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IT Outsourcing for the Health Care Institution: Allocating Risk and Liability Responsibly

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An IT-related outsourcing arrangement, by its nature, can be a high risk arrangement for a health care institution that can directly impact on its ability to function effectively should the outsourcer fail to meet its contractual obligations. In fact, the health care institution may become wholly reliant on its IT outsourcing provider to rectify deficiencies in the services it receives.

The Federal Office of the Superintendent of Financial Institutions has issued detailed guidelines for the conduct of outsourcing arrangements by financial institutions that are under its jurisdiction (the "OSFI Guidelines").¹ The OSFI Guidelines were instituted with the realization that a failed outsourcing arrangement could materially impact on the ability of a financial institution to operate. These guidelines include, among other matters, the steps to be followed by the financial institution's board of directors to assess the risk and impact of outsourcing arrangements on the financial institution, and includes an array of protective legal provisions that ought to be included in material outsourcing agreements entered into by the financial institution.

While the risks of an outsourcing failure for a health care institution would be reasonably expected to exceed those of a financial institution, no guidelines comparable to those established by OSFI are known by the author to exist for health care institutions. Even so, it is suggested that the OSFI Guidelines provide a useful framework for health care institutions and their board of directors when considering both the health care institution's approach to the risk and liability of an outsourcing arrangement for their health care institution, and the nature and types of legal provisions that ought to be considered for such an arrangement.

An outsourcing agreement, much like a life insurance policy, is an arrangement where the customer would rather not be collecting remedies. One would much rather have satisfactory performance than a right to damages for a breach of performance. For this reason, a due diligence exercise on the experience and ability of the prospective outsourcer to conduct the precise nature of the IT outsourcing in a health care environment would be prudent.

For example, there may be general IT outsourcers who do not have particular experience in the health care environment and may not be prepared to meet the service level requirements necessary in a health care environment, or be prepared for the confidentiality and privacy obligations that a health care provider may require. Further, they may not be experienced in dealing with many of the application providers in the health care environment. There is also a growing interest among health care software application

providers, both large and small, in becoming health care IT outsourcers. Many of them have a corporate strategy of seeking the revenue stability brought by the constant cash flow streams that a long-term outsourcing arrangement may bring. While they may have a knowledge of the health care environment and of their particular applications, they may not necessarily have the full knowledge and experience of a traditional IT outsourcer in addressing service level arrangements. Further, they (and the health care institution) are faced with the challenge of having to support competing products (products in respect of which their competitors may have contractual provisions with the health care institution, disallowing such health care institution from using a competitor to provide outsourcing support relating to their products without prior written consent).

While this article focuses on certain concepts intended to help the health care institution to address risk and liability responsibly, and that ought to be considered in any IT outsourcing arrangement, the rights and remedies under an outsourcing agreement will only be as strong as the financial resources of the outsourcer. Many outsourcers are public companies; some with strong balance sheets and others somewhat weaker financially. Ultimately, the financial wherewithal of any outsourcer will need to be considered. Remember that while the US parent of an outsourcer may be financially strong, its Canadian subsidiary may be a "shell" with few financial assets and a corporate guarantee from the US parent may be required. Further, some may have their resources concentrated in a particular geographic area of Canada or the US and may not be able to provide the same access to resources in the health care institution's particular geographic area. This must be borne in mind when considering references.

The time required to determine the detailed requirements applicable to the successful transfer of IT-related functionality to an outsourcer, the time required to select the appropriate outsourcer, and the time required to negotiate a robust outsourcing agreement with the outsourcer are often greatly underestimated by the health care institution. The health care institution will often feel pressured to "get a deal done quickly" and they may wish to expedite the process. Often, the outsourcing arrangement will involve the transfer or termination of health care institution personnel. Rumours among employees are often rampant within the health care institution and this can place increased pressure on the health care institution to close the deal.

The outsourcer will likely propose their standard form of outsourcing agreement, which may or may not be amended to reflect the procurement process, if any, that had been followed to

¹ OSFI, Guideline B-10 - Outsourcing of Business Activities, Functions and Processes, May 2001 (revised December 2003), online: OSFI http://www.osfi-bsif.gc.ca/app/docrepository/1/eng/guidelines/sound/guidelines/b10_e.pdf (date accessed: 28 February 2005).

date. The outsourcer will know their agreement quite well. The outsourcing agreement may not be reflective of the procurement process that preceded its arrival or the health care institution's requirements.

The challenge for health care institutions is to negotiate amendments to the outsourcer's standard form of agreement that meet the health care institution's reasonable business and legal requirements within a reasonable period of time.

Generally speaking, the lifecycle of an outsourcing arrangement can be described as having several phases, and each phase should be specifically considered in negotiating the outsourcing agreement:

- (a) A Start-Up Transitional Phase when the outsourcer takes over outsourcing responsibilities from the health care institution. This phase may, in turn, be broken into several phases (some of which may be elective on the part of the health care institution)
- (b) Day-to-day performance of the outsourcing arrangement by the outsourcer following the completion of the Start-Up Transitional Phase; and
- (c) The Wind-Down Transitional Phase when the outsourcer transfers the outsourcing responsibilities back to the health care institution or to another outsourcer.

