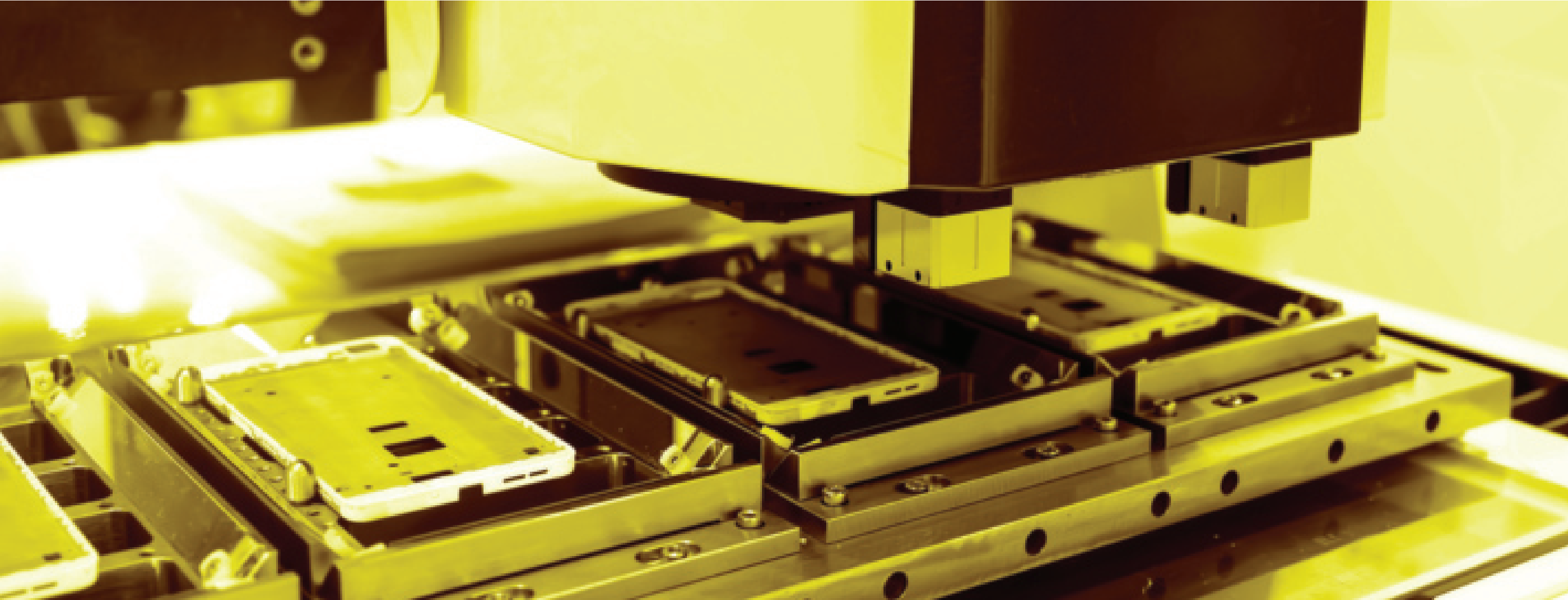

ICLG

The International Comparative Legal Guide to:

Outsourcing 2019

4th Edition

A practical cross-border insight into outsourcing

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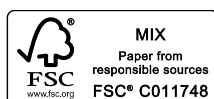

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India

Dhruv Suri

PSA

Arya Tripathy

1 Regulatory Framework

1.1 Are there any national laws or regulations that specifically regulate outsourcing transactions, either generally or in relation to particular types of outsourcing transactions (e.g. business process outsourcings, IT outsourcings, telecommunications outsourcings)?

There is no national law that specifically regulates outsourcing transactions. Multiple regulations govern different aspects based on the industry, parties' jurisdiction, preferred structure, and outsourcing scope. Some laws that generally interplay are:

- *Indian Contract Act* – contract essentials, performance, termination, rights and damages.
- *Companies Act* – establishment, operation, management, restructuring, and dissolution of companies.
- *Foreign Exchange Management Act* – foreign investment, presence in India and foreign exchange.
- *Income-Tax Act* – taxation of income, profits and capital gains.
- *GST Act* – taxation on provision of services.
- *Information Technology Act* – data processing, transfer, protection and privacy.
- *Transfer of Property Act* – transfer of immovable property.
- *Labour laws* – several state and central legislations regulating employment matters.
- *Specific Relief Act* – specific performance of contracts.
- *IPR laws* – protection of intellectual property (**IP**) and rights.

