UNIT 2:

On line Contracting, IP Law and other IT Contract Concepts
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Unit 2
On line Contracting, IP Law and other IT Contract Concepts

1. Introduction

This unit builds on the concepts covered in Unit 1. Unit 2 deals with the essential elements of contracting on-line. These issues include the way in which contracts can be entered into electronically, the current best practice for incorporating electronic terms and conditions and the way in which shrink-wrap, click-wrap and web-wrap agreements work. The Unit then provides an overview of Intellectual Property law concepts specifically related to software and technology services contracts so that the learner is aware of issues and legal protection available. This Unit provides a summary of the different types of procurement processes and discusses when each process should be used. It also discusses how parallel negotiations can be used to control the negotiations and secure a better deal for customers. Unit 2 concludes with a discussion on general concepts relevant for IT contracts, such as warranties, service levels, termination and assignment and novation.

Learning Outcomes

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2. Other Forms of Contracting

2.1 Introduction

In Unit 1 we covered the general contracting process. This section is intended to provide an overview of other forms of contracting, specifically “shrink wrap” licences and online contracting such as “click wrap”, “web wrap” and “browse wrap” agreements.

2.2 Shrink wrap licences

“Shrink-wrap” licences have become a common feature of software distribution. Under a shrink-wrap licence, a software vendor distributes software on CD-Rom or floppy disk that has been wrapped in shrink plastic (or its equivalent). The licence terms for the software usually state that the user accepts the licence terms and conditions by opening the shrink-wrapped package, by using the software, or by doing some other specified action.

There are different types of shrink-wrap arrangements. In some cases, the licence terms are on the outside of the package visible through the shrink-wrap. Notices on the packaging usually instruct the user to read the licence terms and conditions before opening the shrink-wrapped package. The user accepts the licence by breaking open the shrink-wrapped plastic. If the user does not want to accept the offer, he or she can usually return the (still shrink-wrapped) software for a refund.

In other shrink-wrap arrangements, the entire package, including the licence is wrapped in shrink-wrap plastic. The licence terms are sometimes printed on the envelope containing the CD-Rom or floppy disk, located inside the manual, or printed on a separate sheet. Sometimes there will be stickers or notices on the CD-Rom or floppy disk referring the user to the licence. The licence provides that by using the software or in some
cases opening the envelope containing the CD-Rom or disk, the user is accepting the licence terms. The licence agreement may also state that failure to return the software within a certain period constitutes assent to the licence terms.

In many purchases of shrink-wrapped software the purchase occurs before the customer has had a chance to read the licence. Accordingly, the first question that arises is whether a customer can be legally bound to the licence terms of which he or she was not aware of at the time the contract was formed. It is generally accepted that the transaction is complete and the contract formed when the vendor takes the customer's payment (in the case of vendor as offeree) or the customer accepts the vendor's offer by paying for the goods.

A second question arises when the software company is not the vendor: can the software company impose the licence terms when it is not a party to the sale contract? The doctrine of privity of contract can prevent third parties from being bound to or being able to enforce a contract between other parties (see Unit 1 on Privity).

There have not been any English cases determining whether shrink-wrap licences are enforceable, although they have been enforced in the United States and Europe. The overseas cases show that the enforceability of a shrink-wrap licence depends on the individual circumstances of each case and local law. The cases outlined below show that even in the United States a common approach to enforceability of shrink-wrap licences is still to be reached.

In the United States case ProCD Inc v Zeidenberg 86 F 3d 1447 (7th Cir 1996), the court found the shrink-wrap licence was valid (even though detailed licence terms were communicated after payment), in part because the software could not be used until the user viewed and accepted the licence terms that showed on the user's screen each time the program was run. In addition, every box containing the software stated that it came with restrictions in an enclosed licence.

The court found that ProCD had proposed a contract where the customer could accept by using the software after reading the licence terms (that is, in this case the vendor was the offeror and acceptance did not occur on payment) and stated that:

'A vendor, as master of the offer, may invite acceptance by conduct, and may propose limitations on the kind of conduct that
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constitutes acceptance. A buyer may accept by performing the acts the vendor proposes to treat as acceptance.

The court also stated that:

'Shrink-wrap licenses are enforceable unless their terms are objectionable on grounds applicable to contracts in general (for example, if they violate a rule of positive law, or if they are unconscionable)'

In another United States case, Hill v Gateway 2000 Inc 105 F 3d 1147 (7th Cir 1997), cert denied 522 US 808 (1997), Hill ordered a computer over the telephone, and the computer arrived in a box that contained licence terms. The licence terms were to govern unless the customer returned the computer within 30 days. The customer was not required to view or expressly assent to these terms before using the computer. Hill did not return the computer within 30 days. The court found that Gateway's supply of a computer was an offer and held that Gateway could invite acceptance by conduct. By keeping the computer for more than 30 days, Hill accepted the licence terms. However, in this case the court may have been influenced by the fact that Hill was seeking to take advantage of the warranty provision in the same licence that he claimed he had not accepted.

In Klocek v Gateway Inc 104 F Supp 2d 1332 (D Kan 2000), the court considered a similar shrink-wrap licence as in Hill v Gateway 2000 Inc. In the Klocek case the customer also ordered a computer over the telephone, but the court analysed the situation in a different way. (Gateway gave the customer 5 days to return the computer (instead of 30 days as in Hill v Gateway 2000 Inc)). The court considered that the customer was the offeror and the vendor accepted the offer by shipping the computer. Therefore, the contract for the sale of the computer was complete by the time the customer received the licence terms. Because the vendor had not made acceptance of the licence terms a condition of the customer's acceptance of the goods, the customer was not bound by them.

The United States cases discussed above did not address the issue of privity because the vendor was seeking to impose the licence terms.

Shrink-wrap issues were also considered in the Scottish case of Beta Computers (Europe) Ltd v Adobe Systems (Europe) Ltd [1996] FSR 367. Adobe ordered third-party software called Informix from Beta Computers by telephone. The terms and conditions of sale were not discussed. The shrink-wrapped
software contained a partially visible end-user licence, which stated that opening the package indicates acceptance of the licence terms and conditions. The main issue before the court was whether Adobe was entitled to return the still shrink-wrapped software to Beta for a refund. The court found in Adobe’s favour on the basis that there was no completed contract until licence terms stipulated by the software owner were tendered/accepted by parties to the contract. The customer was able to accept or reject the licence terms before becoming bound to the contract. The court also considered whether Informix could have enforced the licence against Adobe. Based on a principle of Scottish law, the court held that if Beta had accepted the licence terms by unwrapping the package, Informix could have enforced them directly against Adobe.

2.3 Are shrink wrap licences valid?

The decisions outlined above do not always sit with English principles of contract law. They do, however, highlight an area where contract law needs to evolve to deal with what has now become a common industry practice.

2.4 Improving the chances of enforceability

To improve the chances of being enforced by the courts, the shrink-wrap “mechanism” must allow the customer at least a minimum chance to analyse their purchase (it is clear that the original shrink-wrap concept is the poorest choice in this respect). The mechanism should allow the user access to the documentation to evaluate the program’s functionality and require some significant overt act by the user to signify acceptance of the agreement.

As mentioned, one currently popular method is to package the program disks sealed inside of an envelope. The license agreement is either positioned prominently inside the manual, on a separate license sheet or on the envelope containing the program disks. The disk envelope is sealed with a label which reads something like this: “By Opening This Envelope You Are Accepting the Terms of the License.”

In addition, some software owners display a screen the first time a package is launched instructing the user to read the license. This scheme is clearly an improvement over the original shrink-wrap concept since it allows the user a chance to review the program’s documentation before accepting the license agreement.

Another scheme implemented by some software companies involves a “key” used to activate the software, a password
which is sealed inside of a separate envelope from the program
disks (the key is also a useful form of copy protection). The
program is modified to allow only limited use prior to the
entering of the key. When the user reaches the software’s
transaction limit they are prompted to enter the password. The
envelope and the software indicate that the entering of the key
(or just the opening of its envelope) constitutes acceptance of
the terms of the license.

This mechanism would seem to present a much fairer chance
for the user to evaluate the software before deciding whether
or not to accept the license agreement, thus, increasing
the chances that a court will interpret it as an equitable
arrangement. However, this arrangement might leave the
software company exposed to possible liability, since the user
can actually load and use the software before they accept the
agreement. Should a problem occur, the software company
might not be able to protect itself by asserting the limitations
of liability and warranties contained in the license since by the
software company’s own admissions, it would not yet be in
effect.

In light of this analysis, how should a prudent software company
structure their license agreements? Although there are no hard
and fast answers, what does seem clear is that the user should
have an opportunity to review the software’s documentation
prior to accepting the license agreement, but should not be
able to run the software without accepting the license. The
user must also be given the option of returning the software
for a full refund should they decide not to accept the license.
The availability of this option makes it clear that the acceptance
of the license is a voluntary act and not one of adhesion.

Returning the software should not be a difficult task for the
user, and software distributors should be instructed to accept,
for full refund, any software without explanation (or hassle) as
long as the seal on the software’s envelope is not broken.

One last consideration would be to insist that the user sign
the registration card to signify their acceptance of the license.
Registration cards provide an opportunity to have the customer
actually sign a document which indicates their acceptance of
the license agreement. However, it is obvious that this system
cannot be primarily relied upon since many users never return
registration cards. Therefore, registration cards should be
viewed as a back-up to a shrink-wrap license. Since it is in the
software owner’s interest that users sign and return those
cards, they should be given some inducement to return them,
such as a free update to the software, a t-shirt or some other
incentive.
Task 1
Assume you are acting for a software company who is intending to supply software to users via a “shrink wrap” licence. How would you advise your client in relation to improving their chances that the shrink-wrap licence is valid?

2.5 Click-wrap, web-wrap and browse-wrap agreements

In essence these type of agreements work in exactly the same way as a shrink-wrap licence. Before the contract is made, a potential customer is taken through the terms and conditions which he can either accept or decline by clicking on the relevant acceptance button. The courts in the United States have held this type of agreement to be enforceable in the decision in *Hotmail Corporation v Van Money Pie 1998 WL 388389, 1 (ND Cal.)*. Hotmail offers an online email service. This is a free service which is subject to various authorised use conditions. In particular, Hotmail prohibits the use of the Hotmail account for spamming. Hotmail can be accessed only if the account is set up online and Hotmail’s terms are accepted by clicking on the accept button. Van Money Pie opened up an account by clicking on the accept button and then used its Hotmail account to send unsolicited commercial email. Hotmail was successful in its claim against Van Money Pie for breaching its terms and conditions and the case shows the court’s willingness to accept the validity of click-wrap agreements.

If a business simply has a statement on its website that terms and conditions are available upon request, then this will not be sufficient to incorporate those terms into any agreement which is entered into online as the potential customer will not have had an opportunity to receive the terms before placing an order. Until recently, some people argued that a hypertext link to the terms and conditions which the potential customer may follow was sufficient. This led to the use of “browse-wrap” agreements. A “browse-wrap” agreement involves the supplier placing its terms and conditions on its website and then permitting its potential customers access to those terms and conditions via a hypertext link. This approach is seen to have the least interference with the purchasing process.

In 2001 the US Southern District New York Federal court ruled on a preliminary issue in the case of *Sprecht and others v Netscape and AOL (2001 WL 755396, 150 F. Supp. 2d 585)*. The validity of the license agreement was questioned following challenges to the use of a tracking device, which was incorporated into the SmartDownload software to monitor users’ online activities. Netscape removed the tracking device but argued that the license agreement obliged any users, who
had complained about it, to participate in an arbitration process rather than filing a suit in the courts. The court held that a mere reference to a license agreement purporting to bind users downloading free software did not create an enforceable contract. The statement inviting users to review the terms of a license agreement appeared on the Netscape web page when users went to download its SmartDownload software.

The Judge in the case ruled that because there was simply an opportunity to read the terms and conditions and the users attention was not clearly drawn towards reading them, they did not form the basis for a binding contract. Moreover, the user was not required to give express consent to the agreement and so could not be shown to have agreed to its terms. One way of managing this issue is place a tick box next to the hypertext link to the terms and conditions. The customer will be required to check the tick box before proceeding to place an order to indicate that it has accepted the vendor’s terms and conditions. This method can be used to demonstrate the customer’s agreement to the terms (see Example 1). However, the safest way to ensure that terms and conditions set out on a website are fully incorporated is to use a “web-wrap” agreement.

Example 1
Use of a tick box to incorporate standard terms and conditions

☐ Tick this box if you accept our terms and conditions

A “web-wrap” agreement works in exactly the same way as a click-wrap licence. Before the contract is made, a potential customer is taken through the terms and conditions in a dialogue box and has the opportunity to either accept or decline the terms by clicking on the relevant acceptance button.

2.6 Regulation of electronic contracts - Consumer Protection (Contracts concluded by means of Distance Communication) Regulations 2000


The DSRs provide additional protection to consumers who are purchasing goods or services at a distance, which means that
the customer and the supplier are not both physically present when the contract is entered into.

The DSRs apply when a consumer enters into a “distance contract”, which is defined in Regulation 3 as being

“any contract concerning goods or services concluded between a supplier and a consumer under an organised distance sales or service provision scheme run by the supplier who, for the purpose of the contract, makes exclusive use of one or more means of distance communication up to and including the moment at which the contract is concluded.”

The DSRs define a “means of distance communication” as “any means which, without the simultaneous physical presence of the supplier and the consumer, may be used for the conclusion of a contract between those parties”.

The DSRs apply to all distance contracts other than those categorised as “excepted contracts” which are defined in the DSR’s

**Task 2**
Access a copy of the Consumer Protection (Contracts concluded by means of Distance Communication) Regulations. You can access, using the search function a copy from the Office of Public Sector Information (http://www.opsi.gov.uk/acts.htm). Identify the section and list the “excepted contracts”.

2.7 Prior information

Regulation 7(1) of the DSRs provide that consumers must be provided with certain information before they enter into a distance contract. The information to be provided is as follows:

(a) full details of the name and address of the supplier;
(b) a description of the main characteristics of the goods or services:
(c) the price of the goods or services including all taxes:
(d) the delivery costs:
(e) the arrangements for payment, delivery or performance:
(f) the existence of a right of cancellation:
(g) the period for which the offer or price remains valid; and
(h) where appropriate the minimum duration of the contract.

The information must be provided in a “clear and comprehensible manner appropriate to the means of distance communication used”. There is no requirement for the
information to be given in writing. The first of these elements is an offer. An offer is a statement made by a person wishing to enter into a contract, by which he or she shows a willingness to enter into a binding contract. The person making an offer is known as the “offeror” and the person to whom the offer is addressed is known as the “offeree” (Regulation 7(2)).

2.8 Written confirmation and extra information

The DSRs provide that the information to be provided under Regulation 7(1) and certain other information must be provided to the consumer either before the formation of the contract or in good time thereafter during the performance of the contract and at the very latest at the time of delivery of the goods to the consumer. The information must be provided in writing or in another durable medium. This will include the provision of the information by email.

The information to be provided under Regulation 8 (2) must include:

(a) the information to be provided in accordance with Regulation 7 (1);

(b) information concerning the right to cancel under Regulation 10, including information about returning any goods and who is responsible for cost of returning them and information as to how the right to cancel may be affected by the consumer agreeing to performance of the services;

(c) geographical address for complaints;

(d) details of any after-sales service or guarantees; and

(e) any conditions for exercising a contractual right to terminate the contract if it is of an unspecified duration or exceeds one year.

Following a consultation on proposed changes to the DSRs undertaken by the Department of Trade and Industry in early 2004, the DSRs were amended with effect from 6 April 2005.

