

A Thorogood Special Briefing

Chapter 1

The IT Contract Environment

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The IT Contract Environment

The IT industry is still young, dynamic, amorphous and growing. Evolution and change are taken for granted. The kinds of contracts which are made are affected by the development of IT and of the IT industry.

IT ubiquity

The computer has become pervasive – a web of interconnected devices in constant use, embedded into everything. All organisations in business, commerce, professions, not-for-profit and the public sector will use IT as an essential part of their business. They will be using the internet, displaying information and marketing material on websites, entering into e-commerce contracts, using hardware and communications technology, and licensing software and databases. They will be using services to enhance their use of software and technology. Every organisation will be making a major investment in IT or services from time to time.

Computing is ‘ubiquitous’, with distributed interactive systems, networks connecting large numbers of components of various kinds, including small devices which can be embedded in many things and sensing technologies to relate to the physical environment. Computing reaches everyone as a background part of everyday life taken for granted, in the activities and functions which it supports.

Internationalisation

IT has long been an international industry, the technology itself enabling independence of physical location, and with combinations of products and services from different countries traded internationally. It used to be the case that many IT contracts had their origins in US law and business practices. In the last quarter-century the European Union (EU) has influenced IT law in harmonisation of some aspects across its member states.

There are numerous channels of marketing, supply and distribution from the manufacturer to the eventual end user, and varying routes to procurement, often cross-border. This all has implications for the different kinds of contracts being created between the parties, some of whom within the supply chain will be both customer in buying or licensing from one or more vendors, and also supplier, putting together the different elements of a product and adding value for onward supply. This supply also is becoming more and more international – including India, the Far East, the US and Europe. Sending the management of IT functions and processes offshore through outsourcing provides savings. The international business context brings into focus the law and jurisdiction clauses of the contract and its enforceability.

Commoditisation

Hardware contracts used to be negotiated, but now hardware and much software has become a low margin commodity which is likely to be supplied on standard terms and conditions. Modules and routines are coded and then customised or combined with other software in various ways, with little adaptation, utilising various skills and services. Numerous software components can be re-used. Software applications are often delivered electronically on a one-to-many basis, the hosting and maintenance being carried out on a central system remotely. Meanwhile the number of service-related industries and activities is growing. Service providers can exploit economies of scale for many users.

The growth of information

Commoditisation has also affected information. Through advances in technology, and especially using the world wide web, information may easily be collected, collated, organised and structured, for example through on-line commercial databases which are continually updated and profitably traded.

Much information is readily available for direct access, often at no cost to the user, although frequently with no checks on accuracy or reliability. This has led to a greater recognition of intellectual property rights and greater opportunities for infringement, particularly for material protected by copyright. Owners of rights in software appreciate the need for its protection by contract as an economic asset, to exploit it commercially and to prevent its unauthorised use, reproduction and modification.

Innovative business models

Suppliers must keep refining and enhancing their products and services for continuing marketability. Together with continual technological advances, more sophisticated and innovative ways are found by IT entrepreneurs to share development and marketing risks, and to distribute products and services, to make profits. New kinds of contracts evolve, to structure the transactions and to allocate responsibilities and rights between the parties.

Technology is itself a facilitator for progress and strategic use of IT enables businesses to stay competitive. The internet is transforming ways of doing business. In the EU legislators are attempting to encourage e-commerce transactions by various laws and regulations to protect purchasers, especially consumers, but take-up is still at an early stage.

In this go-ahead environment technical knowledge is not synonymous with business awareness. Companies are not always successful. Yet there is immense ability, determination and resilience to move on, try again and do better next time.

IT contract relationships

As in most areas of business, IT suppliers and customers have different commercial perspectives in making contracts. Historically IT suppliers were often in a position to dictate the terms they wanted. There might be only one unique product available to buy at the time of the decision. The customer came to the negotiating table in ignorance of what terms were reasonable to accept and what were not. On the other hand, there were also very small IT companies whose technically brilliant founders had little idea of negotiating realistic commercial terms with large overbearing user organisations – whose contract managers were themselves not necessarily skilled in understanding the IT market.

Many suppliers and customers have now learned negotiating skills and gained some idea of the legal context, and customers have acquired greater knowledge of the technology environment in which they are making their purchase, with informed Board support.

Technical and quality standards and management methodologies are commonly invoked to assess levels of service and reliability.

Unlike many commercial contracts, in IT the relationship between the parties does not end once the initial performance of the contract has taken place; when the hardware has been installed, the system implemented or the services provided. There will be an ongoing requirement to maintain the hardware, support the software or deliver more services.

A well-managed relationship between the parties should be defined in the IT contract. It has to be co-operative, yet must be at arm's length. Over a number of years, people move on and the individuals negotiating or managing the contract will not stay the same. The contract should specify what is necessary from each party for effective operation in terms of communication and reporting, as well as what services are to be provided at what charges. As part of the formal communication procedures, dispute management processes should also be built in to minimise disruption, since over a period of time differences in interpretation and perception are almost bound to arise occasionally.

A contract should be definite with unambiguous wording and unequivocal conditions so that it is binding and enforceable. Yet an IT contract must also build in change control procedures and other means of allowing for flexibility during its life.

With greater complexity of IT, its use in safety critical systems and its increased interaction with other systems over which the supplier has no control, the supplier's risks can be great. In a relationship taking the benefit of the supplier's experience, there is no point in a customer driving such a hard bargain over such ambitious performance levels, relentless reliability or tight profit margins, that a competent supplier will not survive.

The IT industry continues to grow and change, and therefore IT contracts will continue to evolve.