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On-going Support: Typical Contractual Issues and Best Practice Solutions

Speaker: Mark Vincent, Partner, Intellectual Property and Technology Group, Truman Hoyle

Introduction

Issues of software support are usually addressed in a software support agreement (SSA), which is typically separate to the software license agreement itself. There may be some cross over between these two agreements, however the applicability and terms of both agreements are usually a matter of negotiation between the parties in each instance.

The paper is designed to give an overview of critical issues to be addressed in an SAA and the relevance of these issues to both the supplier and customer alike.

Software Support Agreements Generally

The terms “Support” and “maintenance” when used in the context of software, are often interchangeable and are not terms of art. “Support” and “maintenance” in this context refer to a wide gamut of services, from system performance levels, help desk and escalation, error correction to software updates and file maintenance.

Typically stand alone “maintenance” services will be charged by suppliers at a rate of between 15 and 20% of software licence fee annually. “Maintenance” will typically cover error correction, bug fixes, updates and new releases. Customers will remain current with access to the latest version of an application and have access to a product road map that identifies the future direction for the software.

“Support services” will usually be based around service availability using agreed service levels with proactive system monitoring, help desk and escalation for performance issues. It will be difficult to provide support without a customer also signing up for “maintenance” in the form of error correction, bug fixes and updates to the code.

The terms of every SSA will be unique and will depend on the nature and extent of the software itself, the capabilities of the supplier to supply support services, service levels, the longevity of the software itself and security issues.

It is important that the parties have a clear understanding of each other’s capabilities when negotiating an SSA so that they both get the maximum benefit possible from the services provided under the agreement and appropriately manage the expectations of one another.

A supplier should be aware of a customer's hardware capacity; the availability and technical capabilities of in-house IT staff, if any; security of data processed by the software; remote access and disaster recovery practices.

A customer should enquire as to the effect of warranty periods on the provision of support services; costs for support and price protection; availability of support including: priority levels; response and restore times; the retention of the source code of the software in escrow; updates; new releases; and data recovery.

In the preliminary stages of the negotiation of an SSA, as in many commercial contractual negotiations, there may be a preliminary joust as to which party should draft the agreement. It is reasonable for a customer to want a document that suits and reflects the requirements of their particular project, rather than having to fit in with a standard form agreement, for example. However it is common for suppliers to draft the initial document so as to ensure it accurately reflects their own capabilities.

A mutual understanding of each party's capabilities and expectations from the outset of negotiations is an excellent means of ensuring that the SSA will be drafted in accordance with the understanding of both parties thereby avoiding any unnecessary argument as to why one party and not the other should draft the SSA.

Service Levels

Generally

Service levels are at the heart of any SSA and are the benchmark for the performance of the agreement by both parties. Unrealistic or disproportionate service levels will hinder the efficient operation of the agreement.

The scope of the service levels set in an SSA will usually be dependent on each project and the nature of the software. However generally speaking, the supplier has an obligation to maintain the software in substantial conformity with the descriptions and specifications disclosed to the customer.

Suppliers should pay specific attention to what level these obligations will be performed at. Will a missed service level constitute a breach of the SSA leading to a claim for damages and termination rights or will a performance credit be the sole remedy? Will the supplier use best or reasonable endeavours to maintain the software in this way? I discuss "Performance Credits as Sole Remedy" in the section below entitled "Risk Allocation".

The terms "best endeavours" and "reasonable endeavours" are interchangeable (in Australia at least). It may be argued by some that a best endeavours clause sets a high obligation on a party to do all it can to bring about the specified goal or purpose set out in an agreement, where as a reasonable endeavours clause gets a lower threshold as to what efforts a party should take to bring about the specified goal or purpose of an agreement.

There is Australian High Court authority that a best endeavours clause is a clause in a contract requiring a party to do what may be reasonably done in the circumstances, having regard to the nature, capacity, qualifications and responsibilities of the parties, to bring about a certain result.¹ In any event, a best endeavours clause will normally be implied in commercial contracts.² Therefore, it would seem that the threshold test

for any such clause is a reasonable attempt by a party to bring about a desired outcome as contemplated in the agreement. This duty would apply to a supplier's efforts to meet service levels.

