

Avoiding Technology Contract Disputes

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1. Background

It is well known that a significant number of technology contracts end up with a dispute between the parties. It is often said that one in five technology projects fail.

A significant dispute is generally a disaster for a supplier as it will typically result in loss of further business from the customer as well as loss of very valuable referrals. In addition, the dispute process itself will often eat up the margin that was made on the project.

It is also a disaster for the customer as in most cases the customer is left with a delayed or part completed project that does not satisfy its needs and costs significantly more than expected.

The purpose of this paper is to summarise, based on our experience some of the practical steps that can be taken by suppliers and customers to reduce the likelihood of disputes.

2. Customer or Supplier Selection

The most obvious but commonly disregarded step is to carefully select your business partner.

For suppliers this means taking care to select the right customers. By this we mean a customer that has a genuine need for your product or service and an ability and willingness to pay.

For customers this means carefully evaluating the proposed supplier and its product or service on a number of criteria of which price is only one and it should never be the primary one. There are two reasons for this. Firstly, a cheap price is no good if you end up without the solution you need. Secondly, in technology projects the headline price is hardly ever the final cost. This is because scope variations will add to the overall cost. The criteria should include the fit between the product and the requirements of the project, the financial strength of the supplier and the experience that other customers have had with the supplier.

On both sides it also helps to look for long term mutually beneficial relationships. If the parties are able to think beyond the current project to further projects down the track it makes it so much easier to sort out current project issues.

3. Scope Scope and Scope

The key to getting technology contracts right is to carefully define the scope in a properly negotiated detailed contract. There is no doubt that a poorly defined scope of work is the root cause of most technology contract disputes.

The problem with “scope” is that there is a mismatch between what customers and suppliers consider to be a properly scoped job. In simple terms customers tend to think in terms of business requirements (to use an analogy – we need a house for a family with 5 children aged between 2 and 10) and suppliers tend to think in terms of technical specifications (to continue the analogy – we will build a house to the attached drawings and specifications). There is no doubt that in nearly all cases a list of business requirements is far from the detail required for a supplier to cost a job.

When faced with a significant difference between the customer's expectations and a detailed technical specification that the supplier needs most reputable technology consultants recommend that a detailed scoping study be conducted in order to properly scope the job. While this may seem to some customers to be an unnecessary cost, our view is that any customer spending significant money on an IT project ought to invest in ensuring the technology meets their business need and that the supplier understands those business needs. In doing this, the statement of works describing the project will have a level of "buy in" from both sides and is more likely to properly describe the actual needs of the customer.

A proper scope of work avoids the all too frequent dispute scenario where the customer encourages a supplier, usually through a tender process, to quote based on a scope consisting of high level business requirements. The supplier then provides a quote based on assumptions which are often unrealistic and the eventual outcome is a great deal of added work and cost arising from having to make changes as the project progresses in order to meet the business requirements. This tends to be further complicated as in most large businesses there tends to be at least some level of variation between different people as to what those business requirements mean and they also tend to change over time.

4. Change Control

Another common case of a dispute is failure to clearly agree and document changes that inevitably arise during the life of the project. Technology contracts should include a clear change control process and proper contract management should ensure that the contractual process is followed.

5. Liability Clauses

Liability clauses that are crafted and carefully drafted to suit the circumstances of the transaction are essential. Each party needs to consider the particular risks and needs of the transaction they are considering. No two deals are ever quite the same. Liability clauses that limit liability to a fixed amount (normally with carve outs in a limited number of areas) are also important in reducing disputes. These are obviously more important from a supplier perspective but the clarity of the clause is also important from a customer perspective if only to ensure there is a healthy discussion of the topic and if there is a risk the customer wasn't expecting, it considers how best to mitigate that risk. Failed technology project can lead to all sorts of costs and losses, if there is clarity as to what costs and losses are recoverable then the scope of any dispute will be reduced, making it easier for a dispute to be resolved.

6. Contract Management

Every technology project has issues as the project progresses, some larger than others. It is often the quality of the contract management that is the difference between issues being quickly and easily resolved and issues festering and turning into a major dispute. The contract itself should facilitate this by making clear who is responsible for contract management on both sides and by allowing for appropriate escalation of issues.

Throughout the project the parties should clearly document all changes and address and deal with issues as they arise, rather than allow them to grow into something larger. Disputes in IT contracts frequently have a long gestation period where the parties interests have diverged with neither party wanting to face up to the issue.

7. Conclusions

Based on our experience, a summary of some of the practical steps that can be taken by suppliers and customers to reduce the likelihood of technology contract disputes are:

- Carefully select your customer or supplier
- Define the scope to a level of technical specifications (if necessary this may require a preliminary scoping study)
- Include a clear change control process in the contract and make sure it is followed
- Be sure you clearly discuss and document who is liable for what and to what extent in the liability clauses
- Implement active contract management, documenting changes and discussing issues as they arise

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Truman Hoyle is a Sydney based law firm serving the new economy industries across the Asia Pacific region. Australasian Legal Business has recently ranked the firm's Telecommunications, Media & Technology and Intellectual Property practices as top-tier in Sydney. The firm was named Australian Law Firm of the Year in 2005 and again in 2006, for firms with 50 lawyers or less. In 2009 our firm was awarded the prestigious ACOMM Award for Professional Services Excellence at the annual Australian telecommunications industry awards.

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