have been provided to the new service provider).

Where the supplier has developed or acquired assets (including IP rights) specifically to meet the customer's needs, it may be appropriate to include provisions for the buy-out of those assets and their transfer to the new service provider or the customer. Similarly, it may be appropriate to impose obligations on the supplier to use best or reasonable endeavours to novate or transfer any key agreements with subcontractors in favour of the new service provider or the customer.

Intellectual Property Rights

As regards IP rights, consideration may need to be given to how far any IP developed specifically for the customer relies on IP of the supplier (so called "background IP"), which it needs to retain for the purposes of its ongoing business. In such cases, it will not be appropriate for the IP rights in the background IP to be transferred to the customer. Instead, the contract will need to provide a licence for the customer to continue to use any such background IP, but only for purposes connected with performance of the relevant services.

Where the customer licenses IP rights to the supplier in connection with the outsourcing, the licence terms generally govern the continued use of those rights by the supplier post-termination (either in the main agreement or a separate document). The customer is usually reluctant to agree a continuation unless it receives some benefit. Where there is no specific agreement and a licence has been implied, it is generally implied that the licence ends on termination. The parties can (and should) make specific provision to regulate how far either will remain entitled to use the other's IP rights post-termination.

Employees

Some outsourcing contracts involve a dedicated group of the supplier's employees working primarily for the customer. In such cases, it may be desirable from the customer's perspective for those staff to transfer to the new service provider on termination,

as they will already be familiar with the customer's requirements. Legally, dedicated staff would usually transfer by operation of law to the new service provider.

However, achieving this in practice is not always straightforward and requires careful consideration of the legal and practical issues discussed in *Country Q&A: Transferring Employees on an Outsourcing in the United Kingdom: Overview*).

In particular, the customer may wish to:

- Provide that any changes to staff forming part of the core service team can only be made with its consent (otherwise it may find that the supplier has moved particular staff which it wishes to retain into different teams, servicing the needs of other customers; this in turn makes it less likely that they will transfer to the new service provider on termination).
- Impose a requirement on the supplier to provide it with information about the number of employees in any dedicated team, their seniority, salary costs and so on. This is particularly helpful when customers are at the stage of negotiating with a new service provider to take over the outsourced service.

In contrast, a new service provider may not wish to inherit the outgoing supplier's employees and may want the ability to dismiss any employees that transfer by operation of law, as well as protection from the associated costs of doing so.

Other

In addition, the contract will usually include confidentiality obligations that survive termination. In some cases, there may be a need for provisions requiring the customer to return property of the supplier or delete copies of the latter's IP, such as software.

27. To what extent can the customer (or if applicable, its new service provider) gain access to the service provider's know-how post-termination and what use can it make of it?

To the extent that specific IP rights cover the supplier's know-how, the customer's ability to gain access is likely to depend on the terms of any agreement governing use of IP rights post-termination (see *Question 26*).

Where the know-how is in the supplier's confidential information, the customer usually expressly undertakes to maintain the information in confidence and use it only in connection with the outsourcing contract. However, if the know-how is the skill and experience of employees engaged in performing the services and the employees transfer to a new supplier (or back to the customer) under TUPE (see *Question 8*), the customer can benefit from these skills (but not from specific confidential information).

Where the supplier develops know-how (or IP rights) during the term of the outsourcing contract for use in the performance of the services, or otherwise embeds its IP into the assets and systems of the customer, the customer usually requires a written licence to continue using the know-how or IP.

Liability, Exclusions and Caps

28. What liability can be excluded?

The parties are generally free to exclude most forms of liability, subject to a number of important conditions outlined below:

