

# Home or Away?

Understanding due diligence and contract considerations provides insight for collection agencies asking the offshore outsourcing question.

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Outsourcing is certainly not a new concept in the credit and collection profession. In fact, the very idea of using a collection agency to pursue the collection of defaulted obligations may be one of the oldest and most highly evolved examples of business process outsourcing—contracting out or divesting a business function which is an integral part of extending credit. The reasons for outsourcing include taking advantage of lower-cost labor and facilities, gaining access to innovative or proprietary services, achieving economies of scale and, often cited as a primary motivation, permitting businesses to focus their efforts and capital on their core business functions.

This last reason certainly accounts for why many credit grantors choose to outsource collection functions to professional collectors. But as more and more collectors explore outsourcing their call centers and related business processes to lower-cost providers offshore, they must consider that, unlike the credit grantors, the collectors are outsourcing their core business function. Indeed, as Internet-based telecommunications and other technological developments continue to progress toward making outsourcing collection offshore seamless and as cultural sensitivity training and accent neutralization programs make it more transparent to provide consumer-contact services from any part of the world, the collectors who are embracing such cost-saving programs in an increasingly competitive marketplace may find that they are training new low-cost competitors that may replace them in the future. This trend appears likely to continue, although instances of “insourcing” some previously outsourced functions have been noted in other industries.

International outsourcing poses an array of unique challenges, including geopolitical risks, cultural and language differences, foreign exchange fluctuations, local law issues in the outsource vendor’s country, application of the outsource client’s domestic laws and potential conflicts of law or issues of jurisdiction for enforcement or resolution of disputes, telecom and electrical infrastructure,

time zone differences and, not least, the potential for political and legal issues in the client’s home country growing out of the exportation of jobs. (An example of the last point is the recent uproar in a Midwestern state when it came to public attention that a large outsourcing contract had been awarded to an Indian company by the state agency responsible for unemployment insurance.)

### **Geopolitical risks**

One of the principal objectives of offshore outsourcing is to take advantage of dramatically lower labor costs in less-developed economies. The outsourcing agency must consider, however, the political and overall economic stability of the outsourcing vendor’s country, the likelihood of disruption from threats of terrorism or other causes of business and economic insecurity, the political relationship between the two countries and the possible impact of laws relating to international boycotts, currency controls, technology import and export, immigration restrictions, trade and customs and taxation, as well as laws relating to foreign investment in or control of businesses in the host country.

To gain this and other knowledge critical to the process of developing a contract that is likely to benefit the client agency’s business, the services of sophisticated local counsel will be an essential complement to experienced outsourcing counsel at home.

### **Cultural and language differences**

In the context of collection call centers, matters of local attitudes and customs toward dealing with strangers, confronting resistance or outright hostility from consumers, discussing personal matters, direct versus indirect manners of expressing agreement or disagreement and even class and economic sympathies may have a bearing on both the negotiation process for the outsourcing agreement and the bottom line results of the outsourced debt recovery process.

Even in a country such as India, where English is widely spoken among white collar and managerial workers, the question arises

whether a foreign accent may be a greater impediment to a caller attempting to collect a debt than it may be when the foreign speaker is staffing an inbound help line for technical advice or customer service. So-called “accent neutralization” programs have diminished such concerns, but the additional training expenses will cut into labor cost savings.

Closely related to the preceding issues are the size, education level and other characteristics of the local work force. India boasts a large number of college-educated workers for whom an office job in a modern, air-conditioned facility that pays \$8,000 to \$12,000 a year may be an attractive career option, whereas as comparable jobs in the United States are often viewed as temporary. It has been reported that this segment of the Indian work force has a strong work ethic, responds well to training and has a lower turnover rate than comparable workers in some U.S. facilities. On the other hand, due to the calling hour restrictions under Fair Debt Collection Practices Act (FDCPA), collection call center jobs in India require a shift to overnight hours that may not be sustainable over a long period.

### **Foreign exchange**

As with any cross-border contract, long-term outsourcing agreements, currently running three or more years in duration, must address fluctuations in foreign exchange rates. If, as may be desired by U.S.-based outsourcing clients, the contract specifies that all payments will be made in U.S. dollars or equivalent, the resulting currency fluctuation risk for the outsourcing vendor may be reflected either in higher pricing, more frequent price adjustments or may necessitate the vendor using foreign exchange hedging transactions.