The key change affected the way in which the cancellation right in relation to a contract for services operates under the DSRs. As originally drafted, a consumer lost the right to cancel a contract if “the performance of the services has begun with his agreement” provided that the consumer had been told that this was the case in writing or other durable form prior to the conclusion of the contract in question. This caused concern in relation to contracts entered into by telephone as a written notice could not be given prior to the conclusion of the contract which was made over the telephone. The example given in the consultation related to vehicle hire.
In essence, the obligation to provide information in relation to the right of cancellation under Regulation 8 of the DSRs has been clarified. The original regulation 8(3), which required the notice to be in writing has been repealed. The DSRs have been amended so that the obligation to provide such information has been added to the list of information to be provided in accordance with the provisions of Regulation 8(2). It is no longer a prerequisite that information regarding the consumer losing his or her right of cancellation must be given in writing prior to the conclusion of the contract in question. The obligation imposed on a supplier is that at the time that the consumer enters into a contract for the provision of services, the consumer must be advised that if the services are commenced with his consent during the cancellation period then the consumer’s rights of cancellation will be lost.

As a consequence of the amendments to Regulation 8, the period during which the right of cancellation runs has also been amended. A new Regulation 12(3)A has been inserted into the DSRs which provides that where information in Regulation 8 has not been provided then the cancellation period will be a period of seven days from the date that the information was given to the consumer or if shorter until the performance of the contract in question has been completed.

2.9 Right of Cancellation

The right of cancellation granted to consumers is covered by Regulations 10-13. Once a distance contract has been entered into and the consumer has been provided with the information required by Regulation 8(2), the consumer has a period of 7 working days after the goods have been delivered within which to return them or within which to cancel the contract for services. The period of 7 working days will run from the date on which the consumer receives the information required to be provided under regulation 8(2) or at the latest from the date which is 30 days after the date on which the contract is concluded (see Regulations 11 and 12).

The effect of cancellation is that the contract shall be treated as if it had never been made. This means that there is no cost to the consumer, other than the actual cost of returning the goods in certain circumstances. Any credit agreement entered into by the consumer is cancelled at no cost to the consumer.

Regulation 13 sets out the following exceptions to the right of cancellation in relation to distance contracts:

(a) for the supply of services if the performance of the contract has begun with the consumer’s agreement:
(i) before the end of the cancellation period applicable under regulation 12(2); and

(ii) after the supplier has provided the information referred to in regulation 8(2);

(b) for the supply of goods or services the price of which is dependent on fluctuations in the financial market which cannot be controlled by the supplier;

(c) for the supply of goods made to the consumer’s specifications or clearly personalised or which by reason of their nature cannot be returned or are liable to deteriorate or expire rapidly;

(d) for the supply of audio or video recordings or computer software if they are unsealed by the consumer;

(e) for the supply of newspapers, periodicals or magazines; or

(f) for gaming, betting or lottery services.

In March 2005 the European Court of Justice pronounced judgment in the case of easyCar (UK) Limited v Office of Fair Trading (Case C-336/03) [2005] All ER (D) 175 (Mar). easy Car is a car hire company which enters into agreements with its customers over the internet. The price of hiring a car is determined by supply and demand. As fewer cars remain available, the price of hire goes up. In theory, the earlier that a customer hires a vehicle the cheaper the price.

There had been a number of complaints to the Office of Fair Trading that easyCar did not comply with its obligations under the DSRs. easyCar applied to the High Court for a declaration that its rental agreements were exempt from the cancellation rights granted under Regulations 10 and 12 on the basis that car hire contracts fell within the exception of “contracts for the provision of transport services”. The Office of Fair Trading then sought an order to make easyCar comply with the provisions of the DSRs. There was no dispute as to the fact that the car hire contracts in question constituted “distance contracts” for the purposes of the DSRs nor that there was a provision of services within the meaning of the DSRs. The matter was referred to the European Court of Justice for determination.

The European Court of Justice decided that the term “transport services” should be treated as a sectorial exemption. Accordingly, the exemption applied to services which were generally available in the transport sector. In the court’s view, the exemption within the Directive was intended to cover all services provided within the transport sector and not merely some forms of agreement relating to specific transport services.
Regulation 6 provides that “Regulations 7 to 20 shall not apply to … contracts for the provision of … transport… services where the service provider undertakes, when the contract is concluded, to provide these services on a specific date or within a specific period”. The wording of Regulation 6 is in effect the same wording as that in Article 3 of the Distance Selling Directive (the “Directive”). If it had been the intention that the cancellation rights were to apply to contracts in respect of transport services, then there would have been explicit provisions dealing with the contracts in question. Whilst the Directive had been adopted with a view to protecting consumers’ interests, the purpose of Article 3 of the Directive (Regulation 6 transposes Article 3 into English law) of the Directive was to ensure that service providers in certain sectors were not disproportionately affected by the application of any regulations made under the Directive. In the court’s opinion, car hire undertakings constituted an activity which the Directive had intended to exempt from the application of the Directive.

By contrast, online car dealers are caught by the DSRs. In May 2005 the Office of Fair Trading (“OFT”) issued guidance on compliance with the Distance Selling Regulations in relation to cars and other vehicles sold by distance means Cars and Other Vehicles Sold by Distance Means Guidance on Compliance May 2005 (OFT689).

In the past a distinction had been made between selling brand new cars and used cars. The argument was that a brand new car required the customer to choose not only the model and make, but also the colour of the vehicle and various other optional extras. The motor industry had argued that this amounted to customisation of the car and as such was outside the scope of the DSRs (Regulation 13(1)(c)). Not so, according to the Guidance published by the OFT. Merely selecting optional extras from a list of standard options did not amount to customisation. In order to be taken outside of the scope of the DSRs, something far more imaginative is necessary.

The same regulation also provides an exception for goods that deteriorate quickly (Regulation 13(1)(c)). The OFT made it clear that this related to the physical deterioration of the goods and not just the loss of financial value. The fact that a car has been sold and registered to a new user does not amount to any deterioration in the goods even though there is a marked decrease in the value of the vehicle.

However, the consumer is under an obligation to take reasonable care of the vehicle. The OFT made it clear that it would be unlikely to object to suppliers pointing out to a consumer what they considered to be reasonable care by suggesting an acceptable mileage limit. However, if consumers
did not follow such guidance, it would be a question of fact as to whether they had taken reasonable care. Any excess mileage in itself would not take away a consumer’s statutory right to cancel.

**Task 3**
Access and print out a copy of OFT’s Guidance on Compliance in relation to Cars and Other Vehicles Sold by Distance Means (available from [http://www.oft.gov.uk](http://www.oft.gov.uk)). Review the document as it will be useful for answering one of the questions in Assignment 1.

### 3. Overview of IP Law

#### 3.1 Introduction

Intellectual Property (IP) and Intellectual Property Rights (IPR) refer to the rights and property that can arise or be acquired from intellectual creations (i.e. creations of the mind such as musical, literary, and artistic works; inventions; and symbols, names, images, and designs). The first recorded forms of IP existed right back in the 15th century and the laws and systems have evolved over time to those in existence today.

This section is intended to provide a background and some basic guidance on IP, identifying protection available and potential issues. It should not be considered a substitute for a detailed course on IP.

IPRs are national rights and are defined by national laws. This section focuses on UK law and practice, although many of the principles are common throughout the world, particularly in respect of Europe. Key non-UK law and practice is identified.

#### 3.2 Non-registrable and registrable rights

There are two types of IPRs i.e. those that subsist automatically (non-registrable) and those that require registration in order to subsist. The table below illustrates this division:

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<td>Database rights</td>
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<td>Unregistered Trade Marks</td>
<td>Registered Designs</td>
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<tr>
<td>Unregistered Design Right</td>
<td>Confidential Information</td>
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In relation to software and technology services contracts, copyright, database rights, confidential information and patents
are the most relevant. These various rights are discussed in the following sections (except for confidential information, which was discussed in Unit 1).

3.3 IP systems

In most countries, IP law is implemented in a 2 tier system. A national patent/IP office is responsible for accepting, processing and granting patent, trade mark and registered design applications whilst the courts of that country provide a forum for IPR infringement to be enforced and for IPR validity to be contested.

With a handful of exceptions that will be discussed in their relevant sections, IP rights are national rights and must be secured and enforced in their respective nation.

4. Copyright

4.1 Background

Copyright automatically protects original works. Copyright protection extends over a wide range of artistic and business-related fields: books and other literary works, plays, paintings, music, sculptures, broadcasts and photography etc. An important point to note is that copyright does not protect an idea - it simply protects the particular way in which the idea is expressed. Where the text of a short story, say, is protected by copyright, it is not an infringement to write a story with the same “twist” provided different words are used.

The scholars of Ancient Greece and the Roman Empire were the first to be concerned about being recognised for their works. However, control over works was not a great issue in view of the limited number of people able to read and write at that time.

The invention of the printing press in the fifteenth century resulted in the ability to print books easily and cheaply and raised the issue of piracy. Major changes in the availability of works required a form of copyright protection. As the number of printers increased in England, the King exercised the royal prerogative to regulate the book trade and protect printers against piracy. This was the first of many decrees to control what was being printed and was probably the first form of copyright in the UK.

For a number of years, this form of “copyright” was primarily used to seize books suspected of containing matters hostile to the Church or Government. The 1709 Statute of Anne was
the first UK Act of Parliament relating to copyright in which books and other writings gained protection. It defined an author as the owner of copyright and provided a fixed term of protection for published works.

Copyright law in the UK is set out in the Copyright, Designs and Patents Act 1988. However, this has been amended numerous times by various other Acts of Parliament (many of which enact EU Regulations in the area). If referring to specific provisions, care should be taken to ensure the text relied upon is up to date.

4.2 Works protected

Copyright is a property right that protects original literary, dramatic, musical and artistic works, published editions of works, sound recordings, films and broadcasts.

Computer programs, their preparatory materials and databases are treated as literary works. Copyright protection also covers operating manuals, instruction booklets and publicity material. No registration procedures are required, but your clients should be advised to keep carefully signed and dated evidence of original work.

Copyright protection in the UK exists (also referred to as subsists) automatically if the work has been “fixed” in some manner. Normally, a work must physically exist, even if encoded on a computer readable medium, for copyright to subsist.

To have copyright, works must all be original. This simply means, for most purposes, that a work must be the product of the skill, effort and labour of its author and not copied from another preceding work. “Originality” does not impose any other standards of quality or creativity. There are special rules here for database copyright. A database is original if, and only if, by reason of the selection or arrangement of the contents of the database the database constitutes the author’s own intellectual creation. So for example an alphabetical listing of names would not in itself be an original structure for a database, since the author did not create the alphabet (although an original arrangement or selection within the alphabet may be). The standard is generally taken as slightly more demanding than ordinary “originality”. (There is no requirement of originality in the special, sui generis database right - see under the heading “Database Rights”).

Generally, there is no copyright in a name, title, slogan or phrase, although these may be eligible for registration as
trade marks. Similarly, copyright cannot protect an idea, it may protect the work that expresses an idea but not the idea behind it.

Although some countries require that copyright works are marked with the international © mark, followed by the name of the copyright owner and year of publication, this is not essential in the UK or most other European countries. However, it is advisable to mark the copyright work to deter copying.

As a form of intellectual property, copyright can be bought, sold or otherwise transferred. Copyright owners can choose to license others to use their works whilst retaining ownership over the rights themselves.

4.3 Protection provided

The copyright owner has the right of preventing others from:

(a) copying the work;
(b) issuing copies to the public;
(c) performing, showing or playing the work in public;
(d) broadcasting the work or including it in a cable program;
(e) make an adaptation of the work;
(f) importing, possessing, selling, exhibiting or distributing an infringing copy; and
(g) dealing with items or providing premises used for making infringing copies

For the last two acts, knowledge or reason to believe that the copies are infringements is usually necessary. Shutting ones eyes to the obvious is not enough to avoid infringement. Infringement is in respect of a whole or a substantial part of a work.

For most purposes, copyright lasts for the life of the author plus seventy years. For qualifying articles such as artistic works which are industrially produced, protection lasts 25 years. (This avoids anomalies with regard to articles protected by Registered Design). These terms only apply to work originating in the UK or another state of the European Union. In all other cases the term of protection is that granted by the country of origin of the work.

Copyright exists irrespective of the medium on which it is recorded. For example, buying a copy of a book or CD only gives you ownership of the medium (in the case of the book, the paper and in the case of a CD, the CD itself). However,
buying a book or CD does not necessarily give you the right to make further copies - even if they are for private use. Photocopying a work, scanning a work to produce an electronic copy or downloading a copy which is in electronic form all involve copying the work and will also require permission.

4.4 Infringement and "substantial parts"

Copyright infringement occurs when one of the restricted acts takes place in relation to a substantial part of the copyright work without the prior authorisation of the copyright owner. What is "a substantial part"? It is first important to remember that copyright subsists in expression rather than ideas or information.

Substantiality depends as much (perhaps more) on the quality of what is appropriated as on its quantity. Some previous publishing industry assumptions, for example that taking up to 400 words is “safe”, are now unreliable. So, for example, an extract of 250 words from James Joyce’s Ulysses (less than one thousandth of the entire work) was held to be substantial on the basis of their unique and distinctive quality. Similarly, an extract taken from the musical work ‘Colonel Bogey’, consisting of some 20 bars and lasting only 50 seconds, was held to be a substantial part, because it was that bit of the music which the public would immediately recognise (the “hook”).

There are accordingly no quantitative rules regarding what amount of a given type of work is acceptable to copy or quote: a small taking could be substantial, a large one insubstantial, depending on the nature of the work being copied.

4.5 Copyright protection for software

In the case of software, there are various additional rights. The copyright owner can prevent others from:

(a) permanent or temporary copying of the program, including where this is required to run, store, load or display the program (although the lawful acquirer will have the right to use a computer program for its intended purpose, including error correction, unless agreed otherwise);

(b) translation, adaptation, arrangement or other alteration of a program; and

(c) putting into circulation or possessing for commercial purposes any means the sole intended purpose of which is to facilitate the unauthorised removal or circumvention of any technical device which may have been applied to protect a computer program (device should be interpreted very broadly in this context and may include algorithms, software, hardware and possibly instructions).
The English High Court has decided on certain occasions in software copyright cases that copyright can be infringed by non-literal copying. Reference to the original work is required when the new work is produced but the original work need not be copied line for line. Use of architectures, algorithms or sequences underlying a computer program could be copyright infringement if a substantial part of a programmer’s skill, labour and judgement has gone into them.

In *John Richardson Computers Ltd v Flanders* (1993) IP & T Digest 25, even though the alleged copied work was written in a different programming language, similarities at the user interface level were found to be sufficient for copyright infringement.

More recently in *Navitaire v easyJet Airline Co* [2004] All ER (D) 162 (Dec), re-emphasises some important limitations on the scope of copyright protection as it applies to computer software. In particular, the reluctance of the UK Courts to protect the “look and feel” of a computer program has been highlighted.

The facts

easyJet had previously enjoyed a licence from Navitaire in respect of their airline booking system, OpenRes. In conjunction with that, easyJet also had a licence in respect of a web interface to OpenRes called TakeFlight. Subsequently, easyJet developed an alternative system which it called eRes.

It was not disputed that easyJet wanted a program which was substantially indistinguishable from the OpenRes system. It was also not disputed that none of the underlying software or code in any way resembled that of OpenRes. However, the eRes system did act upon identical or near identical inputs to that of OpenRes and produced very similar results or outputs. Navitaire claimed that the copyright in its OpenRes system had been infringed by what they called “non textual copying” i.e. without any direct copying of the underlying code but simply by a detailed analysis of and reproduction of the operation of the program.

