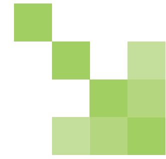
India

Nishith Desai Associates



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GENERAL

1. To what extent does national law specifically regulate outsourcing transactions?

There is no specific law in India that regulates outsourcing transactions except in relation to telecommunication services (*see Question 2, Telecommunications*).

The following legislation covers the various components of an outsourcing transaction:

- The Indian Contract Act 1872.
- Specific Relief Act 1963.
- Foreign Exchange Management Act 1999.
- Information Technology Act 2000.
- Companies Act 1956.
- Income Tax Act 1961.
- Policy on Foreign Direct Investment (FDI).

In addition, common law may have a role.

2. What additional regulations may be relevant on:

- **A financial services outsourcing?**
- **A business process outsourcing?**
- **An IT outsourcing?**
- **A telecommunications outsourcing?**
- **A public sector outsourcing?**
- **Other outsourcings?**

Financial services

There are no laws that specifically deal with financial services outsourcing.

Business process

All business process outsourcing (BPO) suppliers must be registered with the Department of Telecommunications (DoT) (*see below, Telecommunications*) and comply with its regulations. For the purposes of exchange control rules, foreign direct investment (FDI) is allowed in all BPO companies without needing to obtain the prior approval of a regulatory authority (*see Question 2*).

IT

There are no laws specific to IT outsourcing. Customers and suppliers can, however, refer to the general laws that are applicable to the IT sector (*see Question 14*). The same rules relating to FDI apply as for BPO (*see above, Business process*).

Telecommunications

Outsourcing suppliers that provide application services must:

- Register themselves with the DoT as other service providers (OSPs).
- Comply with the DoT's regulations applicable to OSPs.

An application service includes services such as tele-banking, telemedicine, tele-education, tele-trading, e-commerce, call centres, network operation centres using telecommunication resources (for example, leased circuits and public switched telephone network (PSTN)) provided by authorised telecommunications service providers.

Public sector

There are no relevant regulations. However, the relevant public sector organisations or companies produce tenders that provide specific provisions governing public sector outsourcing.

Other

There are no other relevant additional regulations that deal with outsourcing transactions.

LEGAL STRUCTURES

3. In relation to the legal structures commonly used on an outsourcing, please describe how each structure works, and its potential advantages and disadvantages.

Companies considering whether to invest in BPO companies in India must examine exchange control and structuring issues.

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According to the exchange control regime in India, FDI in the software industry or information technology enabled services (ITES) does not require any prior approval from any Indian regulatory authority. As the activities of BPO companies are also categorised as ITES, all FDI is permitted in these companies. According to the guidelines issued by the DoT, all FDI is permitted in call centres.

Captive unit

A customer usually sets up a wholly owned subsidiary to which some functions and services are outsourced. Captive units along with outsourcing to third parties (*see below, Outsourcing to a third party*) are the most common models used by foreign entities when they intend to outsource to India.

When using a captive unit, the customer has complete control of the supplier's operations. Since the customer and supplier are related entities, issues relating to transfer pricing and permanent establishment must be looked into before structuring the arrangement.

The advantages of this model are that the customer can ensure:

- Greater management control over processes and operations.
- A better safeguard of IP and confidentiality than other models.
- That critical activities are kept within the organisation.
- Minimal intervention is required to manage the captive unit.
- Well-defined processes and service level agreements (SLAs) (*see Question 16*).

The disadvantages of this model are that:

- The captive unit may give rise to a permanent establishment taxation issue.
- The parties must comply with formalities in creating the captive unit as a legal entity.
- There are increased operational, managerial and infrastructure costs.

Indirect offshore model

A foreign company establishes a wholly owned Indian subsidiary or enters into a joint venture with an Indian company. In either case, the foreign company sets up a holding company in a tax efficient jurisdiction (for example, Mauritius), which makes the investment in the Indian company.

Under the provisions of the India-Mauritius Double Taxation Avoidance Agreement (India-Mauritius DTAA), capital gains that a Mauritian resident company realises from the sale of shares in an Indian company are subject to tax only in Mauritius and not in India, provided that the Mauritian company does not have a permanent establishment in India. In addition, under Mauritius' domestic tax laws, capital gains are not taxable on this sale. The foreign company should use this model if its business objective is to sell the Indian company and enjoy the capital gains tax (CGT) exemption provided under the India-Mauritius DTAA.

