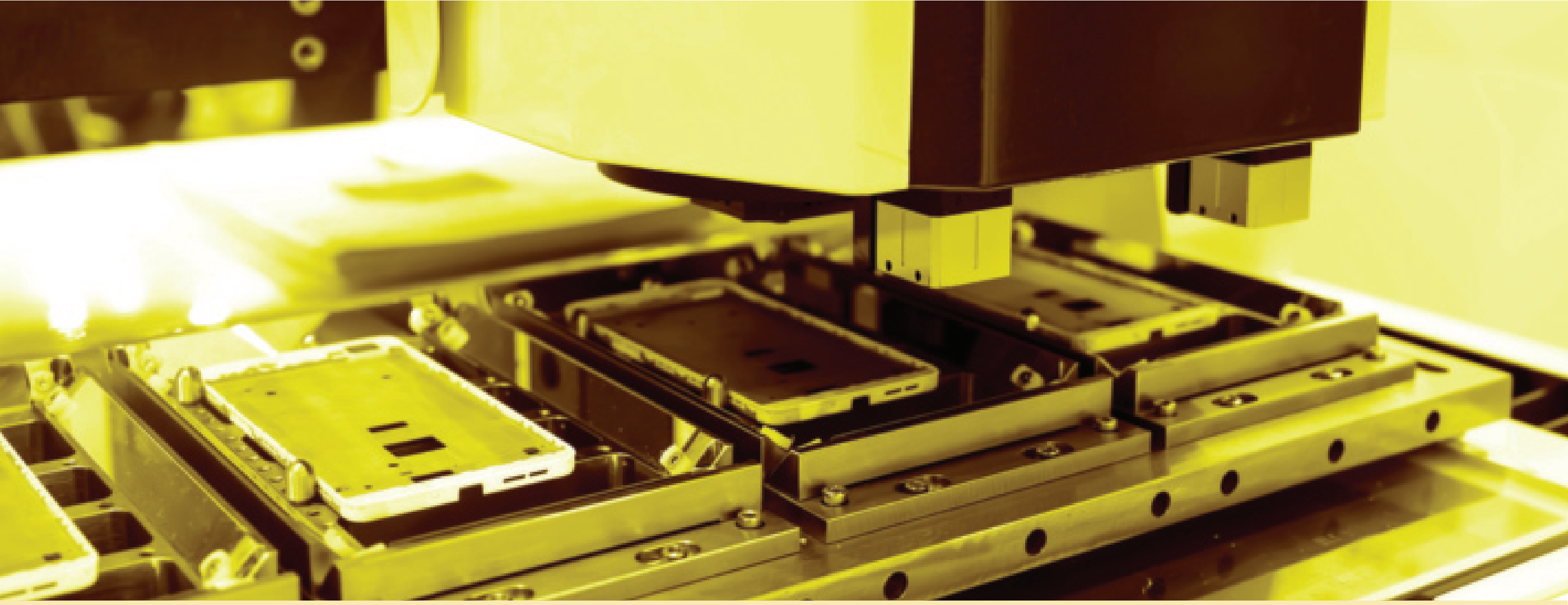


ICLG

The International Comparative Legal Guide to:

Outsourcing 2019

4th Edition

A practical cross-border insight into outsourcing

Published by Global Legal Group, with contributions from:

Anderson Mōri & Tomotsune
Angara Abello Concepcion Regala & Cruz Law Offices (ACCRALAW)
Arioli Law
Ashurst Hong Kong
Astrea
Bird & Bird LLP
BSN Bufete Sánchez-Navarro, S.C.
Centre for Outsourcing Research and Education (CORE)
Cliffe Dekker Hofmeyr Inc.
Frieh Associés
Ikeyi Shittu & Co.
Integra Law Firm
MinterEllison
NautaDutilh Avocats Luxembourg
Noerr LLP
Portolano Cavallo
PSA
Sabara Law LLC (a member of the Deloitte Legal Network)
SAMANIEGO Law
SIQUEIRA CASTRO ADVOGADOS
Wiggin and Dana LLP
Yazıcıoğlu Attorneys at Law

global legal group

Contributing Editor
Mark Leach,
Bird & Bird LLPr

Publisher
Rory Smith

Sales Director
Florjan Osmani

Account Director
Oliver Smith

Senior Editors
Caroline Collingwood
Rachel Williams

Group Consulting Editor
Alan Falach

Published by
Global Legal Group Ltd.
59 Tanner Street
London SE1 3PL, UK

Tel: +44 20 7367 0720
Fax: +44 20 7407 5255
Email: info@glgroup.co.uk
URL: www.glgroup.co.uk

GLG Cover Design
F&F Studio Design

GLG Cover Image Source
iStockphoto

Printed by
Ashford Colour Press Ltd
July 2019

ISBN 978-1-912509-86-7
ISSN 2397-6896

Strategic Partners

General Chapters:

Country Question and Answer Chapters:

Chapter 18

South Africa

Preeta Bhagattjee

Christoff Pienaar

Cliffe Dekker Hofmeyr Inc.

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 are no specific national laws regulating outsourcing.

However, there are provisions relevant to outsourcing transactions in the airline industry, medical and medical schemes industry, defense industry, banking and financial services and telecommunications industries.