Apart from these, outsourcing in certain sectors is regulated through special laws. Some illustrations are below:

- *Business process* – Business process outsourcers providing voice and data/application services such as call centres, tele-trading, tele-medicine, tele-banking, and e-commerce must obtain "*other service provider*" registration from the Department of Telecommunications and comply with reporting regulations.
- *Financial services* – Banks and financial institutions are regulated by the Reserve Bank of India (**RBI**). Barring core banking and management functions, activities such as recruitment, payroll, and customer query can be outsourced and further, sub-contracted, subject to adherence with RBI directions and the Guidelines on Managing Risks and Code of Conduct in Outsourcing of Financial Services.
- *Insurance* – The insurance sector is regulated by the Insurance Regulatory and Development Authority of India (**IRDAI**) and the outsourcing of insurance services is as per IRDAI (Outsourcing of Activities by Indian Insurers) Regulations, which lists out the prohibited outsourcing activities and prescribes compliances for insurers and outsourcers.
- *Defence* – In defence procurement from foreign vendors in excess of a certain value, the vendor is obligated to offset a fixed % of the value through prescribed routes. One route is to agree for provision of eligible services (*like maintenance, repair, overhauling, engineering, designing, testing, R&D vis-à-vis defence products*) from Indian offset partners through direct purchases, foreign investments, or non-equity investments, and these outsourcing methods are regulated by the Ministry of Defence's offset guidelines.
- *Export promotion* – In order to encourage service exports, the government has notified designated areas as export-oriented units and special economic zones. Outsourcing companies based in these areas obtain various tax incentives, provided they comply with requirements under the Foreign Trade & Development Regulation Act, Foreign Trade Policy, Special Economic Zone Act, export-import regulations and state specific rules.

1.2 Are there any additional legal or regulatory requirements for outsourcing transactions undertaken by government or public sector bodies?

Outsourcing by public sector enterprises (**PSUs**) and government bodies is mostly tender driven, and each case has its specific non-negotiable requirements. Additionally, outsourcing by the Central Government ministries, departments and subordinate bodies is regulated by the Ministry of Finance's General Financial Rules, 2017. In order to promote MSMEs, the Public Procurement Policy notified under the MSME Act mandates central ministries, departments and PSUs to set a 25% annual procurement target from MSMEs. Further, guidelines are also issued by the Central Vigilance Commission and Directorate General of Supplies and Disposals for ensuring transparency in public procurements. Furthermore, certain ministries like defence, railways and telecom, and some states such as Tamil Nadu, Karnataka and Andhra Pradesh have their independent procurement manuals.

1.3 Are there any additional legal or regulatory requirements for outsourcing transactions undertaken in particular industry sectors, such as for example the financial services sector?

See question 1.1 above.

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1.4 Is there a requirement for an outsourcing transaction to be governed by local law? If it is not to be local law, is there any generally accepted norm relating to the choice of governing law?

Under contract law, outsourcing parties can agree on foreign law as the contract's governing law, if the chosen law has close nexus with the contract and parties. However, courts can disregard such choice in light of overriding statutory requirements, consumer protection, employment concerns and public policy. If both parties are Indian, Indian law must be the governing law. Nonetheless, parties can agree that specific clauses (*like data protection and anti-corruption*) shall be governed by foreign law.

2 Legal Structure

2.1 What are the most common types of legal structure used for an outsourcing transaction?

Some of the commonly used outsourcing forms include:

- *Third party outsourcing* – purchase of services based on contract terms with the supplier and without the customer's ownership stake; for example payroll management services from an ERO solutions service provider.
  - Pros: structural simplicity, cost efficiency, lesser tax issues.
  - Cons: minimal control, implementation risks, confidentiality and IP concerns.
- *Project* – a turn-key contract where the supplier designs, completes and delivers a project as per agreed milestones; for example, vendor to set-up and operationalise communication network and infrastructure.
  - Pros and cons: similar to third party outsourcing.
- *Captive centres* – the customer directly or indirectly through another group entity establishes a wholly-owned subsidiary (**WOS**), exercises direct operational and management control in such WOS, and in turn, the WOS provides outsourced services to the customer as well as third parties; for example, MNCs setting up GICs for IT/ITES services to the group and its clients.
  - Pros: direct control, data protection and confidentiality, IP ownership.
  - Cons: increased cost, taxation risk as permanent establishment, related party transactions and transfer pricing concerns, cultural and social differences.
- *Build operate transfer* (**BOT**) – the supplier builds and operates the customer's outsourcing unit as per the customer's specifications (unlike a project model) and performance goals, followed by transfer of the unit to the customer on an agreed date, event and prices as per terms of the BOT contract; for example, a foreign company contracting a software developer to BOT an ITES unit.
  - Pros: cost efficiency by capitalising on technical expertise and reduced execution risks, and similar advantages as captive centre.
  - Cons: unit transfer process, and similar disadvantages as captive centre.
- *Joint venture company* (**JV**) – two parties collaborate to set up a JV for synergies, and in turn the JV provides services to JV partners and third parties.
  - Pros: cost efficiency from synergies and similar advantages as captive centre.
  - Cons: conflicts between JV partners, and similar disadvantages as captive centre.

