

**Hot Topics in Foreign Outsourcing:
How Can My Healthcare Organization Avoid Getting Burned?**

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I. Introduction

A hospital seeking to streamline its technology support department can reorganize the department by hiring and/or firing personnel or it can contract with a tech support outsourcer to take over some or all of its technology support operations.

A cardiology group exploring alternative methods to save money in its billing department can reorganize the department or it can contract with an outsourcer who specializes in billing to serve as its billing and collection provider.

An ambulatory surgery center considering how to optimize its coding procedures can hire coding personnel or it can contract with an outsourcer who specializes in coding services.

Outsourcing is the process by which a company retains a third-party to perform some process or function that was or would be performed by the company itself. A company may contract with an outsourcer to perform some functions which the company or one of its departments performs, may contract with an outsourcer to augment certain functions, or may move all of the functions to the outsourcer.

Although outsourcing is considered a hot topic, it is not a new trend. In fact, companies have been outsourcing back-office functions for decades. Such outsourcing initially was primarily to U.S. based outsourcers. However, the expansion of outsourcing overseas, and the use of non-U.S. based outsourcers, is a new phenomenon. Countries in Asia, specifically India, and Europe, specifically Ireland, have been successful in recruiting the business of U.S. companies.

Companies outsource for many reasons. The most obvious reason is the potential to save money. Instead of investing in the development or maintenance of a business function, a company can outsource the function to a party who already has the expertise

and resources. The overall cost of the outsourced function, specifically the payment made to the outsourcer, the cost of the company's personnel retained to manage the relationship and the cost of the transition of the function to the outsourcer, is often less expensive than the cost which would be incurred by the company if it were to perform the function in-house. In addition, the relationship will enable the company to gain access to a greater skill set and, in many instances, shorten response and cycle time. In any event, it hopefully enables a company to focus on its core competencies. For example, a hospital can perform its data entry tasks in-house by hiring and maintaining a data entry department. To do so, the hospital must pay its data entry employees a salary and provide benefits to them, would need to dedicate space (whether on-site or off-site) to the department and pay all expenses relating thereto (including, rent, utilities, etc.), would need to retain the resources necessary for such department to function, such as a computer system and staff, and may need to retain a supervisor to oversee the department, among other things. This could come at a great expense, especially relating to the start-up costs. Alternatively, the hospital can engage the services of an outsourcer which already has the personnel and expertise to perform the data entry functions. By doing so, the hospital can reduce or eliminate the need to maintain the department and presumably, save money and other resources.

There are, however, risks associated with outsourcing. Notably, entrusting a critical function to a third-party makes companies uneasy about outsourcing. Additionally, outsourcing decentralizes operations, making communications and management more difficult. To complicate communications between the company and the outsourcer, outsourcers located overseas, such as in Asia and Europe, operate in different time zones which, in turn, requires the company, the outsourcer or both to operate during non-standard business hours. In addition to the cost of the outsourced service, there are additional costs, such as the start-up and maintenance costs of the relationship (including the cost of the staff and equipment necessary to coordinate the relationship). The transition of the function into and out of the relationship may pose operational difficulties. When the outsourcer is overseas, cultural incompatibilities become an issue, and the necessity of complying not only with U.S. laws, but with international laws, treaties and regulations, becomes critical. As outsourcers often

perform services on behalf of competitors, the extent to which an outsourcer has access to confidential information and trade secrets may be a major issue. Finally, outsourcing may create a dependency by a company on their outsourcer which creates a risk that a company will not be able to change the outsourcer at some point in the future, thus, giving the outsourcer bargaining leverage in the relationship.

In any event, offshore outsourcing has ignited much debate and controversy because of the potential impact on jobs in the U.S. Generally, labor advocates criticize offshoring overseas because it attempts to capitalize on foreign cheap labor and correspondingly ships important U.S. jobs overseas, whereas proponents view offshore outsourcing as a logical step in the operation of a business in a global economy.

The purpose of this article is to focus on some of the key concepts a health care organization must analyze when considering whether to enter into an outsourcing relationship with an overseas outsourcer.

II. Recent Trends in Outsourcing

Initially, outsourcing primarily focused on the technology sector. Healthcare providers that did not possess in-house information technology departments, such as computer hardware and software services and support, outsourced such services. This is called Information Technology Outsourcing (“ITO”).

More recently, we have seen the emergence of Business Process Outsourcing (“BPO”) and Business Transformation Outsourcing (“BTO”). BPO involves the provision of both labor and technology. In a BPO relationship, a company enters into an agreement with an outsourcer relating to a specific function of the healthcare provider’s business. In the healthcare sector, this may include areas such as billing and collecting, coding, payroll, and human resource administration. The BPO outsourcer performs a process or function in which it possesses expertise, and the healthcare provider benefits by obtaining a service at lower costs. BPO raises a number of legal issues which are further described herein.

In a BTO relationship, the outsourcer is more intimately involved in the entire business of the healthcare providers, as opposed to merely a few specific functions. In this relationship, the outsourcer may update and improve upon the healthcare provider’s business. Instead of a specific function, the outsourcer becomes involved in the future

operations of the healthcare providers. Similar to BPO, BTO raises a number of legal issues which are further described herein.

III. U.S. Healthcare Outsourcing

The U.S. healthcare segment has not been immune to the outsourcing trend. The development of information technology has led to the outsourcing of an increasing number of functions in the U.S. healthcare industry. Technologies such as computerized physician order entry (CPOE), electronic medical records (EMRs), inbound voice response systems (IVRs), network and data management, automated claims processing, and regulated compliance monitoring are significant outsourcing activities. Additional services center on application maintenance, system integration, application development, product reengineering/maintenance, HIPAA consulting, and e-business initiatives. BPO for healthcare includes insurance claims processing, adjudication, receivables management, billing and coding services, radiology reporting, and transcription services.

