

DBRIEF

Issue 48



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Welcome

Welcome to the first governance focused issue of Dbrief. With the new regulatory regime coming into force on 1 April, we highlight how this could impact Registered Providers' constitutions.

This issue also focuses on issues of banking and corporate law that will be of interest to both Registered Providers and unregulated trading companies.

Happy Reading!

New World, New Rules

In this article we explain the impact of the new Regulatory Code on constitutions for our Registered Provider (RP) clients and discuss what changes our clients should be considering making to them. In essence, post 1 April, constitutions can now be made more flexible and can be more tailored to our clients requirements than was previously the case.

The TSA's new regulatory code is now in force. There are three key changes, so far as constitutions for "non profit making" RPs are concerned:

The first is that the TSA will not have a role in approving rule changes except where they relate to:

- Removal of any lock on distributing profits
- Changes to a group structure
- The objects

The second is that RPs will be required to formally adopt a Code of Governance.

The third is that "Schedule 1" (the restriction on the ability of RPs to make non-contractual payments and grant benefits) no longer exists.

Our position is that the combination of the changes means that:

- Restrictions in constitutions which were only included at the behest of the Housing Corporation no longer need to be included. This includes items such as additional quorum requirements as well as the Schedule 1 requirements.
- Items which are not legally required in the constitutions but represent "good governance" provisions should also be removed on the basis that instead RPs will comply with their selected Code of Governance.
- The objects of our clients can be expanded.

The distinction in both cases is important. In the first case, this is because until the "schedule 1" related provisions are removed from the constitutions they will continue to bind members. The second is important because whilst the governance arrangements are included within constitutions they continue to bind the body; whilst if they are solely included in the Code, then RPs can breach them on a "comply or explain" basis in their annual report.

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Derivatives – What are you getting yourselves into?

Derivatives and other related transactions that seemed like a good idea in one economic climate can be a lot less so in changed times. The English courts are proving themselves robust at holding commercial parties to the bargains they freely enter into even if past performance really does prove no guide to the future and a transaction turns out to be unprofitable.

The recent High Court decision in *Titan Steel Wheels Limited v Royal Bank of Scotland plc* [2010] EWHC 211 (Comm) continues a line of authorities which hold contracting parties to the terms as agreed regardless of whether they subsequently become unprofitable for one party. This case is important for anyone who has entered into unprofitable derivative transactions.

Facts

Titan Steel Wheels Limited (**Titan**) manufactures steel wheels for off road vehicles, most of its income is in euros and most of its costs are in

sterling. Titan therefore faces a currency risk to its profitability in that if the euro declines against sterling then its profitability will be hit as more of its income will be required to meet its costs. Equally, should the euro rise against sterling Titan's profitability will increase as a result. Foreign exchange markets offer options to companies in this situation including foreign exchange transactions, options and other more complex structured transactions.

Over a long period Titan, in order to hedge its risk, entered into foreign exchange transactions with various banks including Royal Bank of Scotland plc (the **Bank**). Titan's transactions with the Bank were structured so that Titan had the option to sell a number of euros each month to the Bank at a fixed rate if sterling rose above that rate against the euro. If sterling remained in a band between that ceiling rate and a floor rate then Titan could sell its euros to the Bank at whatever the market rate was; however if sterling fell below the floor

rate then Titan was obliged to sell a certain number of euros to the bank at that floor rate regardless of how low sterling had dropped. Titan had therefore hedged its potential risk if sterling suddenly shot up against the euro but at the cost of foregoing its potential gain should sterling plummet below the floor rate. Titan entered two of these transactions in June and September 2007.

In the period following the transactions sterling did indeed fall below the floor rate meaning that Titan was tied in to unprofitable contracts. Titan advanced three arguments as to why it should not be bound by the contracts or was entitled to compensation for its losses.

The Bank had breached the FSA's Rules

Firstly, Titan was seeking to make a claim against the Bank under section 62 of the Financial Services and Markets Act 2000. Only a *private person* can bring a claim under section 62 so the first issue for the judge was whether Titan met the definition of a *private person* under the Act. A company will not be a private person if it "suffers

argument also. The judge felt that the Bank had discussed the transactions with Titan but that these discussions were focussed on the Bank **selling** the transactions to Titan rather than the Bank **advising** Titan as to their suitability. The fact that there were no documents appointing the Bank, no requests for advice (written or oral), no fee charged and that Titan shopped around for these products were all indicative of the Bank not being appointed as an adviser. All communications made between the Bank and Titan included a statement that Titan should not rely on the Bank for advice or recommendations of any sort and that it should seek independent advice should it feel that it was necessary.