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

As a public entity in South Africa or as a supplier tendering to public entities for technology related outsourcing or procurement contracts, any decision to embark on a tender process for the outsourcing of services or to bid for the provision of such services should be taken after careful consideration of the legislative backdrop. A public entity would be required to consider the various legislative constraints under which it would have to conduct the tender process and evaluation of bids. The importance of government procurement in South Africa is underpinned by its specific mention in the Constitution of South Africa which states that all such procurement has to be "*fair, equitable, transparent, competitive and cost-effective*".

To give effect to the constitutional status of government procurement, various statutes have been enacted to regulate these activities. These include the Public Finance Management Act, the Municipal Systems Act, the Municipal Finance Management Act, the Broad Based Black Economic Empowerment Act, the Promotion of Administrative Justice Act and the Preferential Procurement Policy Framework Act. In addition, the common law and the general rules applicable to administrative and constitutional law also have application. Unlike contracting for technology services in the private sector where basic commercial requirements are generally the only overarching factor in making a determination to appoint a supplier, public entities, being statutory creations, are required to act strictly within the legal bounds conferred upon them by statute.

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?

In the financial services industry, there are a number of national laws and regulations that regulate aspects of outsourcing transactions. The Financial Sector Regulation Act, 9 of 2017 ("**FSR Act**"), Insurance Act, 18 of 2017 ("**Insurance Act**") and Prudential Standard Governance and Operation Standards for Insurers ("**GOI Standards**") are applicable to the outsourcing of 'material business activities' by insurers. In short, GOI 1 (Framework for Governance and Operational Standards for Insurers) sets out the high-level framework for assessing the governance and operational soundness of South African insurers from a regulatory perspective. The principles set out in GOI 1 are supported by detailed standards and attachments which address certain aspects of the framework, i.e. GOI 5 is a more detailed account of the standards applicable to insurers in respect of outsourcing.

The basic principle of outsourcing by insurers, as set out in GOI 5, is that the insurer retains responsibility for all regulatory obligations, regardless of whether or not an activity or function is outsourced. Therefore, the outsource arrangement must provide the Prudential Authority with the same visibility over regulated activities as it has with the insurer. It also means that an insurer must have appropriate oversight of the person (supplier) who provides the outsourced activities or functions, so as to ensure that the insurer's regulatory compliance is not impaired. GOI 5 deals with three general sets of circumstances applicable to outsourcing by insurers, namely (i) circumstances in which an insurer may not outsource a function or activity, (ii) circumstances in which an insurer must notify the Prudential Authority before entering into an outsource arrangement for a material activity, and (iii) matters that must be considered in any outsource arrangement. GOI 5 further sets out a very broad set of factors which should be applied by an insurer to determine whether or not a business activity is "outsourced" and whether it constitutes a 'material business activity'.

The FSR Act defines "outsourcing" (as it relates to financial institutions) as an arrangement between a financial institution and another person for the provision to or for the financial institution of any of the following:

a. a control function;

b. a function that a financial sector law requires to be performed or requires to be performed in a particular way or by a particular person; and

c. a function that is integral to the nature of a financial product or financial service that the financial institution provides, or is integral to the nature of the market infrastructure, but does not include:

(i) a contract of employment between the financial institution and a person referred to in paragraph (a) or (b) of the definition of "**staff member**"; or

(ii) an arrangement between a financial institution and a person for the person to act as a representative of the financial institution.

In July 2014, the South African Reserve Bank issued Guidance Note 5/2014 replacing Guidance Note 3/2008 which applies to banks in South Africa who outsource certain components of their operations to a third party. This Guidance Note requires banks to notify SARB of any outsourcing arrangements which they intend entering into which have a bearing on the risk profile of the bank, affects the systems and controls of the bank, is classified by the bank's management as being of strategic importance and which has implications for SARB's discharge of its supervisory responsibilities. In respect of any such outsourcing arrangements, a bank has to have undertaken an investigation into the competence of the proposed supplier, be able to verify the supplier's performance levels and that such supplier is able to perform at the expected levels for the duration of the agreement. Appropriate structures would be required to be set up within the bank to ensure ongoing management and monitoring of the terms of the outsourcing arrangement. The bank is required to have stringent service level agreements with early exit provisions. Banks are also required to have formal contingency plans in place. The agreements with an outsourcing provider should specifically allow for SARB access to all relevant information in order for it to carry out its regulatory functions. If a supplier is located outside of South Africa, the bank must ensure that SARB is still able to effectively conduct its supervision duties. The Circular specifically states that SARB does not support the outsourcing of a bank's internal audit function to a third party. Directive 8/2016 was issued by the SARB on 13 December 2016 and this Directive specifies certain reporting requirements in respect of the outsourcing of material functions by a bank.

The SARB issued a directive and guidance note in terms of the Banks Act during September 2018 specifying aspects banks must consider when electing to adopt cloud computing as a service or any offshoring of data. SARB requires that banks follow a risk-based approach, taking into account the bank's risk profile, size of the bank and its operations. In essence, banks are directed to:

- ensure that a formal board-approved data strategy and governance framework is in place;
- ensure that the offshoring of data and use of cloud computing in no way inhibits any regulators' (having jurisdiction over the activities of the bank) ability to fulfil their duties; and
- ensure that any cloud computing arrangement does not prevent the bank's ability to conduct forensic audits or investigations.

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?

There is no requirement for outsourcing transactions to be governed by local law. The general principle or norm applied is for the governing law to be the law where the customer and its business (recipient of the services) are based.