- An exclusion of liability for fraud or fraudulent misrepresentation is unenforceable and should be carved out from any general exclusion of liability.
- Explicit wording is usually required if exclusions or limitations are intended to apply to liability arising from a party's negligence or deliberate breach.
- Exclusions or restrictions of liability for negligent or innocent misrepresentation must satisfy the requirement of reasonableness in the Unfair Contract Terms Act 1977 (UCTA).
- Under UCTA, it is not possible to exclude or restrict liability for death or personal injury resulting from negligence. In the case of other loss or damage, the exclusion or restriction of liability for negligence must satisfy UCTA's reasonableness requirement.
- If the parties are dealing on written standard terms of business, any exclusion or restriction of liability for breach of contract must satisfy UCTA's reasonableness requirement. However, in an outsourcing contract, there is likely to be considerable debate as to whether a liability provision (which will usually have been negotiated) is part of the written standard terms.
- Implied terms as to title to assets cannot be excluded or restricted, while those relating to satisfactory quality, fitness for purpose and certain other matters can only be restricted where this meets UCTA's reasonableness requirement.

Subject to the above, a supplier will usually aim to exclude liability for:

- Indirect and consequential loss.
- Loss of business, profit or revenue, where these constitute a direct loss.

In contrast, the customer will usually try to ensure that it is able, under the contract, to recover all its direct loss (including direct loss of profit, business and revenue). It can also specify particular heads of loss that are recoverable to evidence that these are agreed to constitute direct loss. In practice, these are subject to negotiation.

29. Are the parties free to agree a cap on liability and, if desirable, a cap on indemnities? If so, how is this usually fixed?

The parties can and frequently will agree a financial limit on liability, subject to the limitations set out in [Question 28](#). This can be a fixed amount, or a percentage or multiple of the contract value (for example, 125%). In negotiating the amount of any cap, account will usually be taken of the overall value of the contract, the potential damage to the customer's business if the supplier fails to perform and the availability of insurance against potential risks.

The extent to which any cap will be held reasonable under UCTA (in cases where it is required to be reasonable) is uncertain. Current practice suggests that a percentage is better than a fixed sum, and that anything under 100% of the contract value can be held to be unreasonable, where the liability covered is significant. When using this approach, it is important to:

- Define contract value.
- Identify any areas where the liability should not be subject to a cap (for example, the supplier's indemnity in relation to IP rights and/or TUPE is often unlimited).

The supplier should take care that the drafting of the cap does not restrict its right to recover for non-payment of charges that are properly due to it from the customer.

30. What other provisions may be included in the contract to protect the customer or service provider regarding any liabilities and obligations arising in connection with outsourcing?

Most outsourcing contracts will contain *force majeure* provisions designed to relieve the parties of liability if performance is prevented by certain matters beyond their control, such as extreme weather events or government decisions to make certain activities illegal (such as through the imposition of any sanctions). The customer will typically prefer the scope of this clause to be relatively narrow and may wish to exclude any events which the supplier could reasonably have been expected to plan for in advance. It may also seek a right to terminate if non-performance continues beyond a specified period.

Both parties may seek to include acknowledgements in the contract with a view to limiting the scope of their overall liability. For example, suppliers will typically seek to include an acknowledgment of non-reliance by the customer on any pre-contractual statements not expressly incorporated into the contract. In practice, such provisions can often make it difficult for customers to bring claims based on alleged pre-contractual misrepresentations (such as promises made by sales staff during negotiations, but which were not written into the contract).

Similarly, the customer may wish to include an acknowledgement that the supplier has been provided with sufficient information and carried out sufficient due diligence on the customer's business to establish that it will be in a position to carry out the services to the standards required under the agreement. This makes it more difficult for the supplier to argue that any failure to meet those standards arose because it could not reasonably have been expected to appreciate how certain key aspects of the customer's business were organised.

More generally, careful attention should be paid to the service specification (see [Question 11](#)) to ensure that it adequately describes what is required. From the supplier's perspective, it may sometimes be beneficial to specify what is not required as part of the services. See also [Question 20](#) on customer protections and [Question 21](#) on warranties and indemnities.

Dispute Resolution

31. What are the main methods of dispute resolution used?

The main methods of dispute resolution used in this area are set out below.