As noted above, Asia and Europe, are the major overseas markets for outsourcing. There are fifteen to twenty large and midsize vendors in India that provide information technology services to the healthcare market in North America. About 5,000 professionals are involved in the healthcare informatics segment. U.S. healthcare providers spent more than \$4.2 billion on outsourcing information technology in 2002 and are projected to spend more than \$5.2 billion by 2006. Sixty percent of healthcare organizations will outsource more than half of their information technology operations by 2007. Significant sums are also spent in the other outsourcing sectors. The total spending for medical transcription (which involves electronic capturing of patient information and converting it to a useable format) alone in the United States in 2000 was \$10.6 billion. Nearly half of the total transcription dollars are being spent in the outsourced transcription market.

There are numerous explanations for why U.S. healthcare organizations are looking to outsource, most of which are the same for any business desiring to outsource. Time and money are the primary reasons, but staffing shortages in key positions, such as nurses and coders, are also contributing to this growing trend. In the past few years, information technology's increasing reliability has intersected with the increasing importance of information technology in healthcare to lower costs and reduce errors.

Providers also choose outsourcing to meet staffing challenges posed by local labor markets, the need for specialized training, and their own staffing limitations.

There are three model types used when analyzing a potential outsourcing relationship. Under the cost-based model, entire functions or projects are exported to a vendor in another country or location where the work can be completed at a lower cost. By using outsourcing to obtain low cost labor, the provider can cut costs from the maintenance of services that are no longer profitable to maintain using U.S. resources. Another model of outsourcing, BPO, which was mentioned earlier, involves the outsourcing of an entire business unit, process, sales, or production function. This model is most often used to: (i) maintain a continuous work schedule by having teams in various time zones and/or (ii) expand sales or services into a new geographic location. As noted above, under a BTO arrangement, the outsourcer becomes an integral component of the entire business.

Healthcare providers generally follow the cost based model of outsourcing. The outsourcing may be of a task, such as medical transcription, which, upon completion, is imported into the U.S. as a portion of the work process for the healthcare provider. The latter kind of outsourced operation has the added benefit of allowing the company to utilize a 24/7 work plan. When a hospital elects to use the cost based model, it is often because it believes that it does not have to closely supervise the work. This assumption may be incorrect and may have expensive consequences. Supervision through audit, quality control standards, service level agreements and inter-company task forces is critical for maintaining quality. A hospital must make sure both the United States and foreign teams can effectively communicate and work together to seamlessly transfer work between venues. Because the goal of this type of outsourcing is generally “cost” savings and its success is measured by that metric, a hospital must make sure that the margin of cost savings is large enough to handle unexpected expenses, start up costs associated with transferring operations overseas, and the ongoing costs of communication between teams, foreign taxes, employment expenses, and legal/regulatory costs.

IV. Due Diligence and Preparation

Many outsourcing relationships fail because the parties were not a good fit, or a proper foundation was not laid for the relationship. A failed relationship may be

extremely costly to a healthcare provider. Accordingly, a company should take all possible steps to minimize the risk of such failure.

With this in mind, it is critical that prior to outsourcing a function, a healthcare provider should conduct an exhaustive due diligence investigation on the outsourcer in order to thoroughly prepare for the relationship. Due diligence is the process by which one party researches and learns about another party. It is through this process that the risks inherent in an outsourcing relationship can be minimized. Inherent in this process is the internal review that the healthcare providers must conduct to prepare for the relationship.

Initially, the healthcare providers must identify with specificity the function to be outsourced. As each outsourcer possess a unique skill set, the function to be outsourced must be identified to confirm that the outsourcer is the best fit. Also, as the provider conducts such an inquiry with respect to its needs, it may learn that functions that it initially believed would remain in-house must (or may) be outsourced. Alternatively, the provider may determine that the retention of certain functions in-house is more appropriate. In any case, the first step a provider must take prior to identifying an outsourcer and implementing the outsource plan is to identify the function or functions which it desires to outsource.

Then, the healthcare providers must establish short term and long term goals. What does the provider desire to accomplish from the relationship? A cost savings? A quicker response time? Some other benefit?

The healthcare providers should set forth an outsourcing plan to assist with the process. All plans typically include the same basic elements. It must set forth the defined objectives which the provider expects the outsourcing project to accomplish and set forth the parameters and levels for measuring the success of the plan. The plan should also evaluate the deferred business objectives against various outsourcing business models to determine which model is best used for accomplishing the objectives. Generally, two models, the cost based and business process models are examined and most outsourcing projects are a hybrid of both models. As noted above, healthcare providers typically employ the cost based model. The plan should examine the legal risks associated with implementing the selected business model and objectives. These

risks and the mitigating strategies should be contained in the written plan. The plan should be updated and reviewed during each phase of the project, including when selecting the business model, negotiating documents under the model, and during the evaluation process. The plan should also set forth specific implementation steps for the outsourcing project. During the implementation phase, the outsourcing documents necessary to create and support the business model selected for the outsourcing project must be prepared, which may include the outsourcing agreement with the outsourcer. Finally, a monitoring system should be set forth to measure the ongoing results of the relationship and to measure the success or failure of the relationship against the goals, parameters, and levels initially established.