### **Application of U.S. laws**

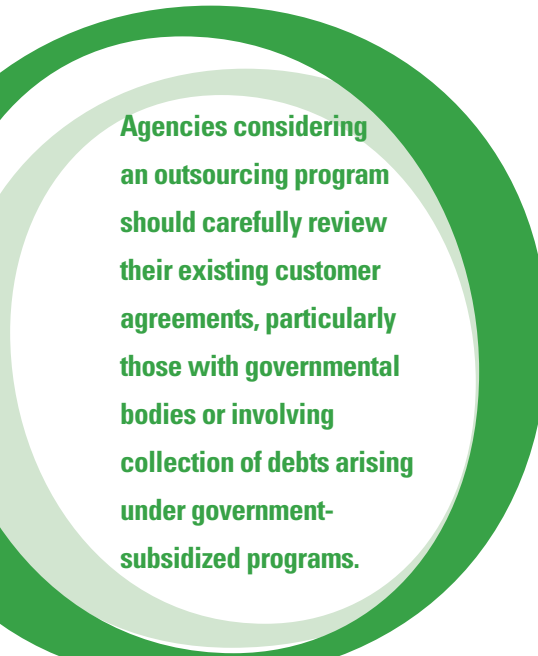
The use of offshore outsourcing services necessarily results in the application of aspects of both the home country’s laws in some fields and the outsourced country’s laws in others and presents a number of

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opportunities where these two regimes may conflict, particularly as relates to the enforcement of the contract.

In the case of outsourcing collection call center work, U.S. federal and state laws relating to consumers rights, including the FDCPA, the Truth-in-Lending Act (TILA), the Gramm-Leach-Bliley Act, the Health Insurance Portability and Accountability Act (HIPAA) and even elements of Sarbanes Oxley, such as the records retention and whistle-blower protection provisions, as well as state consumer protection statutes and licensing regulations, will continue to govern the U.S. company's relationships with debtors. In other home countries, such as those subject to the EU Data Protection Directive, which imposes restrictions on the exportation of personal information, there will be additional challenges.

Whether by reason of "direct or indirect" language in applicable statutes and regulations or by application of the principles



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of agency law, it would be prudent to assume that a U.S. company that delegates collection work to a foreign company will likely be held to account for the acts and omissions of the outsource vendor. The

outsourcing contract should address the responsibility of the outsource vendor to comply with, or facilitate the client's ability to comply with, federal, state and local laws and regulations to which the client continues to be subject. In addition, U.S. immigration policies may present hurdles to bringing foreign supervisors and trainers to the United States for training or to perform managerial or liaison roles.

## **Application of foreign laws**

Although it is unlikely that the laws of the vendor's country will apply to calls to or collections from U.S. debtors, a number of other aspects of foreign laws must be considered for their possible impact. These include laws governing taxation, employment, health and safety, the ownership and licensing of intellectual property, the protection of confidential information and the ownership of innovations developed in the course of the contractual relationship.

The outsource client should also seek advice regarding whether, as a practical matter, enforcement of the law or of negotiated contract terms can be obtained against the outsource vendor in the vendor's local courts in a timely and reliable manner, the availability of alternative dispute resolution methods (such as arbitration or mediation) and the enforceability of judgments and awards under local law or applicable international treaties.

Although it would be prudent to attempt to have the outsource contract specify that U.S. law governs all disputes between the parties and that all disputes will be litigated or otherwise submitted for resolution in the United States, questions may still remain regarding obtaining effective relief against the foreign entity or its principals. The outsourcing contract may provide for indemnities or guarantees of various kinds, but the practical realization of these contract protections may be limited by the vendor's local law. U.S. outsourcers would be well advised to explore the applicability of their current insurance coverages to acts or

omissions by foreign contracting parties performing services for them and, if necessary, to explore the availability of special endorsements to clarify these issues.

## **Infrastructure issues**

The due diligence process should include a review of the national and local infrastructure for telecommunications and electrical service, as well as the local availability of both IT support capabilities and disaster recovery facilities. It may be advisable to maintain the critical host servers for the call center in the United States as well as other redundant equipment and services in order to minimize disruption from service interruptions in the foreign country. In any event, frequent off-site back up of all critical information on as close to a real-time basis as possible is essential.

## **Time zone issues**

Although the inconvenience both to offshore workers working through the night and to U.S.-based supervisory personnel may seem obvious, it is advisable to consider at the outset how reporting and communications will be handled, whether U.S.-based personnel will be sited in the outsource country or whether foreign nationals will be based in the United States or some combination of the two. (See also, the immigration, employment law and tax law issues mentioned earlier.) Depending upon exactly how many time zones separate the client and the vendor, the window for live communication during normal business hours in both countries may be short or nonexistent.

