Drafting and Negotiating Computer Contracts

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Butterworths

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Foreword

I warmly welcome the publication of this book, as I believe it addresses an area of central interest and importance in the computer field. Writing computer system contracts is a peculiarly fraught experience due primarily, I think, to the intangible nature of the product. I refer in particular to the software component of a system, which determines how that system will respond in practice to its users and which controls the services delivered. Software quality is very hard to assess – the real 'product' is its behaviour when actually in service, and this is generally not possible to predict with certainty during the development process.

It is an inescapable fact that, except perhaps in a few very specialised areas, software can never be assumed to be free of errors, and indeed the general view is that all software, and hence all computer systems, must be assumed to contain an unknown number of errors which are as yet undiscovered. Nevertheless, we are surrounded by computer systems, often of great complexity, and we rely on the operation of such systems in very many of our activities, from flying an aircraft to using the washing machine.

This central issue in computer systems engineering leads to severe problems in effective project management and in quality control. The record of achievement by the computer systems industry over the years in delivering products to specification, on time and within budget, is notoriously poor, and has often led to client dissatisfaction and indeed to litigation. A well-constructed and effective contract is not easy to establish in this difficult area, and this book provides, both for lawyers and for computer systems specialists and their clients, much helpful guidance.

In such a book, a wide range of computer-related contract formats must be covered and analysed. The discussions of areas such as the specification-driven approach widely used in the last two decades, consultancy contracts, software licences, intellectual property issues, fixed price and time and materials charging and indeed many other areas must produce practical and widely-acceptable guidelines for writing these contracts.

I particularly welcome the discussions on more recent approaches to contracting. These are moving away from the requirements for a full specification prior to development, which can be cumbersome and even confrontational, to more collaborative fast-prototyping and joint development approaches. I think these newer approaches to building computer systems have much to offer and they

may well provide more effective routes towards the goal of delivering products which truly meet the requirements. Successful systems have been built in this way, on the basis that only the client can really understand the requirement, but in general contracts cannot effectively specify it either in computer or legal terminology, and so a 'partnership' is the best approach. Recent technical advances, for example in very high level application-specific programming systems, can give more effective support for fast prototyping and so make the use of such an approach more realistic and feasible.

Personally, I found this book interesting, informative and a pleasure to read. The subject, I think, is of crucial importance to the development of our use of computer systems and I hope it will be widely read and consulted both by lawyers and by computer systems engineers.

John Buxton
October 1993
Kings College, London

John Buxton is Professor of IT at King's College, London, and Chairman of Room Underwriting Systems Ltd.

Preface

Now that we are undergoing the information revolution, where society has come to depend on information and the technologies by which it is communicated and used, the computer industry continues to advance at an unprecedented rate, far outstripping the rate of growth of any other industry, in terms of both technological advances and new applications.

A distinct body of law relating to the supply and use of computer products and services is evolving. There are numerous forms of legal agreements designed to address the issues arising in computer-related business transactions. Some precedent materials are now available to assist those whose work involves drafting and reviewing computer contracts. Nevertheless, the industry has not reached the stage of maturity where standard forms of agreements are in common use. To a large extent this reflects its dynamic and innovative approach to business, with the variety and multiplicity of transactions. Moreover, very little assistance is available in respect of the negotiation of these contracts or of their administration. In this book, we focus firmly on these aspects.

Each major category of computer contract is discussed, but, rather than provide absolute precedent wording, we have chosen to offer examples of the principal clauses normally found in each type of contract, using them as a basis for discussion about negotiability. We have concentrated as much as possible on the commercial factors which typically confront the supplier and the user when a computer contract is under consideration.

We have deliberately sought to avoid an academic standpoint and to give the work a practical flavour, founded on our respective backgrounds working within the computer industry and for computer users, initially as systems analysts and consultants and, since the early eighties, as practising lawyers. We hope, therefore, that this book will be useful to computer and system suppliers and users as well as to those professionally engaged in advising them.

We would particularly like to thank the following: Professor Colin Tapper for his thorough review of the manuscript and his invaluable suggestions for its improvement; Professor John Buxton for his practical advice on the manuscript and for the helpful observations on industry practice; Antony Smith for his comments in connection with Chapter 3; Lindsay McNish for his comments in connection with Chapter 4.

Any surviving errors are all our own work.

We would also like to thank our various secretaries who have contributed to typing the manuscript, and especially to thank Gwen Clarke for her general secretarial support and organisation and for tackling the whole of the final manuscript so patiently and efficiently.

Finally, reflecting the empirical experience we have gained over the years, we would like to thank our clients and our professional colleagues for their significant contribution towards the development of the arguments — and to the suppliers and customers of our clients without whom some of the arguments would not have been considered in the first place.