Once the healthcare provider has identified the function or functions which it desires to outsource and its ultimate goals of the relationship and once the outsourcing plan has been prepared, it can then begin the task of identifying an appropriate outsourcing partner. Obviously, each outsourcer possesses skills specific to one or a few functions and may not possess the resources necessary to perform other functions. Also, an outsourcer may have expertise regarding a specific function. However, the nuances of the particular industry in which the company operates, in this case, the healthcare industry, may dictate that such skills are not comprehensive enough. Indeed, there are many outsourcers which perform data entry functions. However, if the company is a hospital and it desires to outsource healthcare billing data entry functions, this involves a unique data entry skill set which is not possessed by all data entry outsourcers.

Then, a careful review of the business history of the potential outsourcer(s) should be performed. This may include, among other things, contacting references and observing operations, performing background checks and criminal history checks.

Once an outsourcer is selected, clear objectives should be specified and performance standards should be established with the outsourcer in order to ensure that the company's objectives are met. With this in mind, the economics of the relationship must make sense and the provider must make sure that the outsourcer and the key players are incentivized to ensure that the relationship works.

Finally, as with any relationship, the healthcare provider should have an exit strategy in place. What happens when the relationship is over? Who will perform the previously outsourced functions?

It is imperative that the relevant provider personnel are involved throughout this process. For example, if the provider is outsourcing its billing functions, personnel from the company's billing and collection, finance, and legal departments should be involved in each step of the process.

V. Contract Overview

As with all relationships, a written outstanding contract must be carefully negotiated to address all potential issues. For instance, it is very common, and understandably necessary, for outsourcers to want to limit their exposure to liability and to control ownership of their intellectual property. On the other hand, it is also reasonable for a company to not want to accept such risk or share the ownership of such intellectual property when the outsourcer is providing services critical to such company's business items and the company is paying for such services.

Initially, the description or specification of services to be provided throughout the relationship must be identified. This is fundamental to an outsourcing arrangement. To minimize the risk of future misunderstandings and disputes, the parties must set forth, clearly and unambiguously, their respective expectations with respect to such services. Relating to the service description, the contract may include clauses to specify the required performance levels; the timing of the provision of services; consequences for failing to meet performance levels or time specifications; any applicable quality or technical standards; any environmental requirements (safety, for example); service targets; incentive schemes; issue resolution mechanisms; reporting requirements; and structure and frequency of performance reviews.

In the event the outsourcer requires particular assistance from the healthcare provider, it must specify the assistance, such as providing facilities and equipment. Also, a contract may indicate whether the outsourcer may provide services for other customers (that is, competitors of the healthcare provider).

A provider may also want to include some of the following provisions in order to gain more control and influence over its contractual relationship with an outsourcer: (1)

the designation of certain persons as project managers for each party; (2) the designation of the outsourcer personnel that will provide the services for the provider or alternatively, the right to approve all outsourcer personnel on a project; (3) the establishment of workplace rules and regulations while on the provider's premises; (4) the right to request that the outsourcer replace employees upon the provider's request; (5) the requirement that all personnel assigned to the project meet certain minimum training, experience or educational requirements; (6) the prohibition of an outsourcer from using key personnel to provide similar services to competitors; (7) the right of the provider to hire selected outsourcer personnel upon termination of the outsourcing contract; (8) confidentiality and handling of trade secrets by outsourcer personnel and the provider's processes such as methodologies, quality control, and productivity expectations; (9) audit and review rights and procedures; and (10) choice of law and venue.

The pricing model used in the relationship must also be set forth. The contract must establish how and when the healthcare provider is required to compensate the outsourcer. An adjustment to the price, downward or upward, may be appropriate in to penalize or reward the outsourcer for failing to meet, or exceeding, certain productivity-based, response-based, up-time based, or other specified requirements. It may also be appropriate to build in a mechanism to change the pricing structure from time to time.

Central to any contract is how the risk of liability will be allocated. An outsourcer typically will seek a total exclusion of liability, and conversely, the provider will seek to impose unlimited liability. A compromise is often reached by incorporating a cap on the liability at a specified level and/or excluding certain losses from the cap, such as those resulting from a breach of confidentiality, infringement, and/or personal injury and property damage.

The ownership of the intellectual property used and/or developed during the relationship, if the relationship includes technology and software, must be set forth. This issue is explored in greater detail in this article.

Finally, the term of the relationship should be set forth, along with events of default, and the ramifications thereof. Each party's rights and obligations upon termination should be set forth and, if necessary, details of the transition of the functions from the outsourcer back to the company or a third-party should be specified. For

example, upon termination, it may be necessary for data to be converted and provided to the company or to a third-party who will then resume the functions.

In the U.S., contract law is governed by common law and the uniform commercial code. The laws of the country in which the outsourcer is located must be reviewed as well when entering into an agreement with an outsourcer. For example, contract law in India is codified. The Indian Contract Act of 1872 (the “Contract Act”) establishes, among other things, the requirements for a binding contract, such as offer and acceptance, as well as agreements which are expressly void, such as an agreement in absolute restraint of judicial proceedings. The Contract Act establishes the basis for all contracts and agreements in India and is therefore relevant when entering into an offshore outsourcing agreement governed by Indian law.

VI. Intellectual Property

When intellectual property comprises some or all of the outsourcing relationship, it is imperative that the contract address the issues relating thereto. It is not unusual that an outsourcer creates certain intellectual property, often in the form of software programs, that are customized and tailored to the needs of the healthcare providers. Often, such software is the subject of the outsourced function, such as billing software. Put another way, a provider will engage an outsourcer to develop a software program for use in the provider’s business. As a result, the outsourcer develops software to perform the required function. The issue of who owns the software, whether the healthcare provider or the outsourcer, is frequently disputed.

