

Negotiating a Successful Data Center Outsourcing Arrangement

Brad L. Peterson

Partner – Mayer, Brown, Rowe & Maw LLP

bpeterson@mayerbrownrowe.com

Key Success Factors in Outsourcing

- **Aligning the service provider's incentives with your company's objectives**
- **Getting the savings that your company expects**
- **Maintaining control of critical processes, including those affecting Sarbanes-Oxley compliance**
- **Positioning yourself to smoothly manage the outsourcing arrangement**

Where is your company on outsourcing now?

1. (a) We have outsourced substantial parts of the data center.
2. (b) We are currently considering a data center outsourcing.
3. (c) We have not outsourced data center functions.

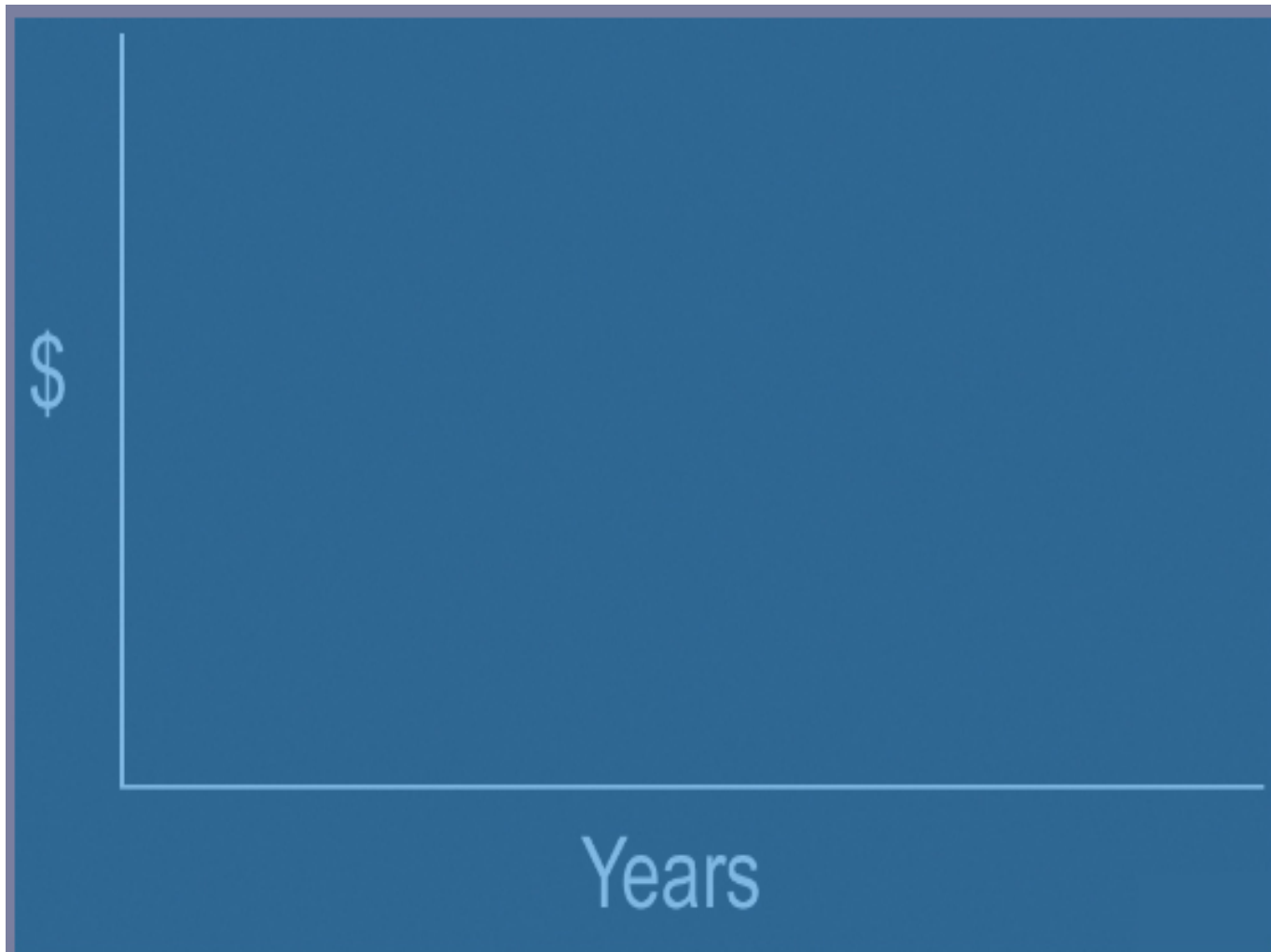
How risky is data center outsourcing compared to running an internal data center?

