Sourcing World

This is a work of significant value to businesses from all industries which are considering their outsourcing options.

This second edition of *Sourcing World* serves as a single starting point of reference for corporations and their advisers. It provides valuable insights and guidance to international sourcing transactions, covering both contractual and commercial arrangements and their regulation.

Written by outsourcing experts, every chapter gives a detailed overview of the legal and regulatory framework within each jurisdiction and of the terms and conditions relevant to finalising an outsourcing deal. This is one of the first works to also cover commercial practices on key negotiation items, such as financial terms and pricing models. Further, this second edition contains a comparative chapter with an overview of common trends and local variations thereof, so that readers can build outsourcing arrangements on the lessons learned from many outsourcing transactions in multiple countries.

SECOND EDITION 2015

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General Editors:
Lukas Morscher Lenz & Staehelin
Ole Horsfeldt Gorrissen Federspiel

THE EUROPEAN LAWYER REFERENCE

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Jurisdictional comparisons **Second edition 2015**

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Foreword

Lukas Morscher, Lenz & Staehelin
and Ole Horsfeldt, Gorrissen Federspiel

Today, outsourcing is an effective and, in most countries, mainstream management tool used to both reduce costs and achieve strategic goals. It is seen across many business activities in all industries, from back-office functions (such as finance & accounting, HR/payroll, facility management or call centres) to core processes (like research & development, production or banking transactions in securities trading) and infrastructure outsourcings (IT and telecoms including network communication and security services or application development and support).

Most businesses have long ventured beyond outsourcing of simple, commoditised services and rely deeply on well-designed value chains across nations and their outsourcing partners' ability and will to fulfil contractual arrangements that underpin strategic objectives, whether they operate onshore, nearshore or offshore.

Outsourcing arrangements, pricing models and the associated governance are becoming increasingly complex. While some globally accepted commercial models and practices have evolved, local regulations and customs still play a large role when negotiating deals. So how can firms be confident that they remain in charge of their own business and in control of their key risks?

The objective of this publication on sourcing law and practice across the globe is to create a single starting point of reference for practitioners – customers, vendors and advisers – involved in sourcing transactions covering both the contractual and commercial arrangements and the regulatory side to things.

The first edition of *Sourcing World* was published in 2012 and covered 19 jurisdictions. We are pleased that this second edition has been expanded and now covers 24 countries.

The format of the chapters, each from leading lawyers in that jurisdiction, follows a common order, thus enabling readers to make quick and accurate comparisons. While covering legal topics, the country contributions are strongly business-oriented and include valuable insights into local commercial practices, in particular related to financial terms and conditions, pricing models and key negotiation issues with price impact.

As local and regional commercial practices and risk allocation models vary significantly – even among countries that are all mature outsourcing markets – we have created a new comparative chapter in this second edition. It is intended to establish an overview and to enable practitioners to be inspired by recent common trends and local variations thereof, and on that basis to

craft outsourcing arrangements that are on the cutting edge and build on the lessons learned from many outsourcing transactions in multiple countries.

We would like to acknowledge the work and support of the legal experts who each have contributed with new or updated country-specific chapters.

Lukas Morscher, Partner and Head of IT, Telecoms & Media, Lenz & Staehelin
Ole Horsfeldt, Partner and Head of Outsourcing, Gorrissen Federspiel

Zurich and Copenhagen, November 2014

Comparative overview

Gorrissen Federspiel Ole Horsfeldt

1. INTRODUCTION

When embarking on an international outsourcing project, the contract drafting process often starts out with a few fundamental choices. What will the structure of the agreement look like? Will it be a framework agreement with local service agreements, central to central, central to local, etc? Very often, tax considerations will drive such structural choices. The other fundamental structural issue is choice of law (and the associated dispute resolution model).

In respect of choice of law, there are fundamentally two alternatives: either the main agreement and all local service agreements and service/work orders are governed by the same choice of law, or the main agreement is governed by the law of the jurisdiction of the customer's and the local service agreements are governed by local law. Irrespective of the choice of model, mandatory local law will apply in many aspects.

This book will assist you in assessing how the choice of a particular local law will work and which mandatory local laws will have to be complied with.

Generally, deciding between a single central law model or a local law model is not difficult, and depends on:

- the local service agreement and the structures of the local parties;
- how the governance model and dispute resolution model are intended to work;
- enforceability issues; and
- the choice of venue.

The real difficulty when negotiating international outsourcing agreements is in assessing and dealing with relevant local commercial practices. If a contract is negotiated in England between international parties but the service delivery is pan-European or pan-Asian, should English commercial practices prevail and how should local practices be taken into consideration? Is there such a thing as a common international outsourcing practice?

The short reply is that there are recognised international practices on a number of key negotiation items, that there are regional variations and that practices vary, based on the maturity of the outsourcing market in a particular region or country.

Based on the country chapters in this book, this comparative chapter identifies such common trends and practices on a number of key commercial issues.

2. AVERAGE DURATION OF PROCUREMENT PROCESSES

2.1 The average duration of procurement processes in months

It used to be that procurement exercises for large-scale outsourcing projects would take 12–18 months. Driven by a maturing professional advisor community and by customers' need for rapid implementation of business change and cost consciousness, the average procurement time now is only 6–8 months. See Figure 1.

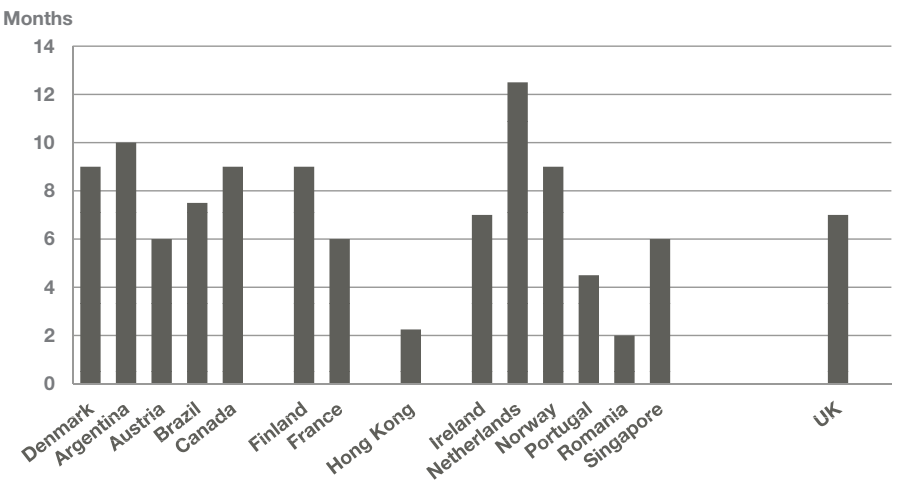

Figure 1: Average duration of the procurement processes

3. MANDATORY STATUTORY REGULATION ON OUTSOURCING

3.1 Mandatory statutory regulation of outsourcing

Very few countries have general legislation pertaining to the practice of outsourcing. However, just about every country has sector-specific regulation relevant to the outsourcing of business processes or IT infrastructure. In particular, the telecoms and banking industries are subject to mandatory legal requirements when outsourcing. See Figure 2.

