Computer Systems Contracts

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This article on computer system contracts is the second in a three part series dealing with computer contracts. The solicitor's role in negotiating a computer contract was examined in the last issue of the Newsletter. Some of the main areas of risk will be discussed in the next issue.

Computer systems are comprised of hardware (the CPU and peripherals), systems software and applications software. Hardware is usually sold, software licensed and the system maintained.

Hardware Agreements

Hardware has become very reliable and hardware contracts somewhat standardised. The main points to consider are:

- Acceptance test - trigger for payment;
- Careful description of hardware modules;
- Primary risks - failure of delivery or performance as specified;
- Benchmark testing;
- Supplier's proposal to be incorporated;
- Environment - cable lengths, humidity, dust, heat, flooring, etc;
- Price - freight installation, support, sales tax, customs duty, exchange rate fluctuations;
- Warranty - response time, service calls, replacement;
- Disaster Availability, liquidated damages - unforceable penalty;
- Title and risk - reserved pending full payment;
- Leasing - special arrangements.

Hardware maintenance involves:

- Preventative maintenance;
- Remedial maintenance;
- Other maintenance;
- Response time;
- Downtime warranties;
- Availability (8.00 am - 6.00 pm Monday to Friday);
- Termination.

Software Licensing Agreements

Software (unlike hardware) is likely to become more expensive and problems ("bugs") are more likely to arise from its operation.

The typical clauses are:

Definitions - These should precisely define the basic terms used in the licence.

Grant - This should be perpetual and is usually non-exclusive but can be exclusive. It can be site or computer oriented. An additional licence fee is payable if an additional computer or site uses the software.

Payment - Either a lump sum or an annual licence fee or both. Interest on overdue licence fee should be avoided.

Delivery and installation - The software supplier should deliver and install.

Testing and acceptance - Acceptance testing should be by the customer on the customer's site and configuration to determine whether:

- the package meets its specifications, warranties or functions and other requirements of the Agreement;
- the run time meets the requirements of the customer, e.g. on a daily basis per of volume and the package will require ten minutes to run;
- the package is capable of running on a repetitive basis on a variety of data, without failure;
- the documentation and support meets the contractual requirements.

If the package successfully meets the tests the customer should accept the package and if no acceptance is made within say 14 days, the package is deemed accepted. If the package fails to meet any of the above requirements there should be notification and further acceptance testing. Failure to meet the test ultimately must result in the same remedies to the customer as are applicable on non-delivery.

"acceptance testing should be by the customer on the customer's site and configuration"

Warranties - Should continue and not be limited.

Proprietory Rights - An intellectual property rights indemnity.

Confidentiality - The confidential information should be defined and kept confidential without prior consent except to:

- employees who need to know;
- auditors, inspectors, etc;
- persons maintaining the programme.

The customer can either be required to inform those persons of the confidentiality provisions or be required to have them sign a Confidentiality Agreement of their own. The customer should indemnify the software supplier against loss or damage as a result of failing to do so and notify the software supplier if it becomes aware of any breach of confidence.

Copying - The number of copies is usually restricted to those necessary for the business of the customer.

Security and Control - An obligation to properly safeguard the software and all copies and maintain records of their whereabouts.

Modifications - Either no right to modify or right to modify (with or without consent) with indemnity against modifications infringing the intellectual property rights of third parties and provision as to who will own the copyright in the modifications. Modifications usually discharge certain warranties and maintenance rights.

Documentation - The number and type of manuals delivered with the software should be clearly specified. e.g. customer's manual, systems manual, operating manual, programming manual, modification manual.

Training - The amount of free or chargeable training of staff should be clearly provided and the competence of the training staff provided for.

Termination - Sudden death clauses where termination is upon breach without notice should be avoided because termination deprives the customer of the benefit of the bargain and a dependency is built up upon the use of the software. Termination should only be permitted by the software supplier where serious breaches of material terms have occurred and the customer has failed after notice to rectify them.

