

# **A BUYER'S GUIDE TO KEY LEGAL ISSUES IN INFORMATION TECHNOLOGY CONTRACTS**

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## 1. PURPOSE OF THIS GUIDE

This guide is for people who enter into or advise on IT contracts. It takes the point of view of a buyer of hardware, software and/or IT services.

The guide is an overview aimed at providing you with a strong foundation for negotiations, and enabling you to identify and evaluate key risks at the outset. We want you to have successful projects!

We have focussed on the three most common types of IT contracts, namely:

- software licence agreements;
- IT services contracts, for example, installation and integration, support and maintenance or consultancy; and
- hardware purchase contracts.

Where we refer to a “supplier” this includes all types of service providers, consultants and other parties with which you might negotiate or contract.

Having advised buyers of IT over many years, in a wide variety of procurement projects, we can say with certainty that a buyer that is well prepared and informed on key legal issues at the outset of a project has a hugely increased prospect of a successful negotiation and outcome.

**And importantly...** will also be well ahead of the game in the unfortunate event of a future legal dispute!

## **2. PRE-CONTRACTUAL STEPS**

### **2.1 Proper approvals**

We expect that you may have certain procedures that must be followed before and during contract negotiation and prior to execution of contracts. The procedures may vary depending on the contract terms, the supplier and project type.

Before negotiating an IT contract, your business case may also need to be approved by the Board/Executive.

### **2.2 Business case**

It is of course a fact of business life that there are many immediate and potential risks in entering into an IT contract. The terms and conditions of a contract can address some of those risks through placing legal obligations on the supplier and having the appropriate remedies available. However, the success of the contract will ultimately depend on the planning and investigation that is done in relation to:

- the needs of your business;
- the products or services you require to fulfil those needs; and
- the supplier and its ability to supply those products or services on acceptable terms.

Therefore, before entering into negotiations for an IT contract, if your business case needs to be approved by the Board/Executive the following may need to be considered:

- whether the supplier owns the intellectual property in the software or technology, or otherwise has power to grant you the necessary rights in key intellectual property;
- the functional specifications which will be used to assess the performance of software;
- the plan for assessing whether software does what it should - performance testing and acceptance testing;
- who will do the performance assessment and whether they are independent of the authors of the business case;
- whether you are taking known software that is widely used;
- risk measures, for example, is the product in reality a generic product that you could buy off the shelf;
- the need to develop an internal capability and whether you have that capability at this time; and
- commercial viability of the supplier.

Some of the considerations relating to these points are discussed below in more detail in relation to the particular types of IT contracts. However, they are some key issues that should be considered before contract negotiations commence. These are outlined in the next section.

### **3. CONTRACTS AND PRE-CONTRACTUAL DOCUMENTS**

#### **3.1 Contract formation**

Don't forget the contract law basics! The best negotiated contract can end up without many of your hard won provisions included. This applies as much to a purchase on standard terms as to a contract resulting from in-depth negotiations.

To be recognised as a legally binding contract, an agreement does not need to be called something in particular (such as a "contract" or an "agreement") and does not even need to be in writing. The Courts look at the circumstances surrounding a transaction, including whether one party has made an offer to supply goods or services, whether the other party has accepted that offer, and whether the parties intended to be legally bound. In these circumstances even spoken communication between parties is capable of being held to be a legally binding contract.

Many documents are frequently not thought of as being legally binding contracts, such as "Service Level Agreement", "Memorandum of Understanding", "Heads of Agreement", and "Statement of Work". However, in many cases these documents will satisfy the requirements of a legally binding contract with terms and conditions that must be observed. Even a series of letters (or emails) exchanged between parties is capable of constituting a legally binding contract between the correspondents.

Therefore, care must be taken in negotiations and in any documents you issue that may be construed as constituting a contract with the supplier.

If you are involved in a tender or panel procurement process with a supplier, you are likely to decide the award of a tender or the appointment of a panel supplier on the basis of the supplier's response to your requirements for the tender. Therefore, the successful tenderer or panel appointee should be held to all of the representations and other promises they made during the response for tender process. The subsequent contract negotiation is to finalise the precise terms of how the tenderer will supply the relevant services. The contract negotiation stage should not be seen as an opportunity for the successful tenderer or panel appointee to "readjust" the representations it has made to win the tender. Therefore, the important items in the response for tender should normally be included as part of the contract finally entered into.

