OVERVIEW

• Part 1: Issues in ICT Procurement
  • “Classic” supplier defences
  • Key Contract Terms
  • Governance
  • Off-shoring and “the cloud”

• Part 2: Managing ICT supplier Performance
  • Building Flexibility into ICT contracts
  • Outcomes based payments
  • Benchmarking
  • Dispute Escalation
  • Step in rights
  • Termination
SECTION 1: ISSUES IN ICT PROCUREMENT
THREE CLASSIC SUPPLIER DEFENCES

• Keep these issues in mind when issuing an RFT, negotiating an ICT services agreement and/or Statement of Work.

1. Out of Scope
2. Customer resources / obligations
3. Services to assist -v- services to deliver

• One or more of these occur in every ICT dispute

• Assumptions
THREE CLASSIC VENDOR DEFENCES

• Defence 1 “Not in Scope”
  • In scope v out of scope

• Recommended approach during drafting stage:
  • Clarity of Scope
  • General and specific wording
  • Inclusive wording with specific exclusions
THREE CLASSIC SUPPLIER DEFENCES

• Defence 2 “Customer failed to do something”
  • Delay in Decisions
  • Access to people
  • Provision of information
  • Provision of certain inputs or resources

• Recommended approach during drafting stage:
  • Specify Customer supplied items in SOW
  • Require supplier to tell you if there is Customer caused delay impacting the vendor.
THREE CLASSIC SUPPLIER DEFENCES

• Defence 3 Services to “assist” v services to “deliver”
  • ‘we are here to help’......only

• Recommended approach during drafting stage:
  • Make SOW output driven
  • Avoid language such as “assist”, “intend”, “with a view”
SUPPLIER “ASSUMPTIONS”

• Be mindful of supplier ‘assumptions’
  • Used by suppliers to remove or dilute obligations
  • Often scattered throughout RFP response
  • Dangerous when RFP response incorporated into contract

• Recommended approach during drafting stage:
  • If assumptions are required they should be collated into a single part of the contract
  • Limit as much as possible through negotiation
  • All assumptions should state a consequence
  • Supplier must immediately notify Customer once assumption comes into play
KEY CONTRACT ISSUES: LIABILITY

• Striking the balance between supplier who wishes to limit exposure and customer who wants supplier to take responsibility for loss caused by supplier.

• Industry standard position
  • Allow cap on supplier contract liability
  • Allow supplier exclusion of certain ‘consequential’ losses
  • Allow certain exclusions from cap

• Current liability caps 1 – 3 times annual fees

• What are consequential losses?
KEY CONTRACT ISSUES: LIABILITY

Exclusions from the cap

- Repudiation
- IP infringement
- Breach of confidentiality / privacy
- Personal injury / death
- Property damage
- Fraud
KEY CONTRACT ISSUES: SERVICE LEVELS

- Service Levels – if fail to meet supplier can be liable for service level rebates
- Contract may need to be flexible to allow payment of incentives – that is, additional payment if supplier achieves the service levels
- What do suppliers say about service levels?
  - Sole remedy – avoid
  - No right to terminate – avoid
  - Minimal amount – avoid
- Supplier will often provide its own service level regime – review it carefully
- Must be easy to administer (e.g. measurable service levels)
KEY CONTRACT ISSUES: WARRANTIES AND INDEMNITIES

• What is a warranty?
  • Right to sue for damages – no right to terminate

• Distinguish from “indemnity”
  • Extended scope of damages
KEY CONTRACT ISSUES: INTELLECTUAL PROPERTY

- What is Intellectual Property?
- Who owns IP? Employee v Independent Contractors
- Why do suppliers fuss about their IP
  - Suppliers don’t like customers owning IP that they create
  - If SOW specifies that supplier owns developed IP, Customer should obtain broad licence
- In relation to supplier that provides pre-existing software:
  - Supplier will want to impose its own licence terms
  - Supplier software licence terms can be attached to SOW
  - Important to review any supplier software licence terms to ensure Customer obtains the required rights to use the relevant software
KEY CONTRACT ISSUES: GOVERNANCE

• “Early Warning System”

• Good Governance model indicia:
  
  • Governance Plan – specifying governance requirements such as meeting frequency, committees and reports
  
  • If supplier is or will be delayed due to Customer, supplier is obliged to notify Customer
  
  • Supplier obliged to cooperate with Customer’s other contractors and commits to joint problem resolution with third parties
  
