

Incentivisation, not remediation, should be the focus in IT projects!

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IT contracts should be geared to incentivising IT service providers to work with their customers to deliver successful solutions for the customer's business, through performing contract obligations, rather than purely dealing with a customer's contractual remedies. IT solutions are complex, and we all know they are prone to delay and issues arising - often not solely due to one party. If things start to go awry, most of the time the customer would rather persevere with the supplier and it is relatively rare that all faith is lost in the service provider's ability to perform.

In light of this, by focussing less on remedies and more on incentivising the service provider to sort things out, the project has a better chance of success. The two critical phases where this principle is applied in IT contracts is 1) deployment, either implementation and/or transition, and 2) 'BAU' (business as usual) running of services.

Deployment/Implementation Phase

In respect of deployment the focus is on delay payments: these typically kick in when a contractual 'milestone' (a key stage in the deployment phase) has been missed; sometimes a short 'grace period' is provided. Delay payments tend to apply weekly until the relevant milestone is achieved - although often a short 'grace period' will be agreed to postpone the application of delay payments. In the event the delay continues beyond a 'long stop date', being a severe level of delay which is pre-agreed as unreasonable, the customer would instead have the right to terminate and/or claim for losses incurred under the contract. Such a right to terminate would often be specified as a specific right to terminate on the long stop date being reached.

In some cases the delay payments are a genuine attempt to compensate the customer for the consequences of the delay - so they are a form of 'liquidated damages'. However in most contracts the delay payments are significant proportions of the relevant milestone payment, without being large enough to represent meaningful compensation for a significant project delay. As we discuss below, this would therefore mean that these delay payments are not liquidated damages.

BAU Phase

In terms of BAU, once the solution has been deployed the focus switches to using service credits to ensure that the supplier delivers the services in accordance with the agreed service level regime - which is intended to be the measures of whether the service is meeting the customer's requirements.

Service credits tend to put around 15% of the annual charges 'at risk' - against service levels not being met. They typically use a graduated performance measure such that the worse the service gets, the greater the service credit. This credit is then applied against the next month's charges.

The service credit is not recognised as paying an amount to compensate the customer for the loss they suffer as a result of not meeting the service levels: the refund is unlikely to cover serious costs of fixing issues arising; instead they are very much there as an incentive on the supplier to put the service right - and by eating into the service provider's precious profit margin gradually they ensure the issue gets attention.

The court's view!

From a legal point of view there is a need to consider how such commercial levers could be treated by the UK courts. In recent years the position with respect to liquidated damages (i.e. delay payments and service credits) has been reviewed by the courts with a focus on whether liquidated damages are 'penalties' (and therefore so unfair and unenforceable). The leading judgement of *Cavendish Square Holding BV v Makdessi and Parking Eye Limited v Beavis [2015] UKSC 67*, is commonly cited when discussing liquidated damages. In essence while considering the law on penalties the court remarked that in order to be deemed a 'penalty' that such obligation needed to be "unconscionable and extravagant and one which no court ought to allow to be enforced". Therefore the key consideration when negotiating any delay payments or service credit regime, would appear to be to endeavour to make the regime reasonable and not onerous. In most IT contracts this tends to be the case as the loss to the customer resulting from the relevant delay of service loss, is usually more substantial than the amounts in question.

To sum up

Delay payments and service credits are useful tools in contract management, but it is important that customers do not go too far when setting out the fiscal value of such payments. The primary focus of an IT contract needs to be on how the parties will work together and what levers will be available to ensure that the relevant party is incentivised. For a customer this will be the use of delay payments or service credits. IT contracts should be used as a 'toolkit' to support risk management and collaboration; not just put in the drawer and forgotten about after signature.

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