3 Procurement Process

3.1 What is the most common type of procurement process that is used to select a supplier?

Common procurement processes up to the execution of binding contracts comprise the following steps:

- *Identifying outsourcing goals, requirements and risks* – The customer delineates the goals (*like economies of scale, tax concessions, and synergies*), the requirements (*technical, infrastructural, resources, operating processes*) and associated risks (*could be operational, strategic, reputational, financial and contractual*) of outsourcing. These also help the customer to identify the optimal model.
- *Short listing and identification of supplier* – In alignment with goals, requirements and the risk matrix, the customer shortlists the suppliers. The customer conducts due diligence on shortlisted suppliers to determine their suitability. Depending on scope and model, various aspects are evaluated, including financial credibility, human resources, technical expertise, service levels, pending disputes, and past records.
- *Negotiations* – After identifying the supplier, parties negotiate the key terms. Some of the material terms are scope of services, mode of delivery, payment method, parties' obligations, reciprocal promises, confidentiality and data protection rights, performance monitoring, service levels, standard operating processes, IP, indemnification, limitation of liabilities, termination rights, post-termination obligations, governing law and dispute resolution.
- *Execution* – Once negotiations are completed, parties execute binding contracts and perform their respective obligations.

While the contract is being performed, a customer typically retains periodic and event-specific monitoring, audit and inspection rights to exercise supervision. These are exercised through supplier reporting obligations, documentary access, interviews with the supplier's representatives, and in some cases, site inspection as well.

Where contracting parties are related entities such as in captive models, the typical stages of the procurement process indicated above are not necessary. Between related entities, the process is customer driven, although caution is required in certain aspects such as the captive's employees, potential taxation, corporate compliance, transfer pricing impact, financial consolidation and anti-corruption practices.

4 Term of an Outsourcing Agreement

4.1 Does national or local law impose any maximum or minimum term for an outsourcing contract?

No, the term and its renewal are agreed contractually.

4.2 Does national or local law regulate the length of the notice period that is required to terminate an outsourcing contract?

No, there is no law that prescribes the length of notice period.

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5 Charging

5.1 What are the most common charging methods used in outsourcing transactions?

There are multiple charging models. The most commonly used are:

- *Fixed price* – Parties agree upon a fixed price based on pre-identified scope of work. This is usually the preferred option when scope has been clearly identified.
- *Fixed price for time and material* – The cost is linked with time and manpower used in outsourcing. The formula of the fee is negotiated and contractually agreed. This model is common where the scope of work and time cannot be determined upfront, or where there are multiple suppliers.
- *Cost plus* – The fee consists of the actual cost of the services rendered plus a pre-agreed mark-up or margin, and is common where the scope is evolving and cannot be ascertained upfront. Captive units typically opt for this model as it minimises transfer pricing risks.
- *Milestone based* – This is linked with the project milestones. If certain milestones are not achieved, the customer either stops payment partially or wholly, or reduces future payments by a pre-agreed amount.
- *Other methods* – In some creative outsourcing transactions, customers and suppliers agree on a combination of the above models. Certain charges are on fixed cost, whereas the balance could be structured as milestone-based payments, or any other variable pricing model. In outsourcing transactions where milestones are linked with user engagement, a user-based fee is also agreed upon. Further, in some transactions where the supplier is allowed to commercially exploit the deliverables, the customer can choose to reduce the variable fee.

5.2 What other key terms are used in relation to costs in outsourcing transactions?

Some other key terms relating to costs pertain to invoicing and payment schedules, tax liability, exchange rate, payments for additional scope of work, payment of damages for breach, reimbursements, salary payments and other employment-related benefits.

6 Transfer of Assets

6.1 What formalities are required to transfer, lease or license assets on an outsourcing transaction?

The formalities depend on the nature of the asset, i.e. whether the asset is immovable or movable.

- *Immovable assets* – The Transfer of Property Act governs transfer of immovable assets, including sale, lease, mortgage, and creating any other right over the asset. The transfer and related rights are captured in conveyance deeds, which are subject to payment of stamp duty under the state-specific Stamp Acts, and in most cases, the stamp duty is computed on the consideration payable under the deed. Further, these deeds may have to be registered under the Registration Act.
- *Movable assets* – While there are multiple legislations, such as Sale of Goods Act, Indian Contract Act (“**Contract Act**”) and Companies Act that could potentially apply to the transfer of movable assets, parties are generally free to determine the transfer mode and its value. In fact, movable assets could be transferred by simply handing over possession, but it is recommended that a formal deed be executed.
- *Intellectual Property* – From a customer’s perspective, if its own IP is being transferred, it should always be through a written contract. Depending upon the nature of the IP, this contract may also be required to be filed with the relevant authority to affect the transfer. However, in most cases, the customer licenses its IP instead of transferring it. Even in such cases, the licence terms must be provided in a licence agreement. In case any corresponding technical training, manuals, system documentation, etc. also need to be passed on, the agreement should capture these with adequate representations and warranties. The licence agreement must also detail other aspects such as the nature and purpose of the licence (*i.e. whether exclusive, revocable, worldwide, perpetual, etc.*), term, royalty, and whether the IP is registered or not. The assignment or licence agreement, as the case may be, is liable to payment of stamp duty under the relevant state-specific Stamp Act.
- *Key contract* – Contracts can be assigned if all parties agree to the assignment. In case prior approval is required, then such approval is mandatory for a valid assignment. Typically, if certain rights are assigned, a tripartite agreement is executed between the parties to the original contract and the supplier.