The judgement

Navitaire did succeed in some less important respects. The Court held that:

(a) sufficient skill and labour had gone into the creation of certain screen icons to enable them to attract copyright and that copyright had been infringed because the icons had been copied exactly by easyJet;
(b) some of the computer screens produced by the OpenRes system qualified as artistic works and had been copied in such a way as to constitute an infringement; and

(c) easyJet had made some illicit copies of OpenRes at various stages during the process of migrating data to the new system.

However, in the most important respects, Navitaire’s claim failed. Crucially, the Court said that there was no protection for the “business logic” (what might otherwise be described as the underlying business purpose) behind the OpenRes program. The Judge said that “as a matter of policy, to permit the ‘business logic’ of a program to attract protection through the literary copyright afforded to the program itself was an unjustifiable extension of copyright protection”. The Court refused to draw the analogy with the plot of a book, which, in certain limited circumstances, has previously been held to attract protection. Because none of the program code had been copied, the Court refused to say that the business function of creating a reservation for a particular passenger on a particular flight was, of itself, capable of being the subject of copyright protection.

The Court also held that:

(a) screen displays, which the Court described as “providing the static framework for the display of the dynamic data…”, were capable of amounting to literary works but that the acts complained of did not amount to copyright infringement at law;

(b) copyright did not subsist in individual words or letters making up commands recognised by the program either individually or as a compilation; and

(c) copyright does not subsist in computer languages by themselves but does subsist in the expression of a program written in a particular language.

The consequences

The case highlights the limitations of copyright protection in the UK, particularly in cases where there has not been direct copying of computer code but simply access to the operation of a program. The decision has not fundamentally changed the law but the Court has declined the opportunity to extend the line of isolated cases which had begun to recognise the possibility of protection for the look and feel of programs, generally in the context of ex-employees who have gone off to develop a program in competition with their ex employer. This is, in contrast with US copyright law which has tended to offer
much greater protection to the look and feel of programs. The judgement will need to be analysed carefully by any company which seeks to develop a product which mimics the operation of another.

4.6 International copyright?

Copyright is a national right and where more than one territory is involved, the issues can become extremely complex. There is a principle called “national treatment” that underpins international aspects of copyright. Countries providing such national treatment provide authors and publishers of other countries with the same rights, protection and remedies as its own authors and publishers.

This is a very complex area of the law and beyond the scope of this course. However, as a general rule:

(a) the law of the nation where the work is created will determine the author and ownership; and

(b) the law of the nation where an infringing act takes place will determine whether copyright subsists and whether there is infringement.

4.7 Moral rights

Various moral rights are granted to authors of copyright works including:

(a) the right to be identified as the author/director of the work, for example when copies are issued to the public;

(b) the right to object to derogatory treatment of the work; and

(c) the right not to have a work falsely attributed to them.

Moral rights are concerned with protecting the personality and reputation of authors. The right to be identified must be asserted, i.e. the author/director must indicate their wish to exercise the right by giving notice to this effect. The right to be identified and the right to object to derogatory treatment can be waived by the author/director.

Moral rights do not apply:

(a) in computer programs;

(b) where ownership of a work originally vested in an author’s employer;

(c) where material is used in newspapers or magazines; and

(d) in reference works such as encyclopaedias or dictionaries.
5. Database Rights

In addition to its contents (which may be copyright protected works in their own rights), a database may be protected by two copyright based IP rights: copyright and database rights. Under copyright law, a database is usually defined as a collection of data or other material that is arranged in a systematic or methodical way so that the items are individually accessible. Copyright protection covers any forms of database that falls within this definition, not just computer based ones.

For copyright protection to apply, the database must have originality in the selection or arrangement of the contents. For database right to apply, the database must be the result of substantial investment.

There is no registration for database right, it is an automatic right like copyright and commences as soon as the material that can be protected exists in a recorded form. Database right can apply to both paper and electronic databases.

The term of protection for database right is much shorter than for copyright. Database right lasts for 15 years from creation or publication. However, whenever a database is updated, the term of protection recommences.

Database right provides the rights to control extraction and re-utilisation of the contents of the database. To infringe a database right, a person must extract or re-utilise a substantial part of the database.

It should be noted that databases are normally a collection of copyright works where copyright in the work will exist independently of the database. When compiling a database, permission should be sought from the copyright owners for use of their material. When using a database, the rights of copyright owners of the content should be considered as well as database right owners. Where a database has been delivered on-line, there will often be a contractual agreement between the database owner and the user setting out what use is permitted, and this will generally take precedence over any exceptions in the law.

Database rights are a relatively new type of IPR and there has only been limited guidance from the courts on their scope and effect. The most prominent case to date is British Horseracing Board (BHB) v William Hill C-203/02 [2005] RPC 260.

BHB claimed the publication by William Hill of data, extracted from BHB’s database, concerning the runners and riders in British horse races on its website was an infringement of its database rights. The English High Court held William Hill to have infringed the BHB’s database right. However, as database rights originate from EU law, the appeal was referred to the European Court of Justice (ECJ).
The ECJ held that the quoted £4 Million annual cost for running the database was largely for creating the data, not the database. As the data extracted and re-utilised by William Hill had not required substantial investment by the BHB, it did not constitute a substantial part of the contents of the database.

BHB also argued that William Hill had infringed by the repeated and systematic extraction and re-utilisation of insubstantial parts of the BHB’s database. The ECJ held that the reasoning behind this provision was to prevent repeated and systematic extractions of data, the cumulative effect of which would be to reconstitute or make available the whole or a substantial part of the contents of the database.

As William Hill had only taken insubstantial parts of the BHB database (albeit on a daily basis), the ECJ held that there was no possibility that the cumulative effect of William Hill’s insubstantial extractions could lead to the taking and making available of the whole or a substantial part of the BHB’s database.

The ECJ’s decision has been followed to date by the English courts and appears to have reduced the potential scope of protection provided by database rights by focusing the requirement for a “substantial investment” on the production of the database without taking into account costs in producing the content.

**Task 4**

Go to the UK Intellectual Property Office (“IPO”) website (http://www.ipo.gov.uk). Look at the various materials on copyright on that site to answer the following questions:

(a) What is protected by copyright?
(b) Does material have to have novelty or aesthetic value to get copyright protection?
(c) Are ideas protected by copyright?
(d) Is material on the internet protected by copyright?
(e) What IPR protect databases?

**6. Patents**

**6.1 Overview**

A patent is a monopoly right in an invention. Patents generally cover how things work, what they do, how they do it, what they are made from or how they are made. A patent can cover not only such things as an electronic circuit, a chemical product, heavy machinery or a control system, but also small household items such as a tin-opener. It can also cover processes such as a new or improved process of making a new material or a
new method of navigation. In certain situations, patents can also cover software based inventions.

6.2 Background

The origins of patents for inventions are obscure and no one country can claim to have been the first in the field with a patent system. However, Britain does have the longest continuous patent tradition in the world. Its origins can be traced back to the 15th century, when the Crown started making specific grants of privilege to manufacturers and traders.

The first recorded patent was granted in England in 1449. King Henry VI awarded a patent to John of Utynam for stained glass manufacturing. This patent established the notion of a state-granted limited monopoly. There was nothing novel at the time about the art of stained glass making. However, the monarchy recognised the value of protecting certain arts and industries, including those that were imported from other parts of Europe (in this case Italy).

Starting in 1552, “letters patents”, open letters marked with the King’s Great Seal, were issued by the Crown. The monarchy granted patents for its own benefit and for the benefit of officers and friends of the Court. Patents were issued on entire industries, not just inventions. For example, the Stationers enjoyed complete control over the publishing industry in England.

In an effort to curb such abuses of power, Parliament, in 1624, passed the English Statute of Monopolies, which outlawed all royally sanctioned monopolies. Realising the importance of protecting inventors and the economic benefits associated with encouraging innovation, an exception was allowed for patents of “new manufactures”. These patents were awarded to the inventor as long as their new devices did not hurt trade or result in price increases. Additionally, a statutory limit of fourteen years was imposed on English patents.

Today’s patents remain a bargain between the state and an inventor. A monopoly of 20 years is granted in return for teaching the invention to the public.

The UK Patent Office alone receives approximately 30,000 patent applications per year. At any one time around 295,000 granted patents are in force in the UK.
6.3 Monopoly provided

A patent provides a monopoly that can be used to restrict others from making, selling or using an invention without permission.

Of course a UK patent only restrains commercial activity in the United Kingdom. To restrain activity abroad, you must have a patent in the relevant country. Also it is important to note that you cannot initiate legal proceedings for infringement until your patent has actually been granted. To mitigate the effects of this it is possible in certain circumstances to back-date a claim for damages to the date of publication of the patent application (which happens long before grant).

6.4 What is patentable?

What is, or is not, patentable is determined by national law. However, all patent systems, to some extent require:

(a) novelty;
(b) inventive Step; and
(c) industrial Applicability.

In addition, many patent systems, such as those in European countries have exclusions from patentability for certain fields.

Novelty

To be patentable, an invention must be novel and also involve an inventive step at the time of filing. The requirement of novelty is absolute. The invention must not have been published (made available to the public in verbal, written form, by use or in any other way) anywhere in the world before the initial patent application is filed. A disclosure made under a duty of confidentiality is not considered a publication for the purposes of novelty.

Publication depends on whether the public is free and able to identify how the invention works. For example, in the case of a control system for traffic lights that has been trialled in public, operation of the traffic lights can be studied and the manner of operation identified even if the underlying programming or electronics cannot be evaluated. As such, the manner of operation will most likely be found to lack novelty. However, if the invention resided in the electronics arrangement within the traffic lights that used less power or operated more quickly for example, this would most likely remain novel assuming access by the public to the electronics was not possible. If the traffic light had actually been sold before the date of filing and there
were no prohibitions on reverse engineering etc, novelty would most likely be lost for all aspects.

There are moves at an international level to introduce a “grace period” or “period of immunity” for those who reveal their inventions before filing a patent application. Until the law is changed one must observe the strict principle of filing before disclosure to anyone except in conditions of strict confidence. Disclosures at conferences and seminars are not exempt.

Inventive step

For an invention to have an inventive step, it must not be obvious to a skilled person having regard to the state of the art. In other words, to be patentable, an invention must not be obvious to someone who is skilled in the particular technology of the invention in the light of everything that was publicly known before the date on which the patent application was filed. The skilled person is assumed to have read all the relevant materials available but is not expected to be imaginative or inventive. An invention is obvious only if it follows plainly or logically from what has gone before. The nature of the problem solved, how the problem had existed, whether large numbers of people were seeking a solution and whether alternative solutions are available are all relevant when assessing inventive step. Only the prior art teachings available before the inventions are considered for inventive step - hindsight is an unfair test and is not applied.

Most industrial products and processes are patentable provided they are novel and not obvious. Chemical processes, improved methods of operating already-known machinery, methods of checking parameters or product quality are all patentable. Provided a useful technical or economic result is obtained, there is generally no problem in obtaining protection. Thus for chemical processes the invention may lead to an increased yield or less pollution, or it may be cheaper to operate, or it may require a lower power input or less pure starting compounds.

For a method of operating machinery, this may lead to an improved product, or be quicker or cheaper. Methods of checking, for example inspecting the interior of pipelines, can be more reliable or quicker or require less interference with the process or product being checked.

Industrial applicability

This criterion is usually used to exclude “impossible” inventions such as perpetual motion machines. In this context the term “industry” includes agriculture.
6.5 Excluded subject matter

There are several areas of subject matter which UK (and European) patent law specifically excludes from being patentable. These are:

(a) a discovery, scientific theory or mathematical method;

(b) a literary, dramatic, musical or artistic work or any other aesthetic creation whatsoever (copyright or design protection is more appropriate);

(c) a scheme, rule or method for performing a mental act, playing a game or doing business, or a program for a computer;

(d) the presentation of information (again copyright protection will apply);

(e) any variety of animal or plant or any essentially biological process for the production of animals or plants, not being a micro biological process or the product of such a process;

(f) methods of treatment of the human or animal body by surgery or therapy and diagnostic methods practised on the human or animal body. (products, substances or compositions for use in any such methods are patentable); or

(g) inventions where the commercial exploitation of which would be contrary to public policy or morality (a letter-bomb is an often quoted example).

For all but the last two areas, the exclusion only relates to the extent that the patent “relates to that thing as such”. Taking a mathematical method as an example, it has always been possible to obtain a patent for a non-obvious invention which uses a mathematical method to achieve an advantageous result. The use may, for example, be in the use of a device or in a process, or embodied in the final form of a device. In summary, a patent application for a mathematical method would be rejected but an application for a control system that used a mathematical method would most likely be accepted.

6.6 Computer implemented inventions

For many years there has been a misconception that software based inventions are not patentable. However, there have been many tens of thousands of patents granted in Europe and in other countries covering computer software. Part of the problem is that there are categories of computer implemented inventions that are excluded from patentability.
If the end result of a computer implemented invention does not fall into one of the other excluded categories such as a mental act, presentation of information or method of doing business then the invention may be patentable in Europe (subject to novelty and inventive step).

Whilst patent law in Europe is based on common concepts, its implementation has often differed. This is particularly the case for granting patents for computer implemented inventions. Many inventions fall into the definition of a computer implemented invention and are generally agreed to be patentable (for example, telecommunications systems, control systems etc).

Take, for example the following examples of patents granted for software inventions. These have been selected as being closer to the borderline between what is and is not allowable. There are many granted patents for inventions that include software components where problems are not even encountered. The commentary provided on why the patents were most likely granted are the author’s opinions only:

**Data Processing System (GB1274768)**

This patent was granted under the previous version of the UK Patents Act and in fact covered spreadsheets. It was dressed up to look like hardware (a dodge that patent examiners are now very aware of and does not work). It is unlikely that such a patent would have been granted under the current laws.

**Complier (GB2391348)**

This patent covers an improved compiler in which non-invasive information on compilation is obtained and used to improve effectiveness of compilation without intervention of a programmer. The patent was originally objected to for being directed to a computer program but was granted after a hearing. The decision stated that the ability to modify compilation in response to performance data results in a faster, more accurate and adaptable compiler that constituted technical advances rather than cosmetic changes that took the invention beyond being a computer program as such.

**Graphics file format (GIF – EP129439)**

This patent was directed to a method and system of compressing data that was faster and produced better compression ratios on data (particularly image data) than prior methods and systems. The method was used for the GIF file format. It was not a specific software algorithm that was
claimed but rather a new and non-obvious way of compressing data that could have been implemented in circuitry as well as in software.

**Computerised diary scheduling system (EP326778)**

This patent covers a diary scheduling system that operates over a network. Meeting invitations are displayed simultaneously to a number of users allowing them to accept, reject or save the invitation. The operation of the system over a network and simultaneous display of data were most likely key to avoiding rejection of this case as a computer program or presentation of information as such.

**Teaching systems (EP461127)**

This patent covered an interactive learning system in which selected model text is displayed and also converted to audio and output to the user. The user’s own speech is recorded and played back after the model text to enable comparison. The claims in this case were directed to a system including storage for the model text and a text to speech system that amounted to more than a computer program as such.

**MP3 data structure (EP287578)**

This patent covers the digital coding process for audio signals used for the MP3 format. The patent was most likely granted for the same reasons as that covering the GIF format, discussed above.

**Amazon 1click (EP927945)**

There was a great deal of controversy concerning the US version of this patent which covers an online system allowing customers to enter their credit card number and address information just once so that on follow up visits to the website all it takes is a single mouse-click to make a purchase from their website.