Preparation and due diligence play key roles with respect to this issue. Understanding which items of intellectual property will be most significant to the outsourcing relationship before such relationship commences is important. Only with such an understanding will the parties be able to address intellectual property licensing, allocation, and indemnification issues.

Significantly, each party may possess preexisting intellectual property prior to the commencement of the relationship which is necessary for the relationship. Identifying each party’s preexisting intellectual property is important at the outset. A healthcare provider wishing to safeguard its interests should specify in the governing documents the exact pre-relationship proprietary interests it possesses. A provider may wish to take a

step further and obtain patents (or at least have patent applications on file) covering the intellectual property which is the subject of the relationship.

Then, the parties are left to negotiate who will own the developed technology, often with both the provider and the outsourcer claiming that ownership should be vested in them. There is no correct answer as to who is entitled to ownership, and often, joint ownership or ownership by one with the other having a long term (or perpetual) license, are appropriate compromises.

The healthcare providers must ensure that the outsourcer has the right to perform services with the developed technology, use the developed technology, and/or transfer title of developed technology to the provider. In connection with the foregoing, the outsourcer should make customary non-infringement related representations with respect to the developed technology and any third-party technology incorporated therein and should indemnify the company for any third-party infringement claims.

It is also important that the outsourcer's employees and personnel comply with the agreement reached between the parties. In the event the outsourcer's employees are developing items, such as software, the outsourcer's contract with such employees must clearly state that copyright and other intellectual property rights in any material developed by such employees in the course of their employment with the outsourcer, vest with, and are assigned to, the provider, without exception. A program should be put in place to track the intellectual property developed by the outsourcer and require the reporting of such developments to the company.

Ownership of technology or intellectual property will be of little use if third parties are not prohibited from infringing on a company's rights. Thus, the outsourcer's laws regarding intellectual property must be considered. Intellectual property laws and enforcement vary considerably around the world. It is imperative that the healthcare provider understands the laws of the outsourcer's country and such country's enforcement efforts. For example, according to the International Intellectual Property Alliance, India is considered to have one of the most modern copyright laws in the world, which is codified in the Indian Copyright Act of 1957. Unfortunately, India suffers from high piracy rates and overwhelming deficiencies in the infringement enforcement system. Criminal fines and jail terms are among the toughest criminal provision. However,

criminal enforcement, on the other hand, although getting better, is minimal. As of May, 2003, there were five active criminal cases relating to software piracy. Such lax criminal enforcement has forced many companies to implement a civil litigation strategy. In any event, while the law seems to be strong in the intellectual property field, the enforcement needs reform.¹

VII. Tax Issues

Many jurisdictions offer U.S. companies favorable tax treatment for initiating significant outsourcing programs. Although it may be time consuming and initially expensive to complete the paperwork and/or establish the corporate structure dictated by national tax laws, the savings may be significant. Favorable tax treatment may include tax credits and tax free zones if local companies are used for technology related work. Some countries, including Australia and India, have entered into treaties with the U.S., so that performance of work in either country will be “tax” neutral.

Unfortunately, most tax “breaks” are politically motivated. Accordingly, the benefit may be modified or withdrawn without notice. Moreover, even the most favorable tax incentives are premised on a commitment by the foreign company of resources and an assumption that the company will develop a successful business relationship with the country. This incentive program may require that the company retain operations in the foreign country for a period of time or hire a certain number of national employees. If the company fails to develop a long range plan or commitment to this venue, these tax savings may need to be returned and/or left unrealized upon exit. This issue alone could cause the venture to incur unanticipated losses. In addition, while one tax incentive may seem attractive, different tax and/or legal issues related to doing business in the country may cancel out the value of the incentive. For example, many countries have stricter employment related taxes than the United States, making it more expensive to maintain the workforce even though the salary scale net of taxes is lower. In addition, many countries impose significant import taxes on supplies (including software and computer equipment) necessary to import into the country in order to get a subsidiary or outsourcing relationship going.

¹ International Intellectual Property Alliance 2003 Special 301 Report.

In sum, if the healthcare providers expect a tax break from the outsourcing relationship, it must review the outsourcer's country's laws before entering into the relationship.

VIII. Disaster

There are certain risks associated with outsourcing services, and those risks are magnified when outsourcing to an offshore location. In addition to the inherent risks of allowing a third party to perform certain key functions, offshore outsourcing adds multiple layers, including geopolitical and political events.

Accordingly, it is imperative that healthcare providers ensure that an outsourcer has appropriate safeguards, including disaster recovery and business continuity plans, to address such events and contingencies. A provider should evaluate whether it could function without the outsourced service should the vendor be unable to provide it.

Contractually, a healthcare provider has various alternatives that it could employ. It could require that the outsourcer "mirror" its outsourced service; that is, require the outsourcer to operate their services out of more than one geographic location, so that each location may provide identical services. The failure of one site will cause little to no disruption in the services as the second site can continue the provision of the service with little complication. However, requiring mirror sites may be prohibitively expensive.

A less expensive alternative is to require a "hot site" configuration in a geographically separate location whereby the outsourcer establishes a second office with the same equipment and software in which the outsourcer could provide services should it be unable to furnish them in the first location. Again, the duplicative nature of this alternative increases the cost of the relationship.

Alternatively, a simple tape backup without an alternative site ready and waiting could be required. In this case, the software and data is easily accessible, but the data center operations are not always on the ready.

The exact disaster recovery strategy, naturally, depends on the nature of the outsourced function and the expense a provider is willing to incur.