2 Legal Structure

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

Single supplier outsourcing

This is the most common form of outsourcing arrangement whereby an entire service requirement is outsourced to one supplier with whom a comprehensive outsourcing agreement is concluded. To the extent that the services may require the services of a third party other than the supplier, it is the supplier's responsibility to subcontract such services to the third party, usually with the customer's prior written consent. Despite any such sub-contracting, the supplier continues to retain full responsibility for the service provision to the customer. Hence, the supplier is responsible for meeting the full set of service levels which are imposed on it by the customer in terms of the agreement. The supplier is usually required to take out adequate insurance cover to cover its risks under the contract, and the customer may require a parent company guarantee to be furnished to it by the supplier's ultimate parent company.

Multiple vendor sourcing

For strategic business or technical reasons, a customer may prefer to engage in sourcing arrangements with multiple suppliers within the same service or operational area or division within its business. In this case, the customer will enter into separate agreements with each such supplier, but would need to ensure that appropriate accountability is contracted for with each supplier with stringent provisions ensuring that each supplier fully cooperates with the other suppliers, where this is required. This model requires more specific management of each of the suppliers and the interfaces between the services which each supplier provides to the customer.

Supplier with an integrator function

In the multiple vendor sourcing model mentioned above, the customer would retain the role of integrating and coordinate the services and service provision of each of the suppliers. The customer may however wish to contract a third party to carry out this function instead of retaining this role. Such third party would be required to ensure that the customer receives timeous, seamless and continuous service performance between all the relevant suppliers.

Joint venture (JV) arrangements

In some cases, the customer may enter into a JV arrangement with its supplier, setting up a separate company in which both the customer and supplier has an interest. This approach allows both parties to benefit from the arrangement from a commercial perspective. This arrangement also allows the customer to exercise greater control and direction in the management and operation of the JV and accordingly in the ultimate service provision to itself.

The most common contractual structures used for outsourcing agreements are (i) a services agreement with schedules (or annexures) attached to it, or (ii) a master services agreement with statements of work (or transaction agreements, or work orders) executed under it. From a legal perspective, there is no 'preferred' structure and the contract structure should be determined by the nature of the services, whether or not the parties have an existing contractual relationship and the preference of the parties. The primary difference between (i) and (ii) is that (i) constitutes a single contract, whereas (ii) consists of multiple contracts governed by the same overarching terms.

3 Procurement Process

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

The first step in any outsourcing process is that the customer is required to carefully analyse their specific business processes and problems comprehensively and based on this, come up with the most practical and workable solution for that problem. This solution is then drawn up into a request for information (RFI) or request for proposal (RFP) specification document.

The customer will then identify and invite potential bidders to respond to the RFI or RFP, as the case may be. In some cases, a customer may issue a RFI first and then require formal bids based on a subsequent RFP process. As part of the RFP documentation, the customer may include the text of the outsourcing contract which it intends to conclude with the successful bidder (or a term sheet containing the key legal risks which it requires the bidder to assume), its required service levels and specific service requirements.

Once the RFI and/or RFP responses have been received, the customer will assess and evaluate same and such evaluation may include onsite investigations, client site visits and due diligence exercises which the customer may conduct on the bidders. The bidders are also often afforded the opportunity to carry out a due diligence exercise of the customer's service environment in order to provide accurate and binding pricing. When such due diligence exercise will take place would depend on the number of phases in the tender process. Generally, the customer will not choose a successful bidder before it has short-listed a number of the bidders and entered into negotiations with each of these in order to then carry out a further set of evaluations to arrive at the determination of who the successful bidder would be.

Additional regulatory requirements apply with regard to outsourcing within the public sector (see above, section 2 *Public Sector*).

4 Term of an Outsourcing Agreement

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

As a general rule, no, but public sector legislation such as the Public Finance Management Act, will have an impact on the award and renewal of outsourcing contracts.

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

No, the parties are free to negotiate the duration.

5 Charging

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

Based on our experience, the typical charging models adopted in outsourcing contracts are (i) fixed price, (ii) time-and-materials, and (iii) cost-plus. It is not uncommon to find all three pricing models in a single outsourcing contract, depending on the nature of the services. In our view, the primary driver of a pricing model should be alignment of the parties' incentives.

Among the new pricing structures increasing in popularity are gain-sharing arrangements, incentive-based contracts, shared risk-reward arrangements and demand-based pricing.

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

Pricing which is subject to variation would usually be governed by:

- Inflationary index changes (e.g. CPI) and other indices such as changes in petrol prices, salary-based indices and market changes.
- Audit rights, which allow the customer to investigate charges and charging mechanisms. If any errors or overcharges are discovered during such audit exercise, the contract should oblige the supplier to refund any such overcharges.
- Benchmarking provisions.
- Most favoured customer status provisions, which provisions oblige the supplier to reduce its prices to the customer if it is providing the same service to any other customers at a lower price.
- With regard to services which have a foreign currency component or impact to the supplier, pricing terms usually provide a mechanism to cater for changes in the applicable exchange rate and would state which of the parties would be responsible for taking out forward cover, if applicable.

6 Transfer of Assets

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

<u>IP rights and licences</u>

A transfer of ownership of intellectual property rights must be in writing and must be signed by the assignor, and may require registration of the transfer, depending on the intellectual property rights involved. Transfer or assignment of patents rights, design rights and trademarks in particular have to be effected in the prescribed manner.

