Legal update

Specific performance of outsourcing contracts

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Abstract Outsourcing is a common practice in the database marketing industry, with companies outsourcing marketing functions to database marketers and database marketers outsourcing a variety of functions themselves. But what happens if the relationship breaks down to a point where one of the parties does not want it to continue even if the other does? The recent case of *Vertex v Powergen* is a useful reminder of the courts' discretion about whether to order specific performance of a contract to get the parties to do what they agreed to. This paper discusses the High Court's decision in *Vertex* and considers the situations in which database marketing companies might want to consider seeking orders for specific performance and the likelihood of such orders being made.

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INTRODUCTION

Outsourcing is the process by which a business procures certain services, which it had previously undertaken itself, from an outside supplier in order to save costs and benefit from the service provider's expertise. Such relationships are common in the database marketing industry, with database marketers striking deals with other businesses that wish to outsource marketing functions,¹ and outsourcing various functions to external providers themselves.² This means that a number of key aspects of a database marketing company's business (both in terms of the services it provides to its clients and the company's own internal functions) may well be the subject of one or more outsourcing agreements at any one time.³

While such relationships are in many cases beneficial, if not essential, for both parties, there are instances where outsourcing relationships do not work out. For example, a recent dispute between Bedfordshire County Council and HBS led to the termination of HBS' 12-year, £250 million contract to administer and manage the Council's IT, finance and other support services.⁴ It is therefore important for those involved in outsourcing business operations to fully understand all the options open to them in the event that a dispute arises. This paper considers one particular remedy that a party may consider if an outsourcing relationship has broken down to the point where the other party is refusing to perform its obligations under the outsourcing contract; namely, specific performance.

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SPECIFIC PERFORMANCE

Specific performance is a discretionary remedy that the courts can order in a breach of contract dispute, such as the contract underlying an outsourcing relationship. Such orders compel the defaulting party to perform its contractual obligations. They may be granted in addition to or instead of other remedies designed to compensate the losses caused by the defaulting party.

In most instances where a contractual relationship breaks down to the extent that court proceedings are being contemplated, the last thing that the party alleging breach wants is to perpetuate that relationship by asking the court to compel the other party to perform the contract. Rather, it would ordinarily seek damages in respect of that breach with a view to recovering compensation for its losses and moving the project in question forward with another commercial partner.

There are, however, instances where it may be desirable, or even necessary, to persist with the existing contract giving rise to a dispute, even though the relationship has broken down. Such instances could include situations where

- The party in breach is a specialist supplier in a narrow field with an otherwise impressive track record — you might take the view that, having resolved the dispute at hand, it is still best placed to provide the service you require. This could be the case with specialist software providers, for example.
- The original contract was so favourable (perhaps because it was agreed on a fixed fee basis) that the scope of the outstanding work could not be obtained on similarly favourable terms with an alternative provider and making the switch would lead to a significant increase in cost. Starting again from scratch would also involve the commitment of significant time and

money, the duplication of work already undertaken and all of the associated upheaval.

- The project is time-critical and the delay that starting again with a new partner would necessarily involve (possibly requiring a new tendering process, etc) would be prohibitive.
- Continuity of service provider is integral to providing a consistent service to the end customers.

Each of these reasons could mean that for the aggrieved party, the recovery of contractual damages may be an inadequate remedy, because the only way that the issue could be resolved favourably would be for the other party to fulfil its contractual obligations.

AN UNUSUAL REMEDY

It should be noted from the outset that it is very unusual for the courts to exercise their discretion to grant an order for specific performance. The courts are particularly loath to grant relief of this nature in the case of contracts requiring the services of certain named key individuals, mutual trust and cooperation between the parties, and the overseeing of contractual performance by the courts.

Nor will incorporating an 'inadequacy of damages' clause into your standard outsourcing agreement force the court's hand in this regard. Such a clause can, however, do no harm and can be cited as a statement of the parties' intentions at the time the contract was entered into which could prove persuasive in borderline cases.

DAMAGES

If specific performance is not possible or refused by the court, the aggrieved party will normally be entitled to damages for breach of contract. The damages are measured so as to place the aggrieved party in the position it would have been in if the contract had been properly performed.

Subject to being able to prove the other party's breach, the losses and causation (i.e., that the losses naturally flow from the other party's breach), damages are available as of right and can be distinguished in this way from the discretionary remedy of specific performance.

For the reasons outlined above, however, such monetary compensation will not always appear to be adequate in the light of the real impact of the breakdown of the contract on the business. Specific performance should not therefore be overlooked as a possible remedy. It can be pleaded in the alternative to damages and does not prevent the aggrieved party from claiming for damages in the same proceedings (although the costs of the proceedings may increase and legal advice should be sought early on). The remedy was effectively sought in relation to an outsourcing contract in the recent case of *Vertex v Powergen*⁵ discussed below.