6.2 What are the formalities for the transfer of land?

For transfer of land, a title diligence is done and all title documents are reviewed. Thereafter, a conveyance deed is executed capturing essential terms such as property type, consideration, end-use restrictions (*if any*), encumbrance status, representations and indemnities. The execution is in accordance with state-specific stamping and registration laws.

6.3 What post-completion matters must be attended to?

Generally, any assignment, lease or encumbrance of assets requires post-closing reporting to third parties and regulators such as the Registrar of Companies, income-tax department and concerned local bodies. Further, if any IP has been assigned or licensed, and depending on the nature of IP, regulatory filings may trigger.

6.4 How is the transfer registered?

Prior to registration, the signatories must ensure that proper stamp duty has been paid. Thereafter, the parties must physically appear before the concerned sub-registrar’s office under whose jurisdiction the asset is located. The sub-registrar’s office verifies the conveyance deed and registers it upon payment of the registration fee, which varies for states and in accordance with the Registration Act.

7 Employment Law

7.1 When are employees transferred by operation of law?

In India, employees can be either workmen or white-collar. Workmen are employees engaged in manual, unskilled or skilled, technical, operational, clerical or supervisory work in an industry. Employees engaged in administrative, managerial or supervisory work with monthly remuneration exceeding INR 15,000 (*about*

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USD 69) are white-collar employees. White-collar employees are primarily governed by the contracted employment terms, while a variety of legislations regulate workmen's employment conditions.

As such, the supplier's employees continue to remain under the supplier's employment, although they can be seconded, or posted, to the customer's location to perform outsourced services. The supplier continues to be responsible for all employment matters, including payment of wages and social security contributions. However, where the supplier hires an employee only for the outsourced services which happen to be the customer's core operations, and the customer directly exercises supervision, the customer may qualify as the principal employer under the contract labour regulations. In such cases, the customer is legally responsible for all employment matters.

Employees are transferred by operation of law when there is transfer of ownership or a business undertaking on a going concern basis. Thus, in the context of outsourcing, employee transfer does not trigger, unless outsourcing involves acquisition of the supplier or is structured as BOT.

Where the supplier transfers ownership or a business undertaking, employees must be transferred with service continuity and on similar or more favourable terms. Accrued employee benefits and social security provisions must also be transferred to the transferee. However, a white-collar employee has the option of not joining the transferee, as their employment is based on offer and acceptance. In such scenario, the supplier can terminate employment by providing notice, remuneration and severance pay as per the employment terms, concerned state Shops & Establishments Act (**S&E Act**) and applicable social security legislations. In case of workmen, the supplier is obligated under the Industrial Disputes Act (**ID Act**) to transfer employees with service continuity on similar or more favourable terms, and where terms are varied, the supplier must comply with the retrenchment process, which essentially requires the employer to provide one month's written notice or pay *in lieu*, notify the concerned government authority, pay severance compensation equivalent to 15 days' wages for every completed year of service, and social security benefits. Further, where the transferor has a collective bargaining agreement with a workmen's trade union, additional terms as per such agreement must be followed.

7.2 On what terms would a transfer by operation of law take place?

See question 7.1 above.

7.3 What employee information should the parties provide to each other?

There is no legal mandate, and the scope of information shared depends on the nature, structure and duration of the outsourcing arrangement. The supplier's human resource is a key aspect of its technical competence and resourcefulness, and often, customers require contractual representations on diligence, skill, qualification and expertise of deployed human resources. In outsourcing models involving ownership/business transfer or with a long duration, the customer usually conducts due diligence, where it reviews supplier's employment terms, records, policies and practices, to identify compliance with law, unfair labour practices, existence of trade unions, collective bargaining agreements, potential and ongoing industrial disputes and allied risks.

7.4 Is a customer/supplier allowed to dismiss an employee for a reason connected to the outsourcing?

Yes, the supplier and the customer can dismiss their respective employees for reasons connected to the outsourcing, provided dismissal is as per the employment contract and applicable law. The applicable law is contained in the state-specific S&E Act and ID Act. Generally, an employee can be dismissed for misconduct, without any notice or pay. Further, employers can dismiss for reasonable cause (*like poor performance, conflict of interest, redundancy of position*) or for convenience, with notice and pay as agreed in the contract or provided under applicable law, whichever is more favourable. Termination of the outsourcing contract *per se* cannot be the reason for dismissal, except where the employee was specifically hired for the project and such eventuality is a termination ground under the employment contract.