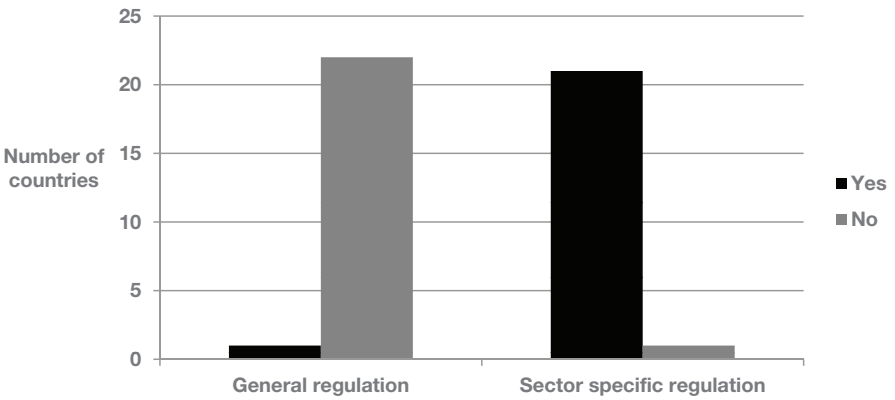

Figure 2: Number of countries with statutory regulation on outsourcing

4. PERSONAL DATA

4.1 Mandatory statutory regulation of processing of personal data

The EU's Directive on the Processing of Personal Data has set global standards (while of course only being relevant to processing of data within the EEA and export of data outside of the EEA). Countries such as Argentina, Turkey, Singapore and Hong Kong now have legislation that must be observed when considering the data flows that will apply under an outsourcing arrangement.

5. TRANSFER OF EMPLOYEES AS PART OF AN OUTSOURCING TRANSACTION

5.1 Mandatory statutory regulation of transfer of employees as part of an outsourcing transaction

Another EU-based concept, as presented in the Acquired Rights Directive, is the rights of employees when a part of a business is outsourced. This directive appears to be a European speciality – legislation or practices with similar effects will not generally be found outside the EEA.

6. TRUE-UP AND BASELINING

6.1 Is true-up or baselining a common commercial practice?

True-up or baselining is the practice associated with conducting a verification post-signing of the information and baselines compiled as part of the pre-signing negotiations. Mostly, such verification exercises work on the one hand as a reasonable safeguard to the benefit of the chosen vendor, while on the other hand as an opportunity to renegotiate at a time when the customer has lost all negotiation leverage.

In many mature markets, true-up exercises have been replaced by more elaborate pre-agreement due diligence and due diligence cut-off provisions. However, as illustrated in Figure 3, the true up or baselining practice is still in use in many countries.

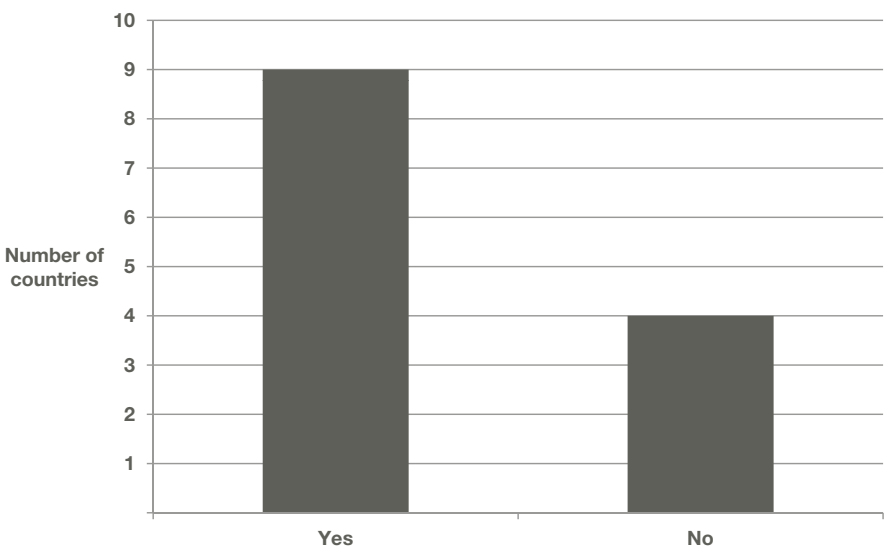

Figure 3: Is true-up or baselining a common commercial practice?

7. BENCHMARKING

7.1 Is it common commercial practice to benchmark at unit level, tower level or any other level?

The efficiency (from a customer perspective) of a benchmarking clause can be measured on two counts:

- the increments which are subject to benchmarking (fees per resource units, fees per tower or total fees); and
- whether automatic adjustment has been agreed or not. If not, any adjustment will be subject to negotiation and the customer's protection is weak.

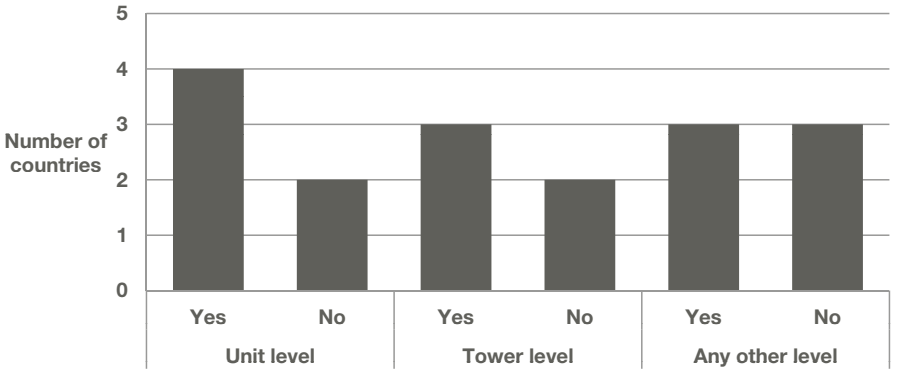

Figure 4: Is it common commercial practice to benchmark at...?

As illustrated by Figure 4, there is no common practice as to the incremental basis for outsourcing. Essentially, this is a negotiation topic that depends on the negotiation power of the customer.

Similarly, there are no clear trends towards automatic adjustments. In mature outsourcing markets, Western Europe and the USA, there is a tendency towards automatic adjustments. However, the unilateral right to require adjustments is tempered by caps applicable to yearly or total adjustments.

8. DURATION OF AN OUTSOURCING ARRANGEMENT

8.1 What is the common duration of an outsourcing arrangement in years

In recent years, most consultancies have advised that customers should opt for 4–5 year outsourcing arrangements. Certainly, there are few of the 10 year plus deals around, which used to be the norm for complex arrangements, but there is no evidence globally that outsourcing agreements in general have shorter terms than 5–7 years. See Figure 5.