1. Low risk and straightforward
2. Low risk if proper risk mitigation steps are taken
3. Moderately risky even with proper risk mitigation
4. Very risky.

Typical Pricing in Data Center Outsourcing

- **Fixed prices are standard in data center outsourcing**
 - Baseline price for baseline resource volumes
 - Price adjustments for resource use above or below baseline
- **Common pricing units include:**
 - Gigabytes of DASD allocated
 - Gigabytes of tape used
 - Number of small, medium and large servers
 - Number of tape mounts

Outsourcing Economics



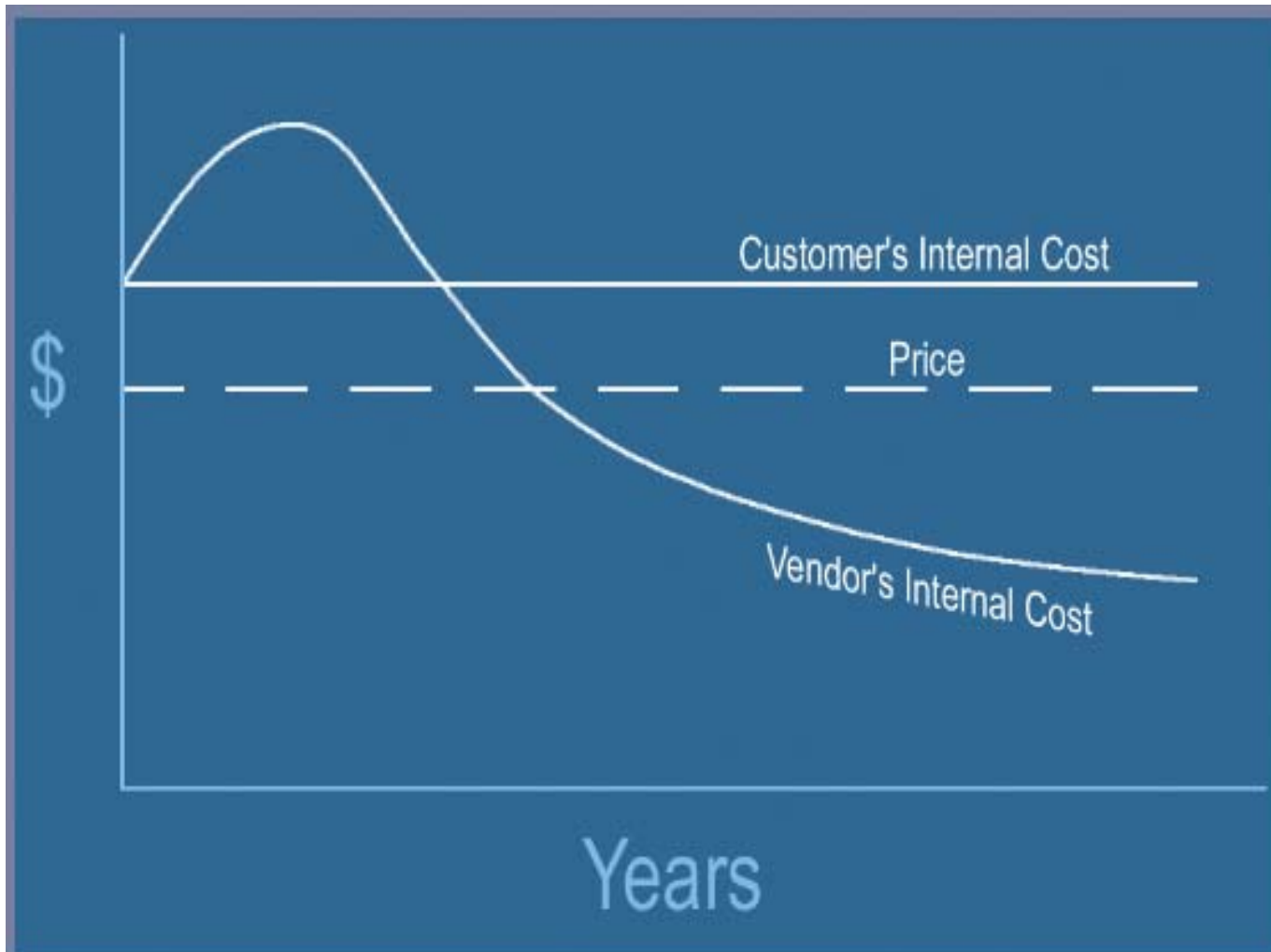
Outsourcing Economics



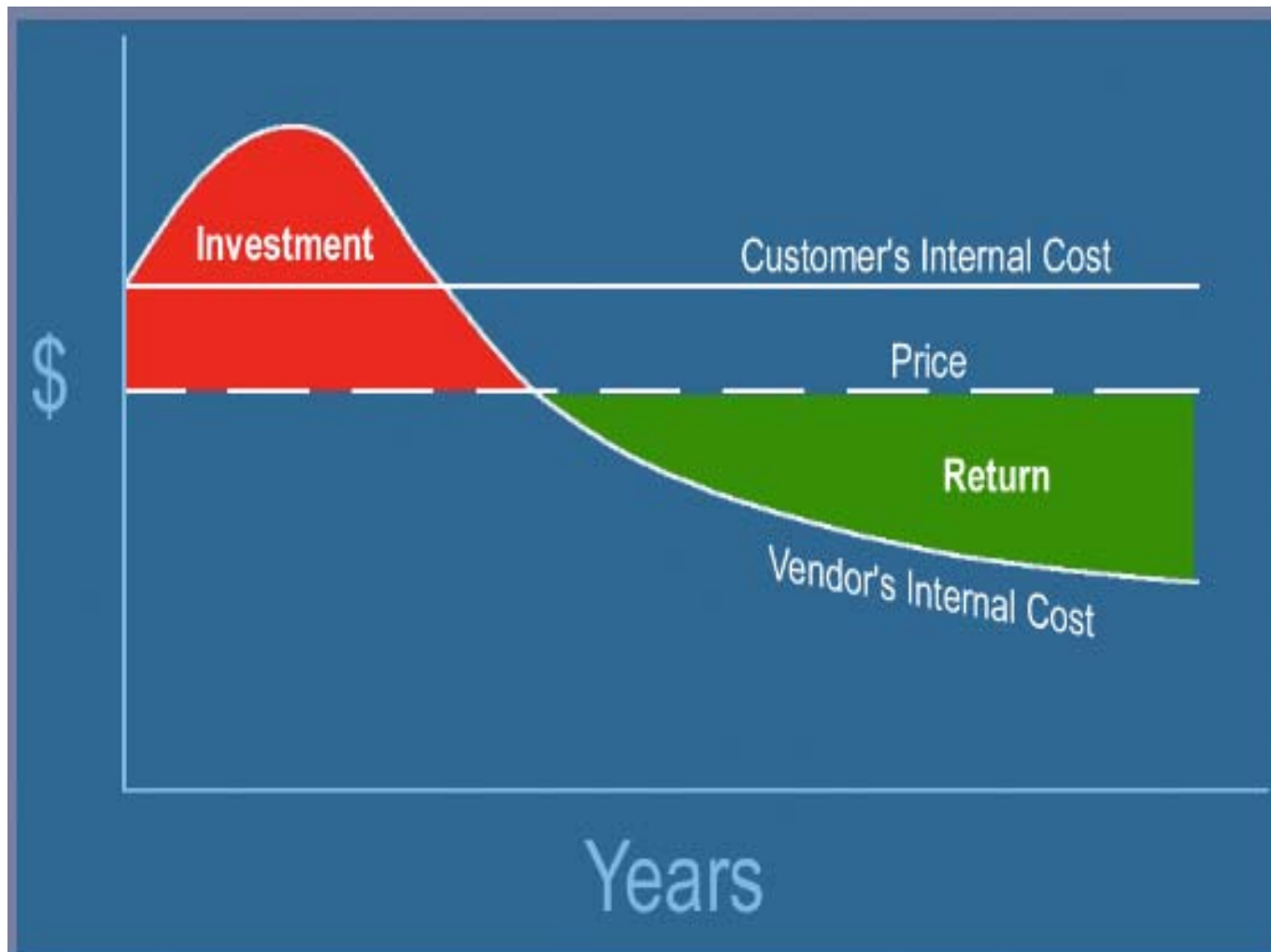
Outsourcing Economics



Outsourcing Economics



Outsourcing Economics



Economics Drive Supplier Incentives

- **Supplier's margin is based on how cheaply the services can be performed, which creates incentives to:**
 - **Maintain inefficient resource use**
 - **Do only what is required, not what the business needs**
- **Supplier's total profit is based on how long the contract continues, which creates incentives to:**
 - **Foster customer dependence on the supplier**
 - **Be inflexible**
 - **Make exit as risky and difficult as possible**

Ways to Align Incentives