Assignment - Usually assignment by both parties is prohibited but the licence

should permit assignment or sublicencing to related corporations of the customer or purchasers of the computer system (perhaps to respectable and responsible assignees). It is important to provide for the right of assignment to avoid paying an additional licence fee if the system is sold.

Force Majeure - Obligations of the parties delayed for causes beyond their control should be delayed only while such causes exist and be subject to a time limit after which termination is available.

Whole agreement - An attempt to prevent the customer from relying on oral representations and other material specifying that the whole agreement is within the terms of the written agreement.

Liability - Software supplier to indemnify the customer against loss or damage or injury caused to third parties by negligent acts or omissions or wilful misconduct.

Waiver - Indulgence in enforcing provisions doesn't waive other rights or notices. Provisions for servicing should be made, e.g. by telex, arbitration.

Arbitration - Arbitration clauses favour the strong against the weak and are therefore to be avoided by most Licensees. Arbitration is expensive (because the premises, the shorthand writer are not free as in a Court) and slow (notwithstanding that this is an often quoted advantage of Arbitration).

"a financially strong party who is about to lose an Arbitration may cease paying and prolong the hearing until the other party runs out of money"

Arbitrators only sit if paid. This is usually done equally by the parties as the matter proceeds. A financially strong party who is about to lose an Arbitration may cease paying and prolong the hearing until the other party (it hopes) runs out of money. The Arbitrator leaves as he has not been paid and no decision is given.

On the other hand a clause providing for any dispute to be settled by a person appointed by the President for the time being of the Australian Computer Society or the NSW Society for Computers and the Law, who shall act as an expert and not an Arbitrator and whose decision shall be final and binding upon the parties is preferable.

Jurisdiction and Governing Law - Generally the Courts will apply the Law the parties have chosen unless it is totally unrelated to the transaction but will not necessarily accept the jurisdiction agreed by the parties. Difficulties arise when agreements from overseas suppliers to Australian customers provide for foreign law to apply and foreign Courts to have jurisdiction. If one ensures that any agreement is signed in Australia after the foreign supplier has signed it so that acceptance is here, at least the Australian Courts will assume jurisdiction notwithstanding the provisions of the Contract. A Contract is made where acceptance takes place and most Australian Courts will have jurisdiction over Contracts made within their territorial jurisdiction.

Development or Bespoke Software Agreements - Fundamental Elements

Note the similarity and overlap between Software Development Contracts, Software Licence Contracts and Consulting Services Contracts.

Definition of the Developed Software - A detailed specification or definition of stages should be attached to the Contract which describes the software to be developed by the supplier. Most important of these is the anticipated practical benefits of the software package to the customer, i.e. it should be purpose oriented. This obliges the supplier to create software which will achieve a purpose, something he may be reluctant to do, because one can never be certain how difficult (or easy) and therefore how costly it will be to create it in the absence of a detailed specification showing precisely how it will be done. But at least the things the supplier cannot do should be highlighted and will enable the customer to decide whether to proceed with the Contract at the outset.

Acceptance tests - A function performance specific set of acceptance tests must be designed for development software and the following should be minimally included:

- A detailed description of the tests including procedures to be used, functions to be tested objectively, measurable criteria to determine whether the tests succeeded or failed;
- Specify customer's site;
- Customer's own data should be used and not hypothetical data;
- Customer's discretion if possible to decide whether tests are successful;
- Ownership - Without agreement, ownership in software developed by an employee performed in the course of his employment resides with the employer and where there is an independent contract with the contractor. Clear contract provisions should be made on who is to own and market the developed software and subsequent modifications to it;
- Warranties and Maintenance Support - Warranties should include performance warranties, intellectual property indemnity, obligation to repair all non-conformities with descriptions, functions, and capabilities at own expense for at least 12 months. Provision for maintenance payments should be either fixed price with payment by milestones or time and materials subject to a maximum annual retention. The amount of each is subject to negotiation but rates should be clearly specified with no right or a limited right to increase them, e.g. tied to the CPI.