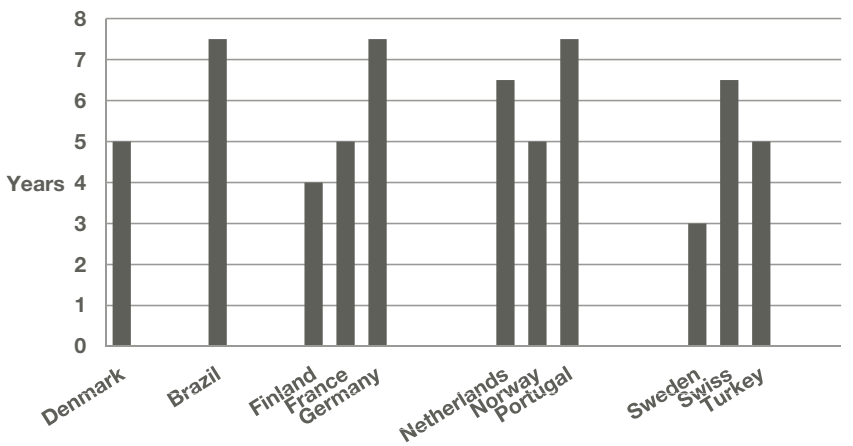

Figure 5: Common duration of an outsourcing arrangement

9. TERMINATION FOR CONVENIENCE BY THE CUSTOMER

9.1 Is it common practice for the customer to have a right to terminate for convenience?

A key element in the flexibility of an outsourcing agreement is whether the customer may terminate a part of an agreement for convenience, typically against the payment of termination fees. As illustrated by Figures 6 and 7, termination for convenience may take place per service tower, site or country, depending on the nature of the agreement. There is no clear global practice as to the parts of an agreement by which termination for convenience can take place, but there is an established practice that termination for convenience will apply in respect of both an agreement in its entirety and of parts of an agreement.

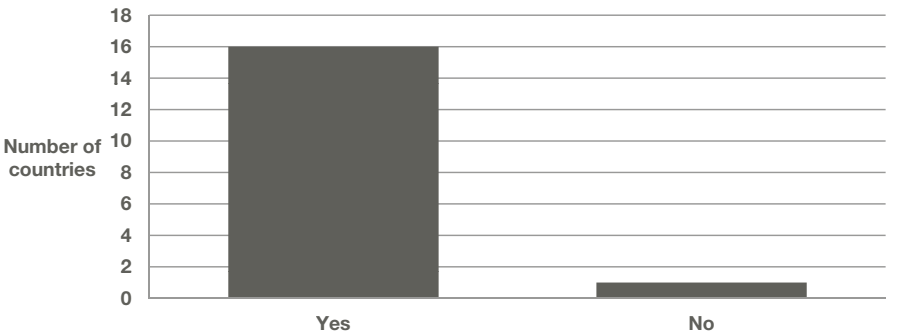

Figure 6: Is it common practice for the customer to have a right to terminate for convenience?

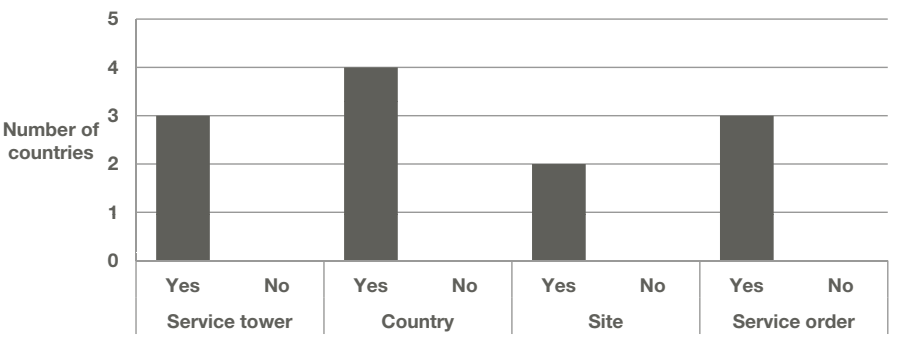

Figure 7: Which parts of an agreement may a customer commonly terminate for convenience?

France

Gide Loyrette Nouel Thierry Dor & Foulques de Rostolan

1. BUSINESS PRACTICE (INTERNATIONAL DIVISION OF LABOUR, BREAKING-UP VALUE CHAINS)

1.1 Describe generally the maturity of the outsourcing market in your jurisdiction

France can be considered to have a mature outsourcing market, all functions included, with the exception of business process outsourcing.

The IT outsourcing market was valued EUR 9.8 billion in 2010 and shall reach EUR 15 billion in 2014.

The French IT outsourcing market is concentrated, the main suppliers are Atos, Capgemini, IBM and Accenture.

Most outsourcing operations take place within France. The use of offshore outsourcing is still limited. Top offshore destinations are India, Eastern Europe and Maghreb.

The banking/insurance companies are among the main users of outsourcing and offshore outsourcing, despite the restrictive regulation applicable to them.

1.2 How are cloud-based services affecting traditional outsourcing models?

Within the French market, business-to-consumer cloud offers are more developed than business-to-business cloud offers. In the aftermath of the Snowden leaks, professional customers are looking for suppliers located outside of America or for suppliers undertaking to host data outside of America.

However, the main actors for cloud services remain Amazon, Google and Microsoft. For the time being, outsourced services in the cloud concern mainly office applications and non-critical applications.

1.3 Describe the current supplier landscape

The current supplier landscape has been modified by the entry of cloud service actors (see section 1.2 above).

2. PROCUREMENT PROCESS, ROLE OF BUSINESS ADVISORS AND MATURITY OF THE CONSULTANCY INDUSTRY

2.1 Describe generally the procurement process

Public sector

Where an outsourcing contract fulfils the criteria for public procurement contracts, the public sector customer has to comply with the French Public Procurement Code (*Code des marchés publics)* and ensure:

(i) free access to public procurement;
(ii) equality of the application process; and
(iii) transparency of procedures.

Where the contract implies the provision of services listed in Article 29 of the Public Procurement Code, which includes telecommunications and IT services, the public sector customer shall follow a mandatory competitive tender process. If the estimated value of the contract does not exceed EUR 207,000 (local public sector customer) or EUR 134,000 (national public sector customer), the tender process is then simplified.

Ordinance No. 2005-649 also imposes specific procurement processes, notably on public companies acting in the field of transport, water, energy and post services (which are not under the scope of the Public Procurement Code).

In addition, specific rules regulate public/private partnerships, especially Ordinance No. 2004-559 of 17 June 2004. When public entities award service contracts under public/private partnership to a private supplier, different regulations govern the contractual relationship. These set:

(i) tender procedures, including rules on advertising and transparency and assessment methods; and
(ii) criteria and conditions for the performance of contracts.

Depending on the type of the public/private partnership, the private supplier receives payment from the public entity or from the users of the service.

Public servants' statutes are also relevant to public sector outsourcing. Public entities must comply with specific rules when they award contracts and transfer employees to a private supplier.

Private sector

Normally tender offers are organised, pursuant to the usual practice: request for information, request for proposal from selected vendors, negotiation with a short list of bidders (or one of them).

It is more and more frequent that the customer requests a mark-up of a proposed outsourcing agreement as part of the criteria for the selection of the shortlist of bidders, or the final bidder.

Due diligence, if any, will depend on the nature of the outsourcing transaction.

2.2 What is the average duration of a private procurement process?

A standard private procurement process usually lasts approximately 6 months. Fast track procurement processes are not common in France.

2.3 Which roles and tasks are generally performed by business advisors, including legal advisors?

Legal and business advisors assist the customer at the start of the process, for the issuance of the documentation (request for information, request for proposal etc) and the selection of the bidders, and participate in the negotiation of the contract. Business advisors are present more often than legal advisors in the validation of the business case.