The transfer of intellectual property licences would generally be required to be effected by written assignment and may, in addition, require the licensor's consent.

The transfer of intellectual property rights by a South African resident company/person outside of South Africa also requires approval from the Financial Surveillance Department of the SARB as it constitutes an export of capital for exchange control purposes.

<u>Movable property</u>

Ownership of movable property is transferred by delivering such property to the supplier with the specific intention to transfer ownership. However, a written assignment is usually recommended to transfer movable property for evidential purposes and would generally be recorded in the outsourcing agreement. Where assets are leased, the transfer would usually require the lessor's consent.

<u>Key contracts</u>

The assignment of key contracts should generally be required to be effected in writing as stipulated in the outsourcing agreement. These key contracts would need to be reviewed to determine whether the counterparty's written consent is required before the contract may be transferred. If key contracts cannot be transferred or where the customer would prefer that it retains such contractual relationship with the counterparty in question, the customer would contract the supplier to provide management services in respect of such contracts whereby the supplier would, for a fee, be responsible for liaising and interfacing with the counterparty in order to ensure that the counterparty performs in accordance with the contract with the customer.

6.2 What are the formalities for the transfer of land?

The transfer of ownership in immovable property is governed by legislation, specifically in terms of Section 16 of the Deeds Registries Act 47 of 1937, which stipulates that transfer must be affected by means of a Deed of Transfer, which has to be registered by the Registrar of Deeds. Further, the transfer of title to immovable property has to be effected in writing. Where the property in question is leased, the consent of the landlord or licensor may be required to transfer the lease to the supplier.

6.3 What post-completion matters must be attended to?

The purchaser must pay the South African Revenue Services (SARS) transfer duty, a tax levied on property transfers.

6.4 How is the transfer registered?

The transfer of immovable property and leases for 25 years or more must be registered at the Deeds Office.

7 Employment Law

7.1 When are employees transferred by operation of law?

Initial Outsourcing

Section 197 of the Labour Relations Act, No 66 of 1995 provides that when a business is transferred as a going concern, the effect is that employees of that business automatically become employed by the new owner of the business, without the need for new contracts of employment between the employees and the new owner. An automatic transfer of contracts of employment takes place from the transferring employer (previous employer) to the acquiring employer (new employer) now takes place in the event that the whole or part of any business, trade, undertaking or service is transferred from the previous employer to the new employer as a going concern.

The requirements for the operation of section 197 are that (i) the whole or part of a business (ii) must be transferred by the old to the new employer (iii) as a going concern. All three requirements must be met in order for the section to be operative.

In an outsourcing situation, if the infrastructural assets necessary to operate the business stay with the company outsourcing the service then, all things being equal, the business would probably not be transferred as a going concern. If they do not stay with the company outsourcing the service and instead go to the outsourced supplier, it would ordinarily be a significant factor weighing in favour of a section 197 transfer.

Second Generation Outsourcing

There exists conflicting case law and commentary as to whether the provisions of section 197 of the LRA apply to second generation outsourcing. Some commentators have asserted that the wording of section 197 precludes its application to second generation outsourcing.

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

General Terms

In terms of the LRA, all rights and obligations between the old employer and an employee at the time of transfer continue to remain in force. The supplier may, however, alter some terms and conditions of employment by agreement with the transferred employees (*see below, Pensions*).

Employee benefits

All contractual benefits transfer with the transferred employees in terms of the LRA (*for example medical insurance, severance pay*).

Other matters

The supplier is also bound by all arbitration awards or collective agreements binding on the old employer.

For a period of 12 (twelve) months after the transfer, the old employer is jointly and severally liable with the supplier to any employee who becomes entitled to receive a payment as a result of the supplier's dismissal for a reason relating to the supplier's operational requirements, liquidation or sequestration, unless the old employer is able to show that it has complied with the provisions of section 197.

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

In terms of section 197(6) of the LRA, the old employer must:

(a) agree with the supplier a valuation as at the date of transfer of:
- The leave pay accrued to the transferred employees of the old employer.
- The severance pay that would have been payable to the transferred employees of the old employer in the event of a dismissal arising from the Supplier's operational requirements.
- Any other payments that have accrued to the transferred employees but have not been paid to employees of the old employer; and

(b) conclude a written agreement that specifies:
- Which employer is liable for paying any amount referred to above and, in the case of apportionment of liability between them, the terms of such apportionment.
- Disclose the terms of the agreement to each employee who after the transfer becomes employed by the supplier.
- Take any other measures that may be reasonable in the circumstances to ensure that adequate provision is made for any obligation on the supplier that may arise.

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

Dismissals can be implemented before or after the outsourcing, but a dismissal will be deemed unfair if the reason for the dismissal is related to the transfer.

This does not prohibit the dismissal of employees resulting from *bona fide* reasons valid in law but not related to the transfer both before and after the outsourcing.

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

The transferee may seek consensual amendments to existing contracts of employment for certain categories of employees through collective bargaining.

Changes may be effected with any employee, including those not covered by the collective bargaining process, subject to the limitation that the terms and conditions of the transferred employees cannot on the whole be less favourable than the terms and conditions of employment provided by the transferor and that the employees were consulted on the changes and agreed to same.

A transferee may, in the pursuit of harmonisation, vary certain terms and conditions of the contract of the employee provided that this is compensated adequately by an improvement in some other respect.