It is also prudent for a supplier to ensure that the SSA covers training of the customer's personnel in the use of the software. The scope and extent of any such training will depend on factors such as whether the customer employs its own IT technicians, the complexity of the software and its use, the hardware on which the software is loaded and the instructions contained in the manual of specifications for the software. Poor training of a customer's users will also result in an increased cost of supporting the software.

The intended scope of support services should always be clearly defined in an SSA. "Support" to the extent it has a generally accepted scope in the context of software has been defined to include³:

- (a) explaining the functions and features of the software;
- (b) clarifying documentation relating to the software;
- (c) guiding the customer in the operation of the software;
- (d) providing recommendations with respect to the customer's hardware requirements;
- (e) assisting customers when problems occur in their software, including systems crashes, incorrect results caused by improper use or software defects; and
- (f) file maintenance, including correction of corrupted files or data.

Service Exclusions

The exclusions of the support services should also be clearly defined. It is only reasonable for suppliers to exclude support services for defects or errors in the software that are beyond their control for various reasons, including but not limited to:

- (a) defects or errors resulting from any modification of the software by a person other than the supplier;
- (b) defects or errors resulting from the use of the software in combination with equipment other than the equipment designated for use in the SSA;
- (c) rectification of errors in the operating system of designated equipment;
- (d) rectification of faults in the designated equipment;
- (e) training the customer's personnel;
- (f) modification to the software which constitutes a departure from the description and specification of the software in the license agreement and any accompanying manuals of specification; and
- (g) rectification of errors or defects which are the subject of a warranty under another agreement.

Such services can be supplied, but by agreement and for an extra charge.

Priority Levels and Response Times

To ensure the efficient execution of the obligations in a SSA, there should be a clear framework for priority levels and response times of the supplier.

Priority levels and response times should clearly define the following:

- (a) hours during which support services and provision for after hours support, if available;
- (b) classification of issues according to pre-determined criteria;
- (c) the degrees of priority allocated and the type of support will rendered in respect of each priority level (ie. telephone support for low priority errors or defects and on-site support for high priority errors or defects); and
- (d) documents and other materials the customer must provide to the supplier to assist it in reproducing the operating conditions giving rise to the error or defect.

It is especially important for the customer to ensure that priority levels, response times and target restore times are clearly defined as they will act as benchmarks which the supplier's support services must meet. A failure to adequately provide for priority levels and response times may lead to inefficiencies on the part of the supplier in providing the support services and may also give rise to the customer disputing support charges.

The classification of errors will be open to differing judgements as to severity. Typically, the higher the severity the faster the escalation and resolution of issues. It is the writer's view that in the absence of agreement on classification of faults the customer's view should guide the resolution path. The customer is in a better position to determine the impact of any fault on its business.

From the supplier's perspective, the negotiation of priority levels, response times and target restore times should reflect the capabilities of the supplier or the supplier's appointed contractor (in circumstances where the software supplier out-sources its support services).

From the customer's perspective, the negotiation of these issues should reflect the needs of the customer so as to cause as little disruption to its business and to ensure defects and errors are rectified as quickly as possible.

Of course, as the needs and capabilities of both parties will very rarely be compatible there needs to be a reasonable negotiation of priority levels and response times. It is in the interests of both parties to ensure there is a degree of flexibility incorporated in the SSA so as to ensure the parties can manage priority levels, response and restore times and the customer gets the maximum benefit from the support services.

Risk Allocation

Performance Credits as Sole Remedy

Where the parties agree service levels appropriate for the application being supported, a missed service level should not constitute a breach of the SSA leading to a right to damages. A standard industry practice in the writer's experience is to make performance credits the sole remedy for a breach of a service level.

If service levels are seriously breached for example: 3 months in a row or 5 months in any rolling 12 month period, it is reasonable to agree a termination right. The customer should have the right to seek an alternative provider with agreed levels of poor performance.

Most agreements exclude consequential damages. There may well be significant direct damage from a system outage or service level breach. Can the supplier take on the commercial risk of such outage? This will really be determined by the stability of the system (or likelihood of an outage) and the price charged for support services. Ordinarily the customer wears the business risks associated with any system and the supplier agrees to use its "best" or "reasonable" endeavours to ensure response and restore times are met. Apart from performance credits the risk of some unpredictable level of business harm is usually not priced into the cost of support services.

Warranty Period

The warranty period in respect of the software itself will usually be set out in the software license agreement, however it may sometimes be included in an SSA.