The Bank's terms fell within the Unfair Contract Terms Act 1977 (UCTA 1977)

Finally, Titan sought to argue that the Bank's terms fell within UCTA 1977. If this was the case then the Bank could only rely on these terms if it could prove that these were reasonable. As the terms defined the Bank's obligations rather than

"This case is important for anyone who has entered into unprofitable derivative transactions."

the loss in question in the course of carrying on business of any kind". Titan argued that its business was the manufacture of steel wheels and not currency trading and that the structured transactions were not therefore undertaken in the course of its business. The judge disagreed for two reasons. Firstly entry into the transactions, even though it was outside the main business, was a business in itself as it was done for profit and not for any other purpose; secondly that Titan's accounts showed it had used this type of transaction to hedge its currency risks previously and that this was sufficient to state that Titan did indeed carry on the business of currency hedging.

The Bank had acted as a trusted adviser to Titan

Secondly, Titan argued that as the Bank had acted as a trusted adviser to it, the Bank owed a duty of care to Titan in relation to the advice it gave, including advising Titan as to the suitability of the transactions for it. The judge rejected this

attempted to limit their liability, the judge felt that they fell outside of UCTA 1977. The judge went on to state that even if the terms fell within UCTA 1977, they were reasonable as the bargaining positions were relatively equal. Titan also had the option to obtain independent advice and the Bank's terms were not out of kilter with the rest of the market.

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Schedule 1 - Dead But Not Buried

Since 1st April, it's been common knowledge that what was known as "Schedule 1" (or the restriction on payments and benefits) has been replaced by the new Governance Standard – and by implication the new National Housing Federation Code of Conduct.

However, less known but equally relevant is that part of what we know as the old "Schedule 1" regime remains in place. This is set out in Section 122 of the Housing & Regeneration Act 2008.

Section 122 restricts the payment of any gifts, dividends and bonuses by non-profit Registered Providers.

Unlike Schedule 1 it is limited though to payments made to shareholders (or in the case of a company limited by guarantee, its members), former shareholders/members, close relatives and to companies whose directors are any of these persons.

The implications here are significant. For example, usually all non-executive board members are

And like with Schedule 1, because the restriction is set out in statute, no relaxation of this provision is possible without amending legislation.

As things currently stand though, perverse breaches are possible – for example,

- a breach would technically occur with the purchase of flowers for an outgoing board member (who is also a shareholder).
- residents with arrears may not be able to agree a write off with the RP.

A key point here is that there is no sub-limit below which a gift is permissible.

Board member shareholders also need to be aware about the ongoing nature of the restriction and the impact on any business in which they or a close relative of theirs is a director.

Inevitably in the meantime, the way in which we would recommend on our clients focus on this is to ensure that payments are made under services agreements so that they are not characterised as gifts.

“clients updating their Codes of Conduct/Probity Policies, should bear Section 122 in mind.”

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shareholders so they are caught; as are the businesses in which they work. And the restriction is no longer time

limited to one year after their departure. In addition, where residents are also shareholders they too are caught.

And unlike Schedule 1 there are no exemptions to it other than:

- Where they relate to loans or investments made by that shareholder in the RP;
- In certain defined cases in relation to fully mutual housing co-operatives;
- Where the payment is made in accordance with the constitution of the RP to another RP member of its group. This enables gift aid payments to be made between RPs in a group.

Like with Schedule 1 payments made in contravention of Section 122 can be reclaimed by the RP or by the TSA on their behalf at any time.

In the meantime, clients updating their Codes of Conduct/Probity Policies, should bear Section 122 in mind.

Looking forwards, our aspiration is that an amendment is made to the provision in forthcoming legislation which would:

- pass discretion to the regulator to permit breaches
- permit payments to shareholders who are also board members as part of their services package
- time limit the restriction like with Schedule 1 to one year after termination of the shareholding

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Outsourcing Operations - Managing the Process

Avoiding two jobs!

