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Global Trends in IT Outsourcing

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The IT sector has been demonstrating its value in the wake of the COVID-19 pandemic. As more businesses adopt hybrid or even permanent remote work, worldwide IT spending is forecast to reach \$4.5 trillion in 2022 and expand by at least 6 percent in 2023¹.

EMERGING THEMES – IT SERVICE OPTIMIZATION

Businesses are re-focusing on their global IT strategies, especially how to improve and modernize IT outsourcing arrangements. In addition to reviewing price, geography, talent pool and quality of service, many businesses are factoring in automation (including artificial intelligence and robotics), innovation, emerging risks (including cybersecurity, geopolitical and supply chain), strength of contract terms (and their alignment with current market standards), evolving regulatory requirements and compliance costs. Several themes have emerged from this renewed focus.

First, many businesses need to expand their IT workforce to keep pace with growing IT demands and wish to hire their own employees instead of outsourcing. They are facing challenges, including the extremely competitive market for talented IT professionals, which make it difficult to hire a sufficient number of employees to meet their growing needs. One solution becoming more common is the "build-operate-transfer" ("BOT") model, under which a (generally large) company engages a third-party vendor to build the infrastructure and procure the necessary staff and resources to provide a particular IT service, operate the service for a period of time under an outsourcing contract, and then transfer ownership of the operation and its vendor-hired and trained employees to the company. One benefit of the BOT model is that it allows businesses to outsource the recruitment, hiring and training of qualified employees, the very thing proving difficult for many companies in today's market. Another



is that it gives businesses (like U.S. companies) the ability to scale and expand in new jurisdictions (like India) where they may not otherwise have the resources and connections to create a presence from scratch.

A second theme is the consolidation of IT services. IT outsourcing has tended to occur in stages, resulting in businesses often having multiple vendors to provide IT services. Businesses are recognizing the inefficiencies inherent in outsourcing a bundle of services across many (sometimes dozens of) third-party vendors. Consolidating these services can generate significant benefits, including reduced fees, increased partnership and investment by the selected vendors, improved contract terms and greater overall efficiency in service delivery and quality.

Finally, a third theme that has emerged is businesses changing the types of services they outsource to third-party vendors. Instead of outsourcing all services related to a particular function because it is the most cost-effective solution (e.g., IT infrastructure or software development services), businesses are now retaining portions of these services (often the higher-value services or more crucial roles) to be performed using their own employees and using third party vendors to perform commodity-type services. This shift has led to more in-sourcing, as businesses seek to reduce the scope of services being outsourced by bringing certain services back in-house.

LEGAL CONSIDERATIONS

While they may deliver material benefits, changes in how IT services are delivered should be carefully planned and evaluated in advance, taking into account the following legal considerations.

1. **Commercial Considerations.** Businesses must first consider the legacy agreements in place with their incumbent IT outsourcing providers, as these will influence the notice periods, terms and any fees or penalties for termination. They should also consider service continuity risk when terminating a service or changing IT service providers, given the possibility that service quality may suffer once an incumbent provider is notified (or otherwise becomes aware) it is losing a particular service, and carefully evaluate how services will be transitioned between providers (or in-house) as well as what additional resources may be required to ensure service continuity throughout any transition. The BOT model in particular requires careful planning and due diligence in advance to determine the optimal structure from a tax, regulatory and employment perspective, especially since the transfer portion of the transaction can be structured as a transfer of assets or a transfer of shares of a captive subsidiary. In addition, businesses should take the opportunity to update and refresh existing contract terms with incumbent IT providers, particularly for older contracts, and update to account for increased cybersecurity risks, changes in data privacy laws and the adoption of remote working by vendor personnel, as well as incorporate, to the extent possible, any additional flexibility necessary to allow the customer to in-source, step-in, or modify services so the customer has additional options going forward.

2. **Employment Considerations.** Many jurisdictions around the world strictly regulate employee-leasing. Businesses should ensure that their relationship with the vendor in a BOT model satisfies local tests for an arm's length outsourced contracted service. The transition of staff from the incumbent IT providers to the new BOT vendor faces a number of pitfalls, including: damage to the relationship with the incumbent IT providers if the business is perceived as poaching their staff; non-solicit agreements with the existing service provider; the BOT vendor refusing to match or improve the terms and conditions of employment for its (new) staff, hindering their willingness to transition to the BOT vendor; and "acquired-rights" laws (the UK's TUPE is the most well-known) that require the automatic transition of staff when services are moved to another vendor and dictate the terms of this transition. Businesses should prepare at the outset for the transition of staff from the BOT vendor to the business, evaluating any discontinuity between the offerings provided by the BOT vendor and the business, given that the BOT vendor might have its own operational constraints for



what employment terms and conditions it can offer staff. A transfer of the BOT operations via an asset sale will make things more complicated; for example, if the staff's consent is required at the time of transfers. A transfer that occurs via a share sale/acquisition of the company operating the BOT will be more straightforward, but when staff "transfer" with their existing employment terms and conditions when the company is acquired, their integration with the business's existing employees will be more difficult. Finally, the impact of the BOT operations on the business's existing employees should also be evaluated in advance. If employees who are going to be affected by the BOT operations have representation rights, it might be necessary to consult or obtain the opinion of the employees' representatives about the BOT proposal, in a process that must typically occur before any final decisions are made.

3. Privacy and Regulatory Considerations. Privacy laws and regulations should also be reviewed and carefully considered with privacy counsel prior to implementing changes to a business's IT outsourcing strategy. Regulated services – including healthcare services and financial services – should also be reviewed from a regulatory perspective by specialized counsel, as modifying IT outsourcing arrangements which include regulated services could involve the consideration of additional regulatory risks, regulatory notices or approvals, updates to contractual terms and other legal and compliance considerations.

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¹ <https://www.gartner.com/en/newsroom/press-releases/2022-06-14-gartner-forecasts-worldwide-it-spending-to-grow-3-percent-in-2022>