7.6 Are there any pensions considerations?

The LRA permits the supplier to place transferred employees on a different pension fund, provided that the relevant provisions of the Pensions Fund Act, 1956 are followed.

7.7 Are there any offshore outsourcing considerations?

Although not fully in force yet, the Protection of Personal Information Act, 4 of 2013 requires consent prior to the transfer of personal information outside the Republic of South Africa.

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?

There are requirements which may apply under the Protection of Personal Information Act, 4 of 2013 to the extent that personal information as defined under this Act will be processed as part of the outsourcing transaction in question. If the supplier will be carrying out any data processing on behalf of the customer, it would be considered an 'operator' for purposes of the Act and to this end it is required that an operator process personal information with the knowledge or authorisation of the customer, it treat personal information which comes to its knowledge as confidential and not disclose same, unless required by law or in the course of the proper performance of their duties. The Act also requires that the parties enter into a written agreement in terms of which the operator agrees to establish and maintain the security measures and requirements stipulated in the Act. It is a requirement under the Act that an operator notify the customer (the 'responsible party' under the Act) immediately where there are reasonable grounds to believe that any personal information has been accessed or acquired by any unauthorised person.

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

Except for those requirements contained in data protection legislation (the Protection of Personal Information Act, 4 of 2013, the Electronic Communications and Transactions Act, 25 of 2002 (which regulates electronic communications and transactions) and the Regulation of Interception of Communications and Provision of Communication Related Information, 70 of 2002 (regulating the monitoring and interception of communication)), there are a number of industry standards which may have relevance, such as ISO/IEC 27001:2005, COBIT 5, King IV and ITIL.

9 Tax Issues

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

<u>Transfers of assets to the supplier</u>

The transfer of assets to the supplier can either be in the form of a sale or providing the right of use of the asset for the duration of the outsourcing contract. The sale of a depreciable asset by the customer to the supplier will result in a taxable recoupment for the customer where the proceeds exceed the tax value. Where the proceeds do not exceed the tax value, the customer would be entitled to deduct a scrapping allowance.

Where the right of use of a customer's assets are given to a supplier for the duration of the outsourcing contract in return for a reduced fee, the reduced fee will qualify for a deduction. The same result will be achieved where an amount is paid by the supplier for the use of the asset and a fee without reduction is charged.

<u>Transfers of employees to the supplier</u>

Where the supplier becomes the new employer and assumes responsibility for paying remuneration, the employees' tax (PAYE) obligations are also transferred. The supplier is obliged to withhold PAYE from the employees' remuneration, including Unemployment Insurance Fund (UIF) contributions. Employers in South Africa are further liable to contribute a Skills Development Levy (SDL) calculated as 1% of remuneration, which is not deducted from an employee's remuneration. The PAYE and UIF contributions, including the SDL liability must be paid to the South African Revenue Service within seven days after the end of the month during which the remuneration was paid.

<u>VAT or sales tax</u>

The service fee charges by the supplier will generally be taxable supply for VAT purposes. VAT can only be charged and claimed by registered VAT vendors. Where the customer makes VAT exempt supplies (generally in the financial services sector), input tax may not be claimed, resulting in a VAT cost to the customer.

Foreign suppliers of electronic services are required to register and account for VAT in South Africa with effect from 1 April 2019 if at least two of the following circumstances are present:

1. the recipient of the services is a South African resident;
2. the payment for services originates from a South African bank account; or
3. the recipient has a business, residential, or postal address in South Africa.

A foreign electronic services supplier is currently required to register for VAT as soon as the value of the services exceeds ZAR 1 million for any 12-month period. The term "electronic services" means any services supplied by means of an electronic agent, electronic communication or the internet for any consideration.

Virtually all services that are supplied by way of electronic means are "electronic services". The definition includes services such as cloud computing, computer software, online training, online data storage and broadcasting services.

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

An inward licence constitutes an "imported service" for VAT purposes. Thus, if the licensee is not going to use it for the making of taxable supplies, VAT i.t.o. of section 7(1)(c) of the VAT (imported services) will be incurred. This is often relevant to companies operating in the financial services industry. Section 14(5) of the VAT Act exempts, amongst others, from imported services, supplies which are chargeable in terms of section 7(1)(a) of the VAT Act. (Section 7(1)(a) is the core provision which says that VAT is imposed on the supply by any vendor of goods or services.) If a foreign supplier regularly and continuously renders services in SA, the foreign supplier is carrying on an enterprise in South Africa and must register and account for VAT in terms of section 7(1)(a) of the VAT Act. Failure by the foreign supplier to register and account for VAT does not render the recipient liable to account for VAT in terms of section 7(1)(c) of the VAT Act. This is because a "vendor" is defined as any person who is, or is required to be, registered for VAT purposes, and taxable supplies comprise supplies by vendors of goods and services in the course or furtherance of an enterprise.

9.3 What other tax issues may arise?

Although tax on transferring assets and VAT are the main tax issues which arise in an outsourcing context, there are other tax issues that may arise. These include:

- **Permanent establishment issues** – on a cross-border contract, it is conceivable that the supplier create a permanent establishment (taxable presence) of its customer in the jurisdiction in which the supplier is based.
- **Withholding taxes** – payments to the supplier could be subject to withholding taxes, depending on the treatment in the customer's jurisdiction and any tax treaty protection. The persons who bear such taxes would need to be set out in the contract.