#### **3.2 Standard form contracts**

Your business may have a range of "standard form" contracts for use with suppliers. Each of these contracts is usually tailored for specific circumstances.

It is important to remember that every contract should be considered in the context of the commercial transaction being entered into. The contract should be tailored to suit the transaction you want; the transaction should not be altered to suit the document.

## **4. COMMON FEATURES IN IT CONTRACTS**

Each of the three main types of IT contracts discussed below have their own specific considerations. However, each of them share common issues. Some of those issues and clauses common to all IT contracts are discussed in this section.

### **4.1 Specifications**

Every IT contract is essentially for the supply of some product or service. From the point of view of being the customer of such products or services, the entire contract is designed to give you legally enforceable rights for the proper and timely supply of those products or services.

Therefore, it is vital that every contract includes a precise description (or “specification”) of the products or services to be supplied. Nearly all of the rights you have under the contract relate back to the specification. For example, the specification for a software licence should include all of the details about what you expect from that software. If the software does not function in accordance with the specification, you will have rights under the contract. However, if the software does not perform as you require it to perform, and those requirements are not listed in the specification, you may have no or limited rights or legal recourse against the licensor of the software.

### **4.2 Price and payment structure**

As a general proposition, you should not have to pay for:

- products until they are delivered and unless they are of satisfactory quality; or
- services until they are performed in a satisfactory manner and time.

The reality is that the parties will usually have to negotiate a payment structure that requires payment of at least some amounts prior to full delivery of all products and services. However, in negotiating the payment structure for products and services, your potential exposure if the products or services fail should be considered. An option to ensure that your risk is managed is to agree with the supplier that the majority, or at least a substantial part, of the price is not paid until delivery and acceptance of the products or services has been achieved.

### **4.3 Limitation of liability and assessing risk**

Suppliers will invariably seek to limit or exclude their possible liability to you. Limitation amounts should not simply be arbitrary figures that “look about right”. The circumstances under which a supplier’s liability may be limited, or excluded, and the amount of such limitation, should be considered carefully against the backdrop of your possible exposure to loss and damage and its possible need to have recourse against the suppliers for that exposure.

For example, just because software licence fees are £100,000 per year that does not necessarily mean that the licensor’s liability should be limited to £100,000. If the software is to perform central, important functions and fails to function properly, your liability to customers, suppliers, or internally (because of additional costs incurred) may be substantial. If you are restricted to claim only £100,000 from the licensor, you will have to source any shortfall yourself (or rely on insurance).

Different risks may carry different degrees of potential liability. For example, newly developed software carries a greater risk of not functioning as expected than software that has been used by other persons and that has a proven track record. The possible damage that you may suffer if software does not operate properly or if services are not performed on time may be different depending on the function the software performs or the critical or non-critical nature of the services being performed. Accordingly, different risks and levels of liability may necessitate different considerations in the amount to which you may agree a supplier can limit its liability.

Similarly, the risk that the software or services provided by the supplier infringes another person's intellectual property rights, thus exposing you to a potential claim for infringement, are beyond your control. Therefore, there are usually no steps you can take to avoid such potential liability, both to the person claiming infringement and for damages incurred in addressing the claim, before the claim is made. It would usually be appropriate that a supplier's liability for breach of intellectual property rights should not be limited.

You will also need to consider the application of the Unfair Contract Terms Act 1977 (UCTA). Under UCTA, clauses that limit or exclude liability for negligence or for contractual liability (where, in the latter case, the limitation or exclusion is contained in the service provider's standard terms of business) are only enforceable if they meet the "requirement of reasonableness". This involves looking at all the circumstances that were or ought to have been known at the date of the contract, and at factors such as bargaining strength, inducements and alternatives available to the customer.

The application of the UCTA is such that an exclusion clause may be rendered completely ineffective if it does not satisfy the "requirement of reasonableness". The Courts will not re-write the clause by increasing the limitation to an amount they regard as being reasonable. Guidelines for the application of the reasonableness test are included in the Schedule 2 of the UCTA. The burden of proving that a clause is reasonable falls upon the party seeking to rely on the clause.