Joint venture company (JVC)

The customer and supplier can set up a separate JVC. The partners both contribute complementary roles in return for a share in the profits. The JVC can provide services to one of the JVC partners as well as to third parties. The supplier is responsible for the operational aspect of the venture. The customer generally holds a majority stake and so can exercise greater control and supervision over the supplier.

This model achieves economies of scale. However, it is generally not a common model. It works best when there is a distinct third party client to whom the services can be sold by leveraging the strengths of the two partners in the JVC. It is not very effective if the JVC partner is the client of the seller. This model is used when the customer wants to exercise greater control over the services that the supplier provides. In certain cases, the JVC can also provide services to third party customers.

Outsourcing to a third party

Services are outsourced to a third party. There is generally no equity participation in the supplier but merely a simple purchase of services. This is one of the most common models.

There can also be a third party outsourcing where a foreign company (A) enters into a direct contract with another foreign company (B), which in turn enters into a sub-contract with its Indian subsidiary (Z) to provide BPO services to A through B.

Foreign companies generally adopt this model, as they are more comfortable to contract with another foreign company who in turn subcontracts the work to its Indian subsidiary, rather than to outsource directly to India. The advantages of this model are:

- There is no need to set up a separate entity, which results in cost savings.
- The customer enjoys lower costs (for example, training and operational costs).
- The third party's expertise in the relevant processes and technical knowledge needed to undertake the outsourcing assignment means the customer saves time and money.

The disadvantages of this model are:

- The lack of or inadequate provisions for data security protection.
- The lack of or inadequate provisions for confidentiality and safeguarding of IP.
- The customer has reduced control over supplier operations.
- The customer depends exclusively on the supplier.
- Contractual misunderstandings between the customer and the supplier (for example, in service levels).
- Reduced flexibility in reacting to changing business conditions.
- Cultural differences between the customer and the supplier.

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Build operate transfer (BOT)

An independent supplier builds and operates the outsourcing facility according to the customer's specifications, and then at a later agreed date transfers the operations to the customer. This model has three phases:

- **Build phase.** The offshore supplier builds the facility to the customer's standards and specifications and provides administrative, professional and other support staff services (support services).
- **Operation phase.** The offshore supplier provides support services. The supplier is operationally responsible and liable to meet and comply with SLAs (*see Question 16*). The customer is charged for services the supplier provides. The parties agree on the division of responsibilities and the appointment of executives.
- **Transfer phase.** The customer has an option to take over the entire operations and bring it in-house at any time. Both the parties have an option to extend the operational arrangement (*see above*) on mutually agreed terms.

In the event of transfer, the customer agrees to pay the supplier an agreed sum (linked to performance goals) in return for the venture's physical assets and employees.

The advantage of this model is that the customer is able to realise the benefits of offshoring quickly with limited execution risk. This is because the supplier bears the risk and the costs associated with the initial operations. The model also minimises long-term financial risks. The customer retains the flexibility of having an option to acquire the facility, at which stage its operational and execution risk and cost is low or limited.

The BOT model is adopted where the customer's core functions are to be offshored, for example, in software development, to take advantage of low costs elsewhere. Initially when the customer does not have the resources to create and manage a captive entity, it hires third parties with the necessary resources and experience to build the facilities and create dedicated resources for the customer. When the customer gains sufficient knowledge and experience to manage and control an offshore captive entity, it converts these third party facilities into a captive entity.

There are, however, some issues concerning HR, control, transfer pricing and permanent establishment that must be examined when considering the BOT model.

Build own operate transfer (BOOT)/reverse BOT

The customer creates an outsourced entity as a captive entity and then divests its stake from the entity in favour of a third party. The use of this model depends on the customer's commercial strategy.

When the BPO industry was in its early stages and experienced third party suppliers were not available, captive BPO entities were created to benefit from the lower costs and skilled labour in the offshore country. As time progressed, the customers transferred the BPO giving non-core services to third parties (*see above, Outsourcing to a third party*). It is now less common than it was. The advantages of this model are that the customer:

- Is certain that it will divest its stake at a later date.
- Has complete initial control of the outsourcing (much like a captive entity).