3. STATUTORY RULES, INDUSTRY SPECIFIC REQUIREMENTS AND REGULATIONS

3.1 Which statutory rules govern sourcing transactions in general?

Outsourcing transactions are not regulated *per se* under French law. However some regulations apply to outsourcing transactions in specific sectors (see section 3.2 below), and some regulations have an effect on specific outsourcing transactions, for example:

- regulations under Article L.1224-1 of the Labour Code concerning transfers of employees;
- French Intellectual Property (IP) Code;
- data protection regulations;
- unfair practices; and
- competition law, particularly when the outsourcing can be considered as a merger.

3.2 What are the legal or regulatory requirements concerning outsourcing in any industry sector?

Outsourcing is mostly regulated in the financial service and insurance sectors.

Two sets of rules regulate the outsourcing of financial services:

- Regulation No. 97-02, issued by the Banking and Financial Regulatory Committee (*Comité de Réglementation Bancaire et Financière*), which applies to the outsourcing, operations and ancillary services in relation to banking and investment services; and
- the General Regulations of the Financial Markets Authority (*Autorité des Marchés Financiers (AMF*)), which apply to portfolio management companies (companies that have been licensed by the AMF to manage funds belonging to third parties, through mandates (*gestion sous mandat*) or through the management of investment means).

Outsourcing in banking and investment services

Under Regulation No. 97-02, operational tasks or functions that are critical to the decision of the client when concluding banking or related operations can only be outsourced by banks to companies which are licensed or authorised to exercise such activities under the applicable law.

When banks intend to outsource operational activities related to payment services, they must first notify the Resolution and Prudential Control Authority (Autorité de Contrôle Prudentiel et de Résolution).

In any case, outsourcing in banking and investment services must be established under a written contract that contains specific provisions, including:

- the right of the regulated entity or the banking authorities to carry out onsite inspections; and
- guarantees relating to the confidentiality of information concerning the regulated entity's clients.

Banks must ensure their internal controls cover their outsourced activities and must adopt appropriate outsourcing risk management programmes and conduct due diligence.

Outsourcing in portfolio management companies

When portfolio management companies outsource operational tasks or functions that are considered to be critical or important for their services or activities, they must take reasonable steps to avoid undue additional operational risk.

When the tasks or functions are critical or important, the outsourcing must not materially impair the quality of the portfolio management company's internal controls and the ability of the AMF to monitor its compliance with its obligations. Any outsourcing that turns the portfolio management company into a mere mailbox is considered to be a breach of these requirements.

When the management of the portfolio of a non-professional client is outsourced to a supplier which is not located within the European Economic Area, the portfolio management company must notify the outsourcing agreement to the AMF if:

(i) the supplier is neither licensed nor registered in its country of origin for the portfolio management activity; or
(ii) no cooperation agreement has been signed between the AMF and the authority in charge of the supplier.

Outsourcing by insurance companies

Pursuant to European Directive No 2009/138/EC (Solvency II), insurance and reinsurance companies willing to outsource their critical or important functions or activities (such as risk management and compliance services) to another company shall first notify their regulator.

3.3 What are the applicable rules regarding control or monitoring of the supplier, reporting to the regulator, rights of access to, and audit of, the supplier's records to be granted to the regulator, segregation of staff, functions or entities?

Under French law, there is no specific rule regarding the monitoring of the supplier, except for outsourcing from financial service or insurance companies (see section 3.2 above) and health data hosting (see section 3.4 below).

3.4 Which services (if any) must be performed by a regulated or specially licensed entity, or any specially trained personnel?

In addition to the requirements mentioned in section 3.2 above, the main regulation applying to the supplier itself results from the French Public Health Code which states that any time a company intends to provide hosting services for health data, it needs to get a licence from the ministry in charge of health matters. Accordingly, should the customer outsource activities requiring the hosting of health data, the supplier must obtain a specific licence and subject itself to the control of an administrative authority.

3.5 What are the requirements for regulatory notification or approval of outsourcing transactions in any industry sector?

In addition to data protection issues (see section 4 below) and the notification requirements already described in section 3, notification is required for the outsourcing of the issuance of electronic invoicing.

The French Tax Code states that, when the outsourcing of the issuance of electronic invoices is operated with a supplier established in a country which has not signed an international convention with France recognising a principle of mutual assistance for the recovery of claims related to taxes, duties and other measures, the customer shall notify the French tax administration first.

4. DATA PROTECTION, TRANS-BORDER DATA FLOWS, PROFESSIONAL SECRECIES, CLOUD COMPUTING

4.1 What are the requirements for a third party to process data on behalf of the data controller?

This section 4 does not take into account the draft of the new regulation on data protection presented by the European Commission on 25 January 2012 and which has not yet been voted on.

Under the French Data Protection Act (Act No. 78-17 on Data Processing, Data Files and Individual Liberties as amended in 2004) which implements the European Directive No. 95-46, a data processor (eg an outsourcer) can process personal data only under the data controller's instructions.

A data processor must offer adequate guarantees to ensure the implementation of security and confidentiality measures. This requirement does not exempt the data controller from its supervision obligations.

A contract must be concluded between the data controller and the data processor. It must specify the obligations of the data processor in relation to the protection of the security and confidentiality of the data and provide that the data processor can only act upon the instructions of the data controller.

If the data processor is established outside the EU/EEA, the transfer of personal data to the data processor is subject to the rules on international transfer (see section 4.3 below).

4.2 What are the rules and regulations regarding data protection and data security, confidentiality of customer data, banking secrecy and other professional secrecies?

The data controller must take all necessary precautions, in relation to the nature of the data and the risks of the processing, to preserve the security of the data and, in particular, prevent its alteration and damage, or prevent access by non-authorised parties.

In relation to the security of personal data processing, the French Data Protection Authority, the CNIL (Commission Nationale de l'Informatique et des Libertés) recommends specific security measures relating in particular to access, connection and encryption depending on the category of data processed and the potential risks resulting from the processing.

Banking secrecy protects the clients of the bank, which can be individuals but also legal entities, which are not protected under the French Data Protection Act.

4.3 Which rules govern the transfer of data outside your jurisdiction?

Personal data transfers towards an EU/EEA country are possible without any specific formality.

Countries recognised by the European Commission as offering an adequate level of protection

The European Commission has adopted relevant decisions making personal data transfers towards the following countries possible without specific formalities: Andorra; Argentina; Canada; Guernsey; Faroe Islands; Israel; Isle of Man; Jersey; New Zealand; Switzerland; Uruguay; and the US (only if the US recipient has adhered to the Safe Harbor principles).

Other countries

A data controller cannot transfer personal data to any other country, except in the following cases:

- the data subject has expressly consented to the transfer; or
- the transfer is necessary for certain listed purposes such as: (i) the performance of a contract between the data controller and the data subject; (ii) compliance with obligations ensuring the establishment, exercise or defence of a legal claim; or (iii) the conclusion or performance of a contract, either concluded or to be concluded in the interest of the data subject between the data controller and a third party.

A transfer can also be authorised by a decision of the CNIL where the processing guarantees a sufficient level of protection of individuals' privacy, liberties and fundamental rights, particularly pursuant to contractual clauses (data transfer agreement) (see section 4.4 below) or binding corporate rules (BCRs) relating to the processing.