Increasingly, pressure on business efficiency means that many organisations are looking at outsourcing. To many an outsourcing involves the transfer by a business (the **Customer**) to a third party (the **Supplier**), the operational responsibility for the provision of certain services that are currently provided "in house".

In practice, all too frequently, for those close to the operations of the business, managing the process of transferring the operation of the services may feel like taking on a new job. That is – in addition to their existing day job!

Unlike with an outright transfer, which ends with the post signing drink, signing the outsourcing agreement marks the start of the relationship between the two organisations. For those contemplating outsourcing an operation, forward planning is an essential part of the timetable. This is not only to minimise disruption in the provision of the existing service but also to save management time and fees.

It is important to clarify the division of functions. It is also critical, at an early stage of discussions, to

- will any of the key staff involved in running the services, who would otherwise automatically transfer need to be retained by the customer? If not, steps need to be taken for the counterparty and the relevant staff to agree that certain key staff will be retained so that business does not lose the "brains" or "corporate memory";
- are there any relevant staff who also work for part of their time elsewhere in the customer? If so, where are they to end up?;

One result of the application of TUPE is that the transferor has an obligation to inform and consult, collectively, with employee representatives. While this may just sound like good HR sense, it is important because it affects the outsourcing project's timetable. Information must be supplied long enough before a "relevant transfer" to enable proper consultation to take place.

If there is a failure to consult, any affected employee may obtain what is known as a "protective award" of up to a specified number of weeks actual pay (unlike redundancy and unfair dismissal compensation, there is no statutory limit on the amount of the week's

“Accordingly, it is important that pension issues are identified at an early stage particularly if exit charges may be triggered.”

identify who, within the respective business teams, is responsible for "managing" or "owning" the retained operations. Then having done that, assessing how much support he (or she) will have from colleagues during the negotiations.

Employees

It will be necessary to identify the relevant employees in the relevant business operation to be outsourced.

As it is likely that the activity being transferred contains the necessary elements of a business and for service can be separated from the other activities of the customer (and, therefore, forms a discrete part of the business) – there is a strong likelihood that 'TUPE' (The Transfer of Undertakings (Protection of Employment) Regulations 2006), will apply. When TUPE applies to a transfer of a business (or part of a business) or service, those employed in the business, at completion of the transfer, will transfer automatically to the supplier on the same terms and conditions of employment.

Accordingly, it will be necessary for both the supplier and the customer to consider the following:-

pay). Consultation takes place with "appropriate representatives" who will be recognised trade unions where they exist or, in other cases, representatives elected by the workforce.

A potential difficulty in consultation is confidentiality in the very early stages of the project. Regrettably, this is not addressed in TUPE – but does need to be considered in advance. While, the registered provider may be willing and able to agree to impart information to the representatives, they may only want to do so on a confidential basis before the proposal is made public. There are potential difficulties with this. For example, there can be no guarantee that the representatives will not breach the confidence. What is more, if they do so there will be no obvious recourse.

Incentivising of key staff

Consideration may need to be given to putting in place some incentive arrangements, at the outset, to facilitate the tender stage, negotiation process and completion of the agreement.

Pensions

This may become a commercially very significant area. As a general rule, TUPE does not operate to transfer pension rights and obligations under occupational pension schemes. However, in practice, public sector schemes may offer pension benefits which may transfer, such as early retirement or a redundancy. Accordingly, it is important that pension issues are identified at an early stage particularly if exit charges may be triggered.

Information technology and communications

- Consideration needs to be given to the structuring of such shared use/access IT hardware and software (such as splitting of shared systems prior to completion of the outsourcing or putting in place, transitional services arrangements)
- Have any steps been taken:
 - to locate all relevant IT and telecommunication contracts; and
 - to arrange third party consents to the transfer of any computer systems or software.

- Who is in charge? Identification at an early stage who is responsible for “managing” or “owning” contract and assessing how much **capacity** they will have during the deal then get them to:
 - identify among themselves who will resolve internal “turf wars”, so any external lawyers involved do not get involved in internal issues.
 - establish an umpiring procedure to settle any internal issues between departments.
- Storing key documents – Will there be a central repository of key documents (such as property documents, contracts with customers, specimen terms of employment, pension information)?
- Preparatory work
 - consider data protection issues.
 - identify assets (and liabilities) to be transferred.
 - ensure other departments understand what's wanted from them and why.
 - identify a “chaser” and verify that adequate internal resources are available in the different departments.