The disadvantages of the BOOT model include:

- The customer must make a higher initial investment.
- Possible conflict between the customer and the third party at the time of divestment.

PROCUREMENT

4. Please briefly describe the procurement process that is usually used to select a supplier of outsourced services (including due diligence and negotiation).

The procurement process is typically divided into the following stages:

- **Identification of outsourcing requirements.** The customer must identify its outsourcing requirements and any risks associated with these. The customer shortlists suppliers based on their ability to provide services and cost savings. The customer must then conduct a due diligence investigation of the selected suppliers in the following areas:
  - financial strength;
  - resources;
  - service levels;
  - bandwidth, where relevant; and
  - civil actions (if any).

  At this stage the parties may also enter into preliminary negotiations on the cost of the outsourcing.
- **Negotiations with the supplier.** After the supplier is identified, parties negotiate the basic terms of the deal, which can be added to the term sheet or memorandum of understanding. Each party then appoints a contract team that negotiates and finalises the definitive agreement. There are often several technical schedules that are typically prepared by a technical team and reviewed by the lawyers. The parties also often enter into SLAs to measure the supplier's service levels (*see Question 16*). The contract team includes the technical, commercial and legal members. Generally, the customer provides appropriate training to the supplier so that it can carry out the outsourced activities.
- **Performance monitoring.** During the performance of the contract, the customer conducts periodic checks on the supplier's performance.

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TRANSFERRING OR LEASING ASSETS

5. What formalities are required to transfer the following assets on an outsourcing:

- **Immovable property?**
- **IP rights and licences?**
- **Movable property?**
- **Key contracts?**

Immovable property

The customer rarely transfers its immovable property in an outsourcing transaction. In a BOT model, when the operations are transferred from the supplier to the customer, the transfer may include the immovable property. Before acquiring any immovable property the customer should conduct a due diligence investigation to establish the rightful owner of the property. After the title search is completed, the parties concerned must execute a proper sale deed in writing. Under the applicable Stamp Act and the Registration Act 1908, this agreement must be adequately stamped and duly registered with the relevant registrar of sub-assurances. The rate of stamp duty varies from state to state.

IP rights and licences

The customer may want to transfer one of the following to the supplier:

- Its own IP rights, which must be transferred by a written agreement stating the:
  - purpose of the transfer;
  - term of the transfer;
  - extent of rights granted under the transfer.

  The agreement must:
  - satisfy the requirements of the relevant registration;
  - be recorded in the register of the relevant IP Office (if the IP is registered in India).
- Third party licences. In most cases the customer licenses its IP rather than transfers it (*see Question 6, IP rights and licences*).

The formalities specified in the relevant contracts apply (*see below, Key contracts*).

Movable property

Unlike immovable property, it is not mandatory for a transfer of movable property to be written in a written agreement. Movable property can be physically transferred. However, it is advisable that the parties enter into a written contract for evidential purposes.

Key contracts

If the contract can be assigned without the approval of the other party, then the customer and supplier can enter into a simple assignment agreement to transfer the key contract. Generally, a notice of assignment is sent to the other party to the key contract.

If prior consent is required, then the customer and supplier must either enter into:

- The assignment agreement after obtaining consent from the other party to the contract.
- A tripartite agreement between the parties to the key contract and the supplier.

6. What formalities are required to lease or license the following assets on an outsourcing:

- **Immovable property?**
- **IP rights and licences?**
- **Movable property?**
- **Key contracts?**

Immovable property

A customer does not generally lease or license its immovable property in an outsourcing. A due diligence investigation of the title is needed in lease transactions. A lease deed (for leases) or a leave and licence agreement (for licences), must be executed in writing between the parties concerned. The document must be appropriately stamped and registered.

IP rights and licences

To help the supplier perform the outsourced service, the customer may allow (or license) the supplier to use its equipment and software, which can include:

- Operation manuals.
- Systems documentation.
- Computer hardware and software.

The customer can also license its trade marks to the supplier. It must enter a written licence agreement which provides how and for what activities the trade marks will be used and how the usage is controlled. If the IP is registered in India, the licence must be registered at the relevant registry.

Movable property

An agreement for the transfer of movable property must be stamped but need not be registered. This agreement must specify the nature and term of use.