UCTA applies to all consumer contracts and to business contracts made on the supplier's/service provider' standard terms (and where contracts purport to exclude or limit liability for negligence). However, it has to be said that Judges seem very relaxed about overcoming this hurdle and it is extremely hard to argue that UCTA (or some equivalent common law test) does not apply. You should therefore consider the UCTA even in situations where the IT contract has been heavily negotiated. Previous cases have established that:

- lengthy negotiation of a standard contract resulting in additional terms; and
- adding exclusions from another agreement to a supplier's standard form and using some of the customer's own preferred terms,

does not necessarily stop a contract being "standard".

Exclusion and limitation of liability clauses in contracts often require the most negotiation. Those negotiations should be carried out in the context of having considered your potential liability under the contract and the degree to which that risk of liability may be addressed through recourse against the supplier. (As discussed below, you may take other measures to address the risks of the transaction such as insurance.)

#### **4.4 Insurance**

One way of managing possible risks is through insurance. It may be appropriate to require the supplier to maintain specific insurance policies in specified minimum amounts.

Your business is likely to have internal policies concerning the requirements for insurance on particular projects. These should be consulted and adhered to for each project.

#### **4.5 Confidentiality**

A supplier is often likely to be given confidential information of your business. Therefore, confidentiality undertakings need to be given by the supplier.

The type or size of the project may require more strict confidentiality controls such as requiring the supplier to obtain written confidentiality undertakings from employees and or subcontractors.

## **5. SOFTWARE LICENCE AGREEMENTS**

### **5.1 Introduction**

At its most basic level, a software licence agreement is simply a permission or grant of a right to do an act in relation to software which would otherwise be unlawful. Under a licence, ownership of the intellectual property rights in the software remains with the owner, and the uses that the customer can make of the software will be determined by (and are dependent on) the terms of the licence. For a supplier, an effective software licence enables the supplier to control (from a legal perspective) a persons' use of that software and therefore to protect the supplier's interests, including its ability to commercially exploit the software. For a customer, a software licence serves to clarify the extent of rights being granted to it, the exact nature of the software being licensed, and the extent to which the supplier is prepared to "stand behind" the software (for example, through warranties).

A software licence agreement may also address installation of the software and support and maintenance. As both of these are in the nature of "services", these issues are addressed under Section 6 on IT services agreements.

### **5.2 What product is being licensed?**

The contract must specify the software to be licensed to you. The contract will be in terms of the licensor licensing a particular "product". Whilst in a few circumstances it may be sufficient for the contract simply to name that product without any more detail, it is important that the contract includes a precise specification for the product. Many of the terms of the contract, discussed below, will be designed to hold the licensor to the promises it makes about the product in the specification. So it is important that:

- there is a specification; and
- the specification includes all of the functionality and other expectations you have of the product.

If the source code for the software is also to be supplied, this should be specified in the contract. This is addressed further below under the heading "Source code and escrow".

### **5.3 Scope of the licence**

The central part of a licence of software from a licensor is the rights granted to you. The main restrictions on the rights a licensor may grant are:

- exclusivity – the licence may be exclusive or non-exclusive;
- permitted use – is there a restriction on the number of users or units on which the software can be installed?; and
- territory – the rights may be granted for a particular area, including specific countries or the world.

#### *Exclusivity*

Under an exclusive licence, the licensee is given the right to use the software to the exclusion of all others (including the licensor). Under a non-exclusive license, the licensee does not have exclusive rights to use the software and the licensor still has the right to license the software to other persons and to use the software itself.

The most common situations where an exclusive license should be considered are:

- where you are acquiring a specific software package and you want to ensure you are the only party able to use that software; or

- in any project where you have software developed for it.

In most other situations, a non-exclusive licence would be sufficient. However, the issue needs to be carefully considered on a case by case basis.

#### *Permitted use*

Most software licences will be drafted in terms allowing you to “use” the software. This may not be sufficient for many of the purposes for which you require the software. For example, even if a licensor will provide support and maintenance services, you may need to do its own maintenance work on the software, and may need to modify that software to ensure it is compatible with your existing systems. Accordingly, in addition to the right to use the software, you may need the rights to “modify and adapt” the software to carry out such maintenance and modification work. This will also require having access and licences to source materials.

Depending on the specific needs of each situation, you may need other rights. This should be considered in each situation. You may want to consider having the right to sub-licence to:

- related bodies corporate, JV companies and other group companies; and/or
- third party service providers for the purpose of providing you services (for example, where you outsource a particular corporate function, which then necessitates the outsourcing provider using the software).