BCRs are internal codes of good practice based on European data protection standards, which multinational organisations can draw up and follow voluntarily to ensure adequate safeguards for transfers of personal data between companies that are part of the same corporate group.

In 2008, the Article 29 Working Party decided to launch a mutual recognition procedure. Since then, 21 data protection authorities have agreed to engage to mutually recognise the BCRs approved by some of them. The data protection authorities engaged in such mutual recognition procedure are those of Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Estonia, France, Germany, Iceland, Ireland, Italy, Latvia, Liechtenstein, Luxembourg, Malta, the Netherlands, Norway, Slovakia, Slovenia, Spain and the UK.

4.4 Are data transfer agreements contemplated or in use?

Data transfer agreements are commonly used by customers as data controllers for their data transfers.

The CNIL has to authorise the transfer on the basis of a data transfer agreement.

When a data transfer agreement is based on the Commission's standard contractual clauses for transfers to third countries (Decision No. 2010/87/EU concerning data transfers to data processors; Decision No. 2001/497/EC and Decision No. 2004/915/EC, concerning data transfers to data controllers), the CNIL will authorise the transfer without further review of the legal conditions applicable to the transfer. For that reason, most data transfer agreements are based on EC model clauses.

4.5 Is a data transfer agreement sufficient to legitimise transfer, or must additional requirements (such as the need to obtain consent) be satisfied?

A data transfer agreement is not sufficient as the transfer must be authorised by the CNIL before being implemented (see section 4.4 above).

4.6 In cloud computing, which precautions (contractual, factual, others) are usually taken to protect, or to allow control over, the data?

Since the major cloud computing suppliers are based in the US, the question of international data transfer needs to be discussed by the customer and the supplier when personal data are processed (see section 4.3 above). In addition to data protection issues, the main questions relate to security, SLA, permanent access to data and reversibility. The customer generally requires from the supplier that it complies with standard ISO 27001 and gets certified. The customer can also reserve the right to audit the supplier.

4.7 How is supplier liability for breach of data protection requirements generally handled?

Breach of data protection requirements are sometimes covered by an indemnity. Normally no liability cap applies.

5. ASSET DEAL, LEGAL CONCEPTS AND MECHANICS

5.1 What legal concepts apply to the transfer of assets in an outsourcing?

Movable property

There is no general requirement for the transfer of movable property. However, administrative or private notification may be required for:

(i) assets subject to specific regulation (for example, in relation to car or truck registration); and

(ii) assets which have been pledged and similar situations.

Immovable property

Title to real estate assets can only be transferred using a notary. The notary publishes the transaction at the Mortgage Registry (*Conservation des Hypothèques*) after completion of the sale. The notary will supervise compliance of the sale with the applicable rules (redemption of preemption rights if any, mandatory enquiries for specific risks affecting the property, etc).

IP rights and licences

Assuming the transferring party is entitled to transfer IP rights and licences (which might sometimes be difficult to fully assess for basic software as the corresponding software licences are not always properly archived by customers) the following rules apply:

- the assignment of patents and trademarks must be in writing to be valid. To be valid, copyright assignment must also be in writing, in a document where each assigned right is identified and its field of exploitation precisely defined;
- for assignments of patents and trademarks to be enforceable against third parties they must be registered with the French Trademark and Patent Office (*Institut National de la Propriété Intellectuelle*); and
- regarding the transfer of IP licences, the licensor's consent is required (unless otherwise provided in the licence) and the transfer should be made by written assignment to ensure its enforceability against third parties. However, it is customary to transfer commodity software without the consent of the relevant editors when such software remains only used for the benefit of the customer and, in addition, provisions prohibiting assignment of the software medium are likely to be considered unenforceable.

Contracts

A party to a contract cannot transfer it without the contracting party's approval, unless it is expressly provided for in the contract. However, in practice, approval is generally only sought for key contracts. If other contracts are linked to the outsourced activity and are not considered to be key, the customer sometimes simply notifies their transfer to the contracting party. However, since this is not a valid transfer, the contracting party could challenge it. In that case, the supplier may also be considered as the agent of the customer.

French case law is not consistent on the question whether the contracting party's implicit recognition of the transfer (such as the acceptation of the payments by the supplier) infers that the customer is released from the

performance of the contract. Accordingly, it is prudent to assume that the customer is not released.

5.2 Are there particular considerations for the transfer of assets offshore?

In addition to the restrictions on the transfer of personal data outside the EU (see section 4 above), two types of goods are subject to export authorisation by French authorities: (i) encryption means and (ii) dual-use goods (ie goods than can be used for both civil and military purposes).

6. HR, TRANSFER OF UNDERTAKING, MASS DISMISSAL, REPUTATION ASPECTS

6.1 In what circumstances (if any) are employees transferred by operation of law:

6.1.1 to a supplier in an initial outsourcing?

Article L.1224-1 of the French Labour Code reflects Directive No 2001/23/EC on transfers of undertakings. It applies to all transfers of 'autonomous economic entities' from a legal entity to another legal entity.

According to the French Supreme Court (*Cour de Cassation*), an autonomous economic entity exists, and employees are transferred automatically on an outsourcing, if:

- the activity being outsourced has its own staff and tangible and/or intangible assets; and
- the activity remains the same after the outsourcing.

Article L.1224-1 only applies to employees who, on the date of transfer, are assigned totally or in majority to the outsourced business.

The employer and employees cannot waive Article L.1224-1. Therefore, employees cannot object to the transfer. However, the transferor can undertake to continue employing employees that should have been transferred, provided there is an agreement with the transferee and the employees.

Finally, in certain circumstances, the labour administration must authorise the transfer of the protected employees (eg staff delegates, members of the works council and trade union representatives).

6.1.2 to a supplier on a change of supplier?

The Supreme Court does not expressly exclude a change of supplier from the situations where Article L.1224-1 applies. However, to trigger the transfer of employment contracts, the change of supplier must qualify as a transfer of autonomous economic entity (see criteria above). In practice, these criteria are rarely satisfied.

However, in certain facility management businesses (notably security services, cleaning services), industry-wide collective bargaining agreements impose a transfer of employees in the event of a change of supplier, even where the conditions of application of Article L.1224-1 are not met.

6.1.3 back to the customer on termination of an outsourcing?

Case law indicates that Article L.1224-1 applies if an outsourcing contract is terminated, but only if the contract termination constitutes a transfer of an autonomous economic entity. Notably, if the outsourced activity is reintegrated into the organisation of the customer, Article L.1224-1 may apply.

6.2 If employees transfer by operation of law, which terms and effects apply?

Individual agreements

The transferee automatically takes over the employment contracts of all the employees who were employed in the business immediately before the transfer. These contracts continue to apply on the same terms and conditions. All rights based on the employees' presence or length of service (for example, accrued paid vacation and seniority premiums) are calculated from their starting date with the transferor.

Collective agreements

Collective agreements do not transfer automatically from the transferor to the transferee. However, the transferee has an obligation to negotiate new collective agreements for the transferred employees. When doing so, the transferee shall comply with the following procedure:

- the transferred employees continue to benefit from the collective rights in force with their former employer until a new agreement is effective. If the collective rights in force with the transferee are more advantageous to the employees, they also apply; but
- if no new agreement is entered into 15 months after the transfer, the former collective agreement no longer applies, but the employees maintain their acquired individual rights (*avantages individuels acquis*).