Key contracts

Contracts are not leased or licensed in outsourcing transactions.

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TRANSFERRING EMPLOYEES

7. In what circumstances (if any) are employees transferred by operation of law:

- **To an incoming supplier on an initial outsourcing?**
- **To an incoming supplier on a change of supplier?**
- **Back to the customer on termination of an outsourcing?**

Initial outsourcing

Under Indian labour law, employees cannot be automatically transferred to a new establishment except in cases of transfer of ownership. The supplier's employees continue to be employed by their employer even where they provide certain outsourcing services directly to the customer. The employer continues to be responsible for all employment related obligations for its employees under applicable labour laws, including salary, benefits, social security contributions.

In this context, the Contract Labour (Regulation and Abolition) Act 1970 (CLA) may also be relevant. CLA regulates, among other things, the employment of contract labour in certain establishments. However, CLA does not always apply to outsourcing contracts to the extent that they are "contracts for services" as against "contracts of services". A "contract for services" is where the supplier delivers services to the customer. A "contract of services" is where the customer contracts for the supply of workers and exercises control over the supplier's employees. The CLA provides that contract labour can be used for activities that do not form part of the core activities of the customer.

If the CLA does apply, the customer may be deemed to be a principal employer and the supplier may be deemed to be a contractor for the purposes of CLA. The CLA then provides that if a contractor fails to fulfil its employment obligations towards its employees who provide services to the principal employer, the principal employer may be required to fulfil these obligations. The CLA also requires the principal employer to make contributions under the Employees' State Insurance Act 1948 for the contractor's employees, although these can be recovered from the fees paid to the contractor. In certain cases, the courts have held that the contractor's employees be treated as the employees of the principal employer. This results in the principal employer being responsible for all employment obligations for the contract labourers.

Employees are transferred when there is a transfer of the ownership or management of an undertaking to a new employer (*Industrial Disputes Act 1947*). This is likely to occur in BOT transactions where an entire undertaking or establishment is transferred (*see Question 3, Build operate transfer (BOT)*).

When structuring an outsourcing, the outsourcing contracts should address possible future changes in the law. Generally the customer does not have any control over the supplier's employees who are providing services under the outsourcing contract. The outsourcing contract must contain the necessary provisions to ensure that the supplier is liable for all the employment obligations towards its employees. This helps to mitigate any potential risks of the supplier's employees being classified as the customer's employees.

Change of supplier

Under Indian labour law, employees are not automatically transferred in the event of a change of supplier but instead as part of a transfer of an entire undertaking or an establishment (*see above, Initial outsourcing*).

Termination

The termination of an outsourcing contract does not necessarily result in termination of the employees' employment, except when the supplier hires them specifically for a particular project of the customer and the employment contract provides for such a termination. However, in such cases, the supplier is (in its capacity as the employer) responsible for all employment related obligations on termination, including notice and severance payment requirements, under the applicable central and state laws.

8. Please describe the terms on which employees would transfer by law, including any effect on pensions, employee benefits or other matters (including collective agreements) that the transfer may have.

General terms

In the event that there is a transfer of ownership or management of an undertaking, the Industrial Disputes Act 1947 (IDA) may apply. This deals with disputes between employers and workmen (employed in any industry to do manual, unskilled, skilled, technical, operational, clerical or supervisory work but with certain exclusions), and is one of the most important labour laws in India. Where the ownership or management of an undertaking is transferred to a new employer, the transferor must give workmen who have been continuously employed for at least one year by that undertaking (immediately before the transfer) (*section 25-FF, IDA*):

- One month's written notice indicating the reasons for dismissal (retrenchment), or payment of wages instead of the notice period.
- Payment of compensation equivalent to 15 days' average pay for every completed year of continuous service or any part of that in excess of six months.

However, under the proviso to section 25-FF, the transferor is exempt from providing this notice and compensation in the case of a transfer of an establishment, where the following conditions are complied with:

- The workmen's service is not interrupted by the transfer.
- The terms and conditions of service applicable to the workmen after the transfer are not in any way less favourable to the workmen than those applicable to them immediately before the transfer.
- If the workmen are dismissed at a later date, the transferee is legally liable to pay compensation as if the transferee employed the workmen from the time that they were in original employment with the transferor (that is, the transfer does not interrupt the continuity of the employees' service).