"provision should be made for progress meetings and staff should be approved by the customer with a right to reject unsuitable staff"

Implementation Plan Delays - Where delays are the fault of the software house in a fixed price contract, the next milestone price is not paid. However on a time and materials basis, payment continues until a limit is reached. If the delay is the fault of the customer, then in the fixed price contract, provision should be made that payments are to be made on the scheduled dates for completion of milestones even though actual completion is delayed. Where payment is on a time and materials basis, work performed during the delay period will be automatically rewarded but provision for additional payment should be made where delay or client error causes additional time to be spent. Where no written specification exists but merely a definition of project stages, agreement should be made for both parties to review the project at each stage to determine the extent of its completion, to evaluate the quality of the product and terminate if quality is unacceptable. Provision should be made for progress meetings and staff should be approved by the customer with a right to reject unsuitable staff. Computer facilities and office facilities will need to be made available to the software house and provisions about dress and conformity and poaching staff would also be made otherwise the clauses are similar to those in a standard Licence Agreement.

Software Maintenance Agreements

Where warranties of performance are not limited in time in a Software Licence Agreement it would be unnecessary to have a Software Maintenance Agreement for error correction. However, where the warranties are limited in time then a Software Maintenance Agreement is necessary.

The only significant difference between this Agreement and other Software Licence Agreements is a description of the maintenance services. These fall into two types.

Firstly, error correction which is the correction of malfunction in the licenced programme being the failure of the programme to function in accordance with

its specification. The maintenance service does not normally include:

- defects or errors resulting from modifications made by the customer or third parties;
- any version of the licence programme other than the current release;
- incorrect use of the current release;
- operator error;
- equipment fault;
- defects or errors caused by the use of the current release on equipment other than that specified in the Agreement or approved by the software house;
- the software house has an option of correcting such errors at additional expense.

Secondly, the maintenance service includes enhancements or new releases. It is difficult to oblige the software house to so continue to improve the software except where it is an operating system and the equipment manufacturer is substantial and maintaining a competitive position in the marketplace. An enhancement may provide a host of additional facilities and functions (none or all of which may be required by the customer). It may also effect memory capacity or response times which will result in a degradation in performance criteria that might outweigh the other advantages. Additionally the customer may be contractually bound to accept new releases particularly of operating software as the software house does not wish to maintain staff familiar with many different releases. These new releases become confused with surprising results!

Part three of the series ,to be printed in the next issue, examines the main areas of risk, with warranties, exemption clauses, acceptance test clauses, proprietary rights and source code provisions examined in detail.

The Perils of Litigation: The Westsub Case

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Westsub Discounts Pty Limited v Idaps Australia Limited was a decision of Mr Justice Woodward handed down in the Federal Court of Australia on 9 April 1990. The case was an action for damages for breach of contract, breach of warranty, negligence and breaches of ss52 and 53 of the Trade Practices Act 1974. The claims arose out of a proposal for the supply of a hardware and software solution to Westsub by companies later acquired by Idaps.

Brief Facts

Westsub was the proprietor of a business engaged in the rental of video cassettes, based in Melbourne. The Westsub business was growing rapidly and in mid-1983 the applicant had just embarked upon a very successful extension of its business of renting video cassettes "wholesale" to convenience stores, and had plans to move to larger premises in Melbourne. The principals of Westsub were toying with the idea of extending the business to Sydney. At this time, Westsub approached a number of companies seeking a computer system to record the hiring and return of video cassettes, as well as to perform stock control and certain accounting functions at the several Melbourne stores comprising the business.

There were no such computer systems suitable for Westsub's business, but Idaps later offered to modify existing software, called "Technocrat", designed for use by small libraries, and to supply the computer equipment necessary for its use. In so doing, Idaps stated that it was "confident that the installation will be a highly successful one".

There followed some discussions as to Westsub's requirements, and negotiations