10 Service Levels

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

The parties usually identify and agree on quantitative and qualitative performance metrics against which to measure the performance of the services by the supplier. The parties then agree which party is responsible for measuring compliance with the service levels and where service levels are not met, what compensation is payable (if any).

Any penalty imposed for failing to meet any service level is generally referred to as a service credit. Generally, the service credits are either set-off against any fees payable to the supplier or the supplier issues a credit note to the customer for the amount of such service credits. It is important to ensure that any service credits imposed are fair and reasonable, as any claim for a penalty which is out of proportion to the prejudice suffered by the customer may be subject to reduction in terms of the provisions of the Conventional Penalties Act, 1962.

An alternate service credit methodology often applied is that the supplier is able to "claw back" any service credits which it incurs by obtaining "service debits" for those services in which it exceeds the contracted level of service.

When choosing service levels, customers are frequently advised to select items which can be objectively measured. If service level measures are included which cannot be objectively assessed, there is an increased risk of disputes between the supplier and the customer over whether the measures have actually been achieved. In order to avoid selecting unimportant but easily measured services, parties often devote substantial effort to identifying 'emblematic' measurements: simple measurements that signify that a less tangible (but more important) service has failed.

In practice, the common forms of service level measures in IT service provision contracts include availability targets and various response time targets. Availability service levels are particularly applicable for infrastructure and service provision arrangement, such as IT outsourcing, software as a service (SaaS) and cloud service arrangements, where a continuous IT service is provided and can be measured on a continuous basis. It is now relatively common for availability measures to be recorded by the supplier through IT tools which continuously measure the 'uptime' of the IT service provision. This provides greater assurance and objectivity than arrangements which rely on the customer to notify the supplier of any downtime in the availability of the services. Of course, where the service provision to the customer includes elements which are outside the control of the supplier, such as Internet transmission, the supplier will want to exclude any downtime which relates to problems in these elements which are outside its control.

11 Customer Remedies

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

The remedies available to the customer include:

- claims for damages;
- obtaining an order for specific performance; and
- termination of the agreement.

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

- Additional protections which are usually included in an outsourcing agreement include service levels to measure service performance together with a contracted service credit or penalty arrangement.
- Audit rights in relation to service performance, legislative compliance, security issues and technical considerations.
- Extensive disengagement arrangements which are triggered on termination of the agreement.
- Contractual requirements for the supplier to maintain sufficient insurance cover to cover its liabilities and obligations under the agreement.
- Automatic rights to terminate the contract in respect of certain events of default, including serious service level failure, change of control of the supplier, supplier insolvency or liquidation and the like.
- Requesting a parent company guarantee from the supplier's ultimate parent company.
- Benchmarking provisions.
- Holding retained amounts which are only payable to the supplier upon final completion and acceptance of the deliverables or services to which they relate.

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

An outsourcing contract is a contract for services. The only implied warranty in a contract for services is that the person providing the services should use his or her reasonable skill and care when doing so.

Typical supplier warranties and indemnities include:

- A warranty that it has all the necessary rights, powers and authority to enter into and perform in terms of the agreement and that the execution, delivery and performance under the agreement is duly authorised by all necessary corporate action.
- Further warranties include those relating to service performance; operating system compliance, warranties relating to viruses and disabling devices, warranties relating to the financial condition of the supplier, intellectual property warranties and warranties relating to its compliance with all relevant legal and regulatory requirements.
- A further warranty provided is that it has, at its disposal, adequate staff available possessing the required skills, experience and expertise to render the services and shall perform the services with skill and care, in a timely and professional manner.
- Indemnities given to the customer include indemnities against harm suffered due to the supplier, its staff and subcontractors' actions, including as a result of negligence or wilful or fraudulent misconduct on the part of the supplier, breach of the agreement by the supplier and any infringement of a third party's intellectual property rights.
- Indemnities provided to the customer may also include those relating to personal injury and damage to property, security breaches and failure to comply with relevant laws and regulations.

Typically, customer warranties and indemnities relate to:

- Being authorised and entitled to enter into the agreement and perform its obligations thereunder.
- Providing an indemnity in relation to third party intellectual property infringement claims.

12 Insurance

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

- Employer's liability insurance.
- Professional indemnity insurance.
- Business interruption insurance.
- Fidelity or employee dishonesty insurance.
- Public liability insurance.
- Land, buildings and contents insurance.
- Cyber-liability insurance.

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?

Events which would allow the affected party to terminate the agreement include the following:

- Repudiation on the part of one of the parties.
- A compromise or composition or threatened compromise or composition by a party with its creditors.
- Provisional or final liquidation of a party or the placement of a party under judicial management, whether provisionally or finally.
- In circumstances where there is a default or cessation or a reasonable prospect of default or cessation (as the case may be) of a party's normal line of business.
- Commitment of any act or omission which would, had that party been an individual, be an act of insolvency in terms of the Insolvency Act, 1936 (as amended).
- Disposal by the supplier of a material portion of its undertaking or assets which may impact on its ability to render the services.
- the non-retention by the supplier of certain staff members which impact on its ability to make resources with the necessary experience and skills available to the customer.
- Any change in the control or material change in the shareholding of the supplier.
- The supplier is contemplating, considering, or agrees to any business rescue or proposes to do any of these things.
- Any person is proposing to take, or taking, any step to apply to court or actually applies to court for the business rescue of the supplier.