Pensions and employee benefits

Most employers only contribute to the mandatory base pension scheme (*régime de base*) and to the mandatory complementary pension scheme (*régime complémentaire obligatoire*). Where the transferor maintains an optional pension scheme in addition to these mandatory pension schemes, the transferee's obligations (if any) will depend on how the optional schemes were implemented by the transferor.

6.3 How can the customer (contractual or other) retain particular employees, or make them redundant?

Means for the customer to retain particular employees

In order to avoid employees assigned to the outsourced business being transferred to the supplier, the customer has the possibility to redeploy these employees to non-outsourced activities prior to the transfer. However, where redeployment to another position implies a modification to the concerned employee's employment contract, this employee's consent must be obtained.

Dismissal before or after the outsourcing

Continuation of an employment contract is mandatory for the transferee and the employees. Therefore, dismissal of an employee before the transfer in order to avoid such transfer is deemed null and void. In such case, the dismissed employee may choose to ask for reinstatement within the transferee or accept the dismissal and claim damages for the loss incurred.

Following the transfer, the new employer can take measures to restructure and downsize the transferred business as any other employer would, provided, however, it complies with collective redundancy laws.

Calculation of the redundancy fee

An employee made redundant is entitled to statutory severance pay, the minimum of which amounts to one-fifth of his monthly salary per year of service up to 10 years and one-third of his monthly salary per year of service above 10 years.

In addition, if the redundancy is deemed unfair, the employee is entitled to damages, generally ranging from 6 to 12 months of average salary over the last 12 months of employment.

6.4 To what extent can a supplier harmonise terms and conditions of transferring employees with those of its existing workforce?

See section 6.2 above.

6.5 Can the parties structure the employee arrangements of an outsourcing as a secondment?

Article L.1224-1 is a public policy rule, and therefore cannot be avoided.

However, if Article L.1224-1 does not apply, the employee arrangements of an outsourcing can be structured as a secondment on a temporary basis. Before doing so, it is necessary for the parties to consider the risk of the arrangement being seen as an illegal loan of personnel (Article L.8241-1, French Labour Code). In any case, the employees' prior consent concerning the secondment is mandatory, and the staff representatives will have to be informed and consulted. Nevertheless, secondment is not a common practice in outsourcing transactions.

6.6 Describe notice, information and/or consultation obligations of the customer and/or supplier in relation to employees or employees' representatives

The transferor and sometimes the transferee must inform and consult their works councils (if any) prior to any decision being taken to outsource a business.

The works councils must be provided with detailed written information on the planned outsourcing, including on the consequences on the transferred employees' working conditions.

Although a works council opinion on the transaction triggering the transfer is not binding on the employer, consultation is necessary as non-

compliance would allow the works council to obtain a court order barring the transfer and/or to file criminal actions.

Where the works council refuses to give an opinion, this refusal may be construed by the employer as a negative opinion at the expiration of a certain period of time, the length of which generally ranges from one to four months, depending on several factors.

Although European rules provide that, in the absence of staff delegates, each employee affected by the transfer must be directly informed, French law does not require this. However, it is common to inform each concerned employee.

6.7 Describe the consequences (civil and/or criminal) of non-compliance with any of above requirements

Article L.1224-1 is a public policy rule and cannot be avoided or mitigated by contractual means.

Besides, non-compliance with the aforementioned consultation obligations is subject to criminal prosecution and the transfer decision may be suspended.

7. DUE DILIGENCE, TRANSITION, SERVICE COMMENCEMENT, TRUE-UP

7.1 Describe the due diligence processes and methods commonly used by suppliers and customers

When the pricing is based on due diligence, a true-up procedure is generally required by the supplier to adjust the charges. True up procedures are usually conducted in the early stages of the contract.

7.2 How do suppliers usually try to protect their business case?

In addition to true-up procedures and the duty of the customer to cooperate, suppliers protect their business case through minimum payments, especially in the first years of the contract, and price revision mechanisms. The concept of dependencies is used in contracts by suppliers to exclude their liability when dependencies are not fulfilled by the customer.

7.3 How are services usually measured upon service commencement?

Defined SLAs are usually difficult to apply from the beginning of the service. During the stabilisation period, the parties generally agree that the penalties associated with the SLA are frozen or reduced.

8. CHARGING, ADJUSTMENT OF FEES, AUDITING, BENCHMARKING

8.1 Describe the charging methods commonly used in an outsourcing

Charging methods depend on the type of outsourcing. In practice, fixed price, monthly fees and unit price (pay as you go), or a mix thereof,

are commonly used methods. The build and run phases of the contract generally use different charging methods.

It is relatively rare for the supplier to accept a cost plus method or to share profits and losses with the customer, although sometimes contracts may include the passing back over time of some savings achieved by the supplier to the customer.

Price adjustment mechanisms based on the evolution of the volume are customary.

Additional services that were not provided in the original contract are usually charged on a time and material basis or according to pre-approved budgets.

Some services are highly dependent on expenses that vary unpredictably. The contract documentation can therefore contain specific clauses that vary the supplier's fees accordingly. If these clauses are not included, the supplier cannot later impose new contractual terms, as under general contractual principles, a private law contract cannot be varied due to a change in economic conditions.

8.2 Describe customary change management procedures

Contractually defining 'new services' is always a difficult exercise, and change management procedures are generally organised as an integral part of the governance of the contract.

8.3 Are there other adjustment mechanisms?

When a contract is signed for a relatively long period, it generally includes a price revision mechanism based on an agreed index. Under French law, the price cannot be indexed on the minimum legal wage or on inflation as the index chosen by the parties must be directly related to the object of the contract. The Syntec index is often used in outsourcing transactions.

Under the French Commercial Code, 'most favoured nation' clauses are void, which does not prevent the customer from requiring information about more favourable prices obtained by other customers.

Outsourcing agreements can also include a provision enabling the parties to revise the price of the services provided by an offshore supplier in the case of major changes in F/X rates.

8.4 Describe the contract rules for disputed charges and related consequences

Set-off clauses and escrow provisions are not often agreed between the parties. Instead, the parties agree on escalation mechanisms, or pre-dispute third party expert review, before any final dispute resolution.

8.5 What are the contractual rules usually applied to auditing?

It is a common practice to insert in outsourcing agreements a provision enabling the customer to audit and check the performance of the supplier and the charging mechanisms. The audit clause shall define the frequency (usually one per year, in addition to audits by the customer regulators), the

scope, the obligations of each party (cooperation, prior notification, etc) and the allocation of the costs of the audit. Usually the audit is at the customer's expense, unless the audit reveals a breach of the agreement by the supplier, when the latter will share or bear the expenses.

The supplier generally requests that the audit be postponed if there is a serious risk of disruption of its operations and that, if a third party auditor is appointed, it is not one of its competitors.

Finally, suppliers try to limit audit rights by providing regular third party certifications.

8.6 Describe common benchmarking methodologies

Benchmarking clauses, enabling the customer to renegotiate the price of the services after a benchmarking evaluation, are sometimes included in long-term outsourcing agreements. Benchmarking is more frequent when the nature of the services provided enables an easy objective comparison.