#### *Territory*

Where no territory is specified, you will usually have the right to use the software anywhere the parties had contemplated at the time of formation of the contract. Therefore, it is not usually harmful if the contract is silent on the question of territory.

However, where territory is specifically mentioned in the contract, you must ensure the territory is sufficient for its purposes. In most cases, the territory should be for the whole world.

## **5.4 Licence term**

The contract must specify how long the licence to use the software lasts. The term of the licence may vary from:

- one finite specified period (whether short or long); to
- a specified period plus the right to exercise options to extend for longer periods; to
- a perpetual licence (i.e. forever, but refer to commentary under the heading “Termination for breach” below for an explanation of why the term perpetual may be a slight misnomer); to
- an unspecified period.

If a software licence contract does not specify the term of the grant of rights, many uncertainties arise raising problems for interpretation later, such as:

- can the licensor terminate the licence at a particular point in the future and does that timing suit the licensee?; and
- for how long are licence fees payable?

Therefore, every software licence contract should have a *specified* term, or be perpetual.

You will need to ensure that the term of the contract corresponds with its needs. For example, if you need the right to use the software for at least three years, the term should be at least three years. If you are not certain if you want to commit to a long term licence without first trying the software to see if it is suitable, consider having an initial term of, for example, 1 year with an option to extend the licence for further periods at the end of the initial term. Care needs to be taken in drafting options to ensure they are enforceable and do not merely constitute an “agreement to agree” (as the later are not enforceable).

## 5.5 Warranties and indemnities

The main issues that need to be warranted by a licensor to you concerning the software to be licensed are in relation to:

- intellectual property warranties and indemnities; and
- the proper functionality of the software.

### *Intellectual property*

The licensor may own all of the intellectual property rights in the software or the licensor may itself be licensed to grant the licence to you. In either case, it is important that the licensor gives a warranty that it has all of the rights necessary to grant the licence to you.

Together with the warranty that the licensor has the necessary rights, a warranty should also be given by the licensor that use of the software by you in accordance with the contract will not infringe the intellectual property rights of any person. If at some point in the future a third party claims that the licensor’s product infringes the third party’s intellectual property rights, that third party could also extend their claim to you, claiming that by using the product you have also infringed the third party’s rights.

Any such claim by a third party would have two major consequences for you:

- you may have to stop using the product until the dispute is resolved, thus depriving you of the product and perhaps incurring additional costs in finding a replacement; and
- you would incur costs (primarily legal costs) and perhaps damage (for example, a settlement payment or court award) in defending or disposing of the claim.

Therefore, these two warranties should also be accompanied by remedy and indemnity provisions. That is, there must be provisions in the contract requiring the licensor, in the event of a claim that a person’s intellectual property rights have been infringed, to:

- immediately, either:
  - modify the product so it no longer infringes the rights of the third party; or
  - replace the product with a non-infringing product that performs the same functions; and
- indemnify you against all costs and damages it may incur as a result of the claim.

### *Functionality of the software*

There should be a warranty that the software will perform in accordance with the specification for the software. This raises the importance of the specification being as detailed as possible and including all the functionality and other expectations you have of how the software will perform.

Licensors will often want to limit such a warranty to a period of time such as 90 days after installation of the software. Before agreeing to any such limitation, you should consider whether any limitation in time is appropriate and, if so, how long is appropriate. For

example, it may take up to 6 months of using the software before you can be reasonably sure that it performs all the required functions. In such a case, the period of the warranty should not be less than 6 months so that you have recourse against the licensor under the warranty.

## 5.6 Termination

There are three common circumstances in which the parties may contemplate terminating a software licence agreement:

- without cause;
- for breach by the other party; or
- insolvency of the other party.

### *Termination without cause*

In deciding the rights and consequences of termination, the important point is that termination of the licence means the end of your rights to use the software. Termination may require you to replace the software or find other ways of performing the functions the software performed.

For example, a licensor will often seek to have the right to terminate the licence without cause by giving a period of notice, such as 90 days. It will depend on the software and the circumstances as to whether you could replace the software within that timeframe or whether it needs a longer period, or whether there should be no such right for the licensor to terminate without cause.