## **Political repercussions at home**

As the volume of business process outsourcing contracts grows and more local service jobs follow the course of manufacturing jobs exported throughout the past 30 years, there is a growing potential for political pressure or regulatory responses that make it more difficult to perform licensed occupations, such as debt collection, using foreign workers and companies. Although

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the current climate favoring broader free trade agreements makes outright prohibitions on outsourcing jobs to other countries unlikely, indirect pressures from agencies' customers and from consumer advocacy groups and others may narrow some opportunities for outsourcing.

Agencies considering an outsourcing program should carefully review their existing customer agreements, particularly those with governmental bodies or involving collection of debts arising under government-subsidized programs, such as student loans and health services, to determine whether assignment or delegation of collection functions is permitted and, if so, whether customer resistance to foreign outsourcing is likely.

### **Outsourcing relationship forms**

Once the due diligence process has supported the decision to outsource call center activity to a foreign jurisdiction, the agency should evaluate the extent to which the collection process will be outsourced and the relationship to be established between the agency as outsourcing client and the outsourcing vendor. This relationship can range from the establishment of a foreign subsidiary that will hire local workers to provide the required function under the direct supervision of expatriate parent-company employees (not a true outsourcing contract, but a means of maintaining maximum direct control), to a turn-key contract with

a local service provider that will be governed entirely by contract.

In the middle ground are varying degrees of joint venture structures, ranging from joint ownership of a business entity between the client and the vendor, with shared profits and risks, to what may be termed "contractual joint ventures" under which no new legal entity is created, but the contract terms include incentives and penalties which are designed to align the interests of the parties to the contract in much the same way that a true joint venture would. In many ways, the contractual joint venture is likely to prove less complex and burdensome in terms of tax treatment, ownership of proprietary intellectual property,

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entanglement of the client with local laws and unwinding or dissolution mechanisms.

In making these choices, the agency must take into account the degree to which it is prepared to give up control of the outsourced operation, its level of confidence in the experience, reliability and future business objectives of the outsource vendor, whether the relationship will be exclusive and long-term and whether the client intends to outsource all, or only certain components of its collection activities.

The ultimate test of the value of foreign outsourcing will not be the comparative wage levels of the work force or even the total contract cost to the agency, but rather the effective contribution of this redesigned business process to the bottom line of the agency's business. This will include evaluating the true recovery rates on the debt as well as the level of indirect costs incurred, such as for international travel and communications, additional management attention to training and oversight, and the costs of resolving service complaints, administrative agency investigations and private party litigation in a "one-off" structure.

## **Not an all or nothing decision**

Being able to benchmark the performance of the call center is very important. If the entire function is outsourced, it may be very difficult to benchmark accurately over a period of time and under changing economic and regulatory conditions. Because it is likely that many collectors have components of their work that are more susceptible to being outsourced than others, depending upon the customer and the subject matter of the collections, they may choose to outsource only a portion of their call center work. This would have the advantage of permitting direct internal benchmarking comparisons, as well as providing backup facilities and talent in the event of interruptions of service or a later decision to terminate the outsourcing relationship.

Maintaining state of the art capabilities

in-house may result in constructive competition with the outsource vendor for innovations and efficiencies, may enable the agency to market successfully to a broader range of customers and would buffer the "all or nothing" risk of ramping down and ramping back up in the event of unanticipated developments.

## **The outsourcing contract**

As in any outsourcing agreement, domestic or foreign, a carefully drawn specification of the scope of the outsourced function and the allocation of responsibilities between the client and the vendor is the core. The following are issues which may take on additional significance in the offshore context.

## **Standards**

Outsourcing U.S. debt-collection operations offshore involves the outsource vendor in a highly regulated environment enforced by both U.S. federal and state regulators and private litigation. U.S. legal standards must be presumed to apply to all interactions between collection personnel and individual debtors.

The outsourcing contract must provide for extensive and frequently updated training in applicable laws and decisions, and failures to conform to such standards should have financial consequences to the vendor. The agency should have rights to audit not only financial reports and record-keeping requirements of the vendor, but also operational matters such as random tape-recording of collection calls (if permitted by both countries' laws), planted debtor files to enable live interaction with collectors and, perhaps, random post-collection interviews with debtors. The client should have the right to require replacement of unsatisfactory collectors or further training.