“This procedure is to minimise the risk that important issues which may affect price are not ignored”

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Property

Apart from identifying what properties will be transferred and the location of the relevant deeds, consideration will need to be given to whether the registered provider want to retain all the properties – or will the transferee be allowed to pick and choose? Will staff be allowed to remain at their existing desks for a transitional period?

Preparation for a transfer to a third party

Before assembling materials for disclosure or information packs, ensure that HR, Finance, IT and other departments of the registered provider are given time to review them so that their views can be taken into account. This procedure is to minimise the risk that important issues which may affect price are not ignored or key negotiating points casually “thrown away” at the outset.

Internal Project Management Issues Checklist

Set out below is a checklist for those involved in project managing the early stages of the transaction.

- Who is moving? Who are in the core management team and who is going “over the wall”.

- Business issues
 - Funding and cashflow – this needs to be produced, albeit in outline;
 - Ascertaining any services to be provided, if required by the supplier, on a transitional basis, by other departments of the customer (including costs and standards) – for example accounting, IT (hardware and software) and vehicles (the ‘umbilical cord’);
 - Measuring existing internal service levels – which will be essential to calculate KPI's.
- Employees
 - Identifying staff in the care division; for example
 - seconded staff.
 - relevant employers in other divisions.
 - ensuring proper consultation (for example with the unions and staff representatives).
 - maintaining confidentiality.

- Accommodation
 - what sites will be transferred.
 - will there be a licence or deskpace agreement for the use of any shared buildings (particularly offices).
 - are there sharing provisions for any sites where the customer and supplier sharing accommodation under the relevant landlord's leases.
- Legal document handling – aim to cut down legal fees
 - get as full as possible initial drafts.
 - Put in system for ensuring that each team leader gets comments from relevant commercial colleagues and “stakeholders” (using either a signing off procedure or simply “speak up or shut up”)
 - Ensure that internally all are “on side” before the documents go out.

There will be further articles as part of this series on outsourcing. These will include looking at the steps in the outsourcing tender process, key provisions in the

outsourcing agreement between the customer and the supplier and the negotiation of service standards.

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Charity Commission Guidance on Investment Matters

The Charity Commission have recently confirmed that they will be publishing a draft of their new guidance for charities on investment matters, for consultation in early summer. No specific date has been set for publication.

The guidance will be relevant to any charity that may be investing in or making loans either to group members or outside its group.

We will report on the consultation, once it has been published.

AGMs – “Be prepared”

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With the AGM season in full swing, some Chairs may discover that their AGM may not be the non-event of previous years.

Yet, at the same time, for many, the AGM appears to remain an important PR event. Communications with stakeholders, public and private funders and other stakeholders are now a key issue.

This makes the Company Secretary's role more difficult. He, or she, is responsible for ensuring that the business of the meeting is conducted properly and effectively.

The requirement to conduct meetings in accordance with the constitutions and the law of meetings can conflict with the ideas of those concerned about external relations – who may have the leading role in the preparations for the meeting. There will also be increased pressure on the Company Secretary for an instant, and smooth, response to any developments during the course of the meeting, whether it be complaints on the floor, a speaker who simply will not sit down or unexpected motions.

These problems are exacerbated by the fact that

the law applicable to meetings is complex and, therefore, difficult to apply, particularly in the heat of the moment when the spotlights are on. Thus for the Chair and the Company Secretary, thorough preparation is essential.

Questions

These can range from the highly relevant request for some specific, and potentially embarrassing, piece of information about the remuneration of one of the directors, to the irrelevant. The Cadbury report, published some years ago, encouraged quoted companies to consider arrangements which enable shareholders to send in questions in advance. This has the advantage that, at the meeting, the Chair can be sure that he or she tackles the issues which concern most people, without having to reply “off the cuff”. Several companies have followed this idea by issuing question forms to be returned by post or handed at the meeting. That said, use of questions can raise legal difficulties, if it is used to stifle debate on the floor.