13.2 Can the parties exclude or agree additional termination rights?

The following additional rights to terminate are usually included in an outsourcing agreement:

- A material breach which is not capable of remedy or which is not remedied within the prescribed time period.
- The disposal by a party of a material portion of its undertaking or asset.
- A significant change of control in the supplier.
- A compromise, scheme of arrangement or composition by a party with any or all of its creditors.
- Termination for convenience by the customer on an agreed notice period. In certain instances, the supplier may require compensation for early termination.

The customer should also consider the type and duration of post-termination assistance the supplier and its subcontractors shall provide upon termination of the agreement.

A well-drafted outsourcing contract enables either party to terminate the arrangement prior to the agreed-to end date in a fair and reasonable manner. This is not to say that the termination provisions should be mutual between the customer and the supplier because the risk the two parties undertake in an outsourcing arrangement is very different. If an outsourcing contract is terminated, the supplier will lose revenue. On the other hand, the risk for the customer is substantially higher if an outsourcing contract is terminated. For example, the customer losing services for its call centre or IT infrastructure management or its business process (such as reconciliation or payment processing) translates into losing operational time, revenue and reputation. The difference in risk between customer and supplier means that the two parties need to have different termination rights in an outsourcing contract.

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

The SARB Guidance Note on outsourcing (referred to in question 1.3 above) requires that an outsourcing agreement which a bank enters into for a material outsourcing arrangement may not allow the supplier to terminate the agreement for its convenience.

14 Intellectual Property

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

The general starting position is that all intellectual property rights owned by a party as at the commencement of the outsourcing agreement remain vested in the party owning such rights. The customer typically retains its intellectual property rights in and to all data, information or other materials it provides to the supplier for purposes of providing the services. The supplier retains all its "tools and methodologies" (i.e. the intellectual property rights the supplier uses to provide the services). Any bespoke developments are typically owned by the customer.

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

South Africa does not have specific legislation governing trade secrets, confidential information or know-how, though they can be effectively protected under South African common law.

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?

Where the customer licenses IP rights to the supplier in connection with the outsourcing, the licence terms generally govern the continued use of those rights by the supplier post-termination (either in the outsourcing agreement or a separate document), which licence terms are generally limited to use only for the duration of the agreement.

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?

The parties specifically need to deal with this issue in the agreement. This is usually covered by a residual knowledge clause which allows both parties to utilise the generic ideas, concepts, know-how, or techniques developed or learned by them but that this right remains subject to the restrictions imposed in respect of the confidentiality of such information and the intellectual property rights of the other party.

15 Liability

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

The parties are generally free to exclude most forms of liability; however, a contract to exclude liability for fraud is unlawful but the parties may in certain circumstances exclude liability for negligence or innocent misrepresentation.

Subject to the above, a supplier will aim to exclude liability for indirect and consequential loss and loss of business, profit or revenue, where these constitute a direct loss. In contrast, the customer will usually try to ensure that it is able, under the agreement, to recover all its direct losses (including direct loss of profit, business and revenue). These will be subject to negotiation in practice.

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

Yes, the parties can agree a limit on liability. This may be a fixed amount, or a percentage or multiple of the contract value (for example, 150% of the contract value). In practice a percentage is generally better than a fixed sum, but this will depend on the nature of the outsourcing arrangement in question and the parties' respective risk requirements.

16 Dispute Resolution

16.1 What are the main methods of dispute resolution used?

Informal dispute resolution (negotiation), arbitration and the courts.

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?

In a series of cases culminating in *Botha v Rich NO and Others* 2014 (4) SA 124 (CC), the Constitutional Court nodded in the direction of a more communitarian construction of the foundational values of freedom, dignity and equality to infuse a greater degree of fairness into the law of contract. For this reason, the court spoke about the fact that honouring a contract cannot "be a matter of each side pursuing his or her own self-interest ... without regard to the other party's interest". In *Botha v Rich NO and Others* 2014 (4) SA 124 (CC) Nkabinde J developed this approach further by saying:

"*The principle of reciprocity falls squarely within this understanding of good faith and freedom of contract, based on one's own dignity and freedom as well as respect for the dignity and freedom of others. Bilateral contracts are almost invariably cooperative ventures where two parties have reached a deal involving performances by each in order to benefit both. Honouring that contract cannot therefore be a matter of each side pursuing his or her own self-interest without regard to the other party's interests. Good faith is the lens through which we come to understand contracts in that way*."

Preeta Bhagattjee
Cliffe Dekker Hofmeyr Inc.
1 Protea Place
Sandown Johannesburg
South Africa

Tel: +27 1 1562 1038
Email: preeta.bhagattjee@cdhlegal.com
URL: www.cliffedekkerhofmeyr.com/en/

Preeta Bhagattjee is a director in the Technology, Media and Telecommunications Practice. She advises numerous major clients, both within the ICT sector and as customers of ICT services and in both the public and private sector, on technology and communications law, outsourcing and service level agreements, fintech, digital innovation and e-commerce law, intellectual property and data protection and privacy issues.