7.5 Is a supplier allowed to harmonise the employment terms of a transferring employee with those of its existing workforce?

Variation for harmonisation is permissible for workmen only if it results in more favourable employment conditions. While this theoretical possibility exists, in practice it becomes difficult, more so, where the transferor has collective bargaining arrangements and trade unions. In case of white-collar employees, variation is permissible, but the employee may refuse to accept, in which scenario, the transferor can terminate employment (*see* question 7.1 above).

7.6 Are there any pensions considerations?

Pension payments in India are regulated under Payment of Gratuity Act (**POGA**) and Employees' Provident Fund & Miscellaneous Provisions Act (**EPFA**). Where the supplier's employees are seconded or posted to a customer's location, EPFA and POGA contribution obligation remain with the supplier. Where outsourcing involves ownership/business transfer, the accumulated contributions are transferred for the employee's continuity of services. If the employee is terminated or retrenched, the contributions are payable as per the withdrawal process under applicable law.

7.7 Are there any offshore outsourcing considerations?

Yes, several practical considerations can arise depending on the offshore outsourcing model. For instance, where a multinational parent sets up a captive unit, it seeks to implement global employment terms and policies *vis-à-vis* Indian employees. This often results in cultural mismatches leading to difference of opinion between the parent company and the Indian management. Another example is where BOT model is followed, despite contractual provisions for effective and smooth transfer of operations, assets and employees, the transferee may have to obtain prior consent from trade unions to mitigate future risks, even though there may not be any legal requirement.

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8 Data Protection Issues and Information Security

8.1 What are the most material legal or regulatory requirements and issues concerning data security and data protection that may arise on an outsourcing transaction?

Data protection and security is governed by the Information Technology Act (**IT Act**) and rules made thereunder, more specifically, the Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011 (**IT Rules**). These rules contain the procedural and substantive data protection obligations concerning collection, receipt, possession, storage, or any other manner of dealing in personal information (**PI**), *i.e.* information that can lead to identification of a natural person. Certain kinds of PI such as passwords, financial information, physical and mental health conditions are treated as sensitive PI. Some of the relevant requirements under the IT Rules are:

- any organisation processing PI must provide a privacy policy communicating types of PI collected, purpose of collection and usage, and reasonable security practices followed in an easily accessible format;
- PI can be processed under lawful contract and in case of sensitive PI, consent must be obtained for collection, processing purposes, intended recipients and data retention agency;
- disclosure to a third party must be with consent or for legal compliance;
- cross-border transfer is allowed for performance of contract or with consent, provided the transferee's jurisdiction affords the same level of data protection as India; and
- organisations processing PI must implement reasonable security practices and procedures through a comprehensive documented information security programme containing managerial, technical, operational and physical security control measures commensurating with its information assets and nature of business.

With implementation of the European Union General Data Protection Regulation (**EU GDPR**) in May 2018, Indian outsourcing companies, specifically business processing and IT/ITES companies, had to revamp their existing practices to align with the stricter requirements, including data inventorisation, conducting information security audits, implementing privacy contact management, streamlining information sharing and retention policies, and appointing data protection officers.

Additionally, in 2017, the Indian Supreme Court recognised informational privacy as a fundamental right enforceable against state and a horizontal right against private parties. Thus, an individual can seek appropriate judicial remedies against private entities for data privacy breaches and its consequent harm. Further, the Ministry of Electronics and Information Technology's draft Personal Data Protection Bill, 2018 (**PDP Bill**) is in the pipeline. PDP Bill contemplates extraterritorial effect, is significantly influenced by the EU GDPR, proposes establishment of a Data Protection Authority, and contains rigorous principles, conditions and compliances for processing PI. It also provides for substantial penalties and imposes personal liability on corporate officers for breaches.

Apart from the regulatory regime, most outsourcing contracts contain extensive covenants concerning data ownership, data transfer, confidentiality, processing protocol, technological and information security practices, and indemnities for breach claims. Negotiating these clauses takes substantial time and suppliers are likely to resist onerous data protection and privacy obligations emerging from the customer's applicable law.

8.2 Are there independent legal and/or regulatory requirements concerning information security?

Some sectors and business activities could trigger specific information security requirements in addition to the IT Rules. For instance, IRDAI notified the Guidelines on Information and Cyber Security for Insurers in 2017 making insurers primarily responsible for risk, data security and access to outsourced vendors. It obligates them to review outsourcers at a defined frequency, conduct security assessments and audits, and define their information security requirements. Similarly, RBI in 2016 notified the Cyber Security Framework in Banks, as per which banks are required to put in place an "*adaptive*" incident, response, management and recovery framework, and a board-approved distinct cyber security policy.