Alternative Dispute Resolution (ADR)

ADR covers a wide range of procedures, outside traditional arbitration and litigation, from internal conflict escalation steps to more formal mediation processes. Some forms of ADR are automatically binding (such as expert determination (see below)) and some are non-binding. Mediation is a popular ADR mechanism. The mediator, who is appointed by the parties in dispute, acts as a neutral third party. They are not a judge of the merits of each party's case, but facilitate a settlement negotiation, reminding each party of the strengths and weaknesses of their position (in negotiation terms) where appropriate. Mediation is confidential and allows for flexibility, both in terms of the format of the process and in terms of the settlement outcomes that can result. Mediation is not binding unless and until the parties enter into a settlement agreement. The contract should therefore make provision for either arbitration or litigation where mediation is unsuccessful. The English courts will uphold an obligation on a party to make use of an ADR procedure (prior to initiating litigation, for example), provided that the clause sets out the procedure to be followed in sufficient detail. This can be achieved by incorporating the rules of an external ADR body such as those of the Centre for Effective Dispute Resolution.

Expert Determination

Expert determination is a private ADR procedure which has been contractually agreed, with the parties agreeing to refer their dispute to a single expert (for example, an accountant if the dispute relates to a financial matter), whose ruling will be final and binding. Unless specifically agreed, the expert is not required to give reasons and there is generally very little scope for appeal.

In practice, expert determination tends to be reserved for disputes concerned with specific aspects of the contract, usually of a technical nature, such as pricing or service levels. Provision should therefore be made for resolution of other disputes by arbitration or litigation.

Litigation

Litigation involves bringing proceedings to resolve the dispute in the courts. Advantages (as compared with arbitration) include the ability to join third parties, such as subcontractors or other suppliers, so that related disputes can be resolved through one set of proceedings. The English courts are generally well respected with broad order-making powers. Judges in the Technology and Construction Court and the Commercial Court also have considerable experience of hearing disputes involving complex contracts, including outsourcing arrangements. Disadvantages include cost (although only as compared with ADR) and publicity (since the proceedings and the outcome will be a matter of public record). For contracts with a cross-border element, the ability to enforce an English court judgment in relevant overseas jurisdictions should be considered. There may be potential difficulties with the enforcement of some English court judgments in the EU following Brexit.

Arbitration

Arbitration is a private dispute resolution procedure which has been contractually agreed, with the parties agreeing to be bound by the outcome. Potential advantages (as compared with litigation) include the ability for the parties to define their own procedure, appoint persons with relevant experience as arbitrators and keep both the proceedings and the outcome confidential. It is also generally easier to commence arbitration against foreign counterparties and, in certain countries, arbitration awards are easier to enforce. The enforcement of arbitral awards in the EU is generally unaffected by Brexit. Disadvantages include the inability to join third parties, such as subcontractors or other suppliers (which means that related disputes with those parties will have to be resolved by separate proceedings). Arbitration is also usually more expensive than ADR or expert determination and can sometimes be more expensive than litigation.

Arbitration and litigation are mutually exclusive. As such, if the contract provides for arbitration, the parties cannot initiate court proceedings instead, unless they subsequently agree to do so. However, subject to that point, it is possible to use a combination of different approaches (for example, the contract may provide for ADR initially, followed by either litigation or arbitration if ADR proves unsuccessful, but with certain narrowly defined disputes being subject to expert determination).

Tax

32. What are the main tax issues that arise on an outsourcing?

Transfers of Assets to the Supplier

Where the customer transfers assets to the supplier, there is an actual or deemed sale. The actual price or deemed market value (as appropriate) is treated as disposal proceeds for tax purposes and so can give rise to either a profit (on which tax is due) or a loss (which can be relievable against other tax charges of the customer). In practice, this is not usually a significant concern in outsourcings as typically very few assets of value are transferred. Since the outsourced business will generally have been run as a cost centre within the customer's business, it cannot typically be argued to have any goodwill associated with it. Moreover, assets transferred are often IT equipment or similar, which has minimal second-hand value.

The question also arises of whether the customer is required to charge VAT on the transfer of the assets. In some circumstances, the customer can argue that it is transferring part of its business as a going concern and VAT need not be charged. However, even when VAT is chargeable, it is not usually a significant issue, as any price for the assets is often nil or minimal.