- **Service level credits**
- **Milestone payments**
- **Gain-sharing arrangements**
- **Prospect of additional business**
- **Being a reference customer (or a well-known problem)**
- **Right to use third parties for in-scope work**
- **Realistic ability to terminate**

Which best characterizes your experience with outsourcing?

1. Overall, we save more than we expect to save.
2. Overall, we save about what we expect to save.
3. Overall, we have not achieved the expected level of savings.

How Customers Miss Savings Targets

- **Underestimating the cost of retained functions and contract management**
- **Paying for work that they thought was in scope**
- **Paying high prices for change orders**
- **Paying contract prices staying level when market prices go down**

Steps to Get Expected Savings

- **Complete financial base case**
- **Full and complete definition of scope**
 - Complete analysis and due diligence
 - “Sweep clauses”
- **Price protection for change orders and new services**
 - Including evolution in base services
 - General “rate card” pricing, even for out-of-scope services
 - Price protection processes and clauses

Steps to get Market Price and Quality

- **Most favored nations clause**
- **Benchmarking rights**
- **Extraordinary events clause**
- **Technology currency requirements**
- **Continuous improvement obligations**

Does data center outsourcing:

1. Increase your control over your business by establishing clearer obligations and taking advantage of the vendor's more-developed practices.
2. Reduce your control over your business by putting a critical function in the hands of another company.

Some Loss of Control is Inevitable



Key Control Points

- **CMM Level 5, ISO-2001, ISO 17799 ...**
- **SAS-70 and SOX 404**
- **Obligation to comply with laws and customer policies**
- **Technical change control**
- **QA and internal audit obligations**
- **Approval of subcontractors**
- **Approval of supplier facilities**

Keys to Effective Governance

- **Balance of power in an ongoing negotiation**
- **Reporting requirements and audit rights**
- **Defined roles, responsibilities, communication paths and escalation processes**
- **Change management**
- **Management and other internal support**
- **Training**

Conclusion

- **Data center outsourcing is risky and complex**
- **Smart customers can align incentives, preserve savings, maintain control and effectively govern data center outsourcing agreements using available contract management tools**

Questions