9 Tax Issues

9.1 What are the tax issues on transferring the outsourced business – either on entering into or terminating the contract?

There are multiple aspects that get taxed in an outsourcing transaction, and relevant tax impact will depend on the transaction structure and nature of the transferred asset. Outsourcing-related assets and business can be transferred as lump sale (*i.e. transfer of undertaking at a lump sum value without assigning individual value to different assets*) or itemised asset sale. In both instances, capital gains tax is levied on the gains from the transfer consideration, irrespective of whether it is while entering or terminating the contract. If the undertaking or asset has been held for 36 months or more before the date of transfer, long-term capital gains tax is levied at 20%, and where the period of holding is less than 36 months, short-term capital gains tax is levied at 30 to 40%. Additional surcharge may be added for determining the total tax liability. Further, when employees are transferred as part of the business, payments made to them shall be subject to withholding tax deductions. Furthermore, there could be potential Goods and Service Tax implications if the transfer is viewed as supply of services.

9.2 Is there any VAT leakage on the supply of services under the outsourcing contract?

The supplier is entitled to the input tax credit on inputs/input services used in relation to the provision of services.

9.3 What other tax issues may arise?

Some other tax issues that could possibly trigger pertain to:

- Double taxation treaties – Some key tax treaties, like the ones between India and Mauritius and Singapore, have been amended to limit exemption from capital gains. This has led to greater scrutiny by tax authorities where one of the transacting entities is from these "*erstwhile*" tax havens.
- Transfer pricing – In case of captive units, it is important that the pricing is at arm's-length, failing which such transactions are scrutinised for transfer pricing.

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- *General anti-avoidance rule* – This rule allows tax authorities to completely disregard all arrangements that, in its view, may have been entered into with the sole intent of avoiding tax.

10 Service Levels

10.1 What is the usual approach with regard to service levels and service credits?

Service Level Agreements (**SLAs**) are a very critical component of any outsourcing transaction, and parties have full freedom to determine all the key commercial terms of an SLA. Generally, they capture the nature of service, specifications, service levels, commitments for effective support, and other important matters. The customer typically proposes the initial pointers for service levels, based on which the initial draft is prepared, negotiated and agreed upon. SLAs are periodically updated and revised based on how the project is progressing. In case of any breach, SLAs also provide for penalty and/or termination. They expire upon performance of the services.

Service credits are essentially amounts that are deducted by the customer from the amounts payable to the supplier, if the supplier fails to conform to the performance norms under the SLA. Most outsourcing agreements involving a variable fee factor allow for service credits. In some creatively drafted agreements, the supplier is allowed to extinguish the credits given to the customer or accumulate its own credits that can then be set-off against those accumulated by the customer.

11 Customer Remedies

11.1 What remedies are available to the customer under general law if the supplier breaches the contract?

In case the supplier breaches, the customer has multiple remedies, namely:

- *Damages and penalties* – The right to claim and quantum of damages accrues under the Contract Act. However, in most contracts, parties agree on liquidated damages (**LDs**). While damages in India are always "*actual*" and not indirect or consequential, LDs are deemed to be a pre-estimate of the loss arising out of a breach. Therefore, if the contract provides for LDs, the aggrieved party needs to prove breach, and not "*actual*" loss. If the contract is silent on LDs, then the claimant has to prove breach and "*actual*" loss of the amount so claimed as damages.
- *Specific performance* – The right to seek specific performance is governed under the Specific Relief Act. It allows courts to direct performance of the contract, provided certain circumstances do not arise, such as the aggrieved party agreeing to substituted performance, or where the contract is, by its nature, determinable.
- *Injunction* – In case of any urgent relief, the aggrieved party can seek an injunction restraining or directing the other party to perform a certain act. Where there is a risk of confidential information being breached or IP being compromised, injunction is the most sought-after remedy.
- *Criminal case* – In some rare cases, customers may also be in a position to initiate criminal proceedings such as for fraud, criminal breach of trust, and financial embezzlement.
- *Insolvency* – The Insolvency and Bankruptcy Code allows an operational creditor to initiate insolvency proceedings against its debtor for non-payment of undisputed dues. Since the consequences of insolvency are severe, in most cases, parties attempt to settle their debts outside court. However, if any litigation or arbitration proceedings are initiated to recover the debt, insolvency proceedings cannot be initiated on account of an underlying dispute.

11.2 What additional protections could be included in the contract documentation to protect the customer?

From a customer's perspective, it is preferable to not agree on limitation of liability clauses, so that the supplier has uncapped liability for breach. Further, the customer must emphasise on (i) the supplier's insurance covenants to ensure that all risks are reasonably insured, and (ii) retaining audit and inspection rights to be able to monitor contract performance, especially where payments are milestone-based. Furthermore, clauses pertaining to representations and warranties, indemnity, non-compete and non-solicitation, and confidentiality require special care.