You may want to retain the right to terminate without cause after giving a period of notice. This would, for example, allow you to terminate the licence if an alternative better or cheaper product becomes available that you would prefer to licence.

### *Termination for breach*

You should always have the right to terminate for breach by the licensor. You will need to ensure that in the case of a perpetual licence, the licence is expressed to survive termination (otherwise your rights to use the software would also terminate with the licence agreement).

### *Termination for insolvency*

Whilst a clause allowing either party to terminate on insolvency of the other is usually drafted in mutual terms, the primary concern is insolvency of the licensor. In such a situation you should have the right to terminate.

## 5.7 Source code and escrow

In some circumstances, it may be appropriate for the licensor to supply the source code for the software to you at the time of supplying the software. In those circumstances, the contract should also provide for the licensor to provide you with updates of the source code over the term of the licence.

Even where the source code is not provided by the licensor with the software, there may still be times when you require access to the source code. For example, if the licensor is also providing support and maintenance services for the software and either, fails to perform those services or becomes insolvent, you will require the source code to perform the maintenance work itself. In such a case you may need to consider whether separate provisions should be included (or a separate escrow contract entered into) providing for up

to date source materials to be held in escrow to be released on the happening of certain events including:

- the licensor’s failure to perform support and maintenance services; and
- an insolvency event in relation to the licensor.

Whilst these provisions would be most appropriately included in a support and maintenance contract or a separate escrow agreement rather than the licence agreement, they should at least be considered in the context of the licence agreement, and, if included in other agreements, cross referenced in the licence agreement.

## 5.8 Updates and new releases

Most software is developed and improved over time. You may want to ensure that you have a right to receive updates or new releases of the software over the term of the licence. In any case, it is important to agree what ‘updates’ and ‘releases’ mean, because there is no industry standard. Different suppliers use the same term to mean different things. For example:

<b>Upgrade</b> eg WIN 3.1 to WIN 3.2	An upgrade is a minor enhancement or bug fix to an existing product which is typically covered by the software maintenance. Code functionality remains largely unchanged.
<b>New version</b> eg WIN 95 to WIN 99	A new version is a substantial upgrade with major new functions and enhancements. The supplier's commitment to provide new software may be covered by the software maintenance agreement.
<b>New release</b> eg WIN XP to WINDOWS VISTA	A complete redesign of the existing product which involves a substantial change in functionality. Often issued in association with a name change.

## 5.9 Modifications by you

If you make modifications to the software (as discussed under the heading “Scope of the licence” above, the appropriate rights would need to be granted to you for this to be allowed), then the issue arises as to who owns the intellectual property rights in the modifications. The position needs to be set out clearly. You should also clarify your right to make such modifications.

## 5.10 Fees and payment

The fees and structure for payment should be clarified. Often for a software licence, the fees will be payable annually in advance for the term of the licence. However, there may be reasons for the payment terms to be different. For example, if the software requires testing after installation, it may be appropriate to delay paying all or some of the amount due to the licensor until the software has passed acceptance tests.

The contract should also be clear about whether the price is inclusive or exclusive of VAT.

## 5.11 Sublicensing

You may need the right to grant a sublicense to others to use, adapt and/or modify the software. There may be clear instances where you need to give a direct sublicense of software to another party.

However, it may not always be so readily apparent that sublicense rights are required. For example, where you retain an independent person to maintain or modify the software, that

independent person will need a sublicense of rights from you. Therefore, the contract with the licensor will need to include a provision to this effect.

## **6. IT SERVICES AGREEMENTS**

### **6.1 Introduction**

Most businesses frequently enter into contracts with IT service providers. The contracts may be called Services Agreements, Consultancy Agreements, IT Contractor Agreements or a range of other names and they may address the provision of any type of services including:

- IT advice and consultancy;
- installation and integration of systems;
- system/software support and maintenance; or
- software/system development.

Whilst every contract will have some specific clauses depending on the services being supplied, the important and central point of each of these transactions is that the service provider is providing IT related services of some description to you. All such services contracts, therefore, have some common considerations and common clauses.

### **6.2 What services are to be provided?**

The central part of a services contract is the description of the services to be provided. The contract will require the service provider to provide the particular services. Those services should be described in detail in a services specification. It is important that the specification includes as much detail as possible on the services you expect to receive. It should address all issues relevant to the services including:

- a precise description of the services to be provided;
- the time frames and deadlines for performance of the services;
- the service levels to be achieved.