IX. Software Export Restrictions

As many outsourcing transactions require the healthcare provider to transfer pre-existing software or other technology to the outsourcer, U.S. export restrictions may

apply. The most stringent U.S. export restrictions relate to software that contain encryption/decryption capabilities. Depending on the software, the regulations have the potential to be complex, and may yield harsh penalties in the event of non-compliance. Similarly, there may be import restrictions in the country where the outsourcer operates. In sum, import and export restrictions should be analyzed and incorporated into any outsourcing contract.

X. Labor and Employment Laws

When entering into an outsourcing relationship, three basic employment issues generally arise: (1) termination of the provider's existing employees; (2) transfer of employees from the healthcare provider to the outsourcer; and (3) the provider's control of the outsourcer's personnel.

Many outsourcing relationships will involve the healthcare provider laying off some of its employees. Thus, the issue of terminating the provider's existing employees must be examined. First, the provider must determine which personnel are expendable because of the outsourcing relationship and must ensure that key personnel are not inadvertently released. Often, it becomes apparent only as the relationship progresses which employees are necessary and which are expendable (or which provide duplicative duties). Are the employees at-will, giving the provider the right to terminate them at any time? Alternatively, are certain employees party to an employment agreement setting forth a definitive term of employment and their rights upon termination? Upon termination, are any such employees entitled to severance and/or post-termination benefits? Similarly, if there is a collective bargaining agreement in effect governing the employees, the term, termination rights, and post-termination severance and benefits in such agreement must be examined.

In addition, the Worker Adjustment and Retraining Notification Act, also known as the WARN Act, requires employers to give at least sixty days notice to their employees before the effective date of a mass layoff or a plant closing. The WARN Act applies to any business enterprise that employs 100 or more employees. The purpose of the WARN Act is to allow displaced employees to find new employment. Failure to comply with the WARN Act will subject the non-complying company to liability in the form of back pay and benefits owed to employees for the sixty day period following

announcement of the mass layoff or closure. Thus, if the outsourcing relationship contemplates a mass layoff or closing, proper notice must be given.

In many outsourcing relationships, the employees of the company are hired by the outsourcer. In such event, in addition to termination and WARN Act issues, the provider and the outsourcer must also consider the provider's benefit plans and the outsourcer's benefit plans, and whether credit for service to the provider will be given to employees when they become employed by the outsourcer for purposes of such benefit and pension vesting. Again, it is important that the correct employees for retention are identified.

An outsourcing relationship may affect not only terminated employees, but may also affect employees who are retained by the provider. It may be appropriate that the provider offer employees that it desires to retain a bonus or other incentive to induce them to stay, especially when the retention of certain employees by the company is critical to the outsourcing relationship. Additionally, the provider may want to include in the outsourcing contract that the outsourcer will not solicit the employment of certain delineated retained employees.

In addition to laws of the U.S., healthcare providers involved in offshore outsourcing transactions must analyze the employment and labor laws of the outsourcer's country. Often, these foreign laws impose obligations on employers and grant rights to employees that go beyond those required by U.S. law.

The European Union's Acquired Rights Directive requires that in the event that a business is transferred from one employer to another, the latter must assume the rights and obligations of the former. This becomes relevant if the provider is to employ the outsourcer's employees at the end of the outsourcing relationship.

Indian courts tend to favor employees in disputes with management. As a result, employment contracts must be scrutinized to confirm that they are in fact enforceable. Thanks in part to the Trade Union Act of 1926 (the "Trade Union Act"), trade unions in India are particularly strong. The Trade Union Act created rights for workers to unionize and established collective bargaining. The Minimum Wages Act of 1948 established methods to determine minimum wage levels using either a committee method or a notification method. Perhaps most significantly, the Industrial Disputes Act of 1947 includes many pro-worker rules and regulations, including prohibitions against mass lay-

offs, as well as lengthy notice requirements before an employer may alter terms of existing employment conditions.

Finally, the healthcare provider may want to retain some control over the employees of the outsourcer. Often, the provider will insist that it have the right to terminate or approve persons performing services on its behalf. As noted in Section V above, performance levels and other performance related criteria should be specified in the governing document. Significantly, in the event that the outsourcer's employees will be exposed to trade secrets or confidential or proprietary information of the provider, the provider should insist that they enter into a confidentiality agreement. Furthermore, in order to keep the outsourcer's employees from terminating their employment, a restrictive covenant should be considered whereby the employees are prohibited from entering into activities competitive with that of the outsourcer. As noted above, in the event that the outsourcer's employees are developing proprietary items, the outsourcer's contract with such employees must clearly state that all intellectual property rights vest with the company.

XI. Privacy and Security

In an outsourcing relationship, the outsourcer often has custody of, and/or access to, some of the provider's databases. Such databases may include trade secrets, as well as confidential and proprietary information, including patient charts, records, and personal information concerning employees of the provider and/or customers.

Privacy laws regulate access, use, and disclosure of information that pertains to an individual. Such laws require the holder of such personal information to use it for specific purposes only. An offshore outsourcer may be subject to local privacy laws which restrict the exportation or transfer of private data. Thus, U.S. based providers that are contemplating offshore outsourcing should ensure that they will not be precluded from exporting such information and that the foreign outsourcer will not be precluded from receiving such information.

Most U.S. and foreign privacy laws contain the same basic principals: (1) notice; (2) consent; (3) right of access; (4) security; (5) transferability; and (6) dispute mechanisms. If a healthcare provider or outsourcer intends to collect personal information, it must notify the subject individual of such intention and disclose the

purpose for which it will be used and to whom it will be disclosed. Such individual must consent to the data collection and have the opportunity to opt out of the collection thereof. The information obtained must be reasonable in light of the purpose for which it is intended to be used. Such individual must have the right to access the information and must be able to correct or update such information. The outsourcer must keep the information secure and may not misuse it. In the event that the outsourcer desires to transfer the information to a third party, it must notify the subject individual and often obtain their consent. Finally, in the event that an individual has a complaint about the disclosure of their information, a dispute mechanism must be installed.