Amazon successfully enforced the US Patent against Barnes and Nobel. The European Patent cited above was ultimately granted but is much more restricted than its US counterpart. Its claim, in fact, does not even directly cover 1-click ordering but instead is concerned with buying gift purchases. The customer identifies the intended recipient of the gift and the system communicates with the recipient to arrange delivery etc.

Amazon is still pursuing an application with many similarities to the corresponding US patent but this is still under examination.
Task 5

Look at details of some of the above patents at the site: http://ep.espacenet.com and answer the following questions:

(a) Who are the inventors for the Complier patent (GB2391348)?

(b) Who is the applicant for the Computerised diary scheduling system patent (EP326778)?

(c) How many pages is the patent application for the Teaching systems patent (EP461127)?

(d) What is the official title for the Amazon 1 click patent?

Patent applications are more likely to be rejected for lacking novelty or inventive step than whether they are directed to excluded subject matter. For example, EP 0390041 (directed to a system in which a cursor could be moved diagonally using a single keystroke) was rejected for lacking inventive step.

In the past few years, the European Commission and Parliament attempted to pass a law that would clarify what aspects of computer implemented inventions are patentable. A great deal of press coverage was given to this. Unfortunately, much of it was inaccurate. For example, a number of stories stated that if the law was passed, scroll bars used in graphical user interfaces would be patentable. The overriding requirements of novelty and inventive step (which would have prevented grant of such a patent) were overlooked.

The proposed law would not have made computer implemented inventions patentable for the first time, nor would it have opened up the possibility of business method patents, it was merely an attempt to make the national procedures applied by patent offices and courts consistent (indeed, the proposed law was based on that already being performed by the UK Patent Office).

There are opponents of “software patents”, particularly the supporters open source software that argue that patents covering software are damaging to innovation and competition. This argument has little to do with software per se and there has been a notable lack of evidence showing specific damage to the software field. It can in fact be argued that patents are one of the few ways a small innovative company can protect its ideas from the bigger players in the market. It is relatively common for the smaller companies to be bought specifically for their IPR and there is as much evidence that patents are beneficial as there is to the contrary.
Unfortunately, those against patents were much more efficient and vocal in their lobbying and so much confusion was created that the European Parliament rejected the proposed directive outright. The overall effect is that patents for computer implemented inventions are still patentable, it is just that your application/patent may be treated differently in different EU countries (even though they have the same law!).

Attempts to patent novel software concepts by presenting them as part of a computer system providing a technical effect have met with some success at the European Patent Office (“EPO”). The EPO has now granted tens of thousands of patents for software-related inventions and the legal principles being established in the EPO are now being applied by national patent offices and courts in Europe.

However, the English courts have taken a more restricted view of the patentability of software-related inventions, as in *Merrill-Lynch Inc’s Application* [1989] RPC 561, and *Fujitsu’s Application* [1997] RPC 680. Broadly, in *Merrill Lynch* and *Fujitsu* the Court of Appeal adopted the “technical effect” approach to patentability which involved asking whether the invention, as defined in the claim, made a technical contribution to the known art. If it did not, it was deemed to be excluded from patentability by section 1(2) of the Patents Act. The court further restricted the test by holding that novel or inventive purely excluded matter did not count as a “technical contribution”.

There have been a considerable number of recent cases before the IPO and UK courts examining the interpretation of the exclusions from patentability under section 1(2) of the Patents Act. The cases, taken as a whole, suggested that the *Fujitsu* case continued to determine the UK approach to software-implemented inventions.

However, in terms of establishing the correct approach to assessing the patentability of computer-related inventions, this recent case-law has now been eclipsed by the decision of the Court of Appeal in *Aerotel Ltd v Telco Holdings Ltd and others* and *In re Macrossan’s Application* [2006] EWCA Civ 1371. The decision, which was handed down on 27 October 2006, is the first Court of Appeal judgment on the patentability of computer-related inventions since 1997 and provides some much-needed clarification of the law in this area. The case can be regarded as establishing the correct approach to the assessment of patentability by the UK courts and IPO. It is likely to remain the UK approach for the foreseeable future since leave to appeal the decision to the House of Lords was refused.
The appeals in *Aerotel/Macrossan*, which were heard together, related to decisions of the Patents Court rejecting a patent application for an online method of preparing company incorporation documents and finding a patent for a method of prepaying telephone calls invalid. The key points arising from the case, in terms of determining the approach taken in the UK to assessing the patentability of software-related inventions, are summarised below:

- The court decided not to follow EPO practice with regard to assessing patentability.

- The court declined to adopt a new approach to assessing patentability, such as the “contribution test”, which involved asking whether the inventive step resided only in the contribution of excluded subject-matter, because the Court of Appeal in *Merrill Lynch* had rejected this and the court said it was bound by its own precedent. The court instead approved a four-step test for patentability, which it said was consistent with what had been decided in previous Court of Appeal cases including *Merrill Lynch* and *Fujitsu*, comprising the following steps:
  - Properly construe the claim;
  - Identify the actual contribution;
  - Ask whether it falls solely within the excluded subject matter; and
  - Check whether the actual or alleged contribution is actually technical in nature.

- The court also said that the term “computer program” as used in Article 52 of the EPC and section 1(2) of the Patents Act covered not merely a set of instructions as an abstract thing, but also the instructions on some form of media which caused a computer to execute the program.

Applying the test it had set out, the Court in *Aerotel/Macrossan* found that the claim to the method of prepaying telephone calls was patentable but rejected the application to patent the online method of preparing company incorporation documents.

Those who were hoping that the Court of Appeal would liberalise the UK approach to the exceptions in section 1(2) of the Patents Act which had been set in *Fujitsu* or resolve the difficulties due to the differing approaches to exclusions for computer programs and business methods taken by the EPO and the IPO and Courts will be disappointed with the decision.

In light of the judgment in the *Aerotel* and *Macrossan* cases, on 3 November 2006, the IPO issued a notice (the Practice Notice) indicating that patent examiners will assess whether the
invention in a patent application is patentable subject matter
applying the test set down by the court, with immediate effect,
and providing further details regarding the new approach. The
IPO’s view is that the new approach will not fundamentally
change the boundary between what is and is not patentable,
although there may be a few cases right on the boundary which
could be decided differently.

The Gowers Review of Intellectual Property (Gowers
Review), published on 6 December 2006, recommended
to the Government that the policy of not extending patent
rights beyond their present limits in the areas of software
and business methods should be maintained. This suggests
that domestic reform of the law in the UK is unlikely in the
immediate future.

On 8 October 2008, in Symbian Limited v Comptroller
General of Patents [2008] EWCA Civ 1066 the Court
of Appeal reconsidered the four-step approach set out in
Aerotel/Macrossan, and held that it was permissible to
combine the third and fourth steps, thus making technical effect
part of the examination of whether the claimed invention fell
solely within excluded subject matter. The court declined to
follow recent EPO case law, in which any use of a computer
took the invention outside Article 52(2), but when considering
inventive step excluded all non-technical integers of the claims.
On 8 December 2008, the IPO issued new guidance on
software patents following the Symbian decision. The IPO
stated that it will continue to follow the Aerotel structured
approach, but will now consider that a program that resulted
in a computer running faster or more reliably can provide a
technical contribution even if the invention solely addressed a
problem in the programming.

Those who hoped that this appeal would lead to a thorough
review of the UK approach to exclusion of software and
business method patents, bringing it into line with recent EPO
cases, will (perhaps predictably) be disappointed. The approach
set out in 1989, at a time when the judicial understanding
of software was very limited, and since when software has
developed greatly, still holds.

The decision could be said to be the revival of the “technical
contribution”, although it is arguable that it never really went
away after Aerotel, except among patent examiners looking for
a simple approach to rejecting software-related inventions. It
will be interesting to see how the IPO reacts to this decision.
6.7 Steps in obtaining a patent

Although a person may file a patent application themselves they should be strongly advised to obtain professional advice since patent procedure is not simple and mistakes can result in the applicant not getting the best protection for your invention. Many applicants who do not employ professional advice find that their granted rights are not adequate for their needs or that it is too easy for a competitor to design around them.

Figure 2 illustrates the steps involved in obtaining a patent in the UK.

A patent application must include:

(a) a technical description (called the specification) of the invention that is clear and complete enough for the invention to be reproduced by a person skilled in the
technology of the invention. The description does not limit the scope of protection and is merely illustrative; and

(b) one or more claims that define, in words, the matter for which protection is sought. The claims are what limit the scope of protection and determine whether someone infringes or not. The claims are also what are evaluated for novelty and inventive step. If claims are too broad, they will not be novel or inventive – if they are too narrow, a patent would be granted for something that is easily designed around and therefore has limited value.

The search is based on the claims filed and identifies any prior art published prior to the date of filing the patent application that the Patent Office considers falls within the scope of the claims.

At approximately 18 months from filing the application, it is published by the Patent Office (copies are available at http://gb.espacenet.com) along with the results of the search. This is the first time the contents of the patent application are available to the public. From this point onwards, details of the prosecution of a patent application are publicly available.

The applicant has 6 months from publication to request examination. During examination, a Patent Office official examines whether or not the application meets all the requirements of the law for example, is it new? Is it inventive? Is there sufficient disclosure? The applicant is advised of any objections and is given the opportunity to amend the application to address them. At the end of this process and, assuming all has gone well, a patent is granted.

After grant, an annual renewal fee will have to be paid to keep the patent in force - subject to a maximum term of 20 years.

At grant, the specification and claims are published again and it is this version that is relevant for infringement. If you look at published applications (their publication number ends with an “A”), the claims may look incredibly broad and unsupportable. However, for infringement purposes it is only the claims of the granted application (their publication number ends with a “B”) that is relevant. The claims will most likely have evolved and narrowed during examination.

The average length of time between filing a patent application in the UK and the decision by the Patent Office to grant or refuse it is three to four years.
6.8 National security provisions

National security provisions exist within patent systems of a number of countries including UK, USA and France to prevent sensitive information being disseminated without that nation’s permission. Generally, where national security provisions exist, an applicant is required to file his or her first patent application for an invention in his or her country of nationality or residency.

If the information is deemed sensitive, a national security order may be put in place restricting publication or other actions in respect of the invention. In the UK, these provisions only apply in respect of military technology or information prejudicial to national security.

6.9 Paris convention & Priority Rights

A single national patent can have value. However, most companies do not have a single country as their market. For commercially important inventions, patent protection is normally desired covering a number of countries (typically USA, at least part of Europe, possibly Japan). Among other things, the Paris Convention was drawn up to make the absolute novelty requirements that these countries apply compatible with the possibility of filing for patent protection in multiple territories.

The Paris Convention provides priority rights to an applicant that enables him or her to file subsequent patent applications within 12 months of his or her first patent application for that invention and yet benefit from the filing date of the first application. In this way, all applications for that invention benefit from the first filing date for novelty and inventive step purposes.

Disclosures made in the first 12 months can be discounted and it is even possible to have the first application searched within the 12 months to determine whether expenditure on other applications is worthwhile. The date of filing of the first application is called the priority date.

6.10 Patent systems

In addition to national patent offices, there are various collective patent systems that can be used for filing patent applications covering more than one country. These systems keep prosecution central and in some cases keep costs down. However, they do not ultimately result in a collective patent. For example, a patent application can be filed and prosecuted at the European Patent Office covering most European countries (and some others). However, upon grant, the
European Patent breaks down into a bundle of national patents, just as if a patent application had been filed and prosecuted in each country.

There is an International Patent System called the Patent Cooperation Treaty (PCT), through which provisional protection for over 100 countries can be secured. However, in order to progress an International application to grant, it must ultimately be prosecuted within each country of interest according to their national laws and procedures.

6.11 Third party interaction

Whilst the public may observe aspects of the prosecution of a patent application after publication at 18 months from the priority date, they are not normally able to take part in the prosecution proceedings. Before grant of a patent application in the UK, it is possible for the public to submit 3rd party observations on the novelty, inventive step or other aspects of a patent application. These will be taken into account by the UK Patent Office examiner when deciding whether or not to grant the application. After grant, it is possible to request revocation of a patent at the UK Patent Office or via the courts. Revocation is often requested during infringement proceedings and grounds for revocation are discussed in the section dealing with infringement.

Some patent offices, including the European Patent Office, have a post grant opposition procedure in which interested parties can oppose the grant of a patent without having to resort to the costs involved in going to court.

6.12 Petty Patents/Utility Models

Although patents are the only true way of securing a monopoly on how something works or is manufactured in the UK, some jurisdictions (principally Japan, China, Korea, Taiwan and Germany) offer a petty patent or utility model system. This is similar to the patent system except that there are typically lower costs, a lower duration for protection, and limited or no examination (typically validity is assessed upon attempted enforcement). In some cases, a lower threshold (or possibly no threshold) is applied to inventive step.
7. General Principles

7.1 First ownership of IPR

The owner of IPR is usually its author or creator. If the author or creator is employed and the creation of the IPR is in the course of their employment then the first owner will be the employer. No assignment is necessary to effect ownership by the employer in this situation. If an employee’s duties do not include anything that would be expected to result in the creation of IPR (for example if the employee was a cleaner), any IPR created would be owned by the employee. In the case of Directors, a greater duty to the company is expected and it is quite likely that the company will own IPR created by its directors.

A contractor normally retains the copyright in any commissioned work unless their contract is explicit to the contrary.

For the purposes of copyright, the author of a computer generated work is “the person by whom the arrangements necessary for the work to be generated are undertaken”.

Joint ownership (and inventorship or authorship) of IPR is possible. In assessing whether there is joint ownership, the courts typically look at the contributions made by participants.

7.2 Licensing and assignment

Licenses and assignments are merely contracts and can contain whatever provisions the parties are willing and able to include.

In every case, general provisions in law about what contractual terms are acceptable need to be considered carefully as well as the nature of the IP that is the subject of the contract. In particular, competition law and company law may be relevant.

An assignment is typically an outright transfer of rights by the holder of the rights (the assignor) to another party (the assignee).

A licence involves a continuing relationship between the rights holder (the Licensor) and the organisation wishing to exploit the rights (the Licensee). The relationship may involve the continuing flow of information and technical assistance from the Licensor in return for financial payments or royalties from the Licensee. Improvements to the technology might be made in the future by either party and these can also be covered in the initial Licence Agreement.
7.3 Assignments

There are some specific formal requirements for IP assignments. In the UK, patent assignments must be in writing and require the signature of the assignor; elsewhere it is still the case that assignments must be signed by both parties and some countries such as Canada require witnesses. In certain countries including the UK, there is a deadline (typically 6 months from the date of execution) for registration of assignments at the relevant Patent Office. If this deadline is missed then damages from subsequent infringement proceedings may be restricted until registration is completed. An assignment of copyright in the UK must be in writing and signed by the assignor.

7.4 Infringement

The uses that are restricted by IP depend on the IP right and have been discussed in their respective sections. It is important to remember that much material will be protected by more than one IP right.

For example:

(a) A music CD will generally involve copyright in both the music and the sound recording itself, performer’s rights for the singers and musicians and a trade mark for the company under whose label the CD is sold. The band’s name may even be a trade mark. There will also be copyright in any graphics that are inserted on the CD cover.

(b) A cooling fan for a CPU may involve patent rights in several different aspects of its design and operation. Each patent may be owned by a different person. Additionally, there may be registered design and/or design right protection in the shape of various components.

A party may need a licence if it wants to use anything protected by IP. This will largely depend on what uses are restricted by the IPR and whether there are any exceptions to these restricted uses. Otherwise, use without permission will infringe an IP right and that party could be sued by the rights holder.