As with a software licence agreement, many of the terms of a services contract will relate back to the services specification and will be designed to hold the service provider to the parties' expectations about the services to be provided.

### **6.3 Term**

It is important to ensure that the term of the services contract corresponds with your other requirements and contracts.

For example, where you acquire a system accompanied by support and maintenance under a separate contract, there may be an initial warranty period for the system during which period no support and maintenance fees are payable. In these circumstances it is important to specify in any support and maintenance contract that the support and maintenance services commence from a particular time, such as signing of the contract, but no payment is required until the expiration of the warranty.

### **6.4 Intellectual property**

Many service providers will, either as the central part of their contract or as a necessary adjunct to their primary services, develop materials for you in which intellectual property rights may subsist. Intellectual property rights may subsist in, for example, bespoke software developed for you, modifications to or customisations of existing software required for maintenance or installation purposes, and consultancy reports.

In most circumstances, you are likely to require an assignment of the intellectual property rights developed by the service provider. This should always be the case when the service provider is retained to perform specific development services. To obtain this assignment of intellectual property rights, there must be a specific clause in the contract. An assignment is not affected merely by paying the service provider.

The assignment does not usually have to extend to the service provider's underlying "tool kit" or "background know-how", only the materials created by the service provider in performing the services for you.

There may be some circumstances in which you only require a licence of the material developed by a service provider. This needs to be considered on a case by case basis.

## **6.5 Warranties and indemnities**

The main issues that need to be warranted by a service provider to you under a services contract are in relation to:

- intellectual property; and
- the proper and timely performance of the services.

### *Intellectual property*

A services contract should include the intellectual property warranties and indemnities discussed above in relation to a software licence agreement. Those warranties should be extended so that the service provider warrants that:

- it has all the rights necessary to make the assignment of intellectual property required under the contract; and
- in performing the services, it will not infringe the intellectual property rights of any other person.

The indemnities should be extended to cover any loss or damage that you may incur as a result of any claims that:

- the service provider infringes any intellectual property rights in performing the services; or
- the materials the service provider supplies to you in performing the services infringe the intellectual property rights of any person.

### *Services*

We expect that it is important that you have control over the proper and timely performance of the services by the service provider. Those obligations should be reflected in appropriate contractual clauses. Therefore, the service provider should warrant that it will provide the services in accordance with and within the timeframes contained in the services specification (hence the importance of ensuring the services specification includes all of the details you require).

As detailed as the services specification is, there will be some general matters that will not be addressed in the services specification. These should be reflected in a more general warranty to the effect that the service provider warrants that the services will be supplied with due care and skill.

## **6.6 Key personnel**

Although most services contracts will be with companies as the service provider, you may in fact be reliant on particular key individuals from that contracted company to supply the services. If key people are vital to perform the services, there should be a clause in the contract to ensure that those key people are retained by the service provider for the project.

## **6.7 Termination**

If the services to be provided are of a finite nature (for example, for a specific project), the services contract should terminate when the services (including any warranty period) are completed.

As with a software licence, whether or not the service provider should be allowed to terminate the contract without cause needs to be considered in light of whether or not you can find an alternate service provider - if so, in what timeframe.

Also, as with a software licence agreement, you should have the right to terminate if the service provider is in breach or if the service provider is subject to an insolvency event.

## **6.8 Liquidated damages and security**

If a service provider fails to perform the services either satisfactorily or on time (both are issues which should be spelt out in the services specification), the right to terminate may not be a commercially appropriate remedy for you. If a service provider fails to perform, you are likely to suffer some monetary damage as a result. However, the most important priority is likely to be the proper and timely performance of the services.

Particularly on single major projects, you may be able to calculate what its loss is likely to be if a service provider causes a project to be late. For example, you may require personnel to be retained longer than expected, costing an amount that may be known at the time of entering the contract. Accordingly, it may be appropriate to include a requirement in the contract that if the service provider fails to meet certain key dates, it will be liable for liquidated damages in a specified amount. The amount needs to be calculated as a genuine pre-estimate of the loss and damage you are likely to suffer as a result of the service provider's delay.

