

Contracts for Computer Systems – Dealing with Some of the Pitfalls

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Commercial Focus

An unfortunate choice of computer system can have a major adverse impact. If this is compounded by accepting a one-sided computer contract in favour of a supplier, the situation is even worse. If you are a customer you need to protect your organisation, but equally you must appreciate the broader commercial picture.

In most cases it is not economically viable for a supplier even to attempt to produce error-free software, especially if there is a bespoke element to the program, and few suppliers can afford to shoulder unlimited liability for all the damage which could be caused by a malfunction in the system in which it is installed. During contractual negotiations with the supplier some sort of balance will need to be struck between the differing requirements of your organisation and those of the supplier.

In addition to the wording of the contract, you should consider the practical steps that can be taken to safeguard your organisation. For example, it may be possible to continue using an old computer system in parallel with the new one until the new one has demonstrated its reliability. Regular back-up will lessen the risk of having to reinstate appreciable amounts of lost data if the system fails. However, the most important measure that you can take is to choose your supplier wisely. A well drafted computer contract is no substitute for a good supplier; it is easy for a supplier to sign a contract in your favour but compliance with the terms of that contract is far more difficult to achieve and if the worst comes to the worst liquidation will always remain a way out for an unscrupulous supplier.

The Wider Perspective

Before immersing yourself in the detail of the contract it is worth reminding yourself of your basic objective, as it is easy to lose sight of it. In most cases you will want a system that provides a solution. This is true whether you are starting from scratch or whether you are enhancing your existing system. In each case you will be less concerned with the independent function of the parts than with the end result. Do not, therefore, be tempted to accept different contracts for separate parts of the system, even if they are cleverly woven together in one document. If you are buying an entire system, all of the major provisions of the contract should relate to the system as a whole, and if it is just enhancements which are being supplied you will want them to function well in combination with the rest of the system.

Computer Contracts

Some of the most important provisions of a computer contract are, perversely, found in the schedules and attachments, and it is wise to start with these. Most importantly, the attachments should contain a good functional description of the system, particularly the software. If the description is incomplete or inaccurate you may be supplied with the wrong system and it may be difficult to rectify the mistake later, so the carefully written contractual clauses in the main part of the contract will relate to the wrong system and consequently will be of limited value. If at all possible, arrange for a user requirement specification to be drawn up for you so it can form the basis of the contract.

Sale of Equipment and Software Licence

Having assured yourself that the contract relates to the right system, the terms on which it is to be provided should be considered carefully. Of prime importance is the extent of the software licence. Does it include the source code? The licence will often be limited to the machine-readable object code, in which case the drawbacks of accepting that limitation must be understood. It is probable that the source code will be needed to carry out maintenance so it is vital that it is available to your maintenance provider at all times. If the source code is only available to your initial supplier your organisation may find itself tied to that supplier on a long-term basis which could result in the supplier abusing its position. You will therefore need assurances of continued maintenance on reasonable terms.

Another form of protection for the customer in these circumstances is an escrow agreement under which the source code is deposited with an escrow agent. The escrow agent takes a copy of the source code and agrees to release it if the supplier becomes insolvent, if the supplier is in material breach of the maintenance contract or if the supplier stops providing maintenance through no fault of the customer. Escrow arrangements are not a perfect solution as the source code may change considerably over the period of the agreement and it can be difficult to cater for this adequately within the escrow agreement.

Another pitfall to watch out for is the limitation of the software licence to (1) a particular piece of hardware; or (2) a specified location; or (3) a limited number of users or processing capacity, in which case a substantial premium can be charged for upgrading the licence at a time when your bargaining position is weak as you are already using the software.

Payment

The supplier would ideally like full payment to be made immediately. Try to put off as much of the payment as possible until the whole system has been fully installed and tested. It will seldom be possible to delay the entire payment until final acceptance, but it may be possible to stagger some of the other payments to coincide with milestones in the installation timetable.

Installation

The contract should contain either an agreed date for installation or an implementation plan with the dates of the various stages in the installation of the system. It is worth considering what will happen if the supplier fails to meet these deadlines and the response which you would like to make. There will be a point at which you want your money back if the system is still not functioning as it should. You may also want compensation for the disruption caused by the delay, although this is likely to be far more difficult to negotiate. You should consider including such provisions in the contract.

Testing

An acceptance testing procedure is worthwhile if it is more than a formality. Avoid agreeing to tests at a stage when you have scant knowledge of the system and can do little more than watch the supplier conduct some elementary tests that the system is bound to pass. If you are to accept the system formally this should ideally be after thorough training and use of the system in conditions which are similar to those in which it will be used in practice. If you are forced to make the final payment for the system before you have had a chance to test it properly you will be obliged to rely on the supplier's warranty.

Warranties and Limitation of Liability

As you would expect, suppliers are not generous with their warranties. The one crumb of comfort is that suppliers also have difficulties with these provisions, as a limited warranty combined with a clause excluding all other liability may be contractually unenforceable. The minimum that you should accept is the return of the purchase price, and above that you should look for sufficient recompense to give the supplier an incentive to perform properly and to allow you to pick up the pieces within your organisation.

Other Matters

Having successfully negotiated the basic system supply agreement it is time to move on to the maintenance and disaster recovery contracts which could form the basis of another article in their own right. It is most unwise to deal with the maintenance agreement in isolation. Software is never error-free and in many cases requires regular updating so the quality of the system as a whole may depend to an appreciable extent on the quality and type of maintenance services available.

Do not be put off

Whilst a good computer contract should assist the organisation negotiating it, it is easy to get carried away with its intricacies and to allow it to become a barrier to acquiring a good system. In each case the contract must be considered in its commercial context but with an understanding of the important effect which some of the decisions taken may have.

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