VERTEX V POWERGEN

Powergen had entered into a contract with Vertex for outsourcing certain of its customer service activities, some of which were to be provided via Vertex's call centre in India. The relationship between Vertex and Powergen deteriorated early on, with Powergen taking issue with Vertex's performance of its obligations, and in particular the performance of its Indian arm. One year into what was to be a seven-year contract, Powergen then purported to terminate the contract on the grounds of a material breach of its obligations by Vertex. Vertex disputed that Powergen was in a position to terminate and sought a declaration to that end, as well as an injunction preventing Powergen from acting further on its notice of termination, or from taking steps to prevent or hinder Vertex from performing its functions under the contract.

Accordingly, Vertex was effectively asking the court to compel Powergen to perform

its obligations under the contract, which broadly speaking involved a Powergen service team liaising with and providing information and other resources to Vertex in order to enable Vertex to most effectively perform the customer service activities outsourced to it under the agreement. While it should be recognised that this was not a standard claim for specific performance (where the party alleging breach is normally the party seeking the remedy), both the effect of the relief sought and the principles the court applied in coming to its judgment are the same as would apply where a party seeks specific performance of an outsourcing contract.

Indeed, Vertex ran the classic argument that it would suffer irretrievable and unquantifiable loss, for which damages would not represent an adequate remedy, if Powergen was not compelled to perform its contractual obligations. Powergen countered that such a remedy was inappropriate because the contract had become unworkable, citing a failure of co-operation, loss of confidence and mutual distrust.

THE DECISION

In short, the court refused to grant the relief sought on the basis that the contract demanded considerable mutual cooperation for it to be effective and that, in the circumstances, it would be inappropriate and unworkable to seek to compel Powergen to continue to work with Vertex.

In explaining its decision, the court distinguished the facts of *Vertex* from two earlier Court of Appeal cases in which the performance of contractual obligations had been ordered, *Lauritzencoll v Lady Navigation*⁶ and *Regent International Hotels v Pageguide Limited*.⁷ In *Lauritzencoll*, the time charter agreement that the Court of Appeal had to consider demanded the perpetuation of only a very impersonal relationship. Similarly, the hotel management services that were the subject of the *Regent* case were largely subject to autonomous and

independent control, requiring little in the way of supervision or cooperation.

CONCLUSIONS

The *Vertex* case illustrates that where a contract for services such as an outsourcing contact requires extensive cooperation between parties, and the relationship between those parties has broken down irrevocably, the court is likely to be reluctant to order specific performance and compel the parties to continue with their failed relationship. The judgment in *Vertex* seems to indicate that the courts are more likely to make an order for specific performance where the outsourced work is sufficiently discrete to be conducted by the supplier without such close day-to-day cooperation.

While the availability of this discretionary remedy will depend very much on the facts of the individual case, it is more likely, for example, that the remedy would be ordered in relation to a contract to develop and supply a discrete piece of marketing software than for a contract for the supply of ongoing IT services. Many outsourcing relationships require a significant amount of mutual cooperation throughout their term, and, as the *Vertex* case demonstrates,

although it may sometimes be desirable for one of the parties, in most instances, specific performance is unlikely to be ordered as a remedy.

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Notes

- 1 A common example being the outsourcing of the management of a company's B-2-B marketing database. Typical considerations that apply when companies are thinking about outsourcing this function are described in the paper entitled 'Outsourcing your marketing database. A "Request for Information" is the First Step' by Ruth Stevens dated March 2006 which is available at http://www.ruthstevens.com/case_histories.html.
- 2 The Report entitled 'What Database Marketers Think About Outsourcing' by Eric Schmitt dated 28th September 2004 published by US firm Forrester Research suggested that the functions most commonly outsourced by database marketers were data procurement, hygiene and creative functions.
- 3 For example, the Report cited *ibid* includes a survey of 49 database marketers that were found to have engaged, on average, nine outsourcing providers.
- 4 See the article entitled 'UK council pays £7.7m to escape outsourcing deal' dated 14th September 2005 published in the Register (<http://www.theregister.co.uk>).
- 5 *Vertex Data Science Limited v Powergen Retail Limited* [2006] EWHC 1340.
- 6 *Lauritzencoll AB v Lady Navigation* [2005] 2 Lloyd's Rep 63.
- 7 *Regent International Hotels (UK) Ltd v Pageguide Ltd*. The Times 13th May 1985.