Such a clause can be powerful in later negotiations if for some reason the service provider causes delays to a project. However, it is important that the amount is truly a genuine pre-estimate of loss rather than a "penalty". The Courts will not enforce a penalty.

Again, depending on the type and size of the project, it may be appropriate for you to manage the risk of a service provider causing loss and damage by obtaining from the service provider an amount paid on signing of the contract to be held as a security deposit. That amount would be able to be utilised by you if the service provider causes loss to you or returned to the service provider at the end of the contract.

## **6.9 Insurance**

The service provider should be required under the contract to take out and maintain appropriate insurance coverage, for example, professional indemnity insurance.

## **7. HARDWARE PURCHASE AGREEMENTS**

### **7.1 Introduction**

As the name implies, a hardware purchase agreement is an agreement which covers the purchase and supply of IT hardware.

### **7.2 What is to be delivered and when?**

It is important that a complete and accurate specification of the equipment to be supplied by the supplier is included as part of the contract. If the supplier is retained as part of a panel under a master contract, then each purchase order must include a specification for the equipment.

The contract should clearly state when the supplier must deliver the specified equipment. (It may then be necessary to address the installation of the equipment in a services contract with either the supplier of the equipment or any other party that will install the equipment.)

### **7.3 Testing**

Where the hardware is stand alone equipment, it may be possible to test the equipment prior to entering the contract. However, where for example, the proper functioning of the equipment is dependent on its compatibility with other equipment, it may be appropriate for you to test the equipment onsite after installation and to reject it if it fails to perform as required. If this is the case, the contract should include appropriate acceptance testing clauses. Such clauses would usually:

- require either you or the supplier to test the equipment in accordance with specified testing procedures; and
- require the supplier to rectify any defects or allow you to reject the equipment and obtain a refund.

### **7.4 Payment and title**

Ideally, payment for the equipment should be deferred until all of the equipment has been received and passed all acceptance tests. However, in practice, you are likely to have to negotiate on the basis of paying in instalments. It is important to consider the structure of those instalment payments against the background of exposure if the equipment fails, or the supplier becomes insolvent.

As mentioned previously, one approach in negotiating instalment payments could be that the majority, or at least a significant part, of the price should not be paid until the equipment is installed and accepted. In this context, it may assist negotiations to separate the hardware purchase contract from the installation services contract. That is, the supplier can be paid amounts for installation services while those services are carried out satisfactorily under the installation service contract, while payments for the equipment under the hardware purchase contract can be delayed until the equipment is accepted.

### **7.5 Insurance**

The risk of loss or damage to the equipment should be addressed by insurance. If the supplier is to deliver the equipment to you then the contract should specify that risk in the equipment passes when it is received by you at a specified location. If you are collecting the equipment, risk would normally be specified to pass at the time of collection.

The supplier should be required under the contract to take out and maintain the required insurance. Again, your requirements for insurance for particular projects must be observed and reflected in the contract.

## 7.6 Warranties

The same type of intellectual property warranties and indemnities as discussed in relation to software licence agreements should also appear in a hardware purchase contract. In the hardware purchase contract, the warranty should be in terms that the supplier warrants the equipment does not infringe the intellectual property rights of any person.

Also, like a software licence agreement, the supplier under a hardware purchase contract should provide a warranty that the equipment will conform to the specification for the equipment. If you agree to a request from a supplier that a time limit be set on that warranty, you should ensure that the time is sufficient to have tried and tested the equipment to determine whether there are any non-conformities. This may be one month, three months or three years depending on the equipment and your requirements for the particular project. (Normally, any maintenance services should be without charge during the warranty period. It is important to check that any maintenance and support contract is consistent with the timing of the warranty.)

If you require that the equipment to be supplied is new, this should be specified in the contract and the supplier should warrant that the equipment is new.

## 7.7 Spare parts

To ensure the proper maintenance and upkeep of the equipment, you may require a store of working spare parts to be kept either at your premises or another location. If so, the hardware purchase contract should include an obligation that the supplier keeps at all times the number of spare parts as specified by you.

## Contact Us

If you wish to discuss the content of this guide or any legal matters relating to IT contracts or outsourcing, please contact any of the following members of the Taylor Walton Technology and Outsourcing Group.



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*The information in this guide is not intended to constitute professional legal advice and should not be relied upon as such. Specialist legal advice should always be sought for your particular circumstances.*