The customer may sometimes obtain an automatic adjustment of the price based on the results of the benchmark, or the right to terminate the contract if the benchmark results are not implemented by the supplier. Usually a third independent party is appointed to realise the benchmark, at the customer's expense.

9. TAX ASPECTS, TAX EFFICIENCY IN GROUP STRUCTURES, TRANSFER PRICING

9.1 What are the main tax issues that arise in an outsourcing in relation to:

9.1.1 transfers of assets?

Corporate income tax is due (standard rate: 33.33 per cent) on any capital gains resulting from the sale of assets owned by the customer (provided that the seller is a French company and the assets are not connected to a permanent establishment situated abroad). In addition, a 3.3 per cent social contribution is due by customers whose corporate income tax liability exceeds EUR 763,000. Moreover, for fiscal years closing until 31 December 2016, customers generating over EUR 250,000,000 in turnover are subject to an exceptional contribution on corporate income tax at the rate of 10.7 per cent.

The consideration for the transfer of such assets is subject to VAT, unless the transaction qualifies as a transfer of a business as a going concern (transmission d'universalité totale ou partielle de biens) or results in an implicit transfer of clientele – in which case registration duty applies.

The rate of registration duty is set at three per cent for the fraction of the price between EUR 23,000 and EUR 200,000 and at five per cent for the fraction of the price exceeding EUR 200,000.

9.1.2 value added tax (VAT) or other sales tax?

As a principle, services supplied to a customer established in France are subject to VAT at the normal rate of 20 per cent. The VAT incurred by the customer is deductible, provided that the customer is itself liable to VAT.

9.1.3 service charges or other taxes at source?

Services are not subject to any other form of tax except in situations where withholding taxes apply.

9.1.4 withholding taxes?

In the absence of double taxation treaties between France and the country of residence of the supplier, payments for services rendered or utilised in France (including the licensing of IP) are subject to a withholding tax of 33.33 per cent, provided that the paying party carries out an activity in France and the non-resident supplier does not have a fixed place of business in France. The withholding tax rate is increased to 75 per cent where the country of residence of the supplier is a non-cooperative state or territory, the list of which is updated annually (as at 1 January 2014: Botswana, Brunei, Guatemala, the Marshall Islands, Montserrat, Nauru, Niue and the British Virgin Islands).

9.1.5 stamp duty?

There is no stamp duty applicable to outsourcing activities.

9.1.6 corporate tax?

Corporate income tax applies to customers and suppliers under the normal rules.

9.1.7 other tax issues?

There are no other significant tax issues. However, if the outsourcing contract transfers real estate assets (either by sale or by lease), it will increase the supplier's liability to territorial economic contribution (*contribution économique territoriale*). The supplier may ask for such additional territorial economic contribution to be reimbursed by the customer.

9.2 What precautions are usually taken to arrange for tax efficiency?

Parties to an outsourcing agreement tend to manage as efficiently as possible the recovery of deductible taxes. Parties may include gross-up clauses within the agreement providing that in case of withholding or deduction by operation of tax law, the customer shall gross-up the payment so that the supplier always receives the same net remuneration.

In the case of offshore outsourcing, parties will also take double taxation treaties into consideration when trying to improve tax efficiency.

In the case of intra-group outsourcing, transfer prices should be identical to the prices which would be agreed between independent parties in similar transactions.

10. TERM AND TERMINATION, NOTICE PERIODS, MANDATORY TERMINATION, PROLONGATION RIGHTS, TERMINATION MANAGEMENT

10.1 What are the rules and regulations regarding the term of an outsourcing agreement and/or length of notice period?

French law does not impose any maximum or minimum term on an outsourcing. In practice, outsourcing contracts are often for a period of three to seven years. However, exclusive supply agreements of more than five years are subject to specific rules under European competition law.

Usually, outsourcing contracts are entered into for a fixed term with a tacit renewal provision.

The length of the notice period not to renew in a fixed-term contract, or the length of the notice period to terminate indefinite term contracts is not regulated and can be set by the parties. However, the notice period must be reasonable (taking into account the length, the stability and the strength of the contractual relationship), otherwise the termination may be deemed unfair (Article L.442-6 I 5°, Commercial Code).

For contract terms between three and seven years, it is common to have notice periods of between six and 12 months.

10.2 Which events justify termination of an outsourcing agreement without giving rise to a claim in damages against the terminating party as a matter of mandatory law?

The law does not state which specific events can justify termination, but the right for one party to obtain termination of the contract in court if the other fails to perform its obligations is implied (Article 1184, Civil Code).

Only a serious breach can give rise to termination, the seriousness of the breach is regarded on a case-by-case basis by courts.

Generally, termination for breach also gives rise to a claim for damages.

As a matter of public policy, insolvency events in themselves are never a valid reason for termination by the other party. However, French law provides a specific mechanism for terminating a contract in bankruptcy situations, subject to conditions.

Besides, the parties to outsourcing agreements usually insert termination clauses which provide for a list of events justifying termination (see section 10.3 below).

10.3 What contractual termination rights are usually included in the outsourcing agreement?

The parties can include a provision in the agreement allowing them to automatically terminate it, without any court decision, for a specific reason, such as breach of a particular obligation, change of control or the occurring of a specific situation (provided it does not only depend on the will of the party invoking it). In that case, it is not necessary for a court to order termination. However, the other party may ask the court after the event to determine whether the termination conditions were effectively met.

10.4 Are there termination for convenience rights?

The parties can agree termination for convenience rights. They are generally subject to long notice periods and termination fees.

10.5 Are there implied rights for the customer and/or supplier to continue to use licensed IP rights or gain access to relevant know-how post-termination?

There are no implied rights for the customer and/or the supplier to continue using licensed IP rights following termination of the outsourcing agreement. However, parties are free to make specific arrangements.

In principle, the customer has no right to access the supplier's know-how after termination except when such access is provided as part of the reversibility (see section 10.6 below).

The customer may also gain access to the supplier's know-how when the contract or the specific situation provides for the return (transfer back) of certain employees to the customer at the end of the outsourcing.

10.6 Describe particular aspects of termination management, assistance by the supplier

The outsourcing agreement generally includes a reversibility clause designed to assist the customer in the performance of the services itself or the outsourcing of the services to a new supplier on termination. The clause should list the conditions for such reversibility, which can include an undertaking by the supplier to train the customer's or new supplier's staff for a certain period of time or the use of specific elements of supplier's know-how to the extent necessary for the customer and the new supplier to continue to perform the outsourced activity. Parties usually agree on a reversibility plan to be regularly updated throughout the duration of the agreement.

The supplier is either paid under the same conditions it used to be paid under the terms of the outsourcing agreement or gets an additional specific remuneration for reversibility assistance.

In addition, in order to preserve the continuity of the services, the outsourcing agreement may also include a roll-back clause allowing the customer to extend the term in case the reversibility proves unsatisfactory.

10.7 Are disputes common in respect of exit services and transition from one vendor to another? If so, please describe the nature of such disputes and how they are resolved

Disputes related to exit services are rare. However, pre-disputes sometimes occur where the customer does not control the data which is stored by the supplier, and the supplier uses that leverage to negotiate exit.