Countries that are members of the European Union have enacted privacy laws that restrict the collection and use of personal information. These laws restrict the trans-border transfer of personal information unless the entity receiving the information ensures that it will afford the information at least the same level of protection as the privacy laws that the European country has enacted.

Similarly, in the U.S., many privacy laws may affect the outsourcing relationship and the transfer of information.

The regulations protecting the privacy of individual health information adopted pursuant to the federal Health Insurance Portability and Accountability Act of 1996 (“HIPAA”) are comprehensive federal laws addressing health information privacy. HIPAA is designed to protect the integrity and confidentiality of health care data. Generally speaking, HIPAA restricts the use and disclosure of patient health information and establishes strict safeguards to maintain data integrity and confidentiality.

There are security standards which HIPAA requires entities to adhere to. A covered entity must sustain reasonable administrative, technical, and physical safeguards (a) to ensure the privacy of the information, (b) to anticipate security threats and illegitimate uses of the information and (c) to ensure observance of these regulations by the officers and employees of the covered entity.

HIPAA’s privacy rules apply only to healthcare providers, payers, and clearinghouses that are covered entities. Because the law does not directly apply to other parties that may handle medical information (e.g. transcription companies and other vendors), HIPAA attempts to stretch its coverage by requiring healthcare providers to

take certain actions when entrusting medical information to vendors. HIPAA requires that if a provider releases medical information to another person or entity to perform a function on the provider's behalf (the provider's "business associate"), the provider must enter into an agreement obliging the business associate to maintain the confidentiality of the medical information. This agreement is typically called a Business Associate Agreement. HIPAA's privacy regulations require that business associate contracts contain several specific provisions. The contract must specify the permitted uses and disclosures of information by the business associate. The contract also must require the business associate not to use or further disclose the information except as permitted by the contract and to use appropriate safeguards to prevent use or disclosure of the information other than as allowed by the contract. The contract must ensure that any agents, including a subcontractor, to whom the business associate provides medical information agrees to the same restrictions and conditions that apply to the business associate with respect to such information. The contract must authorize termination if the business associate violates a material term of the contract.

Healthcare providers must take great care in choosing an outsourcer as many such entities will further "outsource" their functions to other individuals and/or entities. The provider may be faced with a situation in which the outsourcer has outsourced tasks involving individual health information protected by HIPAA that are, in turn, outsourced several more times to a person or entity over which the company does not have any direct control. In all cases, the provider will be held accountable for any violations of HIPAA committed by the outsourcer. This was reinforced in a recent memorandum issued by the Department of Justice.-

Thus, prior to disclosing medical information to an outsourcer, a provider must ensure that it complies with HIPAA, if applicable. Furthermore, the company must fully understand how the outsourced work will be handled and whether any further outsourcing will occur.

The following steps should be taken by healthcare providers to minimize risk when entering into an outsourcing agreement. For example, if the provider is outsourcing its medical transcription services, it must: (a) ensure that the contract with the medical transcription company obligates the vendor to not only maintain confidentiality itself, but

to require any person or entity to whom the vendor sends information to maintain confidentiality and security of information; (b) require indemnification from the medical transcription company or any breach of the contract (including confidentiality) not only by the medical transcription company, but by any of the medical transcription company's subcontractors or entities to which the subcontractor may send information; (c) consider placing restrictions on the subcontractors that medical transcription company may use; for instance, explicitly requiring that any subcontractor receiving medical information from the medical transcription company be physically located in the U.S. and that, in addition, the medical transcription company's subcontractors be explicitly prohibited from sending any of the provider's information outside the U.S.; (d) consider using a medical transcription company that does not subcontract any work at all; (e) consider whether the transcription company is making investments to obtain and retain the provider as a customer; (f) ensure protection by including specific performance standards in the contract. (g) weigh the cost of training staff regarding confidentiality; (h) ensure that the contract contains the protection terms standard in any contract: (i) the ability (of both parties) to terminate the contract for cause (e.g. failure to comply with the terms of the contract) and not without cause (if the medical transcription company has made a substantial capital investment on the provider's account, this clause may only be agreed upon if the provider takes some responsibility for the investment); (ii) an appropriate length of time for the contract; (iii) inability of the medical transcription company to assign the contract without the provider's permission; and (iv) a requirement that any claim be brought in the state in which the provider is located.

In the healthcare sector, in addition to patient information, general information may be the subject of the outsourcing relationship. Although the outsourcing of financial information is more prevalent in the financial and banking sectors, it does occur in the healthcare sector. In the U.S., numerous federal and state laws regulate the handling of financial information. Most significant is the Gramm-Leach-Bliley Act ("GLBA"). The GLBA limits the ability of businesses to collect and disseminate financial information such as credit and credit worthiness information. GLBA applies to financial institutions (which extends beyond banks to credit cards companies, data processing companies, and investment and credit counseling companies). An entity that is subject to GLBA must

provide consumers with an initial notice about their privacy policy, and state whether they intend to share information. The entity must also provide an opt-out notice before sharing nonpublic personal information with third parties. Once a consumer elects to opt-out, the company must honor that request. Further, GLBA requires entities to implement security measures. Under the security rules, entities subject to GLBA must require their service providers, by contract, to implement and maintain such safeguards. Under GLBA, an entity must oversee third parties with whom it contracts, such as an outsourcing company, and require such third parties to implement and maintain specific security safeguards.