The effect of the warranty period is that the supplier agrees to rectify any defects in the software free of charge during the specified period.

Where the warranty period for the software is stipulated in the software license agreement, it would be prudent to reference or mirror that provision of the software license agreement in the SSA in the clauses dealing with payment for support services.

This may mean that Support charges are substantially reduced during the warranty period. Usually fixes during the warranty period have already been priced in to the licence fee.

Warranties

In respect of the support services themselves, customers should seek express warranties from the supplier that the support services will be rendered with due skill and care and that any materials supplied in connection with those services (ie. documentation accompanying the software) are reasonably fit for the purpose for which they are supplied. Note this warranty may be implied by law, but only where the value of the services is less than \$40,000 and the customer falls within the definition of "consumer".⁴

When negotiating warranties the supplier should always be mindful of the fact that it is virtually impossible to give warranties that the software will be, or can be rectified so that it will be, error free.

The following are examples of warranties that any be included in an SSA to address these issues:

“The supplier warrants that it shall perform the maintenance services in an efficient and professional manner and that it will observe standards generally observed in the industry for similar services.

The supplier warrants that it shall use its best endeavours to maintain the software in conformity with the specifications and to ensure the manual of specifications remains accurate. The customer acknowledges that the supplier does not warrant that the software can be rendered error free.”

Exclusion Clauses

Considering the nature of the software and the scope for defects and errors, it is not unusual to see clauses which seek to exclude a condition or warranty that would otherwise be implied by law. As such, it is advised that where a supplier seeks to include an exclusion clause in an SSA, it should also include a clause capping its liability in the event that the supplier is in breach of the SSA and the exclusion clause is later held unenforceable.

The *Trade Practices Act 1974 (Cth) (Act)* provides for consumer protection. Where the Act applies to a consumer transaction, there are certain conditions and warranties which are not excludable from a contract, including:

- (a) good title and right to quiet enjoyment of the goods;
- (b) that the goods are fit for their specified purpose;
- (c) that the services will be provided with due care and diligence; and
- (d) that the services will be provided for an appropriate purpose.⁵

As noted above, the application of the Act will depend on the value of the transaction and the nature of the goods and services acquired under it.⁶

A supplier should always be mindful of the fact that exclusion clauses which are contrary to law will not be enforced by a court. For example, an exclusion clause which purports to avoid liability for a breach of an implied warranty, would not be enforced by a court. A court will not enforce an exclusion clause which on its face, appears to operate unreasonably. Where the exclusion clause is ambiguous, a court will construe the clause in favour of the non-breaching party.

Caps on Liability

Customers should be mindful not to agree to an exclusion clause that excludes liability for which the supplier should otherwise be responsible. For example, the supplier often accepts uncapped liability for infringement of third party intellectual property which is embedded in the software or any other materials provided to the customer under the SSA. Also, the supplier would accept uncapped liability for misuse of confidential information, wilful default, fraud and any death or personal injury which may result from the provision of the services under the SSA.

A cap on liability is extremely important from a supplier's perspective. If liability under the SSA is uncapped, the supplier effectively becomes an insurer for a customer's business in the event the customer suffers loss arising from the provision of the support services. It is therefore recommended that the suppliers cap their liability. A usual practice is to set the overall cap at the level of all monies received by it under the SSA.

Larger customers may insist on a supplier taking a high level of liability in respect of any breach of the SSA. Whether or not a supplier agrees to allow access the cap more easily, a larger cap, or no cap at all, will require an assessment by the supplier of the actual level of risk versus the strategic importance of the customer. Suppliers should always be mindful of the fact that where a cap on liability is excessive or there is no cap at all, the supplier's liability, if realised, may have the effect of severely damaging its business.

Support Charges

Key to negotiation of an SSA will be the costs for the support services. Support charges should be clear and unambiguous and should specifically state inclusions and exclusions.

From the customer's perspective, it is important to ensure that the SSA contains a performance credit or rebate mechanism so that support charges may be adjusted in the event of substandard performance by the supplier. A performance rebate should be calculated pursuant to a formula agreed by the parties. The inclusion of a performance rebate gives the customer comfort with regards to the quality of the support services and keeps the supplier accountable for the level at which those services are performed. Generally (other than a right to terminate) performance rebates are the sole remedy for the poor performance.