It is important to understand the restrictions on use of IP. This will depend on what type of IP it is.

For example, copyright gives the creator the right to control copying and first publication of works. Another creator who has independently thought of something similar, that is they
have not copied from the first creator, would not infringe the first person’s rights.

In some very limited cases, a use that does fall within the scope of what is restricted by the IP right may not require the permission of the IP owner. For example, doing something for private or experimental purposes relating to the subject matter of an invention is not normally an infringement of a patent.

In the case of patents, your client cannot generally be prevented from doing something it did before the date of application of the IPR. For example, if someone happened to patent something that your client had done (and not made public) before their application was filed, they would be awarded the patent but would not be able to stop your client continuing that act. Prior user rights are typically very limited and your client would not normally be allowed to expand its use.

There are many exclusions (and exclusions to those exclusions) from infringement of copyright.

The more common ones are highlighted here:

(a) Making a transient copy of a copyright work for the purposes of transmission of the work, in a network or for a lawful use of the work is not an infringement of copyright. This exception covers situations such as caching content whilst browsing a website.

(b) Decompilation of software for interface production and making backup copies of software is not normally an infringement of copyright.

(c) Limited use of copyright works is also permitted for research and private study, criticism or review, reporting current events, judicial proceedings and teaching in schools. However, copying large amounts of material or making multiple copies will require permission. Publication of excerpts, such as quotes, from a copyright work will require an acknowledgement.

It is important to remember that just owning a copy of a copyright work does not give you permission to use it in a way that would infringe copyright.

Exceptions do not generally give you rights to use IPR, they just state that certain activities do not infringe. So it is possible that an exception could be overridden by a contract you have agreed limiting your ability to do things that would otherwise fall within the scope of an exception.
If your client is planning to use IP they should carefully consider whether they need to seek a licence. This is often the safest route and avoids any doubt of infringement.

Another possible, but not common, use without permission can occur in the case of compulsory licences. Compulsory licenses are generally granted in the situation where the rights holder fails to “work” the invention. For example, if a company obtains rights to an invention and then fails to work the invention (i.e. sell the patented article, use the patented method etc) and refuses to license the patent rights to another company to work the invention, a compulsory license may be applied for through the courts who will set reasonable license terms if these cannot be agreed.

7.5 Enforcement

Enforcement of IPR in the UK is typically slow, expensive and complex. The Chancery Division of the High Court will hear all IP actions but the complexity of most cases will require a legal team including a Barrister and possibly a Solicitor or Patent Attorney. The Patents County Court will hear Patent and Registered Design related actions and is theoretically quicker and cheaper and does not necessarily require as large a legal team.

7.6 Copyright enforcement

Due to the fact that copyright is not registered, three hurdles must be overcome to bring an action against infringers. First, your client must convince a court that their complaint concerns copying. If another person’s work is the same or similar to your clients by coincidence then your client has no case against them. Second, your client must show that they own the copyright in the original work they allege has been copied. Finally, your client must show that the work in question falls within the scope of those creative works afforded protection under the Copyright, Designs & Patent Act 1988.

For an act to be an infringement, it does not necessarily need to concern the whole copyright work. Infringement is defined as doing an act that is restricted by copyright in relation to the work as a whole or any substantial part of it, either directly or indirectly. As mentioned previously, a “substantial part” is not defined and varies depending on the circumstances. Depending on the work, even very small parts of a copyright work may count as a substantial part.
Infringement is also possible:

(a) by removal or alteration of electronic rights management information without permission; and

(b) circumvention of effective technological measures (any technology, device or component in the normal course of operation is designed to prevent or restrict acts in respect of copyright works that are not permitted by the copyright owner); and

(c) manufacture, import, distribution, sale, rental, possession or advertisement for commercial purposes of products, components or services intended to achieve either of (a) or (b).

7.7 Patent enforcement

Granted patents have assumed validity unlike copyright. It is not necessary to prove a patent’s validity unless it is called into question by a defence. For infringement to occur, all of the features of a granted claim must have been performed by the accused infringer or included in the infringing product. If a claim includes a requirement that is not performed or included, this is not infringement.

7.8 Remedies

Assuming the case is found in favour of the owner of the IPR, various remedies are available including an injunction restraining the defendant from future infringement and damages or an account of profits and costs. However, no recompense will be obtained for “innocent” infringement, so it is important for your client to mark their product with the relevant IP registration number (for example, patent number) to ensure that others are aware of the existence of you clients rights.

7.9 Injunctions

There are two types of injunctions. There are:

(a) interlocutory injunctions. An interlocutory or interim injunction is granted to stop the defendant performing certain acts before the case reaches full trial. Such injunctions are granted in effect to stop the owner of the IPR suffering large and irrecoverable damage by an alleged infringer during litigation proceedings leading to the trial and final Court order. However, such injunctions are granted only if strict requirements are met in terms of proving irreparable damage and the owner of the IPR giving undertakings to compensate the alleged infringer if the owner fails at trial.
(b) “full” injunctions: If the owner is successful in proving the validity of the IPR and in proving infringement, the Court will impose an injunction against the defendant to stop the defendant repeating the infringing activity.

7.10 Damages / account of profits

Damages represent the monetary value of the damage incurred by the claimant (owner of the IPR) as a result of the infringement. An account of profits represents the profits made by the infringer by the infringing activities. An owner has the option to elect for either damages or an account of profits.

Damages are more commonly requested than an account of profits because they can be calculated by the plaintiff, rather than having to rely on and argue over alleged profits made by the defendant. However, the actual selection should depend on the financial circumstances.

In patent cases, damages or an account of profits can be obtained from the date of the “A” publication of the application but only to the extent that it was reasonable to expect grant on the basis of the “A” publication and only if the granted claims and the “A” publication claims cover the infringing act.

Damages or an account of profits are also subject to the 6 year limit in the Limitation Act 1980.

7.11 Costs

These represent the legal costs incurred in bringing the action. In theory, the Court will grant the winning party its costs which would have to be paid by the losing party. However, costs are likely to be “taxed” by the Court. A Court will assess the costs claimed (by the winning party) and see whether there are any costs incurred in reference to points which the winning party did not succeed on. These costs are unlikely to be awarded to the winning party. In general, the court will only award 50-75% of the costs actually incurred. Therefore, the winning party will almost always be out of pocket in terms of the legal costs.

7.12 Third party support

Particularly in the case of infringement cases involving pirated or counterfeit goods, various UK governmental and non-governmental organisations may be able to provide assistance in seizing infringing articles. These include the Federation Against Software Theft (FAST), Customs and Excise and Trading Standards.
7.13 Challenges against an infringement attack

In respect of patents, a third party is able to seek recourse in respect of an unjustified threat. The remedies include damages, a declaration of non-infringement and an injunction preventing such threats. Therefore, it is very important to advise your clients that they should not take any action in this regard without first seeking advice.

7.14 Request for revocation

Revocation of registered rights can be requested at any time, although it is common for a counter-claim to be brought in response to infringement proceedings. Revocation is possible on many points, although the main ground used is that the invention did not satisfy the necessary legal requirements for grant.

Task 6
Assume that a third party is alleging your client has infringed that third party’s patent. What are some key checks you should carry out on behalf of your client?

8. Procurement Process

This next section will cover some of the main issues in the procurement process relating to purchasing IT software, hardware and services.

8.1 Objectives for a successful procurement

Some of the most important objectives for a successful procurement are to:

(a) confirm that there will be a sufficient number of qualified suppliers;
(b) ensure that bidders have sufficient information to make reliable proposals;
(c) minimise the amount of risk premium or number of conditional bids from bidders due to a lack of clarity in the tender documents;
(d) provide sufficient time for bidders to form the appropriate corporate structures (e.g. joint ventures); and
(e) ensure real and perceived fairness in the procurement process.
8.2 Main Types of Procurement Processes

There are a number of procurement processes that are available to the customer. The most straightforward process consists of the customer simply entering into a contract with a pre-selected supplier. However, other types of procurement processes exist. These are:

(a) initial consultation with bidders;
(b) request for an Expression of Interest;
(c) Request for Proposal; and
(d) Request for Tender.

The implications of each of these approaches and when they should be used are discussed below.

8.3 Initial consultation with bidders

In complex procurements, as a first step, it may be useful for the customer to release an information document as part of a general consultation with prospective bidders. Such a document usually sets out the background, objectives, business models, assumptions and scope of the proposed procurement and seeks answers from prospective bidders to a series of questions proposed by the issuer.

The main purpose of such a preliminary consultation is to give information to assist bidders in providing constructive feedback to the customer’s project team.

8.4 Request for Expression of Interest (Request for EOI)

A Request for an Expression of Interest should be used when the customer has a particular problem but is unsure of how the problem can be solved.

The process begins with the customer issuing a Request for EOI to several suppliers. The Request for EOI does not need to be very detailed, however, it should contain sufficient information to allow the supplier to decide whether or not the supplier has an interest in the project.

Once EOI’s have been received they can be reviewed by the customer. If the customer is able to select a particular supplier for the project, they can begin contractual negotiations. Alternatively, if the customer cannot decide between a number of suppliers, the customer can issue a Request for Proposal, and/or a Request for Tender to get further details of their proposed solutions.
A Request for EOI can be particularly useful for customers who want to know in broad terms what the market is offering before proceeding further with a particular procurement. Responding to a Request for EOI offers no guarantee to suppliers that they will be included in the tendering process. However, suppliers who submit a response have an opportunity to influence the process by suggesting ways of solving the customer’s problem that that supplier is particularly able to provide.

8.5 Request for Proposal (RFP)

A Request for Proposal (RFP) is often used when the requirements for the project are well specified but there is no strong view as to how these requirement can be achieved. The RFP is particularly useful in the IT industry where there may be a number of ways to achieve the specified requirements. Typically an RFP will lead to direct negotiations with one supplier or a very short list of prospective bidders. However, at times a RFP may be followed by a Request for Tender.

8.6 Request for Tender (RFT)

A Request for Tender (RFT) is generally used only when the requirements are well specified, and the contractual terms of engagement have already been decided. This means that for complex procurements (such as sophisticated technology projects) a RFT is rarely used.

A RFT can be of 2 types: an open tender or a closed tender. An open tender is a Request for Tender that is available to any supplier who chooses to respond. These types of tenders are generally advertised publicly. A closed tender is a tender that is only available to pre-selected suppliers.

8.7 Market sounding at start of and during a process

It is becoming increasingly common, in large scale procurements, to work towards better business outcomes by taking “soundings” (i.e. informal discussions/meetings with potential suppliers) on relevant topics before settling the terms of the Request for EOI documentation. It is also possible for customers to sound out bidders for procurements on specific issues as the tender process proceeds. In doing market sounding, your client should have procedures in place to ensure that:

(a) anything written or said by the customer during the market sounding cannot be relied upon in the bid process;
(b) anything written or said by the potential bidders cannot be
relied upon in the bid process; and

(c) any helpful result of the market sounding that is used by
the customer does not infringe intellectual property of any
individual market participant.

A particularly useful feature of soundings during a competitive
process can be the ability to limit future negotiation on critical
matters if the customer wishes to settle on a stance on
those matters and prevent bidders competing on them. If,
for example, the customer wanted to pre-determine a key
performance indicator regime and impose it on all bidders, but
wanted to pre-test the viability of that regime, it could do so by
engaging in discussions with pre-qualified bidders on relevant
principles. All this could be done before formalising its position
in draft contract documentation.

8.8 Public sector procurement

It should be noted that the public sector has specific
procurement rules. Public procurement law regulates the
purchasing by public sector bodies and certain utility sector
bodies of contracts for goods, works or services. The law is
designed to open up the EU's public procurement market to
competition, to prevent “buy national” policies and to promote
the free movement of goods and services.

Previously, there were three separate regulations in the UK
which applied depending upon whether goods, works or
services were being procured. These three sets of rules were
brought together in one piece of consolidated legislation which
came into force on 31st January 2006, the Public Contracts
Regulations 2006. These Regulations implement into UK law
the European Commission's Consolidated Directive on public
procurement, which was adopted in March 2004.

The application of the Regulations is detailed and complex and
is beyond the scope of this course. However, the Regulations
generally apply when three main pre-conditions are met:

(a) The procuring body is a “contracting authority” as defined
in the rules. The definition is wide and includes central
government, local authorities, associations formed by
one or more contracting authorities and other “bodies
governed by public law” (e.g. registered social landlords
and fire authorities);

(b) The contract is a public works, services or supplies
contract. Sometimes the contract will be a mixed contract
(e.g. for the supply and maintenance of computers).
Where it is, a contracting authority must determine, in
accordance with the rules, the predominant element of the contract and, therefore, which set of rules will apply. This is important to get right as the rules vary slightly depending on the type of contract; and

(c) The estimated value of the contract (net of VAT) equals or exceeds the relevant financial threshold. The rules expressly prohibit deliberately splitting contracts to bring them below the thresholds.

Where these three pre-conditions are satisfied a contracting authority must normally advertise the contract in the European Union’s Official Journal (“OJEU notice”) and follow the procedural rules set down in the Regulations.

There are various procedures which can be used to award a contract and are as follows:

<table>
<thead>
<tr>
<th>Type of Procedure</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open</td>
<td>All interested parties can submit a tender in response to the OJEU notice (albeit only those meeting the contracting authority’s selection criteria, if there are any, will be entitled to have their tender assessed). No negotiation with the bidders is permitted but there are no restrictions under the Regulations as to when the procedure can be used.</td>
</tr>
<tr>
<td>Restricted</td>
<td>All interested parties may express an interest in tendering for the contract but only those meeting the contracting authority’s selection criteria will actually be invited to do so. No negotiation with the bidders is permitted but there are no restrictions under the Regulations as to when the procedure can be used.</td>
</tr>
<tr>
<td>Competitive dialogue</td>
<td>This is a new procedure introduced by the Regulations which has the advantage of allowing the input of those participating in the tender process. All interested parties may express an interest in tendering for the contract but only those meeting the contracting authority’s selection criteria will actually be invited to do so. During the “dialogue” phase, bidders are able to discuss all aspects of the contract individually with the contracting authority. Once the dialogue has generated solutions to the agreed requirements, final tenders are invited based on each bidder’s individual solution. The best tender can then be selected, but there is very limited room for any further changes to be made once submitted. This procedure can only be used in the limited circumstances described in the Regulations.</td>
</tr>
</tbody>
</table>
There are two types of negotiated procedure. Under the negotiated procedure without prior advert, the contracting authority is not required to issue an OJEU notice and may negotiate directly with the supplier of its choice. Under the negotiated procedure with prior advert, however, an OJEU notice must be published.

All interested parties may express an interest in tendering for the contract but only those meeting the contracting authority’s selection criteria will actually be invited to do so.

Under the negotiated procedure with prior advert, bidders are invited to negotiate the terms of the advertised contract with the contracting authority. The Regulations do not set out any rules to govern the conduct of negotiations, which means that the contracting authority can, within certain parameters, establish its own procedures for the negotiation and tender stage.

This procedure can only be used in the limited circumstances described in the Regulations.

**Task 7**

In the following scenarios which procurement approach would you advise the client to adopt?

(a) Client X is seeking to purchase 1,000 personal computers for its business. The client knows exactly the specifications for the computer.

(b) Client Y would like to purchase a system to address issues it has with long and extended order fulfilment processes. The client does not know whether the problem is as a result of the order taking process, stock inventory or its distribution network.

(c) Client Z has a specific problem with its accounting processes. The client knows exactly what the problem is.

**8.9 Key legal issues relating to procurements**

The tendering process may give rise to legal obligations in relation to estoppel (see below for the meaning of estoppel), the tort of negligence and duties of confidentiality.