The Chair should be given detailed guidance on how to bring a question session to a close. It may not be possible to carry on until there are no further questions on the floor, but a refusal to allow questions could lead to accusations that the Chair is not acting impartially or within his or her powers. A well-briefed Chair will be aware of the steps that can be taken to avoid these difficulties.

Motions from the floor

Is the Chair briefed on how he or she should deal with the wide range of motions that might be put from the floor? For example, a dissatisfied shareholder or member may propose a motion to replace the Chair or for the election of a new board member or for amendment to one of the resolutions being considered by the meeting. A decision will need to be made quickly and the correct response on some of these motions will depend on a number of different legal factors. This is another area where contingency planning in advance of the meeting can be invaluable on the day.

Voting

It can be surprisingly difficult on a show of hands to

judge the result, particularly on a special resolution where the “for’s” must exceed the “against” by at least 3:1. If the arrangements are made in advance, the Chair can demand a precise “hand count”.

In any event, steps should be taken to ensure that only those entitled to vote are counted. This can be done through the issue of colour coded attendance cards which members can raise when they vote.

Preparation

Invariably, on the day many of the difficulties outlined here, will not arise. However, the knowledge that they are well prepared should help the Chair and the Company Secretary give a confident performance.

This article merely highlights some of the issues that Company Secretaries and their respective Chairs need to consider. In the meantime, if you would like a checklist of some of the issues to consider when preparing for a meeting, please contact:

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Small Print and Computers - 8 Software Maintenance Agreements

Many finance or resources directors have learnt, through bitter experience, the deficiencies of hardware maintenance contracts. Unfortunately many of the pitfalls are equally applicable to software maintenance agreements. However, there are also some additional issues that need to be considered when reviewing software supply and maintenance contracts.

Types of software

While there are many types of software that are available, for ease of reference, software is merely divided into “operating software” and “application software”.

“Operating” software can be broadly described as the software which is required to make the machine work. For example, it will “make the lights come on” and the “cogs turn”.

“Application” software is, in contrast, the software which performs functions (such as accounting, housing management or word processing packages).

The maintenance required in relation to each type of software is, broadly, the same. However, the maintenance of operating software is often undertaken by the manufacturer and may be tied in to the equipment maintenance agreement. This can be good for the finance/resources director who wants a seamless maintenance service when his staff complain “the computer is not working, please get it fixed”. However, it is essential to check that the maintenance agreement covers both hardware and software maintenance.

Application software (e.g. the accounting package) will often be purchased independently of the hardware and the operating software. Thus, it will be necessary to obtain maintenance of the application software from the manufacturer or original supplier of that software.

Often, a computer system may be covered by numerous maintenance contracts all of which need to be vetted, paid for and administered. A point that many finance or resources directors can overlook.

Allocation of fault

As a practical matter, unless the user is able to single source its maintenance requirements, for instance from a facilities manager, each time a fault arises somebody has the unenviable task of determining whether the fault is due to defective hardware, operating software or any particular piece of application software. Meanwhile, the collective tempers of the staff will rise, inexorably. All too often the source of a fault is as elusive as the maintenance engineer and as hard to tie down as the computer salesman.

It is vital to be as accurate as possible in determining the source of any fault. Almost all software maintenance agreements will exclude liability for faults arising from anything except the software which is the subject of the maintenance contract.

The painful result of calling in a maintenance engineer (or requesting maintenance services from a particular supplier) when the fault did not

programs being used. Clearly, if unmodified off-the-shelf packages are used then these two steps will be inappropriate.

For larger packages some suppliers will warrant “compatibility” between their software and a defined IT “environment”.

The Software Licence

A key point is that unlike with equipment, a user is unlikely to own the software running in its computer facilities. Usually software is licensed to it, under the terms of a fairly complex licence agreement. It is beyond the scope of this article to consider the terms of such licensing arrangements. However, often maintenance provisions are built-in to the main terms of the licence. If this is the case, care should be taken to ensure that the maintenance provisions can be terminated, separately from the licence provisions, by the user.

Many licence/maintenance agreements bind the user into purchasing maintenance from

“Often, a computer system may be covered by numerous maintenance contracts all of which need to be vetted, paid for and administered.”

arise from that supplier’s software will be the payment of exorbitant time and materials fees. Worse, the user still has to determine where else the fault may lie. In the meantime all the organisation’s computer facilities may be out of action.