  • Should comply with reasonable directions of Customer in event of dispute whether task within scope
  
  • Key personnel
  
  • Warning signs
    
    • Delays
    
    • Scope arguments
    
    • Money!
KEY CONTRACT ISSUES: GOVERNANCE

• Contract Management Tips:
  • Keep meeting minutes and circulate for approval
  • Do not discuss matters of a legal nature or modify an agreement in meetings
  • Immediately escalate any issues to appropriate team (e.g. Legal)
OUTSOURCING/OFFSHORING – KEY LEGAL ISSUES

• Privacy – Information Privacy Act 2009 (Qld)
  • Restrictions on local governments transferring information overseas – cloud computing
• Record-keeping obligations – Public Records Act 2002 (Qld)
  • Record-keeping and information management risks to be considered when implementing cloud computing services, specifically around the creation, storage management and disposal of records with service providers
QUEENSLAND GOVERNMENT AND CLOUD COMPUTING

- *Cloud Computing Guideline*, May 2012 – guideline for undertaking a risk assessment when considering use of cloud computing services

- Be mindful of:
  - compliance with Queensland government policies
  - value for money (VFM)
  - portability
  - data security, ownership and classification
  - data privacy
  - legal issues
  - auditing
SECTION 2: MANAGING SUPPLIER PERFORMANCE
MANAGING SUPPLIER PERFORMANCE

• ICT engagements are often complex and business critical

• Important to be able to effectively manage the performance of suppliers and service providers to ensure optimal results for the business

• There are several ways to do this, including:
  1. Contractual flexibility
  2. Outcomes Based Payments
  3. Benchmarking
  4. Dispute Escalation
  5. Step in rights
  6. Termination
CONTRACTUAL FLEXIBILITY

• Ramp up or ramp down
• Ability to easily cancel or replace an entire service tower
• Contract administration – e.g. variation procedures
• Capacity to acquire short term out of scope work from the supplier via the contract without the need for extensive formal arrangements
• Pre-agreed price and terms for additional work where possible – e.g. project work
OUTCOMES BASED PAYMENTS

What are Outcomes Based Payments?

• Payments for work completed
• Usually tied to project milestones or deliverables
• If properly managed, can ensure that the contractor is providing the required quality on schedule
• Customer has early visibility of potential problems with the supplier’s performance

But:

• Requires the Customer to be diligent in monitoring actual performance against milestones
• Difficult to administer if service is not time dependent or does not produce measurable outcomes
• Consider rights to terminate following poor performance against outcomes
OUTCOMES BASED PAYMENTS

Case study – UK ‘FiReControl system’

- UK Government project aimed at streamlining fire and rescue emergency services by building secured inter-agency network facilities across the country
- Project initially estimated to cost £120m and take 5 years to deliver
- But cancelled in year 6 after cost had reached £250m with additional cost to complete estimated at over £635m
- There were milestones but all geared towards the end of the project - no interim milestones
- Structure of the contract ultimately contributed to the failure of the project
What is benchmarking?

- An exercise in gathering data from similar customers and suppliers and attempting to calculate a ‘benchmark’ for a particular service
- Overriding principle is to protect the customer from a material shift in market conditions – common to have ‘one-way’ effect only
- Benchmarking is usually not in the interest of the supplier, so expect supplier to resist benchmarking, seek to limit the entitlement to trigger benchmark

Steps in benchmarking

- Trigger – frequency? unilateral rights? who pays? tripartite agreement?
- Data Gathering – availability of comparable data, highly customised environments, Queensland specific data?
- Data Normalisation – complex, reliance on judgment of benchmarker, risk of disputes about normalisation process
- Service assessed against benchmark – acceptable market price, banding (5-10%)?
- Contractual consequences – auto-adjustment, escalation meeting, right to terminate?
BENCHMARKING

Benchmarking issues:

• Benchmarking should be used to confirm that the customer receives an acceptable market price throughout the term of the contract

• Risk of triggering dispute if benchmark methodology is unfairly or incorrectly applied

• Be mindful of differences in ICT environment (i.e. legacy devices, on-site and off-site support etc)

• Benchmarking most useful for standardised services

• Supplier allows for the cost of the benchmarking activity when calculating price
DISPUTE ESCALATION

According to IAMA/ACS, nearly half of all ICT contracts involve a dispute of some kind (*IAMA and ACS, 2006 Survey*)

ICT disputes:

- Often relate to project management issues such as failure to meet project scope/quality/timeframes
- Are typically very complex and, should they proceed to court, involve lengthy and expensive proceedings
- Usually involve amounts of less than $500,000, though several high profile disputes in recent years involving amounts exceeding $100m

Parties’ approach to dispute resolution will be heavily influenced by contractual dispute resolution procedures
DISPUTE ESCALATION

Senior Management Meeting:

• Preserve relationship
• Senior Management ‘buy-in’
• Visibility of Supplier’s position
• Appropriate level
• Enforceability of outcomes?