**Non-complying bids**

It is likely that the customer will have a duty to other bidders not to consider non-complying bids.

As a practical matter, there will often be minor discrepancies or differences in bids which will mean that the bids will not strictly comply with the tender documentation. A possible way to overcome this is to include a provision in the tender document that allows the customer to overlook minor differences.
Estoppel

Bidders that believe they have been treated unfairly during the tendering process may also have a case in estoppel. Estoppel will be available where the customer makes a representation to the bidder which the bidder relies on to their detriment.

The courts will generally award damages to the bidder to compensate them for the detriment suffered. To avoid such an action, the customer should ensure that the customer’s staff running the procurement process do not make representations they can not meet.

Misrepresentation

In Unit 1 we discussed misrepresentation. The law of misrepresentation will apply to many of the representations made in the pre-award tendering process.

To avoid liability the customer should ensure that any representations made to bidders are accurate and not capable of misleading.

Negligence

An action in negligence in the tendering process usually relates to claims made by the bidder that important information was withheld by the customer or that some of the information that was disclosed was incorrect. The bidder is likely to claim that that information effected the approach the supplier took in preparing its bid.

The customer needs to minimise the risk of such an action by doing all it can to ensure that all relevant information is disclosed and that the information is accurate. A disclaimer as to completeness and accuracy should also form part of the tender terms, although it is clearly better not to have to rely on such provisions in the first place.

Breach of confidence

A duty of confidence may arise during the tendering process to protect sensitive commercial or technical information disclosed by either party. The duty will arise where information that is confidential in nature, is imparted in circumstances importing an obligation of confidence. If the party receiving the information uses or discloses that information for purpose other than for which it was provided, they will have breached this duty.
8.10 Parallel negotiations

A fairly standard approach to procurement is that a supplier is selected before the contract is negotiated and signed. In some cases, the supplier will have commenced the services before the contract is even discussed.

The problem with this approach is that the customer has little bargaining power when it comes to negotiating the terms of contract. The customer will have expended resources in choosing the supplier and may be on a tight schedule to get the work done. Also, if the supplier has commenced work it will be very difficult for the customer to withdraw from the arrangement. This means the customer will, in many cases, be committed to the arrangement before the key contractual issues are settled, leaving little scope for them to negotiate how they will be dealt with in the contract.

Parallel negotiations can be used to improve this situation. Parallel negotiations are aimed at bringing the contract into the process of choosing a bidder. This has the effect of forcing the contractual issues into the open at an early stage. If parallel negotiations are used effectively they are able to maintain a competitive pressure for longer.

8.11 How to use parallel negotiations effectively

There is more than one approach to conducting parallel negotiations. The method chosen will vary depending on the nature of the deal itself and the complexity of products/service required.

One method is to begin the process by issuing a RFP to potential suppliers. Once the customer has received the written proposals they can be assessed for suitability. The suppliers should be chosen based on technical ability and whether or not the proposal will meet the customer’s requirements. Ideally, the customer should select 3 suppliers. This means that if one party withdraws from the process for whatever reason, the competitive pressure is maintained.

The customer should continue negotiations until a contract is drafted in final form for each supplier. The contract should be given to the supplier, and the supplier should be told that they will be required to sign the contract if they are chosen for the project.
8.12 Advantages of parallel negotiations

Better prices, better terms and maximised bargaining power

Conducting parallel negotiations with a small number of suppliers gives rise to a competitive tension that can produce more favourable outcomes for the customer. This tension is created by each supplier’s desire to win the tender and the fear that other suppliers are offering better deals on the legal terms and conditions. As a result, suppliers have a strong incentive to be reasonable in their requirements on the contractual terms.

Better understanding of the solutions and the suppliers

Parallel negotiations can also provide the customer with a better understanding of the solutions that are being offered. Also, the process allows the customer to observe the suppliers’ different cultures through the negotiation process, and take that into account when awarding the contract.

No post-tender negotiation - immediate contract protection

If parallel negotiations are carried out to completion, there is no need for post-tender negotiations. Once the tender is awarded, the contract is signed.

A common mistake made by customers is to select a bidder after all the “major” issues are resolved but before the contract is ready to sign. The problem with this is that the customer’s negotiating power is significantly reduced and the unresolved “minor” issues can become “major” issues, which can take time to sort out.

8.13 Disadvantages of parallel negotiations

Cost

Parallel negotiations can be a costly process. The customer will need to spend time (and legal fees) negotiating and drafting two or more separate contracts. As against this, the discipline introduced by the parallel negotiations process can lead to each individual negotiation taking less time that it would be if the supplier knew it already had the deal.
Resources

Parallel negotiations can be a strain on resources. The customer will need to allocate sufficient resources to negotiating and reviewing contract documents. For example, where there are 3 bidders involved, the customer will need to read and be familiar with three separate contracts.

Potential liability

If parallel negotiations are not conducted properly they can lead to liability for both parties. To minimise this risk the customer must explain to each party that the customer will be negotiating with other potential suppliers at the same time as their own negotiation. Also, if at any point there is only one bidder remaining, that bidder must be told that this is the case, even though this may significantly reduce the customer’s bargaining power.

There is also the issue of confidentiality. As mentioned previously, a customer cannot disclose information that has been given to it in confidence. It might be tempting to tell one bidder the position the other party is adopting in order to encourage that party to make a better deal. Although tempting, this should not be done as the information may be confidential information. However, it is generally safe to say to a bidder (and this will often be enough) that what they are offering is “uncompetitive” in a particular respect. This signals that the other bidder is offering a better deal without the risk of disclosing any confidential information.

Conditions of contract

The customer should then provide the chosen suppliers with a draft contract which requires them to only insert the price details and technical specifications. All other clauses should be completed by the customer. The suppliers are then invited to negotiate the terms of the contract with the customer.

An alternative approach is to include the draft contract in the RFP and invite suppliers to submit comments along with their proposal. This process however may mean that the customer will need to sort through many different suppliers’ contractual responses during the selection process. Also, suppliers may be reluctant to fully respond to contractual issues at this stage or they may be discouraged from submitting a response at all.
8.14 Letters of intent / instructions to proceed

Having chosen a preferred supplier, the parties should assess if there is a need to raise an “instruction to proceed”. Such a need may arise if the supplier needs to utilise significant internal resources or incur any third party costs prior to the main contract being signed.

The logic for this request is that the customer wants work to start urgently but the negotiation of the contract will take some time. Therefore, an instruction to proceed is often proposed, which acts as a contractually binding arrangement, giving the supplier cover for certain agreed work in the period prior to the signature of the final contract. Some key terms that may be included in the ‘letter of intent / instructions to proceed’ are:

**Timetable**

Need to ensure the work starts and proceeds in accordance with a specified timetable.

**Maximum liability for payment**

The customer may want to know what the charges are for and the basis of charging. For example, is it time and materials or a fixed fee?

The customer will also want to know what its maximum liability for payment is.

**Terminate on short notice**

The customer may want the ability to terminate on reasonably short notice if the negotiations do not go well.

**Minimise liability for third party costs**

May want to include wording that the supplier will do whatever it reasonably can to minimise the customer’s liability under the instructions to proceed, particularly with regard to third party liabilities. This encourages the supplier to get discounts and use its purchasing power.

**“Walk away” for customer**

It is also useful to include wording saying that the customer remains free to decline to enter the final agreement if it is unable to negotiate terms acceptable to it. It is also useful stating that the customer has no liability under the instructions to proceed if the supplier simply decides it no longer wishes
to enter the final agreement. This can perhaps be justified on the basis that the customer is prepared to incur costs only on the understanding that the supplier is interested in the ultimate contract. However, such provisions are questionable since it could be very easy for a supplier to find a legitimate reason to pull out. However these types of clauses do provide some comfort if the supplier clearly took a policy decision.

8.15 Key terms to include in tender documentation

Some key terms to include in the tender documentation are set out below.

Response delivery

An important part of any RFP is setting out the terms and conditions for the bid procedure. This includes the delivery requirements, such as:

(a) the time for delivery of the response;
(b) the address for delivery;
(c) the number of copies; and
(d) any other special delivery details.

One of the fundamental principles for any RFP is the requirement that the bid be submitted on or before a specified time. The RFP should contain an express provision that any bid delivered after that time is disqualified and will be returned unopened. The acceptance by the issuer of a bid that has missed the deadline is only likely to lead to a dispute and the issuer is well advised to avoid such a dispute by strictly adhering to its own rules in the RFP.

Many RFP’s contain a provision that requires all materials that are being delivered in respect of a proposal to be delivered by the deadline in order to avoid bidders forwarding supplementary material for consideration after the deadline. In addition to being a source of potential disputes, the receipt of supplementary material also interferes with the timeliness of the procurement process, since the supplementary material would then have to be evaluated and that bid reassessed.
Timetable

The RFP usually contains a timetable that the issuer hopes to follow in the procurement process. For example:

<table>
<thead>
<tr>
<th>Event</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distribution of RFP</td>
<td>dd/mm/yy</td>
</tr>
<tr>
<td>Date of submissions for written questions</td>
<td>dd/mm/yy</td>
</tr>
<tr>
<td>Evaluation of bids</td>
<td>dd/mm/yy</td>
</tr>
</tbody>
</table>

Bid format

The RFP should also specify the prescribed format for the response, such as whether the bid may be submitted electronically and, if large number of copies are required, the designation of a “master copy” which would be deemed to be the “official” bid proposal.

In designing the prescribed format for the response, the customer should attempt to solicit bids that may be easily compared and evaluated.

Qualifications

The RFP should specify the technical qualifications required of prospective bidders. It also commonly includes financial qualifications. A similar pre-qualification requirement, although less common, involves pre-qualification relating to the bidder’s management capability.

Depending on the type of procurement and the goods and services to be supplied, there may also be regulatory qualifications. These could include requirements to hold certain licences (for example, to provide gaming services in the case of procurement by a casino) or that relate to safety and security clearances for the bidder’s premises or personnel.

Disclaimers

Depending on the particular procurement, the RFP may have provisions that specify that no representation is made as to the accuracy or completeness of any data in the RFP and the bidder has the onus of verifying such data.

The RFP could also provide that the bidder is not entitled to compensation from the customer for any time, effort or expense in preparing its bid.
Confidentiality

The RFP could include an obligation on the bidders not to disclose confidential information about the customer. If particularly sensitive / confidential information is being disclosed the customer may want the bidders to enter into separate confidentiality undertakings.

9. General Concepts Relevant for most Software and IT Services Contracts

The next sections cover some concepts which are relevant for the majority of software and IT services contracts. These concepts include:

(a) Warranties;
(b) Service levels;
(c) Termination rights; and
(d) Assignment and novation.

10. Warranties

10.1 What is a warranty?

A “warranty” is a statement (usually of fact) made by one party to the other party, the truth or accuracy of which is assured by the party making the statement.

In practice, a “warranty” is whatever has been designated as such in the contract. This includes promissory warranties, as where a party “warrants” that they will perform services with reasonable care and skill.

There are also warranties that are implied by law into contracts, for example as mentioned in Unit 1, the Sale of Goods Acts 1979 (as amended by the Sale and Supply of Goods Act 1994).

10.2 Purpose of warranties

The primary purpose of a warranty is to allocate risk. If a supplier breaches a warranty, the result is that the party seeking to rely on the warranty (i.e. the customer) can recover its loss (subject to the ordinary rules relating to damages and any liability provisions in the contract).

When considering warranties as a risk allocation exercise, a party needs to be aware that sometimes neither party may have reliable knowledge of the likelihood of a particular risk happening after signing. This may be because the risk is simply unknown to everyone. However, because a party does not
know about a risk and therefore cannot assess the likelihood of it happening does not mean that they should not bear that risk by providing a warranty.

Information gathering

The other function that warranties serve is to enable a party to test the other on a matter before any contract is signed. For example, if the other side are not prepared to give a warranty that all of the information provided by them in the lead up to the signing of a written contract is materially true and accurate, then there must be doubt about the quality of that information.

Warranties can therefore be part of the process of investigating the transaction before any written contract is entered into. However, this tends to be a secondary function compared to the allocation of risk between the parties.

10.3 Warranties – remedies for breach

A breach of warranty is a breach of contract. The breach of contract is committed by the party, without lawful excuse, giving a warranty which is untrue at the time it is made. Remedies which may be available for breach of contract are termination, damages, specific performance, injunction or a combination of these.

A question which often arises in relation to a breach of warranty is whether, in addition to recovering damages, the injured party is entitled to terminate the contract. Whether a breach of contract entitles the innocent party to terminate the contract or to merely claim damages depends on whether the breach is of a condition, a warranty or an intermediate term.

Conditions, warranties and intermediate terms

If the warranty is a condition of the contract, its breach will entitle the innocent party to terminate the contract and claim damages for any loss suffered. Essentially, a condition is a stipulation that goes to the substance of the contract. Whether a promise is a condition turns on the intention of the parties. In determining the intention of the parties the court may pay close attention to the importance of the promise to the contract.

If the provision is merely a warranty, its breach gives the innocent party a right to claim for damages only and does not entitle it to terminate the contract. This is because breach of warranty does not destroy the purpose of the contract and is capable of being remedied by an award of damages.
A third category of terms has also been recognised by the courts - that of “innominate” or “intermediate” terms. Breach of intermediate terms carries a right to claim damages for breach and may also carry a right to terminate the contract depending on the seriousness of the breach (for example, if the non-defaulting party has been deprived substantially of the benefit of the contract as a consequence of the breach).

The label is not decisive

The labels (“condition”, “warranty” etc) attached to the provisions of a contract by the parties will not necessarily determine their legal classification. Therefore, the provisions which are labelled “warranties” are not necessarily warranties for the purposes of contract law – they may be warranties, conditions or intermediate terms depending on the intention of the parties. If breached, a “warranty” may entitle the innocent party to terminate the contract. That said, the label applied by the parties indicates their intention and that intention is not easily rebutted. This means that an untrue statement in a contract which is described as a “warranty” is likely to only permit the injured party to recover damages.

Agreed remedies apply

Notwithstanding the distinction between conditions and warranties at law, if express contractual remedies for breach of a particular term are set out in the contract, these will generally apply.

For example, if the contract states that any breach of warranty (being in this case a statement of fact) gives rise to a right to terminate the contract, the clause becomes similar in effect to a condition. If, however, the contract expressly provides that only a material breach of warranty gives rise to a right to terminate, then the warranties are similar to an intermediate term and it would ultimately be for the court to resolve a dispute over whether a breach of it was sufficiently material to permit termination of the contract.

It is therefore preferable to set out in the contract what are the consequences of a breach of warranty. If your client expects to pay damages for any breach of warranty but not for the contract to be terminated, then the prudent course is for the contract to expressly state this.

Unless the agreement states distinct rights of termination for particular warranties, termination will be regulated by the general provisions dealing with termination for breach. In such a case the party seeking to terminate would have to exercise...
its rights of termination according to the termination provisions (for example, if the breach is capable of being remedied giving the supplier the chance to remedy and if the breach is not capable of being remedied; giving the supplier the agreed number of days notice prior to termination).

10.4 Warranties – damages

A breach of contract entitles the innocent party to damages. As mentioned in Unit 1, the contractual measure of damages is that the innocent party should be put in the position it would have been in if the contract had been performed as it should have been performed (i.e. the warranty was true). This means that the innocent party is entitled to recover what it expected to get if the contract was properly performed - its “expectation loss”.

In the context of a breach of warranty, the measure of damages is usually the difference between the value of the subject matter of the warranty and the value it would have had if the warranty had been true.