Christoff Pienaar
Cliffe Dekker Hofmeyr Inc.
11 Buitengracht Street
Cape Town
South Africa

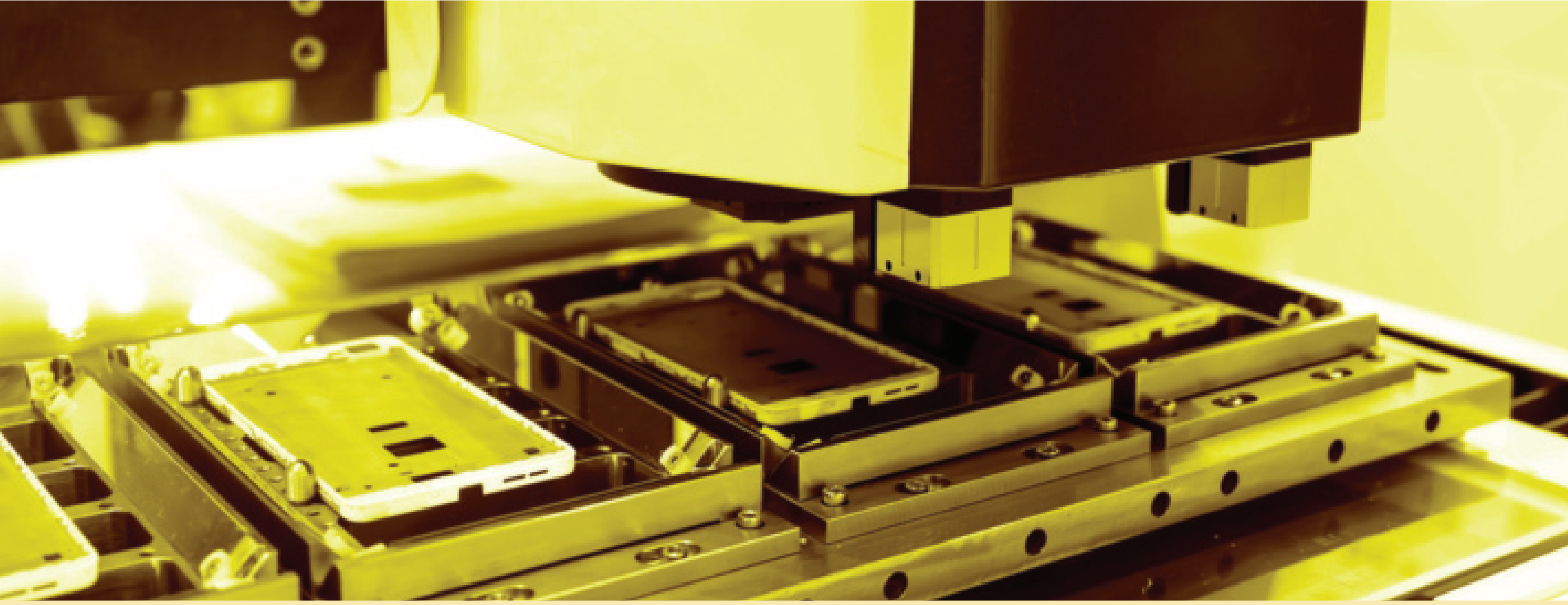
Tel: +27 2 1481 6350
Email: christoff.pienaar@cdhlegal.com
URL: www.cliffedekkerhofmeyr.com/en/

Christoff Pienaar is Director and National Head of our Technology, Media and Telecommunications practice. He advises on commercial, information technology and intellectual property law. He specialises in information technology and commercial matters and has particular expertise in payment systems, technology outsourcing, business process outsourcing, systems integration, hardware acquisitions and maintenance, IT consultancy services, managed services, disaster recovery services, software development and software licensing and support transactions.

Christoff also advises on general commercial and intellectual property issues across a diverse range of industry sectors, especially financial services.

CDH
CLIFFE DEKKER HOFMEYR

Cliffe Dekker Hofmeyr Inc is one of the largest business law firms in South Africa, with more than 350 lawyers and a track record spanning over 164 years. The Technology & Sourcing practice of Cliffe Dekker Hofmeyr Inc is widely recognised as market leaders for their work with a large proportion of the top financial institutions in South Africa on their headline technology projects. The team is renowned across the technology and telecoms industries for its market-leading position in advising on information technology, telecoms, and privacy and data protection. The team handles domestic and global mandates and is involved in changes to key legislation affecting these sectors.



Current titles in the ICLG series include:

- Alternative Investment Funds
- Anti-Money Laundering
- Aviation Law
- Business Crime
- Cartels & Leniency
- Class & Group Actions
- Competition Litigation
- Construction & Engineering Law
- Copyright
- Corporate Governance
- Corporate Immigration
- Corporate Investigations
- Corporate Recovery & Insolvency
- Corporate Tax
- Cybersecurity
- Data Protection
- Employment & Labour Law
- Enforcement of Foreign Judgments
- Environment & Climate Change Law
- Family Law
- Financial Services Disputes
- Fintech
- Franchise
- Gambling
- Insurance & Reinsurance
- International Arbitration
- Investor-State Arbitration
- Lending & Secured Finance
- Litigation & Dispute Resolution
- Merger Control
- Mergers & Acquisitions
- Mining Law
- Oil & Gas Regulation
- Outsourcing
- Patents
- Pharmaceutical Advertising
- Private Client
- Private Equity
- Product Liability
- Project Finance
- Public Investment Funds
- Public Procurement
- Real Estate
- Securitisation
- Shipping Law
- Telecoms, Media & Internet
- Trade Marks
- Vertical Agreements and Dominant Firms

glg global legal group

59 Tanner Street, London SE1 3PL, United Kingdom
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255
Email: info@glgroup.co.uk

www.iclg.com