In conclusion, once the relevant laws and applicable data transfer restrictions are identified, the healthcare provider and the outsourcer should identify necessary safeguards and identify which party is responsible for the implementation of such safeguards. It may be necessary to implement such safeguards both during and after the business relationship. As with any contract, it may be appropriate to specify representations and warranties with respect to the use and collection of the data and include indemnification provisions to address liability that may result from the breach of such representations and warranties. Finally, the agreement should identify who owns the database containing the data upon the termination of the relationship.

XII. The Dangers of Healthcare Outsourcing

Healthcare organizations have been reluctant to outsource until recently because of the enormous potential liability if errors are made or if action items are not timely effectuated. In addition, many outsourcers lack the necessary healthcare domain expertise which is crucial to a successful outsourcing arrangement.

Recently, healthcare entities have acknowledged the possibility that outsourced patient records can be improperly obtained. The violation of medical privacy highlights the danger of offshoring services that involves sensitive materials. U.S. laws maintain strict standards to protect patients' medical data. But those laws are difficult to enforce overseas. For instance, the UCSF outsourced its enormous medical transcription work to an outside firm, Sausalito's Transcription Stat. In turn, this Sausalito outsourced the work to a subcontractor, Tom Spires. Spires outsourced the work yet again to another subcontractor network, with operations in Pakistan. In 2003, one of the workers at the

Pakistani firm emailed UCSF and informed them that she was not being paid by Spires. She demanded that UCSF locate Spires and get her the money she was owed. If UCSF did not comply, she would expose all of the voice files and patient records from UCSF. UCSF officials took the threat very seriously because the worker had included a few files in her email to them as proof. Sausalito contacted the worker and offered to pay some of the money. As a result, the worker retracted her threat. While a crisis was averted in this instance, the problem remains, especially with a growing percentage of work being exported abroad.

XIII. Regulatory Issues

If technology is the subject of the outsourced function, various countries require permits and licenses to commence or perform technology related work. The costs of these licenses, permits, and certifications should be incorporated into the profit and loss statement for any outsourcing project. Many countries also require that the products developed in or imported to the country comply with rigorous industry standards. These standards change with great frequency and often require testing and certification by a government approved laboratory. The testing and certification process may be costly and time consuming. In addition, there may be a requirement that the manufacturer or exporter offer an extended warranty particularly on software or other technology, in the event that the distributor goes out of business. Failure to abide by these regulations can result in significant criminal and civil penalties. In the event that a function is being outsourced, local counsel should be consulted to make sure that the activity is legal in the country and that the appropriate licenses are obtained. Where products are subject to a complex body of standards which change on a regular basis, it is wise to obtain local counsel who can monitor these standards throughout the existence of the manufacturing, sales, and warranty process.

XIV. Legislation

Protecting U.S. based jobs from the risk of offshore outsourcing has recently become an important issue for federal and state governments. Numerous laws have been introduced aimed at reducing or terminating the flow of jobs to low-cost countries.

For instance, New Jersey has had its share of such legislation. On May 8, 2003, New Jersey introduced a bill (Assembly No. 3529) pursuant to which, within 30 seconds

of answering a telephone call made by a New Jersey resident to a business' call center, the person answering such call must identify himself/herself by stating: his/her name, the name of his/her employer, and the location of the state and country in which he/she is located. Similarly, an employee of a call center who responds to an electronic mail message from a resident of New Jersey must identify himself by stating his name, name of his employer, the state, and the country in which he is located. Under the bill, if requested by the caller, the call must be re-routed to a call center located in the U.S. A violation of such requirements can result in fines up to \$10,000 for the first offense and \$20,000 each for subsequent offenses.

Furthermore, the New Jersey State Assembly introduced legislation on March 15, 2004 (Assembly Resolution No. 148) which memorializes the U.S. Congress' desire to enact legislation requiring annual publication of a list disclosing companies planning or currently in the practice of outsourcing U.S. jobs to other countries.

On December 16, 2002, a bill was enacted in New Jersey (N.J. Sen. No. 1349, 210th Legislature) that imposes a "Buy American" rule on all purchases in the State. "The Director of the Division of Purchase and Property and the Director of the Division of Property Management and Construction in the Department of the Treasury shall include, in every State contract for the performance of services, provisions which specify that only citizens of the U.S. and legal resident aliens in the U.S. shall be employed in performance of services under the contract or any subcontract awarded under the contract." One purpose of the bill is to ensure that State funds are used to employ people residing in the U.S. and to prevent the loss of jobs to foreign countries. This legislation does not provide any exception for a determination that a domestic procurement is "not in the public interest", that the cost of a domestic procurement is "unreasonable", or a determination that the particular goods or services being procured are not available in such commercially available quantities or quality as are available abroad. This bill was signed into New Jersey law as Senate bill No. 494 by Acting Governor Richard J. Codey on May 16, 2005. Other states have also explored similar legislation. North Carolina and South Carolina introduced similar bills that require telemarketing services provided under a state contract to be performed only by American citizens or persons authorized to work in the U.S.

On June 3, 2004, the New Jersey State Assembly introduced legislation (Assembly Resolution No. 184) to create the “Outsourcing and Off-shoring Commission” in order to study issues associated with the practices of outsourcing, including a review of the impact of outsourcing and offshoring on private and public employers and employees in the State, to study ways to reduce the outsourcing and offshoring in the State; to determine which employment sectors are most affected; to identify outsourcing and offshoring issues that can be controlled or addressed by State regulation; and to provide recommendations for steps that need to be taken to ensure that outsourcing practices do not have a detrimental impact on the employers and employees in the State.