The contract should also address how the costs of adjusting to changes in applicable law will be borne by the respective parties and whether contractual performance standards will be adjusted to reflect changed regulatory requirements.

## **Term, termination and transition**

Outsourcing agreements are trending toward shorter durations in recent years, reflecting the accelerating pace of innovation and changes in business practices and regulatory requirements. Depending on how well-established and proficient the outsource vendor is in the particular field, the process of transitioning a business process such as a call center to the vendor may be able to be accomplished in a matter of weeks rather than months, making it feasible to consider annually-renewable agreements rather than longer-term commitments.

Such shorter-term contracts may come at a higher per-transaction or per-period price, but the peace of mind from being able to unwind the relationship more quickly may be worth the extra cost, particularly for a client that retains the in-house capability to insource the process or to work through a transition period while changing outsource vendors.

Depending on the length of the contract, the circumstances permitting termination by either party and the duration and terms of any transition period become more important. In addition to customary provisions permitting termination for breach or at the end of a stated term, an international outsourcing agreement should include a carefully thought-out provision for termination (or renegotiation of affected terms) in the event of changes in circumstances that may materially affect the commercial value of the contract to one or both parties.

A boiler-plate force majeure provision relating to acts of God, war, natural disasters and interruptions of critical resources is only the beginning of an analysis of the impact of changes in U.S. or international law, imposition of regulatory or judicial sanctions or even decisions of the client's key customers not to permit the continued outsourcing of collection services. Although it may be tempting to provide for the swiftest possible right to terminate in such cases, consideration should be given not only to a transition period long enough to avoid

disruptions but also to a meaningful termination payment to the vendor to assure its cooperation throughout the transition process.

**Fostering a “partnering” mentality with the vendor to ensure compatibility over time of systems, networks and software, as well as reporting formats and transparency for purposes of operational audits, may increase the likelihood of success.**

### **Protective covenants**

Because of the risk that today’s outsourced call center may be tomorrow’s collection agency competitor, the agency should consider a set of non-predation clauses designed to protect the client from such competition from the vendor.

Such provisions may include a non-solicitation covenant relating to the client’s current, recent and prospective customers or, perhaps, a category of customers in an industry or niche in which the client specializes, as well as non-solicitation of the client’s present and recent employees. In addition to determining the enforceability of such provisions under both countries’ laws, the client will want to consider the reaction of a customer who is made aware of such a provision in the outsourcing agreement.

Protective covenants will also be appropriate to cover the ownership of intellectual property developed in

connection with the outsourcing contract, assuring at least the continued ability of the client to make use of such innovations—if not securing outright ownership of them.

### **Indemnities and insurance**

As noted earlier, the client may be less confident about its ability to enforce compliance with contract terms against an offshore vendor, and customary protections such as indemnification clauses and guarantees may be of uncertain value. Even a provision making U.S. law govern such issues will not ensure the practical realization of such promises against persons or assets in a foreign country. Such considerations may argue in favor of selecting larger and better established contractors with strong track records and reliable references from international businesses rather than more aggressive, newer entrants promising greater savings.

The availability of insurance (for business interruption, if not for direct recovery), letters of credit or guarantees from financially responsible affiliates should be explored.

### **Making the vendor part of the team**

Provisions should be included to ensure that the vendor is required or has financial incentives to function as part of a seamless operation not only with the agency but with the agency’s other vendors, such as custom software suppliers, consultants and hardware vendors and engineers.

Fostering a “partnering” mentality with the vendor to ensure compatibility over time of systems, networks and software, as well as reporting formats and transparency for purposes of operational audits, may increase the likelihood of success in an outsourcing relationship and reduce the level of unanticipated expenses from managing divergent, unintegrated business processes.

Similarly, providing for a collaborative approach to management and oversight of outsourced operations and creating incentives for continued improvement of

standards may prolong the viability of the relationship.

Many U.S. companies may wish to consider specifying somewhat higher standards of employee welfare and relations than those prevailing in the vendor country in order to increase vendor employee loyalty, reduce turnover and, perhaps blunt some likely criticisms from the client’s domestic work force and customers.

Daunting though the prospect may be, competitive pressure is likely to force more and more agencies to explore offshore outsourcing for at least a portion of their core collection function. By not losing sight of the real bottom lines, customer service and effective debt recovery, such businesses may increase the likelihood of designing a relationship for success rather than disappointment and frustration. **CM**

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