The customer also needs to consider the relationship between damages for breach of the agreement and liquidated damages (see Unit 5 for further comment on liquidated damages).

A customer should be advised that if the supplier breaches a warranty, they may not be entitled to recover expenditure wasted as a result of the breach. However, this may be addressed by specific provisions, including by a liquidated damages clause.

10.5 Defects liability period

It is possible that some of the warranties are only applicable during a specified time period (i.e. a “defects liability period”). In software contracts, a defects liability period is commonly referred to as a “warranty period”.

If there is a defects liability period a customer should be advised that it should consider the circumstances under which such period can be extended. For example, if a product does not meet a particular warranty and is then replaced or repaired, should the new or repaired product have the benefit of an extended defects liability period or should it only have the benefit of the original defects liability period?

Generally speaking we recommend that the defects liability period commences from the acceptance of the product (for further discussion on acceptance, see Unit 3).
10.6 Warranties and service levels / support obligations

Unless the warranty is expressed to be a continuing obligation, the customer should be advised that it can only rely on the warranty at the time the contract is entered into.

Therefore, the customer needs to consider the ongoing obligations of the supplier (as it may not be able to rely on the warranty). For example, warranties need to be considered alongside undertakings to comply with service levels, for example, time for response, and other procedures (such as supply of temporary replacements while the supplies are being repaired) (see Unit 4 for further comment on support obligations). Warranties and service level commitments need to work neatly together.

10.7 Third party warranties

In some circumstances the supplier may not be prepared to warrant third party supplies. If this is the case, the customer should ensure that the supplier will assign to the customer, or if it is unable to do so, will hold on trust for the sole benefit of the customer, all warranties provided by third parties in respect of the supplies.

Where the supplier holds the warranties on trust, it should enforce the warranties in accordance with the directions of the customer.

10.8 Points to consider when drafting warranties

There may be many specific points to consider when drafting warranties and these will depend on the type of warranty you are drafting.

Irrespective of the type of warranty you are drafting, the two most important general issues are:

(a) certainty; and
(b) specifying the consequences which will flow from the warranty not being met or observed.

The most important issue is to clearly draft the warranty so that it is certain and will not be ruled void for uncertainty. Too often warranties and representations and performance type warranties are drafted by non-lawyers using technical or quasi-technical terminology and although the originator of the drafting thinks the terminology is clear and certain it is in fact the contrary. Lawyers who are finalising such clauses should ensure they are clear and certain and if they contain technical
terms should ensure that those terms are either well known and understood or are clearly defined.

Secondly, as mentioned above, it is important to set out in the contract the consequences which will flow from a breach of the warranty. In other words, it is essential to make it clear whether it is a warranty as opposed to an intermediate/innominate term or a condition. This is best achieved by making the termination provision in the contract a code for termination and clearly identifying which breaches of which terms will allow the innocent party to terminate and recover damages.

10.9 What to ask for and what to expect?

What the parties should ask for and what they will be able to achieve in terms of warranties will very much depend on the nature of the transaction, the bargaining position of the parties and the commercial overlay (including the insurance regime relating to the relevant contract or project).

In recent times the following approaches have been adopted in some major projects/contracts:

(a) Parties have been prepared to provide warranties regarding the accuracy of critical information, particularly where the other party has not had sufficient time or did not have the ability to satisfy itself regarding the accuracy of the information. More recently parties have focused on what is really being relied upon rather than providing more general warranties as to accuracy.

(b) Parties have agreed to performance warranties in respect of critical performance measures in relation to equipment and specified liquidated damages regimes applicable to breaches of or failure to achieve those warranties.

(c) The parties have agreed that the termination provisions will be a code for termination (meaning that the parties are not entitled to terminate at common law even if the breach does not trigger the relevant termination clause) and have specified which breaches of which terms will give rise to a right to terminate.

11. Service Levels

11.1 Introduction

Service levels which define the performance levels the service provider is required to meet are crucial to the success of an IT services contract. Service levels are useful as they:
(a) set expectations, on both sides, at the outset;
(b) focus attention to customer priorities; and
(c) help both sides to identify incidents and trends, manage performance and when necessary, take corrective action.

Historically, companies began to document, measure and report performance to their internal customers. These internal documents were called “service level agreements”. The term remains, although specific service levels are not, technically, agreements and the tables and metrics attached to outsourcing agreements are not separate contracts. Nonetheless, people refer to “service level agreements” or “SLAs”. This practice spread to IT services contracts.

IT services contracts often include numerous service levels. At least a few are usually labelled “critical” and subject to service credits if they are missed. Others are measured and reported for management purposes, but have minimal, if any, financial consequences.

11.2 Measuring service levels

Service levels should be objective, quantifiable, repeatable measures of matters within the service provider’s responsibility, such as the performance of systems, the resolution of incidents or service requests, or the volume and accuracy of transactions and other outputs. What is critical is that service levels must be meaningful. Service levels which measure too much will be burdensome and costly. Service levels which measure the wrong things will encourage the service provider to focus on certain matters to the detriment of improving the service overall. Service levels must be set with reference to what is important and valuable to the customer.

Many customers consider user satisfaction as very important. For service providers, user satisfaction and surveys can be sensitive, because users’ opinions are (inevitably) subjective. Some expressed dissatisfaction may reflect annoyance with the disciplines and processes imposed by outsourcing, or with the decision to outsource in itself or even simply clashes of personality between particular individuals, rather than the quality of the service. Surveys are often conducted by outside firms, using questions approved by both sides, and measuring satisfaction against a baseline assessment conducted before or shortly after the outsourcing contract was signed. Some surveys deal separately with ordinary users, the customer’s IT organisation, and its executives.
Transactions, such as shipments, deliveries or payments, can be excellent measures of performance, since they reflect actual impact upon the business, and often capture performance of several related functions. Punctual delivery of shipping instructions to a warehouse, for example, may require efficient operation of servers, applications, networks, user workstations.

11.3 Reporting

Service levels should be measured and reported periodically, usually monthly or quarterly. Some should be measured during business hours or other peak periods, and others should be measured 24 hours, 7 days a week, 365 days a year (excluding agreed maintenance periods). The IT services contract needs to specify the frequency of measuring and reporting. The customer may also want to specify the content of the reports.

Many service levels are measured automatically. Sophisticated equipment, for example, tracks calls to the help desk, their duration, the time to answer and other particulars. The service provider’s trouble-ticket or tracking software for help desk calls will report when calls are received and incidents resolved. Many computers produce regular measurements and reports of their performance. In any case, the customer should satisfy itself that performance can be measured easily, inexpensively and accurately.

11.4 Establishing service levels

To negotiate effective service levels, the customer must first decide what matters to its business, and how relevant performance can be measured. Preparation should begin long before the IT services contract is awarded, with thorough analysis of the company’s present performance and needs, and users’ preferences. Surveys of user satisfaction before the proposed transaction often provides a good yardstick for measuring a service provider’s performance, and help the customer to know its own collective mind. The customer could ask itself the following questions:

(a) What works well?
(b) Where is improvement needed?
(c) What matters most to individual users, senior management, or leaders of key business units?

Armed with this information, the customer’s negotiating team is better prepared to propose and negotiate service levels with prospective service providers. Where possible, service levels should be fixed before the IT services contract is signed, rather than afterwards. Using the words
“the parties will agree …” is a failure to address and solve an issue, with the result being a lack of certainty and increase in risk. What if the parties cannot agree later? No court can make them agree. Therefore, you should advise your client not to use these form of words.

Customers want tangible commitments to quality while they retain negotiating leverage before a service provider assumes responsibility for operations. Quality costs money, so service providers need to know what standards will apply before prices are fixed. Neither party will want to begin the relationship with a debate. There are several possible bases for calibration of service levels, including:

(d) The customer’s own existing operations, if adequately documented. This measure is generally most appropriate where the service provider takes over existing operations, and keeps them in place - if existing quality is good. Where current operations are inefficient, historic data may set the bar too low. Sometimes, historic data is incomplete or missing.

(e) The service provider’s own standards for services delivered to other customers. This is particularly appropriate for operations transferred to the service provider’s service centre. If the service provider’s help desk routinely answers 80% of help desk calls within 60 seconds, the customer will expect comparable performance.

(f) Market standards, established as presumptive service levels, and validated during a transition period. Preliminary service levels are fixed at levels the parties think achievable, measured during the transition period. If they are consistently achieved, they become effective after the transition period. If not, the service provider recommends corrective action, which may require investment by the customer. If the customer declines to make those investments, service levels are fixed at levels that can be consistently achieved. This method is often suggested when historic data are lacking.

(g) As a last resort, service levels can be agreed upon after signing, but the customer’s negotiating leverage diminishes when the service provider assumes responsibility for operations. Where the parties disagree, mediation or other expert intervention may help, and in the worst case, the IT services contract may permit early termination if satisfactory service levels cannot be agreed – but such a drastic, disruptive remedy will rarely be attractive.

What needs to be kept in mind is that, especially in long term IT services contracts, improvement in performance is to be anticipated. It will very rarely be the case that the level
of performance ten years ago will be acceptable now. This incremental improvement should often be reflected in the service levels. However, the customer in particular needs to consider what the nature of the IT services contract is and what its primary objective is. IT services contracts are very often entered into when historic performance has been very unsatisfactory and there has been a low level of investment in a particular area. The purpose of entering into new arrangements may be to secure a radical step-change in the levels of performance. If this is expected by the customer then such required improvements in service levels should be documented.

11.5 Classifying service levels

Of the many service levels commonly measured and reported, only a few are usually identified as “critical service levels”. Usually only failures to achieve critical service levels would expose the service provider to financial liability (in terms of being subject to “service credits”). Network outages and failures of key systems that disrupt production are the kinds of service levels often classified as “critical”.

In practice, critical service levels are rarely missed. Service providers pay attention to critical services (at least in part because of the financial consequences), and never sign up for standards they cannot routinely meet. Difficulties more often arise with services of lesser importance, where mediocrity may irritate users, but cannot seriously disrupt the customer’s operations (or, except in extreme cases, constitute material breach sufficient to justify default termination). Long delays at the help desk, interruptions in electronic mail, mismanaged service calls and other such irritants can cause almost as much frustration as more serious, but rare, failures of major systems. To manage this risk, the IT services contract should have a second category: “standard service levels” that are measured and reported monthly, but bear only modest financial consequences at least initially but which can escalate if repeated or if they continue on a large scale.

Sometimes service levels are classified in tiers, with minimums (which cannot be missed without consequences), normal or expected service and more aggressive targets (which might, if exceeded, permit the service provider to collect incentive payments or “bank” credit against future failures). Thus 99.9% availability may be the target, 99% the norm, and 98% the minimum, below which service credits are paid.
11.6 Service credits

Service credits are an attempt to incentivise the service provider and compensate the customer in a pre-agreed manner for levels of performance which are not perfect but not disastrous either. Detailed comments on service credits can be found in Unit 6.

Task 8
Assume you are advising a client who is negotiating with a service provider for call centre services (i.e. the service provider will be running the call centre for your client). The client asks you for advice in relation to what service levels should be included in the contract?

12. Termination

12.1 Overview

The most stressful point a contractual relationship is likely to reach is its breakdown and termination. Even where one of the parties is exercising a right to terminate “for convenience” or “at will”, the termination of the agreement may well have significant consequences for the business of the other party.

A key strategic question for parties to a contractual dispute will often revolve around the question of whether one or other of the parties is entitled to exercise a right to terminate, and the consequences of such an exercise. In particular, the purported exercise of a right to terminate for breach, in circumstances where the party is not so entitled, can have a disastrous effect on the strength of that party’s overall position in the dispute. Accordingly, both the drafting of rights and consequences of termination, as well as the analysis of the exercise of such rights, require significant care.

Indeed, experience indicates that although IT customers and suppliers generally want an agreement which accurately records the commercial deal between them, their ultimate goal in negotiating contracts (and, effectively, the reason they really spend money on lawyers), is to know that their legal position is adequately protected if there is a dispute.

This section examines the basic legal principles surrounding the termination of agreements, considered in the context of software and IT service contracts generally. It focuses on the following key issues:

(a) the termination of an agreement “for convenience” or “at will”, including the imposition of “termination” or “break” fees;
(b) the termination of an agreement due to the other party’s insolvency, and the consequences of such a termination, including the potential release of source code from escrow;

(c) the termination of an agreement for breach, including:
   (i) common law rights to terminate for breach;
   (ii) express contractual rights to terminate; and
   (iii) rights to terminate for repudiation or anticipatory breach; and

(d) the restrictions which may exist in the exercise of an otherwise clear right to terminate an agreement.

12.2 Termination for convenience

It is common, particularly in longer term IT service contracts, for one party (for example, the customer of the IT services) to seek the right to terminate the agreement “for convenience” or “at will” (that is, without there having been any breach of the agreement by the non-terminating party).

In the vast majority of cases, such a termination will involve the exercise of a contractual right: that is, the right will only exist if expressly included in the agreement, as opposed to a right which may be conferred by law. Note, however, that in certain circumstances, a court may imply a right to terminate for convenience upon reasonable notice.

The question of a termination for convenience right is particularly contentious in larger, longer-term agreements such as large scale IT outsourcing agreements. In such arrangements, the commercial realities for the service provider are likely to be such that it will not make a significant profit on the arrangements until some years into the term, whereas for the customer, some level of flexibility in respect of major strategic changes may need to be retained.

There are a number of specific issues which both suppliers and customers of IT services should consider in the negotiation and drafting of such rights, including the following:

The period of notice required for the customer to exercise such a right

Generally speaking, this is likely to depend upon the term of the agreement itself, but, commonly the service provider will seek to defer the date for exercise of such a right so as to ensure that the contract will not be terminated in the first, for example, three year period (particularly if, as discussed above, the pricing model adopted by the service provider recoups its
start up costs over the term and so defers profits to the later years of the contract).

Further, the customer will have an interest in being about to exercise the right of termination as quickly as possible whereas the service provider will want to implement a lengthy notice period. It should be noted, however, that if the customer will be responsible for the service provider’s costs because of early termination; a generous notice period may enable the service provider to reallocate its resources in such a way as to mitigate its loss and thereby reduce the costs payable by the customer; and

What amounts, if any, the customer should be required to pay to the service provider upon the exercise of such a right?

It is commonly accepted, particularly in longer term IT services contracts, the customer will need to pay for un-recouped start-up costs and/or “wind-down” costs incurred by the service provider, including costs of equipment, redeployment of staff, premises and the like. These may well be itemised in a separate schedule to the agreement, ideally providing a clear basis upon which such costs can be calculated; and

A far more contentious question is the extent to which the service provider should be compensated for the “lost” profit which occurs due to the termination for convenience. It is not unusual for a service provider to seek to impose a termination fee (often called a “payout” or “break” fee) on the customer if the customer exercises its right to terminate at will.. This fee is often either calculated with some reference to some projection of the profit or revenue which the service provider would have earned had the agreement continued for the term, or, sometimes, simply by reference to a particular figure (which may itself decrease as the contract term progresses).

Partial termination

A further issue for the parties to consider is whether a partial termination of the agreement is permitted. (This can, of course, be an issue in respect of either termination for convenience or termination for breach). Consistent with the general objective of maintaining flexibility and choice, in particular in long term IT service contracts, customers sometimes wish to secure the right to terminate one part of the contract (for example, one particular line of services) while retaining other parts of the contract. Although there is no conceptual difficulty with such a right, the parties should carefully consider the impact of the exercise of such a right on the remainder of the agreement.
In particular, from the service provider’s point of view, the application of a termination fee in respect of the terminated services and, perhaps even more importantly, whether the provision of the remaining services remains economic on the agreed terms, or whether a partial termination of some services should give rise to a price adjustment in respect of the remaining services.