Transfers of Employees to the Supplier

From the date of the transfer, the supplier becomes responsible for the calculation and payment of:

- PAYE income tax.
- National insurance.
- Apprenticeship levy.
- Health and social care levy.

Exceptions apply where the:

- Supplier makes payments to the customer's employees before the business is transferred to it.
- Customer makes payments to the employees that the supplier acquires after the business has been transferred.

VAT or Sales Tax

Due to the nature of the services provided by the supplier, VAT usually applies. Where the supplier and the customer are both based in the UK, the supplier charges and collects VAT in the usual way. However, depending on the nature of the services, where the supplier is based outside the UK, it is likely that the supplier would not have to charge VAT.

Depending on the location of the customer, the customer may be required to operate the reverse charge procedure and account for VAT relating to the supply, as if it had made the supply itself.

Where the customer's business is fully taxable, it should be able to recover the VAT in full (whether it was paid to the supplier or accounted for it under the reverse charge procedure). However, where the customer's business is not fully taxable, the VAT is not fully recoverable (whether paid conventionally or through the reverse charge procedure). Therefore, the outsourcing gives rise to a significant tax cost. This is a significant issue in the financial services and insurance industries.

Service Taxes

Aside from VAT (see above, [VAT or Sales Tax](#)), there are no significant service taxes on an outsourcing in the UK.

Stamp Duty

Stamp duty or stamp duty land tax (or the equivalent in UK jurisdictions other than England) can arise on:

- Transfers of, or the grant of leases in respect of commercial real property at up to 5%, and up to 17% for residential property (based on rates in force from April 2021 and depending on the value and the identity of the purchaser).
- Transfers of UK shares in companies at 0.5% (although this is rarely relevant to an outsourcing).

Corporation Tax

Companies subject to UK corporation tax on their profits (including gains) are liable to pay corporation tax at 19% (based on the rates in force in February 2022). The main rate of corporation tax is due to be increased to 25% from 1 April 2023.

Other Tax Issues

Consideration should also be given to the impact of the proposed outsourcing on any existing tax planning arrangements. Although, in principle, trade in goods with the EU remains tariff-free following Brexit, such treatment only applies if the goods meet the relevant rules of origin. Costs may also increase to reflect the burden of dealing with additional administrative requirements (such as customs declarations), introduced (as regards imports from the EU) from 1 January 2022.

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Recent transactions

- Advised Monzo, the leading digital bank, on a business-critical near-shore outsourcing.
- Advised leading wealth manager Brooks Macdonald on a long-term, transformational outsourcing to SS&C.
- Advised MicroFocus, the UK's largest tech business, on separation and migration issues for the USD2.53 billion sale of its SUSE open-source enterprise software business.
- Advised a leading blue chip UK firm on a major pensions outsourcing agreement relating to over GBP9 billion in assets and the renegotiation of its terms.

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- Advised Firstsource on outsourcings by Barclaycard, Lloyds Bank, BskyB and Eircom.

- Advised Xoserve on the outsourcing to Correla of UK gas industry critical services as part of Correla's carve-out prior to its sale to North Edge.
- Advised BUUK Infrastructure on its provision of outsourced district energy services at the Wembley Park, Colindale Gardens and Hallsville Quarter developments in London.
- Advised Channel Four on the outsourcing of its playout arrangements to Red Bee Media and Prime Focus Technologies.

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- Advised a client on TUPE and a consequent consultation process as an outgoing provider in a second-generation outsourcing.
- Advised the incoming provider of outsourced logistics services on the application TUPE, in particular whether the activities consisted wholly or mainly of the supply of goods.
- Advised a pension scheme administrator on the outsourcing of its admin function and the TUPE protections being sought by the incoming service provider.
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- Advised a major logistics company on the outsourcing of its collection services, including appropriate indemnity protection for employment liabilities.
- Advised a leading international manufacturer of fresh prepared foods on the employment implications of outsourcing part of its laboratory testing services.
- Advised a media technology business on resisting the transfer of employees and employment liabilities from an outgoing contractor after winning a contract from a competitor.
- Advised an online digital marketing agency on managing employment liabilities as the incoming supplier on a second-generation outsourcing.

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