Paul Klinger
Rachel Burnett
November 1993

Glossary

Generally speaking, these terms are quoted in full on their first occurrence, and by abbreviation subsequently.

ADR	Alternative Dispute Resolution
CE	Communauté Européene
COREPER	Committee of Permanent Representatives
DDP	Delivered Duty Paid
CPU	Central Processing Unit
EC	European Community
ECIS	European Committee for Interoperable Systems
EEA	European Economic Area
EDI	Electronic Data Interchange
EFTA	European Free Trade Association
FAST	Federation Against Software Theft
FCA	Free Carriage Abroad
FM	Facilities Management
ICC	International Chamber of Commerce
ISV	Independent Software Vendor
IT	Information Technology
LAN	Local Area Network
MOA	Memoranda of Agreement
MOU	Memoranda of Understanding
OEM	Original Equipment Manufacturer
PC	Personal Computer
RFQ	Request for Quotation
SI	Systems Integrator

TUPE	Transfer of Undertakings (Protection of Employment) Regulations 1981, SI 1981 No 1794
UK	United Kingdom
US	United States
VAR	Value Added Reseller
VAT	Value Added Tax

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Chapter 1: Introduction

A. GENERAL

This book is addressed to the computer industry and its users. The target readership includes members of the sales and purchasing departments respectively of the industry and its customers, information technology ('IT') and information systems directors in user companies, and directors of computer suppliers and service organisations. In view of this aim unnecessary legal language or jargon has been deliberately avoided, and explanations and interpretations are commercial. Nevertheless, the hope is that this book will also be useful for lawyers, accountants and other advisers servicing this most significant growth sector of the economy.

The intention is to provide a practical guide to drafting and constructing a computer contract and to the principles of computer contract negotiation. Creating a contract relating to computer products or services requires an understanding of the commercial objectives of the transaction and of the reasons for the legal principles which should underpin it. As a prerequisite to negotiation it is necessary to have an awareness of the legal and market environments which influence the ways in which computer contracts are made. It is essential, also, to appreciate the need for adequate systems of order administration and contracts administration.

This book is not an academic treatise on this important new area of contract law, nor should it be regarded as an exhaustive statement on the techniques of negotiation. The approach is, rather, to explain, inform and guide in simple and useful terms, with the hope that those who refer to it will find it a helpful preparation for computer contract negotiations.

B. THE IMPORTANCE OF THE COMPUTER INDUSTRY

The computer industry has grown spectacularly in absolute terms since the 1950s and the days when the total world demand for computers was estimated in single figures. It continues to grow, absolutely and also relatively, both in economic terms and at the expense of other industries. It is the world's largest manufacturing sector. The growth rate is accelerating.

Within the next few years, it is estimated that two thirds of all jobs in Europe will be concerned with IT, whether in the manufacture of equipment, software supply, services or electronic publishing.

Computing is no longer carried out in vast air-conditioned and concrete-floored rooms by a few large companies for internal data processing, calculation and record keeping. Now computing reaches everyone as part of everyday life. Word processing and spreadsheets are commonly used in businesses. Computerised production techniques and automated manufacturing processes are increasingly being used throughout industry. IT is being applied to more and more consumer products.

The chains of supply from the manufacturer to the end user are lengthening and growing more intricate, as computer products are combined with other products and with services utilising various skills. This has implications for the different kinds of contracts being created between the parties, some of whom within the chain will be both customer in buying or licensing from one or more vendors, and also supplier, putting together the different elements of a product and adding value for onward supply.

Society has become dependent on information and information technologies. Technology has transformed the importance of information and turned it into a commodity which can be profitably traded. The number of service-related industries and activities is increasing.

Many commercial or administrative enterprises would not now be able to survive without their strategic use of computer systems. Successful strategy in what has become a turbulent business environment requires high level Board interest and commitment.

Fast growth is typical, and at any one time whilst individual areas of the industry experience commercial losses, other parts are always succeeding. It is often the case that when one sector of the industry is experiencing a fall off in demand, other sectors are achieving sales records. Software developers are constantly putting hardware to new uses but they are still unable to keep pace with the technological advances which are being achieved in speed, power and novelty. Costs are decreasing as computers are getting smaller and yet more powerful. A consequence of increased power is the ability for more tasks to be decentralised.

Within the market, individual companies grow fast. IBM's growth between the 1930s and the 1980s was spectacular. Digital Equipment Corporation grew its revenues from less than 1 billion dollars to more than 10 billion dollars in the decade from the late 1970s to the late 1980s. However, most growth in the industry comes from start-ups, not from established companies getting bigger. Some of today's entrepreneurs forming a new company in the garage or shed will have every opportunity of being tomorrow's millionaires. A distinctive feature of the industry is its ability to attract