12.3 Termination for insolvency

It is common for one or both parties to an agreement to have an express contractual right to terminate in the event of the other party’s insolvency or, indeed, in the event of the occurrence of one of a number of (often broadly drafted) “insolvency events”.

Clearly, such a right may be of critical importance in allowing a party to extricate itself (at least to some extent) from the fortunes of a collapsing entity. Note that some customer’s may resist the right for the service provider to terminate because of the customer’s insolvency by arguing that the right to terminate for failure to pay provides adequate protection. This tends to overlook, however, the risk to the service provider of a liquidator exercising its rights to recover some of those payments in certain circumstances.

A particular issue which arises in respect of licensed software is whether the customer of that software will be able to continue to properly use and operate the software following the insolvency of the software service provider. Without access to the source code, the customer will be dependent upon the service provider (or the successor to the service provider’s business) for the continued maintenance of the software.

Accordingly, it is common for customers to seek that the source code for the software be held in escrow by a third party, and that one of the triggers for its release is the insolvency of the service provider. Further comment on escrow arrangements is in Unit 3.

12.4 Termination for breach – common law right

Given that the majority of software and technology services contracts would usually contain express contractual rights to terminate, rather than relying on the common law rules, it is not necessary to dwell on this analysis.

However, it is useful to note that a party maybe entitled to terminate an agreement for the other party’s breach notwithstanding the lack of such express contractual rights.
Whether such a right has accrued will depend on the breach itself, based on the well-known tripartite categorisation of contractual terms as follows:

(a) conditions, any breach of which will give rise to a right to terminate;

(b) “intermediate” terms, “serious”, “substantial” or “material” breach of which will give rise to a right to terminate; and

(c) mere warranties, breach of which will not give rise to a right to terminate, but may entitle the innocent party to damages.

12.5 Contractual rights to terminate for breach

The question of whether a contractual right to terminate has been triggered by a particular breach of contract by the other party is simply a question of the construction of the termination right itself (i.e. a court would simply need to determine whether the party exercising the right simply has done so in circumstances which make the right relevant, and has exercised the right according to its terms).

Commonly, parties will simply rely on the concept of a “material” or “substantial” breach of the agreement as the trigger for the exercise of the termination right (or perhaps a breach of a “material” term). However, this has the potential to give rise to significant uncertainty as to whether a particular right of termination has been triggered in any particular case. Accordingly, particularly in larger scale IT contracts, parties may designate breaches of particular terms to give rise to the termination right. This could be achieved by either by specifically providing for a right of termination on breach of the relevant provision, or deeming the relevant provision to be material for the purposes of the termination clause. Some examples include:

(a) particular serious breaches such as, confidentiality, data protection, warranties regarding performance of the IT systems or software, assignment without consent or failure to meet key milestones (such as implementation of a core system);

(b) repeated breaches of service obligations, for example an entitlement to terminate if there is a failure to perform X times in Y months or consistent failure to meet Z performance levels; and

(c) a substantial failure to pay. Although customers will almost certainly accept that the service provider has the right to terminate, or at least suspend performance, for non-payment, it should be anticipated that:
(i) the customer will wish to clarify that withholding payment because of a genuine dispute does not give rise to a right to terminate. In these circumstances, the service provider should ensure that the failure to pay money into escrow (if such a procedure is part of the dispute resolution arrangements) will also amount to a breach; and

(ii) customers will usually expect that the right to terminate can only arise after repeated failures to pay; a single oversight will not be enough.

The other important aspect in respect of contractual rights to terminate for breach is the procedure which must be followed in exercising the right. Although this will again be a question of the construction of the particular term setting out the rights, some general principles are relevant as follows:

(a) it is common for there to be a specific period of notice required in respect of such a termination (although there may be some events which are so unacceptable that a party will want the immediate right to terminate); and

(b) such notice may or may not involve the right for the non-terminating party to seek to “remedy” the breach (commonly, such a clause would differentiate between breaches which are capable of remedy, and those which are not). Note that if a party is contractually entitled to such a “cure” period, the terminating party must wait until the expiration of such a period, even if it is highly unlikely, or even impossible, that the breach will in fact be cured (see Hungry Jack’s Pty Limited v Burger King Corp (1999) NSWSC 1029).

12.6 Termination for repudiation or anticipatory breach

Notwithstanding the existence of express contractual rights to terminate for breach, it is likely that common law rights to terminate based on the repudiation of an agreement by the other party will remain.

Such rights focus not on the actual breach of the agreement by the non-terminating party, but on failure by the non-terminating party to be ready and willing to perform its contractual obligations. In effect, the doctrine allows a party to terminate the agreement based on an anticipated absence of readiness or willingness to perform as and when the appropriate time for performance arises.

A key principle to bear in mind is the general rule that a wrongful termination (for example, a termination based on an alleged “material” breach, in circumstances where the
breach did not in fact occur or was not in fact material) itself constitutes a repudiation, giving rise to the right for the other party to terminate.

12.7 Fetters on the right to terminate

There may be a number of grounds upon which a party may be restricted from exercising an otherwise clear right to terminate. These include:

(a) the doctrine of election: a party may, for example through its conduct, have elected to continue with the contract and thus waived its right to terminate;

(b) where an estoppel may operate to prevent such a right being exercised;

(c) potentially, where the party seeking to exercise the right of termination is itself in breach of the agreement;

(d) where other equitable doctrines operate, for example the rules in respect of relief against forfeiture;

(e) where the termination might itself be unconscionable (see generally Sunbird Plaza Pty Limited v Maloney (1988) 166 CLR 245) or contrary to an implied duty of good faith (see Renard Constructions (ME) Pty Limited v Minister for Public Works (1992) 26 NSWLR 234); or

(f) where statutory considerations might apply.

13. Assignment and Novation

13.1 Background

In a services economy, the topic of assignment and novation of contracts is an important one. Lawyers are compelled to consider the implications of the rules on assignment and novation of contracts in a wide range of situations, such as:

(a) ongoing services contract (for example, contracts for the maintenance and support of software and equipment in the IT industry);

(b) contracts for supply of telecommunications services;

(c) contracts for provision of facilities management services; and

(d) agreements for providing security monitoring services.

For all sorts of reason, the parties may want to substitute a third party as the service provider from a specified date. These reasons could include:

(a) a corporate restructure or reorganisation; or
(b) sale or purchase of a business that includes the relevant contracts. There could be many reasons to prefer a novation to a simple assignment of the benefit of the contract. Clearly, the driving issue will be a need to move the future liability for performance to the transferee.

Before we consider some practical approaches to novation of contracts, let us examine the law as it affects assignment and novation contracts.

13.2 The assignment of contractual burdens

The benefit of a contract is a chose in action which, generally, can be assigned. (A “chose in action” is a personal right of property which can only be claimed or enforced by (legal) action, as distinguished from one which is enforceable by the taking of physical possession). However, it is a reasonably settled principle that obligations under a contract cannot be assigned; they can only be transferred by novation.

13.3 Legal requirements for effective novation

Novation is the process by which one contract is entered into in substitution for and supersession of another contract (or part thereof). The two core elements of novation are:

(a) the rescission, by agreement, of an existing contract between the continuing party and the retiring party (or part thereof); and

(b) the entering into of a new contract, which may or may not be on the same terms as the original contract, by way of substitution, between the continuing party and the substitute party.

There must therefore be privity of contact between the continuing party and each of the retiring party and the substitute party. This means that in every novation there will be at least three contracts which are relevant:

(a) the original contract;

(b) the contract of rescission; and

(c) the new, superseding contract (although, as a matter of convenience, the parties may choose to consolidate the latter two contracts into a single agreement).

If the two original contracting parties do not agree to discharge the original contract, there will not be a rescission and there will therefore be no novation. Anything less than the extinction of contractual rights will not suffice. Also, the contract must be extinguished by way of rescission and not discharged by
performance. It is not possible for the original contract and the new contract to co-exist. The rescission of the original contract and the creation of the new contract are linked and dependent on each other. General principles of contract law apply in determining whether or not a new contract has come into existence.

The safest way to effect novation is to obtain express written consent. Having said that, no formal requirements exist as to the manner or form in which a novation may be effected. There is no need for a special formula of words to be used nor for a novation to be manifested in writing. The inquiry in each case will be, on the facts, did the parties intend that a novation should occur? That is, did the parties intend that the original contract should be rescinded and that a new contract be created by way of substitution?

The courts have accepted that, in certain circumstances, consent to a novation may be effected by conduct. In order for this to occur, the obligee must agree to rescind the existing contract and accept the new contract with actual knowledge of, and agreement to, what is happening. In determining whether or not an obligee had actual knowledge of, and agreed to, the novation, the Courts have accepted that:

(a) the provision of notice of the novation to the obligee is not sufficient, of itself, to constitute agreement;
(b) inactivity on the part of the customer may be indicative of consent but, by itself is not sufficient to effect a novation; and
(c) acceptance of benefits from the new contracting party by the obligee may indicate consent, especially where there is something to indicate that the obligee is accepting the benefits from the new party in substitution for benefits which the obligee could otherwise demand from the retiring party.

13.4 Novation versus assignment

Assignment has been defined as

"a transaction between the person entitled to the benefit of a contract (called the creditor or assignor) and the third party (called the assignee) as a result of which the assignee becomes entitled to sue the person liable under the contract (called the debtor)."

The differences between novation and assignment are subtle but many. They include the following:
Transfer of obligations

The main difference is that novation effectively allows for the burden of a contract to be shifted from one party to another. As mentioned above, it is reasonably well established that a transfer of the burden of a contract is not possible with an assignment, even though the contract may provide for assignment and the other party may have consented to it. Party B can assign its right to require Party A to perform under a contract to Party C, but it cannot assign to Party C the obligation the Part B has to pay in return. Party C is not liable unless Party C agrees to be liable, receives consideration and Party A agrees to that arrangement. However, this becomes a novation of the contract and not an assignment.

Consent

It is not generally necessary to obtain the consent of an obligee before an obligor can assign contractual rights to a different obligor. Two exceptions to this rule occur when the contractual rights which are subject to the assignment are of a personal nature (to be performed by an obligor with particular attributes or skills) and when assignment is expressly forbidden in the contract. Consent is essential to novation as it also involves the transfer of a contractual burden.

Pre-existing causes of action

An assignee receives the assigned rights subject to any pre-existing rights and defences against the assignor, whereas a novation does not involve such a transfer. One contract is rescinded and replaced by a new one; the rights and obligations of the parties to the new contract are not determined by what the rights and obligations to the original contract were. This is a matter for the parties to negotiate (see below). If they intended only to rescind the original contract without affecting the causes of action, so be it. On the other hand, if it was contemplated that the original contract and all accrued causes of action arising out of that contract were to be discharged by the novation, that will be the effect.

Connected to this, the time at which the question as to what contractual damages were foreseeable or foreseen, is the time at which the novation took place. With an assignment, the existence of contractual rights is unaffected, so the remoteness of damages is determined with reference to the time that the original contract was entered into.
Variation of terms

In a novation the terms and conditions of the new contract are to be ascertained according to ordinary contractual principles. The terms and conditions may well differ from the original contract. This is to be contrasted with an assignment, where the assignee will take his or her assigned contractual rights according to the terms of the original agreement.

13.5 When is consent for the novation from the continuing party required?

Consent is essential to novation and is required by all parties. When consent is lacking on the part of one party, the transaction fails and there is no novation. This means that if parties B and C agree amongst themselves that C is to take B’s obligations under a contract with A, and A’s consent to this agreement is not obtained, the contract between A and B will not be novated. In other words, C’s assumption of liability per se does not affect the legal relationship between A and B. This is because it is not competent for one party to a contract to effect a novation on that contract without the knowledge and consent of the other. Novation cannot be forced upon A without A’s consent. This argument runs just as well if any of the parties find themselves in the position of needing to give the required consent.

13.6 Allocations of performance obligations between the incoming and outgoing parties

It is a reasonably settled principle that a novation need not be of the whole existing contract, but can instead be for part of the contract. The same principles apply however, in that rescission of part of the existing contract needs to have taken place and a new contract entered into in substitution for that part. In this scenario, it can be seen that obligations of performance are “allocated” between the continuing party and the original contractor as set out in the agreements.

13.7 Is there consideration?

The rescission

The agreement between the parties to rescind is in itself a contract and must therefore be supported by consideration. The consideration for the rescission of the original contract is likely to be:

(a) the promise of the obligee to give up its contractual rights against the obligor; and

(b) the obligor procuring the entry of a new obligor into the new agreement with the obligee.
The new contract

The consideration for the new contract would be:

(a) the promise of the obligee to release the obligor from its obligations under the original contract; and

(b) the promise of the new obligor to perform (or actual performance) in accordance with the new agreement with the obligee.

These mutual promises will constitute sufficient consideration to support the agreement.

13.8 Areas for negotiation

Let us assume for a moment that parties have agreed upon novation as the best method for transferring a contract. There are a number of subjects that could be the subject of negotiation between the parties (transferor, transferee and obligee) in the context of a proposed novation. These will include the following:

(a) The effective date of the novation. This will be the date when the existing contract is terminated and a new contract is entered into between the transferee and the obligee.

(b) Will any of the obligations need to be varied? This could occur because of changed expectations of the parties since the time when the existing contract was entered into. It might also be necessary to reflect undocumented changes to the manner of performance of obligations under the existing contract by the transferor. There may be some services which will not be required by the obligee. Conceivably, the parties might choose to terminate the existing contract only in respect of certain services, and to create a fresh contract between the transferee and the obligee only in respect of those terminated obligations.

(c) Should any of the parties be seeking representations and warranties concerning performance under the existing contract prior to the effective date?

(d) An obligee might want the transferee to agree that any claims it has (or may in the future have) in respect of performance by the transferor can be “carried forward” under the new contract.

(e) Depending upon what is agreed concerning the terms of novation, the transferee might want to obtain specific indemnities from the transferor concerning claims (including third party claims) relating to the period prior to the effective date. Different considerations might apply.
in the context of a sale and purchase of business if the transferee has factored into its price negotiations the risk of claims for which it is responsible that are connected to the period prior to the effective date.

(f) Depending upon the circumstances of the transaction, the transferor might see a release of claims by the obligee or vice versa. In particular, this is something which might be requested in the context of the insolvent administration of the transferor.

(g) Sometimes parties will ask an obligee to undertake that it will not sue the transferor (or for that matter the transferee) in relation to certain categories of claim. These might include claims of a particular character or which relate to a specific period.

13.9 Getting consent of obligee

It is now helpful to make some observations about what is needed to get the consent of the obligee to the novation.

Some of you may have received communications from providers of credit card facilities which state that from a specified date, the credit provider will be a stipulated third party.

Typically, the communication goes on to say that use of the credit card after the specified date indicates consent to the novation on the part of the credit card holder. In practice, many credit card holders do not read the communications which they receive from their credit providers. From a legal technical viewpoint, this is a little unsatisfactory.

It is enough to observe that where the consent relied on is simply conduct contemplated under the contract, there will always be doubt about whether or not consent has been obtained.

In the credit card context, a more accurate method of achieving the novation would be to have the existing credit card provider terminate for convenience (credit card contracts invariably provide for this), and for the existing credit provider to transfer the benefit of its contract to the incoming credit provider. The incoming credit provider would make a fresh offer of credit to the customer on the same terms (on the basis that it would apply charges relating to future use of the card to the same account).
All of this perhaps highlights the fact that a short tripartite novation contract is strongly preferred whenever this is possible.