11. REMEDIES, RISK MANAGEMENT AND PROACTIVE MEASURES

11.1 Which remedies and/or reliefs are available to the customer under law for bad or non-performance by the supplier?

In case of a termination for breach (see section 10.2 above), the terminating party may claim damages.

Under French law, only direct damages are compensated. Courts require a sufficient direct link between the fault of a party and the invoked damage.

Parties can decide to exclude or include certain type of events within the scope of recoverable damages.

Specific performance is increasingly being granted by French courts for service contracts.

11.2 Which customer protections are typically included in the contract to supplement statutory remedies/relief?

The following protections are typically included in outsourcing agreements:

- termination for cause provisions;
- penalties payable to the customer, or provisions for withholding payments to the supplier (courts can reduce or increase penalties);
- service credits (additional services not invoiced);
- a clause allowing the customer to outsource the services to another supplier, at the original supplier's cost;
- insurance;
- parent company guarantees; and
- provisions to escalate resolution of the issues within the respective organisations; etc.

11.3 Which warranties and indemnities are typically included in a contract?

Generally, the supplier must provide the following warranties and indemnities:

- that it complies with all applicable regulations, and has and will maintain all the authorisations needed to carry out the services;
- that it has the human, financial and material means to provide the services;
- that it will provide the services in a professional manner and according to industry standards;
- that the services will comply with the specifications agreed upon by the parties;
- when the outsourced activity is placed in a specific Newco and the customer makes a payment to the Newco (as a down payment or a subsidy), that it will not use this payment for any purpose other than the proper running of the Newco; and
- that it will indemnify the customer if its employees working on the outsourcing contract make a claim to be considered employed by the customer.

The customer usually provides for the following warranties and indemnities:

- that it has provided the supplier with exact and complete information regarding the scope of the outsourcing; and
- that it is entitled to transfer the contracts or assets to the supplier.

The contract also generally includes a warranty against third party claims for IP rights infringement or third party claims for data protection breach. Where employees are transferred, the customer and supplier warrant to indemnify the other party for transferred employee claims, depending on whether they relate to events before or after the transfer.

11.4 Describe the common limitation and/or exclusion of liability

The breaching party is only responsible for the direct loss suffered by the other party (that is, a loss directly resulting from the breach). However, it is advisable for the supplier to include in the agreement an express exclusion of liability for indirect and consequential loss and to precisely list and define in advance what may not be considered as direct loss – a situation less and less accepted by customers.

Parties are free to agree on limitations or exclusions of liability subject to the following restrictions:

- a limitation or exclusion of liability does not apply to cases of:
  (i) wilful misrepresentation (*dol*);
  (ii) gross negligence (*faute lourde*); or
  (iii) death or personal injury; and
- the courts have cancelled exclusions or excessive limitations of liability provisions applying to an essential duty of the supplier which deprive the agreement of consideration.

Parties are free to agree on a provision setting a cap on liability in case of damages resulting from breach, even though the direct loss suffered may be higher than the cap. However, this provision is subject to the general restrictions on limitation of liability.

Generally, the cap is applied per event or for a period (frequently a calendar year or a contractual year, but also the full duration of the contract). In practice, for standard contracts, the cap per year is often calculated on the basis of the fees for 12 months.

11.5 Are there statutory set-off rights and can they can be contractually excluded or limited?

The French Civil Code provides for an offsetting mechanism enabling the parties to reduce their respective debts to the amount of the smallest one (Articles 1289 to 1299 of the Civil Code).

Four conditions are to be met in order to activate the statutory offsetting mechanism: reciprocity; fungibility; payability; and liquidity.

Established case law considers that parties are entitled to waive or limit their statutory set-off rights.

12. INSURANCE

12.1 What types of insurance are readily available in your jurisdiction?

Under French law, some insurance policies are mandatory such as employer's liability, and some are subscribed to on a voluntary basis (property, fraud, professional liability, etc).

To the best of our knowledge, French insurance companies have not developed any specific insurance for outsourcing activities.

13. SUBCONTRACTING AND ASSIGNMENT

13.1 Which rules and regulations apply to subcontracting and assignment of obligations under the contract?

Subcontracting

Subcontracting is regulated by the Act on Subcontracting (Act No. 75-1334, dated 31 December 1975). Under this Act, subcontracting is defined as the operation by which the principal entrusts a subcontractor to execute all or part of an agreement.

The supplier has to get the identity of all subcontractors and their conditions of payment approved by the customer. In addition, the customer is entitled to obtain a copy of all subcontracts upon request.

If the supplier fails to pay the subcontractor, the subcontractor is entitled to take direct action against the customer

Any waiver of direct payment by the subcontractor is void.

It is strictly prohibited to counter the provisions mentioned above within the outsourcing agreement. However, in practice these rules are not always respected, especially in contracts between private entities.

Finally, subcontracting is to be distinguished from the provision of means. When the supplier contracts with third parties for the provision of means necessary for the performance of supplier obligations, the above Act does not apply, even though the third party providing means to the supplier is commonly called a 'subcontractor'.

Assignment of rights and obligations

Under the French Civil Code, assignment of rights is permitted. The French Commercial Code states that clauses prohibiting the supplier from assigning its receivables relating to the customer are void.

On the contrary, assignment of obligations is not permitted under the French Civil Code without prior consent of the other party. In the case of lack of consent, the assignment of obligations is not enforceable against the creditor and the initial debtor is not freed from its obligation toward the creditor.

Assignment of contract

Assignment of contract is not regulated per se by the French Civil Code. Nevertheless, it is generally considered as an assignment of both rights and obligations (see also section 5.1 above).

13.2 What contractual arrangements are usually made regarding subcontracting and assignment?

Notwithstanding the Act on subcontracting (see section 13.1 above), usually, the customer tries to limit the subcontracting right of the supplier in particular regarding material obligations. These restrictions are acceptable when the supplier provides a one-to-one service to the customer.

Parties may also agree on a list of pre-approved subcontractors or on a mere notification of the appointment of subcontractors to the customer.

The customer usually accepts a free subcontracting by the supplier within the supplier's group. In the same way, parties generally accept the intra-group assignment of the contract.

14. JURISDICTION, LITIGATION, ARBITRATION, MEDIATION, FAST TRACK DISPUTE RESOLUTION

14.1 Describe statutory rules and practice regarding contract management, governance and escalation

There is no statutory rule regarding the contract management, governance or escalation. Nevertheless, outsourcing agreements almost always provide for governance mechanisms (generally through one or several committees) which will notably apply to the resolution of the conflicts that may arise, including through specific escalation mechanisms.

The parties may also agree to refer to an alternative dispute resolution process such as mediation.

14.2 What are the usual provisions regarding applicable law and arbitration clauses?

When drafting the outsourcing agreement, parties generally agree on the governing law and jurisdiction.

Based on the nationality of the parties and the value and nature of the outsourcing agreement, parties decide to refer either to arbitration or to court litigation.

Some parties consider that arbitration offers more advantages than court litigation, including but not limited to, the choice of the applicable language (which may be an important factor when all documentation is drafted in English), rapidity, price, flexibility, and confidentiality. Nevertheless, arguments in favour of arbitration are not all completely justified in France, especially with regards to the price.

When the outsourcing agreement involves substantial IP rights, parties may prefer to resort to judicial courts which offer specific IP infringement proceedings.

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