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There are also specific state laws relating to transfer of employees, which may need to be considered. Workmen are entitled to benefits from any provisions, for any matters, which are more favourable than the benefits under the IDA. This does not affect the workmen's right to receive benefits in relation to other matters under the IDA.

Pensions

On the transfer of employment resulting from a transfer of business, employees are entitled to the balance of their provident fund account with the transferor. This is transferred to the transferee's provident fund (*Employees' Provident Funds and Miscellaneous Provisions Act 1952 (EPF Act)*).

On a transfer, the transferor and the transferee are jointly and severally liable to pay the employer contributions and other sums under any provisions of the EPF Act for the period up to the date of transfer (*Section 17-B, EPF Act*). However, the liability of the transferee is limited to the value of the assets that it obtains on the transfer.

Under the provident fund account scheme, a member may withdraw the full amount in its account and be paid dismissal compensation under the provisions of the IDA (*see above, General terms*).

Employee benefits

Insurance cover is provided to employees in case of sickness, maternity, employment injuries and certain other related matters (*Employees' State Insurance Act 1948 (ESI Act)*).

On a transfer, the transferor and the transferee are jointly and severally liable to pay any amount due for any contribution or other amounts payable under the ESI Act up to the date of transfer (*section 93-A, ESI Act*). The liability of the transferee is limited to the value of the assets that it obtains on the transfer.

Other matters

On transfer, the transferor can assign agreements made between itself and its employees to the transferee including:

- Confidentiality agreements.
- IP assignment agreements.

This ensures that the transferee is responsible for the obligations under these agreements.

9. What information must the transferor or the transferee provide to the other party in relation to any employees?

There is no provision under the labour law which requires that the transferor provide any specific information about its employees to the transferee. However, if the transfer of employees is a result of a transfer of an undertaking or establishment under section 25-FF of the IDA, the terms and conditions of service need to remain unchanged. The transferor is generally responsible for providing all existing terms and conditions of employment to the transferee for workmen that are transferred. This allows the transferee to provide the same or superior terms and conditions of service to the workmen.

10. What information and consultation obligations arise for the transferor and the transferee in relation to employees or employees' representatives?

The Supreme Court has suggested that workmen do not need to give their prior consent to a transfer of undertaking under section 25-FF of the IDA that leads to a transfer of workmen (*Management, Mettur Beardsell Ltd v Workmen of Mettur Beardsell Ltd and anr (2006)* and *Madras High Court in Spencer Group Aerated Water Factory Employees' Union and anr v The Presiding Officer, Industrial Tribunal and ors (1996)*).

However, if the employees are informed of the transfer and they provide their written consent, this may help mitigate some of the risks in relation to the transfer. If trade unions are involved, they should also be consulted prior to any transfer.

11. To what extent can a transferee harmonise terms and conditions of transferring employees with those of its existing workforce?

In a transfer under section 25-FF, the transferee must ensure that the terms and conditions of service of the workmen remain unchanged (*see Question 8, General terms*). The transferee must harmonise the transferor's terms and conditions of service with the terms of service that are offered to the transferee's existing employees. This may require re-defining the existing terms and conditions of service to match those of the employees that have been transferred, assuming those terms are more favourable. The changes to the terms and conditions of service must comply with the applicable labour laws and contractual arrangements. If the changes are in any way detrimental to the interests of the existing employees, adequate prior notice must be given and it is also advisable to obtain the employees' prior written consent.

12. To what extent can dismissals be implemented before or after the outsourcing?

Under Indian labour law, the termination of employees' employment should comply with the applicable provisions of the IDA and the relevant state shops and establishments act (SEA). This is in addition to the contractual arrangements between the employer and the employees.

Under the IDA, the employer can terminate the employment of employees by giving one month's prior written notice stating the reasons for dismissal and a severance payment (*see Question 8, General terms*).

13. In what circumstances (if any) is it possible for the parties to structure the employee arrangements of an outsourcing as a secondment?

The outsourcing services can be structured as a secondment. The terms of secondment can be contractually defined and it is advisable that the terms of employment include a provision allowing

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the supplier to undertake a secondment. However, the parties must consider the provisions of the CLA before undertaking any secondment of employees (*see Question 7, Initial outsourcing*).