Mediation:

• Informal and cost effective
• Private and can preserve relationship if used well
• Mediator? If so, who?
• No binding outcome
DISPUTE ESCALATION

Expert Determination:

- Informal and speedy
- Appropriate Expert with a technical or ICT background
- Parties can determine the process
- Binding decision?

Arbitration:

- Confidential
- Less adversarial and quicker than litigation?
- No right of appeal (though award can be challenged in certain circumstances)
- Technical or ICT knowledge of Arbitrator?
What are Step-in Rights?

- The right to replace the service provider in the performance of all or some of the services
- Usually triggered by serious or continued breach or regulatory or legal requirement
- The Customer provides the services using its own or a third party alternative provider for a limited period of time
- Focus is on service rectification and continuity
- Contract should clearly define ‘step-in’ regime and ‘step-out’ events
STEP-IN RIGHTS

Practical Limitations

• Does customer have in-house technical skills to deliver the service(s) in question?

• ‘Poison Chalice’ perception – may be difficult to obtain a third party service provider, especially if the step in period is short

• Risk of disrupting other parts of the business

• Limited scope to step-in in a shared services or shared infrastructure environment

• Outmoded in current outsourcing environment (more appropriate to ‘dedicated outsourcing’ model)

• Regulation/Authorisations/Licences required to perform the services
TERMINATION OF ICT CONTRACTS

• Contracts can typically be terminated:
  • By agreement between the parties;
  • Under an express right to terminate contained in the contract; or
  • By a party exercising a right to terminate under common law.

• Typically IT contracts contain express provisions allowing for termination in several ways:
  • Termination for convenience
  • Occurrence of certain trigger events, e.g. supplier insolvency
  • Serious breaches by a party that are incapable of being remedied
  • Other serious breaches by a party that are not remedied within a defined number of days.

• ‘Material breach’ is commonly used terminology, but what does it mean?
  • Will depend on the context, but has been interpreted to mean a fundamental breach going to the root of the contract, or one which substantially adversely affects the interests of the innocent party.
TERMINATION OF ICT CONTRACTS

Common law rights to terminate

• All breaches of contract which result in loss will normally entitle the innocent party to damages... but not all breaches give rise to an entitlement to terminate under common law

• To terminate the contract at common law, the breach must:
  • Amount to a repudiation of the contract – in other words, there is an absence of willingness or ability to perform the whole of the contract
  • Be a breach of a condition – an essential term going to the root of the contract; or
  • Be a serious breach of an important (although not essential) term.

• Common law right to terminate may in some cases be reduced by the express termination provisions in the contract
TERMINATION OF ICT CONTRACTS

Service continuity during any remedial or notice period is often a key concern

- Contract should include provisions that ensure service continuity following termination notice

- Exit is inevitable – plan accordingly during contract formation and update exit strategy throughout the course of the contract. Contract should require the supplier to:
  - Maintain comprehensive documentation relating to ICT services
  - Socialise key knowledge
  - Maintain an up to date transition out plan
  - Handover passwords and provide access where required
  - Require supplier to maintain services following termination notice
TERMINATION OF ICT CONTRACTS

Conduct during contentious exits

• During a contentious exit there will always be an underlying dispute. As much as possible the dispute should be isolated from the exit:
  • Control communications and be wary of risk of admissions and waivers
  • Be mindful of repudiating contract by conduct
  • Plan prior to termination and assume minimal supplier co-operation
  • Incentivise supplier co-operation
    • What if financial remedies already exhausted? (ie service cap reached)
  • Deal with dispute expeditiously as delays will contaminate exit
    • Consider just do it and just pay for it mechanisms in the contract (that allow claim back from supplier)
    • Efficient dispute escalation mechanisms
QUESTIONS?

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