Where expensive custom designed software is being purchased, this problem can be avoided by:

- hiring in staff with sufficient knowledge of the software and hardware facilities to determine the source of the fault; and/or
- having a facilities manager or an agreement with one of the software suppliers to act as ‘single point of contact’ in relation to any maintenance queries.

Either or both of these steps will mean costs for the user. Nevertheless, it may well save time and money in the long run (and tantrums caused by utter frustration in the short term!). Much will depend upon the complexity of the software

the supplier for so long as the licence is in existence. Even if the licence is for a fixed fee, the maintenance will almost certainly not be, and would be subject to increase on a periodic basis.

Source code

Regrettably, software suppliers, particularly those with a limited number of products in specialist applications, have been known to go into liquidation. For this reason, it is essential to ensure that the user has access to the source code to all its software. This is to provide the user with some hope of arranging further maintenance. The source code is, in summary, the code in which the software is originally written by the programmer and holds within it all the secrets of how the software works. Escrow arrangements are usually offered.

Under this arrangement, a third party holds the source code to the software and is contractually bound or bound as trustee to release the source

code to the user in the event of the insolvency of the supplier and upon other specified events occurring.

Source code arrangements can provide a false sense of security. For example, unless the escrow agreement so provides, there is no check on what the software supplier actually deposits in escrow with the escrow agent. Although the software licence may be specific as to what is required, if the supplier is in breach then this will not become apparent until the source code is released to the user. By which time the supplier may be insolvent. Suing it for breach of contract is likely to be fruitless.

This problem can be overcome by requiring expert third parties to examine all source code deposits; however software suppliers are very resistant to this type of clause. Even if the initial deposit and subsequent deposits adequately contain all relevant source code to the version of the program in use by the user, release of highly complex source code to software is unlikely to

Type of maintenance

Software preventative maintenance - this normally takes the form of an obligation on the supplier to supply updates and new releases of the software as part of the maintenance package. The determination of what software modifications constitute new releases of the programs and what constitute new modules or new programs, is almost always (under a suppliers standard terms) within the sole discretion of the software supplier. The supplier will, hardly surprisingly, make the determination on the basis of whether it considers the modification it has made to the program is something which its customers would be prepared to pay extra for.

Software corrective maintenance - As in the case of hardware maintenance agreements, the supplier will normally undertake to respond to requests for maintenance from the user within set response times and then endeavour to correct the errors it discovers as a result of its investigation. In practice, in negotiations with most

“Sadly, source code arrangements can provide a false sense of security in relation to the ongoing maintenance requirements.”

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allow the user to maintain the software without investment of considerable time and money.

If the rights to the software product concerned are sold to another software supplier so that existing maintenance contracts can be adequately serviced it can be to the users' advantage. With any luck the purchaser will take on staff from the original supplier with the expertise to maintain the software. Unfortunately, it has not been unknown for software to be purchased by a competitor of the insolvent company simply to phase that software out and introduce the competitors own software into the insolvent company's client base (involving the user in further expense for instance in relation to the further licence fees). The incentive for clients to move on to the competitors' new system is simply that the competitor will after a period phase out maintenance of the original suppliers' software.

users, the software supplier will not usually agree to remedy an error within a certain time period, nor warrant that an error can be corrected. The service which is usually provided is limited to the “reasonable” efforts of the supplier to attempt to correct the error within a reasonable time. Clearly, this is hardly satisfactory from the user's point of view. Unfortunately, many software suppliers are notoriously difficult to pin down, particularly where it involves taking on responsibility for their products. Depending on its negotiating position, the user should endeavour to ensure that the software maintenance agreement itemises, in detail, the services which will be provided. While the supplier is unlikely to accept absolute responsibility, the more detail of the service provided that can be agreed, the more negotiating power the user will have if the software supplier fails to provide an adequate service. A regime for “service credits” for service failure will focus minds.

As a practical matter, the user should assess whether the response times and hours of availability of maintenance offered by the supplier are adequate for its requirements. In reaching this assessment, the user's IT team should take into account both the costs involved in any delay and the time critical nature of the work to be performed using the relevant software. They will need to consider, as part of this assessment, whether maintenance can be provided by remote link to the users facilities or whether attendance on site is required.