DATA PROTECTION

14. What data protection issues may potentially arise on an outsourcing and how are they typically dealt with in the contract documentation?

The companies that outsource services to Indian suppliers share their data on a regular basis. Data protection is not specifically regulated in India and there are concerns about data security. The Indian Penal Code 1860 and Information Technology Act 2000 offer some protection as they prohibit theft of data and hacking.

In an outsourcing arrangement, the following data protection issues can arise:

- The supplier identifying, collecting, transferring and processing data that requires protection without the customer's express consent or in a manner that the customer does not expressly authorise.
- A lack of or inadequate security arrangements/processes in place for the supplier in storing and handling personal data.
- The customer's personal data and confidential information being used in breach of the contract.
- Lack of adequate disaster recovery and backup provision.

Customers can take the following steps to protect their data:

- Insist on watertight agreements with suppliers and its employees with appropriate indemnities (*see Question 20*).
- Insist on unlimited liability for breach of confidentiality.
- Share data on a "need to know" basis only.
- Agree on policies and procedures and checks for the supplier to implement in relation to storage and security of data.
- Make background checks of employees. (In India there are background check agencies available.)
- Mark any shared information as confidential.
- Carry out timely audits of the processes to store and protect data.
- Insist on the supplier obtaining international certification, such as ISO 27001.
- Insist on an adequate disaster recovery and backup facility.

Customers can draft non-disclosure agreements with the supplier's employees, so that it can take direct action against the employees without relying on the supplier. Where the supplier or its employees have breached contractual obligations, depending on the facts of the case, the customer can start an immediate criminal and/or civil action against them. Several police departments in India have started a special cyber cell, which deals with such matters. The customer should approach the civil courts for injunctive relief (which criminal courts cannot grant) against the contracting party.

SERVICES

15. How is the services specification typically drawn up and by whom?

The parties to the outsourcing arrangement mutually discuss the services specification and scope. Usually it is the customer that identifies the services required and draws up the initial draft. This draft agreement is supported by various schedules (the schedules are usually annexed to the outsourcing agreement) which covers services specifications, service levels and other matters.

16. How are the service levels and the service credits scheme typically dealt with in the contract documentation?

Typically the parties initially agree on defined measurable service levels to be achieved under the outsourcing agreement. These are recorded in an SLA. The parties may periodically review the SLA. If the service levels are not met, the customers usually provide for penalty provisions in the agreement or, in the case of a consistent breach, the right to terminate the contract.

CHARGING

17. Please describe the charging methods that are commonly used on an outsourcing (for example, risk or reward, fixed price, cost or cost plus, pay as you go, resourced-based charges, use of minimum charges and so on).

The charging methods that are most commonly used on an outsourcing include:

- **Transaction/project.** A customer and supplier can agree to an outsourcing transaction with a fixed scope or project (for example, debt recovery), for an agreed fixed price. This model is helpful when the scope and specification for the transaction is clear.
- **Cost plus.** The fees consist of the actual cost of services to be provided plus a mutually agreed markup or profit margin (for example, cost plus 10%). This model is adopted when the scope of the outsourced services cannot be fixed because they are prone to change. This model is mostly adopted for captive units and sometimes even for BOT.
- **Fixed cost per hour/time and material.** Charging for certain outsourcing transactions is often based on an hourly basis. Sometimes the cost may also be based on the resources (time and manpower) to be utilised for a particular outsourcing arrangement. The customer and supplier will negotiate and agree to a figure. This model is suitable when it is difficult to predict the scope, specification and effort involved at the outset of an outsourcing.

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- **Milestone based.** For customers who are more concerned about the timely progress of their project, milestone based billing is appropriate. If the supplier does not achieve a particular milestone identified by the customer, the customer may either:
  - withhold the payment; or
  - reduce future payments to be made to the supplier by a certain amount.

Other methods

The parties can also agree a combination of fixed and variable price. For example, in an outsourcing arrangement for software development, the initial price for developing the software may be fixed, and any further services, customisation or upgrading may follow a variable price model.

All the above methods are subject to standard SLAs between the customer and the supplier. The supplier is granted debits or credits on the prices, depending on whether SLAs are achieved.