11.3 What are the typical warranties and/or indemnities that are included in an outsourcing contract?

Typical supplier warranties include its legal competence to perform obligations, having all relevant regulatory permits, IP ownership, adequate resources for delivery of services, expertise of employees, compliance with local laws, absence of pending proceedings, data security and anti-corruption practices.

With respect to indemnities, the supplier is generally required to indemnify for breach of confidentiality and data protection obligations, third party IP infringement claims, and loss arising out of breach of applicable laws, service level warranties, fraud, gross negligence or wilful misconduct. Often specific indemnities are also identified based on the nature of the transaction.

12 Insurance

12.1 What types of insurance should be considered in order to cover the risks involved in an outsourcing transaction?

It is very common for customers to require the supplier to obtain contractor all risk insurance equivalent to the consideration value, general property and product liability insurances, and those which are mandatory under applicable law such as public liability and employee's compensation insurance. Of late, customers also seek that the supplier takes out adequate D&O and cyber security insurances.

13 Termination

13.1 How can a party to an outsourcing agreement terminate the agreement without giving rise to a claim for damages from the terminated party?

Outsourcing agreements can be for a fixed time with the option to extend the term mutually. Parties can also agree to terminate for convenience by giving notice and/or payment of determined amounts as termination payout. These two options substantially reduce the risk of claims for damages.

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Further, it is common for parties to agree on termination for *force majeure*, breach of contract, bankruptcy, change of control and ownership, fraud and misrepresentation, negligence and wilful misconduct. Termination on these grounds is likely to result in a dispute and claim for damages.

13.2 Can the parties exclude or agree additional termination rights?

Yes, parties can exclude or include additional termination rights, such as notice delivery modality, notice period, mandatory default cure period, suspension of contractual rights, reasonable assistance for smooth transition, and post-termination non-compete and non-solicitation obligations.

13.3 Are there any mandatory local laws that might override the termination rights that one might expect to see in an outsourcing contract?

There are no mandatory local laws that override contractual termination rights. Nevertheless, general contracting law principles require termination and post-termination related clauses to be reasonable, and hence, one-sided clauses are best avoided. For instance, post-termination non-compete and non-solicitation clauses should be for a reasonable duration that is essential to safeguard a party's interest, depending on the nature of services, customer's business, contract term and other relevant factors. Prolonged durations are more likely to be viewed as restrictions on one's right to carry trade and business, and consequently, ruled invalid.

14 Intellectual Property

14.1 How are the intellectual property rights of each party protected in an outsourcing transaction?

Based on the nature of IP, it can be protected contractually or through registration with the relevant authority, or both. Any IP disclosed during the transaction is usually covered as confidential information and protected contractually. On the other hand, IP such as trademarks and copyrights are either licensed, transferred, or specifically acknowledged as non-transferable and belonging to either the customer or supplier. The customer should try and ensure that all its IP is either registered or filed for registration. If not, stringent representation and warranties ought to be taken.

Further, under Indian law, ownership of all copyrightable work (*like source and object codes, formulae, and know-how*) automatically vests with the employer. Thus, it is important that all of the supplier's employees have clauses confirming this in their employment terms. As far as patents are concerned, there is no automatic assignment and, therefore, any new invention has to be specifically assigned by all those who have worked upon it, including any independent consultants. With respect to trademarks, the transfer or licence, as the case may be, should be registered with the Indian trademark registry.

14.2 Are know-how, trade secrets and other business critical confidential information protected by local law?

No, there is no statutory protection for know-how, trade secrets and confidential information. These are always protected through the contract.

14.3 Are there any implied rights for the supplier to continue to use licensed IP rights post-termination and can these be excluded from the agreement?

No, there are no implied rights, unless expressly agreed upon.

14.4 To what extent can the customer gain access to the supplier's know-how post-termination and what use can it make of it?

This depends upon the nature of the transaction and the contracted terms. For instance, if the contract stipulates that the customer shall have unfettered access to all IP, know-how, and confidential information pertaining to the transaction post-termination, then it can assert such rights. However, if the supplier considers that some information has no bearing with the transaction and as such is not covered within the scope of the contract, it can prevent the customer from accessing such information.

15 Liability

15.1 To what extent can a party limit or exclude liability under national law?

Parties can contractually limit and/or exclude their liability. The supplier can limit liability by capping it to the contract value, or a certain percentage thereof. In instances where payments are milestone-based, liability can be capped to the amount linked with the defaulted milestone. Where the contract is silent, the Contract Act allows the aggrieved party to claim damages only for breach circumstances that arose naturally in the usual course of things, or those which parties knew are likely to ensue from the breach. In any event and notwithstanding the contractual terms, the Contract Act does not allow a party to claim indirect or consequential damages.

15.2 Are the parties free to agree a financial cap on liability?

Yes, parties can agree on a financial cap.