In negotiating the outsourcing arrangement, it is important, to consider the arrangement for each phase, as each phase has its own specific issues and risks.

Should the health care institution be using a request for proposal ("RFP") or other competitive procurement process to select an outsourcer, many of the legal issues that follow ought to be addressed specifically in such procurement process and clear responses required of the bidders. It is during the procurement process that the health care institution's leverage is arguably the greatest, thus providing the best possibility of addressing many of these issues in the most favourable manner. It is the advice of the author that the lawyer be brought in to assist in the development of the RFP, if there is one, to ensure that each bidder is required to specifically address those matters respecting risk and liability that are often contentious and time-consuming at the contract negotiation stage. An ounce of prevention is worth a pound of cure.

1. Getting off on the Right Foot

The Start-Up Transitional Phase is arguably the phase of highest risk for the health care institution. To the extent possible, the outsourcing agreement ought to describe the process of transferring outsourcing responsibilities from the health care institution to the outsourcer in specific detail.

This often works best by detailing the implementation of the Start-Up Transitional Phase in many discrete steps, each setting out the respective responsibilities of the parties in minute detail.

It is during the early stage of the Start-Up Transitional Phase that difficulties become apparent. To the extent possible, the Start-Up Transitional Phase ought to be structured in a manner that best permits the health care institution the flexibility to terminate the arrangement and conduct its own critical IT operations on short notice should the relationship fail near its commencement. Early "trip wires"— objectively ascertainable milestones — ought to be set as early in the process as possible to determine early failures and to have them addressed quickly or otherwise lead to termination before the health care institution is "very deep" into the

arrangement and in a very difficult position to terminate with "minimal pain".

If the outsourcing arrangement is unfolding badly and rectification not appropriately obtained from the outsourcer, the health care institution would reserve the right to terminate the arrangement at the point of an early "trip wire". Again, termination is not an enviable position to be in and is considered as a last resort as opposed to a desirable result.

2. Conscious Allocation of Responsibilities.

A key aspect to the success of each phase is the conscious allocation of responsibility as between the parties. Terms such as "partners", "partnership" and the like in the outsourcing agreement lead to confusion as to the allocation of responsibility and allocation of risk and liability as between the parties and ought to be avoided in all cases.

The agreement needs to allocate responsibility clearly for all obligations under the outsourcing agreement between the parties. Where a party isn't meeting its responsibility, prompt notice ought to be given, or else it may lead to a waiver of such responsibility. The parties need to operate within the parameters of the agreement and to "paper" amendments to the agreement, or else the parties risk "stepping outside the agreement". Once outside of the agreement, obligations and liabilities become blurred to the detriment of both parties.

3. Provide for practical and effective management and reporting.

Outsourcing arrangements are generally, by their nature, dynamic arrangements. While we strive to deal with contingencies with a reasonable level of detail in the agreement, there will be difficulties and uncertainties that the parties may not have fully contemplated at the time of entering into the outsourcing agreement.

While each outsourcing arrangement is unique, generally there will be two levels of management decision-making. One level will be a committee of lower/mid-level management made up of technical and supervisory personnel of both the outsourcer and the health care institution. This committee will meet on a regular basis to address day-to-day technical and other matters that occur under the agreement. A second level of committee will be made up of higher-level management, and will meet on a less frequent basis to resolve material business matters that could not be resolved at the lower level; for example, a persistent material breach under the agreement or a matter of contractual interpretation under the agreement.

Ultimately, the nature and composition of these committees are based on the practical needs of the parties. The committees need to be constituted in a manner that will ensure that they will exist and function in an appropriate manner.

A failure to agree at these levels will, in turn, lead to a dispute resolution process that may either be an arbitration process or a process that leads to court action. Regardless of the process, ultimately it needs to be structured in a manner that allows the health care institution the greatest flexibility in maintaining the outsourcing services it requires to meet its critical needs.

4. Service Level Agreements (commonly known as "SLAs")

From a performance perspective, there is a need for a series of objectively ascertainable service level agreements that set out the standards that ought to be met by the outsourcer. Generally,