18. Please briefly describe any other key terms used in relation to costs, such as charge variation mechanisms and indexation.

The supplier will reduce the cost to the customer of its creation of new or customised software as part of the outsourcing if it is allowed to license or share that software with its other customers. For example, if the cost incurred for creating customised software is US$100 (about EUR68), then the supplier may charge US$20 (about EUR14) plus 10% if it is allowed to license the software to its other customers.

CUSTOMER ISSUES

19. If the supplier fails to perform its obligations, what relief is available to the customer under general law?

Remedies available under the general law where the supplier fails to perform its obligations, include:

- Termination of the contract.
- Specific performance of the contract.
- Penalties.
- Damages.

Which remedy is available depends on the nature of the breach. Typically, the contract will specify the remedies available for breach of contract. If the customer wishes to restrain the supplier from breaching its obligations (for example, in relation to confidentiality, non-compete and non-solicitation), depending on the strength of the case, urgency and balance of convenience, it can apply for an interim injunction through a court order.

The court does not generally grant orders for specific performance when they involve the performance of a continuous duty which the court cannot supervise. Most outsourcing contracts fall into this category. Specific performance orders are rarely granted through injunctive relief.

20. What customer protections are typically included in the contract documentation to supplement relief available under general law?

The following clauses are included in an outsourcing contract:

- Indemnities (*see Question 21*).
- Representations and warranties and consequences if they are breached (*see Question 21*).
- Quality control and assurance.
- Performance and service level monitoring.
- Penalties and service credits (*see Question 17*).
- Damages (*see Question 19*).
- Liquidated damages (*see Question 19*).
- Right of termination of the contract (*see Question 19*).
- A requirement to take out insurance.
- Reporting requirements.
- Audit rights.
- Provision of adequate security measures (*see Question 14*).

WARRANTIES AND INDEMNITIES

21. What warranties and/or indemnities are typically included in the contract documentation?

Supplier warranties and indemnities typically state that the supplier:

- Is a legal entity established under appropriate laws and is competent to contract and perform its obligations under the contract.
- Possesses the required knowledge, skill and capacity to perform and deliver the services under the contract.
- Possesses adequate licences and approvals to undertake and deliver the services.
- Will indemnify the customer against any loss or harm the customer suffers because of the supplier's fault.
- Will not enter into any other agreement that may conflict with this agreement.
- Will not violate third party rights (including IP) while providing services or creating IP.

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Customer warranties and indemnities typically state that the customer:

- Is a legal entity established under appropriate laws and is competent to contract and perform its obligations under the contract.
- Will provide the appropriate training to the supplier and its employees.
- Will not enter into any other agreement that may conflict with this agreement.

22. What limitations are imposed by national law on fitness for purpose and quality of service warranties?

There are no limitations imposed in relation to service warranties.

TERM AND NOTICE PERIOD

23. Does national law impose any maximum or minimum term on an outsourcing? If so, can the parties vary this by agreement?

National law does not impose any term on an outsourcing agreement. The parties contractually fix the term.

24. Does national law regulate the length of notice period required (maximum or minimum)? If so, can the parties vary this by agreement?

National law does not regulate the length of the notice period. The notice period depends on the agreement between the parties.

TERMINATION AND TERMINATION CONSEQUENCES

25. What events are considered sufficient under national law to justify termination of an outsourcing rather than a claim in damages (for example, fundamental breach, repudiatory breach, insolvency events and so on)?

Termination can occur because of either the:

- Contract terms.
- Operation of law, including:
  - a *force majeure* event;
  - a material breach of contract;
  - a minor breach of the contract;
  - bankruptcy.

26. In what circumstances can the parties exclude or agree additional termination rights (for example, for breach, change of control, convenience and so on)?

The parties are free to agree additional termination rights, for example:

- Termination for convenience.
- Termination for change of control.

However, in cases of termination for convenience, where the supplier has committed resources to the outsourcing, it is advisable for the customer to agree an exit cost or pay liquidated damages so that the contract appears fair.

27. What implied rights are there for the supplier to continue to use licensed IP rights post-termination? To what extent can these be excluded or included by contract?

There are no implied rights. If there were, they could be excluded.