Charges

Charges for software are often arranged in a similar way to those for equipment maintenance. Nevertheless, the link between the licence fees and the maintenance charges should be carefully considered. It is not unknown for a software supplier to artificially suppress its licence fees in order to pick up a continuing revenue for maintenance which it may increase periodically once the user is 'hooked'. It is worth considering

- software is normally held only under licence and the relationship between the licence terms and the maintenance terms should be carefully scrutinised;
- software maintenance is normally only available from the original supplier or its authorised representatives. The finance director should, therefore, always be aware of the "monopolistic" position of the supplier and to negotiate as hard as possible to protect his or her position under the terms of the maintenance contract; and
- whilst access to source code should be required, the protection it provides is, more often than not, illusory.

For many users the off the shelf software packages will be adequate for their needs. However, as requirements are becoming more complex, increasingly custom made software is commissioned. The inability to maintain such software can not only prove very expensive but worse, it defeats the point of buying the special

“The inability to maintain such software can not only prove very expensive but or worse, defeat the point of buying the special software.”

imposing some limitation upon the amount of any increase in the maintenance charge by reference to indexation.

That said, always remember that maintenance contracts normally run periodically. If the supplier does not wish to continue providing maintenance because it has become uneconomic or burdensome then it can always stop provision of the maintenance after the period of the contract has expired or by giving the appropriate notice to terminate the agreement. The risk of not having maintenance in these circumstances makes it all the more important to obtain a maintenance commitment for the economic life of the software, and to have access to the source code.

Summary

The same broad principles apply to maintenance contracts for both hardware and software. The following fundamental points in relation to software should be noted:

software. Therefore it is worth poring over the print of each maintenance agreement, if only to avoid abuse from staff when a software defect brings operations to a halt.

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Subject to Contract?

Including the phrase “subject to contract” in a document, may not be enough to avoid a legally binding agreement.

In the case of *RTS Flexible Systems Limited (Respondents) v Molkerei Alois Müller GmbH & Co KG [2010] UKSC 14*, the Supreme Court has found that the conduct of parties to an unsigned agreement can lead to it becoming binding on them despite it being stated to be subject to contract.

Whether or not a contract exists between two parties (and what the terms of that contract are) will depend on the conduct of the parties involved. The test of what a ‘reasonable businessman’ would believe to be the case, is still applicable.

A “subject to contract” clause in a draft agreement prevents this from happening and it will need to be waived for any terms of the agreement to become binding without it being signed. Whilst “subject to contract” clauses will still provide some protection, the Supreme Court has ruled that the

but to rely on the protection of some of its terms in doing so, they should check the wording to ensure that the relevant provisions of the agreement will not be subject to contract.

- b. Where the parties do intend to rely on a “subject to contract” clause to limit their liability to each other, they should be careful not to act so as to waive the clause and so become subject to the terms of the draft agreement before they intend to.

The case also serves as a reminder of the dangers of using non legally binding letters of intent. They can not only act as a disincentive on the parties to agree the formal contract but also do not set out, in any detail, the obligations each party is expected to undertake. This uncertainty as to what is expected of each party under the letter often leads to disputes. For example, where a contractor executes work at the request of a client pursuant to a non legally binding letter of intent, the contractor may still be entitled to be

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conduct of the parties to an agreement may be sufficient to waive their effect without the parties agreeing it explicitly.

It is worth noting that, in this case, there was a “counterparts clause” stating that the agreement would not be effective until each party had executed a separate copy of the agreement (a “counterpart”) and exchanged it with the others. Although some organisations may use this sort of clause, without wishing to make an agreement subject to contract, the Supreme Court has now ruled that it will do just that.

The advice given in the judgement is that contracting parties should avoid these risks by finalising any agreement before acting. Where this is not possible, we would advise the following:

- a. Where parties want to begin work under an agreement that is still being negotiated

paid its reasonable costs and expenses.

Clear and unambiguous language should be used setting out where the agreement is to be treated as “subject to contract” as such at the top of the document ‘Subject to Contract [save as to paragraph...]’ – and language should also be included stating along the lines of: “The provisions contained in this [memorandum] are subject to contract and shall not impose upon the signatories any legal or binding obligation [,except as provided in paragraph...].”

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