TABLE

CHECKLIST OF OUTSOURCING ISSUES APPLICABLE TO RISK AND LIABILITY

- 1. Experience.** Does the outsourcer have the particular experience necessary: (i) as an outsourcer; (ii) in a health care environment similar to yours; and (iii) with the necessary personnel and other resources in your geographic region?
- 2. Financial Resources.** Does the outsourcer have the financial resources to perform under the agreement and to pay any damages that flow from its breach of the agreement? Is a guarantee required from a parent or other financial reassurance such as insurance?
- 3. Management and Reporting.** Does the management and reporting system reflect the needs of reporting to alert the other party of material issues on a timely basis while providing an appropriate platform to constructively address and resolve issues with the arrangement?
- 4. Privacy and Confidentiality.** Does the agreement reflect current privacy laws and hospital policies and provide for flexibility to address changes to those laws and policies in the future?
- 5. Service Level Agreement.** Does the agreement provide sufficient granularity to address both material failures to the services being provided and repeated failures of a less material nature that, over time, impact on the overall quality of the services? Is the implementation of the SLAs appropriate in the circumstances, given the particular technical challenges and is it otherwise consistent with a balanced allocation of risk as between the parties?
- 6. SLA Remedies.** Does the agreement provide for sufficient monetary remedies for failures to meet SLAs such that they will elicit the appropriate actions required of the outsourcer?
- 7. Limitation of Liability.** Are you certain that the agreement provides reasonable remedies for breaches by the outsourcer, including in respect of: (a) privacy and confidentiality; (b) breach of third party intellectual property rights; (c) injury to persons or property due to negligence; and (d) breach of SLAs, among other areas?
- 8. Force Majeure and Exclusive Remedies.** Has the health care institution carefully reviewed those clauses of the agreement (often placed in the back) that can essentially “turn off” the health care institution’s rights and remedies in the agreement?
- 9. Termination Rights.** Bearing in mind both the outsourcer’s and the health care institution’s desire to continue an outsourcing arrangement, does the health care institution have appropriate rights to both terminate the arrangement and to be able to practically migrate from the outsourcer to an alternative solution during the various phases of the agreement?

negotiating these is on the critical path for completing the outsourcing agreement, but they are critical to having an effective outsourcing agreement. The service level agreements may set out anywhere from 10 to 50 or more criteria that the service provider must meet. The outsourcing agreement will often have a process in place to allow for the modification of the SLAs over time to reflect the needs and concerns of the health care institution. The outsourcing agreement will also need to address when during the Start-Up Transitional Phase, such service level agreements will become effective. At times, certain SLAs will be adopted over time while others may be effective at the start of the arrangement. It depends, in part, on the specific technical circumstances of the transition and, in part, on the business deal that is struck.

In addition to setting standards that must be followed and reported on by the outsourcer, there are normally set-offs against service fees associated with a failure to meet the standards set out in the SLAs. The severity of the set-off is often based on the nature and severity of the failures and whether such failures are of a reoccurring nature.

5. Conscious Allocation of Limitation of Liability.

Under an outsourcing arrangement, a health care institution may suffer significant damage from a failure by the outsourcer to fulfill its contractual obligations under the agreement. Normally, the outsourcer will endeavour to contractually limit its responsibility to reimburse the health care institution for such damages. In fact, many “standard form” vendor outsourcing agreements often accept little responsibility for the outsourcer’s failures to perform under the agreement and require concerted negotiations initiated by the health care institution to obtain a reasonable balance of liability as between the outsourcer and the health care institution.

In negotiating a limitation of liability provision, specific consideration must be given to particular types of failures by the outsourcer under the outsourcing agreement, including in respect of: (a) privacy and confidentiality; (b) breach of third party intellectual property rights; (c) injury to persons or property due to negligence by the outsourcer; and (d) breach of the SLAs.

The health care institution must carefully review all provisions of the outsourcing arrangement to ensure that other provisions of the agreement do not “negate” or “switch off” the negotiated limitation of liability provision. For example, there may be a “force majeure” or “excusable delay” provision that excuses the outsourcer from performing its obligations under the agreement. Such clauses, often residing in the back of the outsourcing agreement with the “boilerplate” provisions, must be reviewed with due scrutiny.

6. Privacy and Confidentiality.

Extreme care must be paid in negotiating privacy and confidentiality obligations with an outsourcer. Often the standard form of outsourcing agreement will not accept liability by the outsourcer for damages from third party claims against the health care institution for breaches by the outsourcer of its privacy and confidentiality obligations. Privacy and confidentiality obligations are also not static in Canada, and the outsourcing agreement needs to provide the flexibility of adapting to those changing statutory obligations.

7. Benchmarking.

Longer term outsourcing agreements (for example, five years or longer) often provide for a mid-term independent “benchmarking” audit. Such an audit compares the quality and price of the services against those then prevalent in the industry, and could provide for a “rebalancing” of the outsourcer’s obligations and fees should the

standard under the outsourcing agreement fall below a particular threshold when compared against those then prevalent in the industry at the time of the benchmarking exercise.

8. Termination: Stepping off with the Right Foot

The agreement needs to provide for detailed provisions to ensure that termination, whether for cause by either party or upon expiry of the term, is conducted in an orderly manner that maintains the standards of service required by the health care institution while a transition is made from the outsourcer. This would include the orderly transfer of applicable data to the health care institution or its new outsourcer in a format that can be effectively used by the health care institution.

In summary, as is increasingly being accepted in other industries, the conduct of material outsourcing arrangements ought perhaps to be conducted in a manner consistent with an objective set of criteria approved by the health care institution's board of directors. Further, material outsourcing arrangements require a calculated process of negotiation that ultimately results in the deliberate allocation of risk and liability acceptable to the health care institution. This article includes in the related table, a quick "thumbnail sketch" of some of the factors that ought to be considered in such a process.



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