Performance credits or rebates are typically structured so that the supplier puts at risk the margin on support services delivered in a given month.

Where the software licensor does not provide software support services, but contracts those support services out to a third party, the software licensor needs to be mindful of third line forcing issues. Third line forcing is prohibited by the Act.⁷

In the case of a software license agreement, third line forcing may occur if the supplier agrees to license software to the customer on the condition that the customer acquires the software support services from a third party supplier. Obviously, where the software supplier, or a third party, is the only supplier of support services for that particular software product, then third and full line forcing may not be an issue.

Pricing

A supplier, when negotiating support charges, should seek to have some level of certainty as to pricing, the ability to increase pricing over the term of the SSA and the ability to impose additional charges for services rendered which fall outside the scope of the agreement.

With respect to pricing, it is not uncommon to see clauses in SSAs allowing for an increase in support charges with the increase being referable to increases in the Consumer Price Index. The supplier should be required to give the customer

reasonable notice of any such increase and the customer should be given the option to terminate the agreement should it not agree to the pricing increase.

Suppliers should also ensure the SSA allows them to impose reasonable additional charges referable to the supplier's standard rates, for services which are requested by the customer which are not specifically included or are excluded in the SSA. The supplier may also consider imposing additional charges in the event the supplier is asked, and takes steps, to supply support services which are not ultimately necessary (eg. Where a customer requests an on-site visit from the supplier for a defect or error which could otherwise have been rectified by telephone support).

Currency

Updates, New Releases and Supported Versions

Provisions as to updates and new releases of the software may be contained in either the software licence agreement itself, a maintenance agreement or the SSA.

A "new release" is designed primarily to extend, alter, improve or add functionality to the licensed software. An "update" is provided primarily to overcome errors and defects in the existing version of the software.⁸

It is often to the supplier's advantage if the customer implements updates and/or new releases as this then alleviates the need for the supplier to expend time, money and effort in supporting older and possibly redundant versions of the software. On the flip side, the customer may be reluctant to implement updates and/or new releases because they may be perfectly happy with the version of the software they use at that time.

In any event, the parties to an SSA should negotiate whether the client will have the right to decline to implement and update and /or new release and the consequences if a customer exercises that right to decline, including the issue of costs.

A supplier may choose to only extend updates and/or new releases to customers if they have a current SSA in place with the supplier. However, suppliers should be mindful of the fact that such a condition cannot be imposed where the purpose of the update or new release is to rectify defects which would otherwise expose the supplier to liability if they were not immediately rectified.⁹

In the event that a customer is not given the right to decline updates and new releases, the supplier should consider imposing obligations on the customer to maintain and upgrade hardware and install updates or new releases in a specified time frame so as to ensure that the customer always has the most up to date version of the software. This will ensure the software is operating as efficiently as possible and that the support services can be rendered quickly and accurately.

The preparedness of a supplier to support old versions of the software is a commercial matter for the supplier. In determining whether it will support older versions of the software, the supplier should ensure that any requirement that the customer upgrade the software so as to avoid a need for the supplier to support an older version, is reasonably necessary for the protection of the legitimate interests of the supplier.¹⁰

Escrow

Another key issue affecting the currency of the software is the availability of the source code to the customer. Whilst suppliers usually give a customer the object code of the software, source code is usually retained by suppliers so as to protect its proprietary interest in the software.

As source code is required to maintain and/or modify the software itself, a customer should consider whether or not the source code should be placed in escrow so as to allow the customer to access the source code in situations where maintenance services are withdrawn for reasons of a dispute between the parties, or where the supplier becomes insolvent.

Again, the issue of placing the source code in escrow may be addressed in either the software license agreement itself, or in the SSA. In most cases, escrow provisions will be set out in the software license agreement or a separate escrow agreement.

Security

Issues of security will be of great importance to both parties. A supplier will be concerned with the security of its software to ensure the protection of its intellectual property and may seek to impose a condition on the customer to protect the software from unauthorised access or use, misuse, damage or destruction. Usually, any such provisions are contained in the software license agreement.

A customer may however wish to impose certain obligations on a supplier to protect the information being processed by the software itself. For example, where the supplier is able to access the customer's system remotely for the purposes of providing support services, the customer may wish to impose conditions to restrict which of the supplier's staff may access the customer's system remotely.