16 Dispute Resolution

16.1 What are the main methods of dispute resolution used?

Most outsourcing contracts refer disputes to institutional arbitration (*like ICC, SIAC*) before a panel of three arbitrators, where each party nominates one arbitrator and the two nominated arbitrators then appoint the chairperson. The arbitration seat is typically fixed as the customer's or supplier's location, or a neutral venue. However, before invoking arbitration, contracts contemplate that parties' senior management formally meet and attempt to settle their differences, failing which arbitration is invoked. There is also an increasing trend to opt for formal mediation through mediation centres.

In instances where *ad hoc* arbitration is preferred and where Indian law governs the contract, the Arbitration & Conciliation Act regulates the proceedings. The said Act was amended in 2015 requiring conclusion of all arbitration proceedings within 12 months, extendable to another six months with parties' consent. If these timelines are not met, the mandate of arbitrators can terminate.

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In a few rare instances, parties prefer to litigate instead of invoking arbitration. In such cases, the contract mentions which court shall exercise exclusive jurisdiction to adjudicate the dispute.

17 Good Faith

17.1 Is there any overriding requirement for a customer and supplier to act in good faith and to act fairly according to some objective test of fairness or reasonableness under general law?

The underlying principle of the Contract Act requires contracting parties to act in good faith. The good faith requirement allows an aggrieved party to claim damages, even in the absence of an express contractual right, and multiple judicial precedents recognise the principle of good faith and reasonableness while enforcing contracts.

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Arya significantly contributes to the Firm's *pro-bono* services and is a member of Society of Women Lawyers – India and Inter-Pacific Bar Association. She has represented the Firm at conferences and seminars, and has also published various articles in reputed international and national journals on contemporary legal topics.

PSA is a full service business law firm with offices in New Delhi and Chennai while working pan India seamlessly. The firm was founded by Priti Suri, a lawyer with 33 years of experience in three continents.

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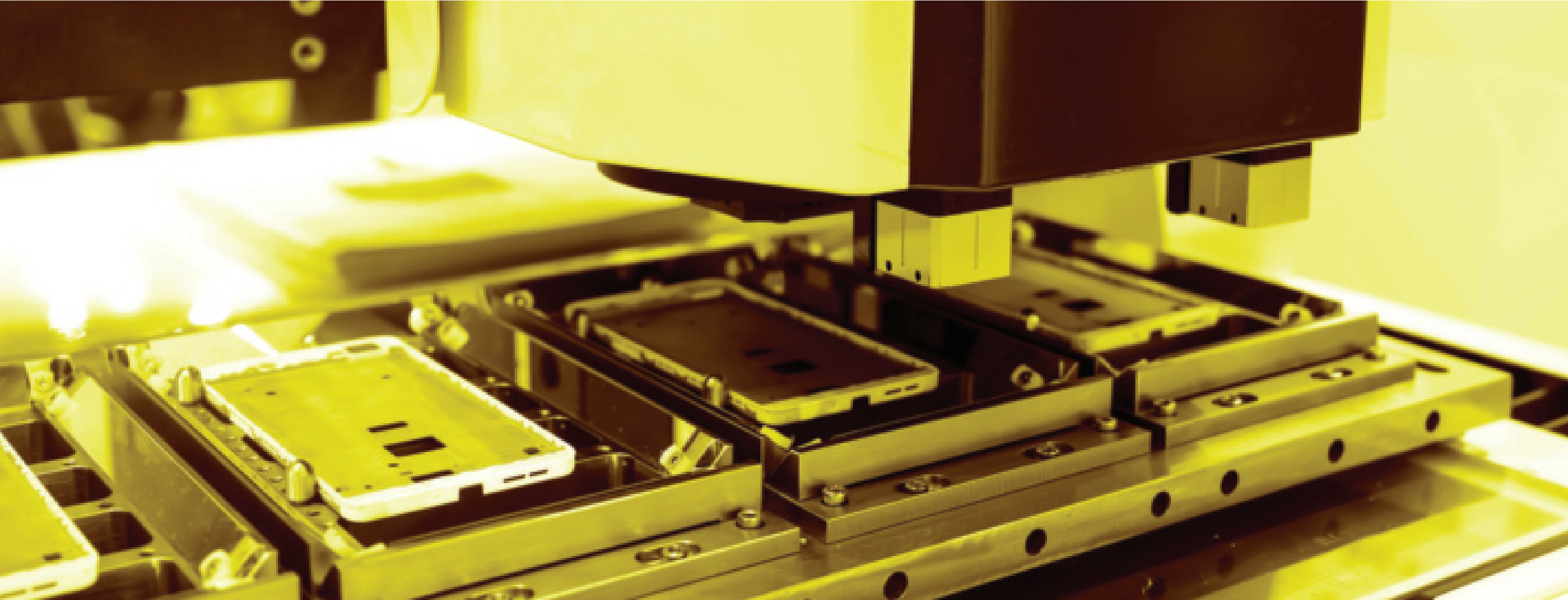

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