Many other states have introduced or adopted similar legislation aimed at curbing the outsourcing trend.

At the Federal level, the U.S. government has passed a law prohibiting the outsourcing of government contracts to other countries. Under the regulation, any American firm that has contracts with the U.S. government cannot subcontract any party of the work to any other country. The measure was passed by the Senate on January 22, 2004 and signed into law by President Bush the next day.

On March 2, 2004, a bill was introduced in the House of Representatives to establish the Commission on American Jobs (H.R. 3878). On an annual basis, the Commission shall collect data on outsourcing, identify the number of jobs outsourced, and propose possible measures to prevent outsourcing by companies of interest. On March 4, 2004, a bill was introduced in the House of Representatives that makes certain companies that have outsourced jobs during the previous five years ineligible for the receipt of Federal grants, Federal contracts, Federal loan guarantees, and other Federal funding (H.R. 3911).

On May 20, 2004, the “Increasing Notice of Foreign Outsourcing Act” was introduced in the Senate and subsequently reintroduced with revisions on June 1, 2004 (S. 2472 and S. 2481). The goal of the bill is to require that notices to consumers of health and financial services include information on the outsourcing of sensitive personal information abroad, to require relevant Federal agencies to prescribe regulations to ensure the privacy and security of sensitive personal information outsourced abroad, and to establish requirements for foreign call centers. For example, an entity which outsources

protected health information offshore must include in its notice of privacy that the health information is outsourced, include any risks to the privacy and security of the health information resulting from such outsourcing, and provide a certification that the entity has taken reasonable steps to ensure that the handling of the health information will be done in compliance with applicable laws. Similarly, an entity which outsources protected financial and personal information offshore must notify the customer that the information is outsourced, include any risks to the privacy and security of the information resulting from such outsourcing and provide a certification that the entity has taken reasonable steps to ensure that the handling of the information will be done in compliance with applicable laws.

Finally, the Senate introduced the “Keeping American Jobs at Home Act” in 2004 (S. 2531). According to the bill, the Senate found that, among other things, by 2005, 588,000 American jobs are projected to be moved overseas. By 2010, that number is expected to grow to 1,600,000, and by 2015, 3,300,000, American jobs will have been moved overseas. As a result, the Act is intended to assist displaced American workers in the software, information technology, and services sectors so that they have access to the same trade adjustment assistance and health care tax credits which manufacturing workers receive. The Act also is intended to provide wage insurance for qualifying displaced workers upon reemployment.

The Federal and state legal landscape is changing on a daily basis and certain outsourcing relationships which are permitted today may not be permitted in the future.

XV. Dispute Resolution

Unfortunately, at some point during many relationships, a dispute arises among the parties. Commercial transactions solely involving U.S. entities operating strictly in the U.S. can rely on U.S. common law and can resolve the dispute in the U.S.

In the context of an offshore outsourcing relationship, this issue is not as clear. In international outsourcing, comparative legal systems need to be understood at all levels, from planning, to negotiation, to implementation of the contract. With this in mind, it is important to understand the judicial system of the outsourcer’s country. For example, India, like America, derives its legal system from the English common law. At the apex of the entire judicial system, exists the Supreme Court of India below which are the High

Courts in each State or group of States. Below the High Courts lies a hierarchy of Subordinate Courts.

It is advisable that the governing agreement specify which country's laws will govern the relationship and, in the event of a dispute, the forum for such resolution. By doing so, a provider can reduce the risk that to resolve a dispute, it must employ the courts of the outsourcer's country. If the outsourcer's courts are used, the provider would be required to engage local counsel and dedicate employees (at a great expense) to administer such dispute. Furthermore, the provider must understand that if a dispute will be heard in the outsourcer's country, the outsourcer may enjoy "home field advantage". However, keep in mind that if the outsourcer is a small or startup company with little or no assets or has no ties to the U.S., it may ignore the demand for dispute resolution in the U.S.

XVI. The Transition Plan

Regardless of the outsourced function, the healthcare provider should not disassemble the outsourcing team once the outsourcing agreement has been negotiated. Upper management must remain engaged in the project to ensure that the persons responsible for implementing the project remain on track and motivated to succeed. Management must evaluate the success of the project using the metrics established during the transition planning phase. This evaluation should occur on a scheduled timeline, ideally, on a quarterly or biannual basis. This way, management can be apprised of any problems in advance of critical reporting dates. This review should also be used to verify that the healthcare entity and the outsourcer are in full compliance with their agreements as well as all necessary tax, visa regulatory, permit, and other legal requirements. The parties should also establish an inter-company task force charged with improving the efficiency of the outsourcing relationship. In order to determine if the goals of the project are being met, these should be defined and measured using hard parameters such as: (a) lowering operating costs by a defined amount or percentage; (b) decreasing processing time by a defined amount of time or transaction rate; (c) increasing operating or processing efficiency by a defined amount; (d) increasing sales by a designated percentage or dollar amount; (e) service level standards negotiated by the parties.

XVII. Conclusion

Given today's economic climate and the fact that companies now do business on a global level, outsourcing will continue to be a major economic force and an accepted method of doing business, including in the healthcare industry. Thus, it is important that healthcare providers and their counsel understand the issues which affect such outsourcing relationships.

Offshore outsourcing has the potential to provide tremendous financial benefits, along with significant risks. Detailed planning by healthcare providers concerning their outsourcing arrangements is essential to ensure proper measures are taken to minimize those risks.