The customer may also wish to negotiate arrangements as to the off-site storage of software that contains sensitive customer information as a means of disaster prevention. Such arrangements are usually negotiated under a separate software media storage agreement, however where the software supplier provides support services and is in a position to provide storage facilities, it may be more efficient and cost effective for the storage provisions to be included as part of the SSA.

The provisions with respect to storage will be largely dependent on the nature of the information, the access to the stored information required by the customer, and the supplier's storage facilities, and may require a delineation of responsibilities between the parties as to matters of storage.

Termination

The parties should ensure that the SSA contains adequate termination provisions to allow either party to terminate in circumstances where it is unwilling or unable to continue performing its obligations under the SSA. Typical termination events include:

- (a) the breach or threatened breach by either party of its material obligations under the SSA;

- (b) the appointment of any type of insolvency administrator in respect of the property or affairs of either party;
- (c) the entry or proposed entry by either party into arrangements with any of its creditors;
- (d) the permanent discontinuance of use of the software or any part of the software by the customer; or
- (e) the merger with or the takeover of either party by another person.

Consideration to the exit strategy to be followed upon termination of the SSA should be given by both parties during negotiations. It is of no benefit to either party to terminate the agreement and then determine how the termination will be effected.

Reasonable notice of a party's intent to terminate should be given. In the event of termination for material breach, the breaching party should be given the opportunity to remedy the breach within a reasonable time frame before the SSA is terminated.

An example of a material breach would be where a supplier continuously provided substandard support or where a customer failed to acquire and maintain the hardware necessary to operate the software.

There should be adequate provision in the agreement for a termination to be effected with as little disruption to the customer and its systems as possible. The parties should consider a "ramp down" period in which the supplier will provide limited support services to assist the customer transitioning from its software to the systems or software of another supplier, if necessary.

A supplier should also ensure that the SSA contains adequate provision for the return or confidential destruction of the software and any manuals of specification or other documentation.

Supporting Open Source Code and Third Party Software

The parties should address support obligations for open source code used with or as a part of an application and any other third party software necessary for the application to operate.

Open source code can be supported by a supplier. Arguably there will be nowhere else to turn, so where use of open source is part of a solution it is often backed with vendor support obligations. Vendors who include open source code as a part of their solution need to decide:

- (a) do we support open source code?;
- (b) what are our processes to include open source code with our solution?;
- (c) do we give an IP Warranty?; and
- (d) what happens in the event of an IP breach or other need to replace the open source code?

For third party software, responsibility for the bug fixes, error correction or other defects with this software often passes to the third party under the escalation regime, with time taken to respond not included in restore times under SLAs. Customers usually don't want various vendors to point to each other and appreciate a single point of contact for support of an application. It is reasonable for a supplier to "manage" the resolution of faults with third party software so that the primary application is restored.

Conclusion

Software support is key to the operation and use of the software by a customer. It is therefore necessary that a customer is satisfied that the provision of support services is commensurate with the software itself and that the level of those services is within the capabilities of the supplier.

In order to enable the efficient performance by the parties to as SSA the issues addressed above should be worked through and negotiated by the parties prior to the execution of the SSA. This will ensure that the parties' performance is referable to a clear framework and enable the parties to resolve any issues arising under the SSA in a reasonable manner.

¹ See *Transfield Pty Limited v Arlo International Ltd* (1980) 144 CLR 83

² See *Camberwell v Camberwell Shopping Centre Pty Limited* (1994) 1 VR 163

³ *GEAC J & E Systems Ltd v Erickson Systems* (1993) 26 IPR 643 at 653

⁴ Section 74(1) of the *Trade Practices Act 1974* ("Act") stipulates that these warranties are implied in contracts for the supply of services, however the application of this section is confined to contracts between a corporation and a "consumer". A person or entity is classified as a consumer if the price of the services does not exceed \$40,000, or, if the price exceeds that sum, the goods or services are of a kind ordinarily acquired for personal, domestic or household use or consumption.

⁵ Sections 69, 71, 74(1) and 74(2) of the Act.

⁶ See note 4 above.

⁷ Sections 47(6) and 47(7) of the Act.

⁸ Hughes & Sharpe "Computer Contracts Principles and Precedents", Law Book Company, at [1.205].

⁹ Hughes & Sharpe "Computer Contracts Principles and Precedents", Law Book Company, at [1.230].

¹⁰ See Section 51AC of the Act.