28. 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 national law does not provide for the customer to gain access to the supplier's know-how. However, parties can contractually agree for the customer to gain access to, use or be restricted from using the supplier's know-how post termination.

LIABILITY

29. What liability can be excluded? In particular, is it possible for the supplier to exclude liability for indirect and consequential loss and also any loss of business, profit or revenue?

The parties to an outsourcing contract are free to exclude liabilities under the contract, including:

- Any indirect and consequential loss.
- Loss of business profits.

30. Are the parties free to agree a cap on liability? If so, how is this usually fixed?

The parties can agree to a contractual cap on liability. The cap is generally fixed according to the fees received for a specified term, prior to the occurrence of the claim.

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TAX

31. What are the main tax issues that arise on an outsourcing in relation to:

- **Transfers of assets to the supplier?**
- **Transfers of employees to the supplier?**
- **Value added tax (VAT) or the equivalent sales tax on the service being supplied?**
- **Other significant tax issues?**

Transfers of assets to the supplier

CGT is levied in India on profits and gains arising from the transfer of a capital asset. For CGT to apply, the capital asset must be located in India and the transfer should not fall under any of the exceptions contained in section 47 of the Indian Income Tax Act 1961 (ITA).

A transfer of assets to the supplier can occur through either:

- **A slump sale.** A slump sale is the transfer of one or more undertakings for a lump sum consideration, without values being assigned to individual assets and liabilities (*section 2(42C), ITA*).
- **An itemised sale.** If individual values are assigned to the assets being sold, the sale is characterised as an itemised sale irrespective of whether the payment may be received in a lump sum.

Profits and gains arising from a slump sale of an Indian undertaking are taxable in India with effect from April 2000 (*section 50B, ITA*). If the consideration received from a slump sale is higher than the net worth of the undertaking which is being transferred, the difference between the sale price and the net worth of the assets is liable to CGT. If one or more undertakings have been held for more than 36 months preceding the date of transfer, the long term CGT rate of 20% (exclusive of surcharge at the rate of 10% and education cess at the rate of 3%) applies. If the undertaking has been held for 36 months or less, the short term CGT rate of 43% (exclusive of surcharge at the rate of 10% and education cess at the rate of 3%) applies to the transferor.

Whether the short or long term rule applies in an itemised sale depends on the period of holding of the asset.

Transfer of the asset can attract stamp duty at the applicable rate (*see Question 5, Immovable property*).

Transfers of employees to the supplier

There is ambiguity as to whether customer contracts or employees transferred to the supplier can be defined as "capital assets" for the purpose of calculating capital gains under the ITA. In addition, if the employees of a foreign outsourcing entity are transferred to an Indian supplier yet continue to function as the customer's employees, there may be implications of permanent establishment, especially if the employees carry on the business of the foreign entity through the supplier's premises.

These issues are examined on a case-by-case basis.

VAT or sales tax

On asset transfers, central sales tax (CST) or value added tax (VAT) is likely to arise if the transaction involves a transfer of assets situated in India. CST applies to inter-state transfers, while VAT applies to intra-state transfers. There could be a liability to pay VAT in the event of an asset sale since this would result in a transfer of assets. VAT rates range between zero to 12.5% and can vary depending on the state-specific VAT legislation.

Other

Service tax is levied on specified taxable services at the current rate of 12.36% (including the education cess of 2% and secondary and higher education cess of 1% introduced by the Finance Act 2007). This rate is calculated on the gross amount that the supplier charges for its taxable services. It is a consumption tax, which means that the levy is on consumption of particular services. Therefore, while the supplier has responsibility for payment of the tax, the tax is typically passed on to the ultimate consumer of the service. Where these consumers do not fall within India's tax jurisdiction (for example, where the consumers are located outside India and the service is considered to have been exported to them), no service tax is payable.

As service tax is a consumption tax, it is only levied on services consumed in India (*The Export of Service Rules 2005, as amended from time to time*) (Export Rules). The Export Rules also contain criteria to determine whether a service has been exported from India. Essentially, the export criteria are based on location, performance or recipient, depending on the service in question. For a service to be exported, it must be:

- Provided from India.
- Used outside India.
- Paid for in convertible foreign exchange.

There is no custom duty where the goods are imported and the outsourcing entity is set up in a designated specific area known as a free trade zone.

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