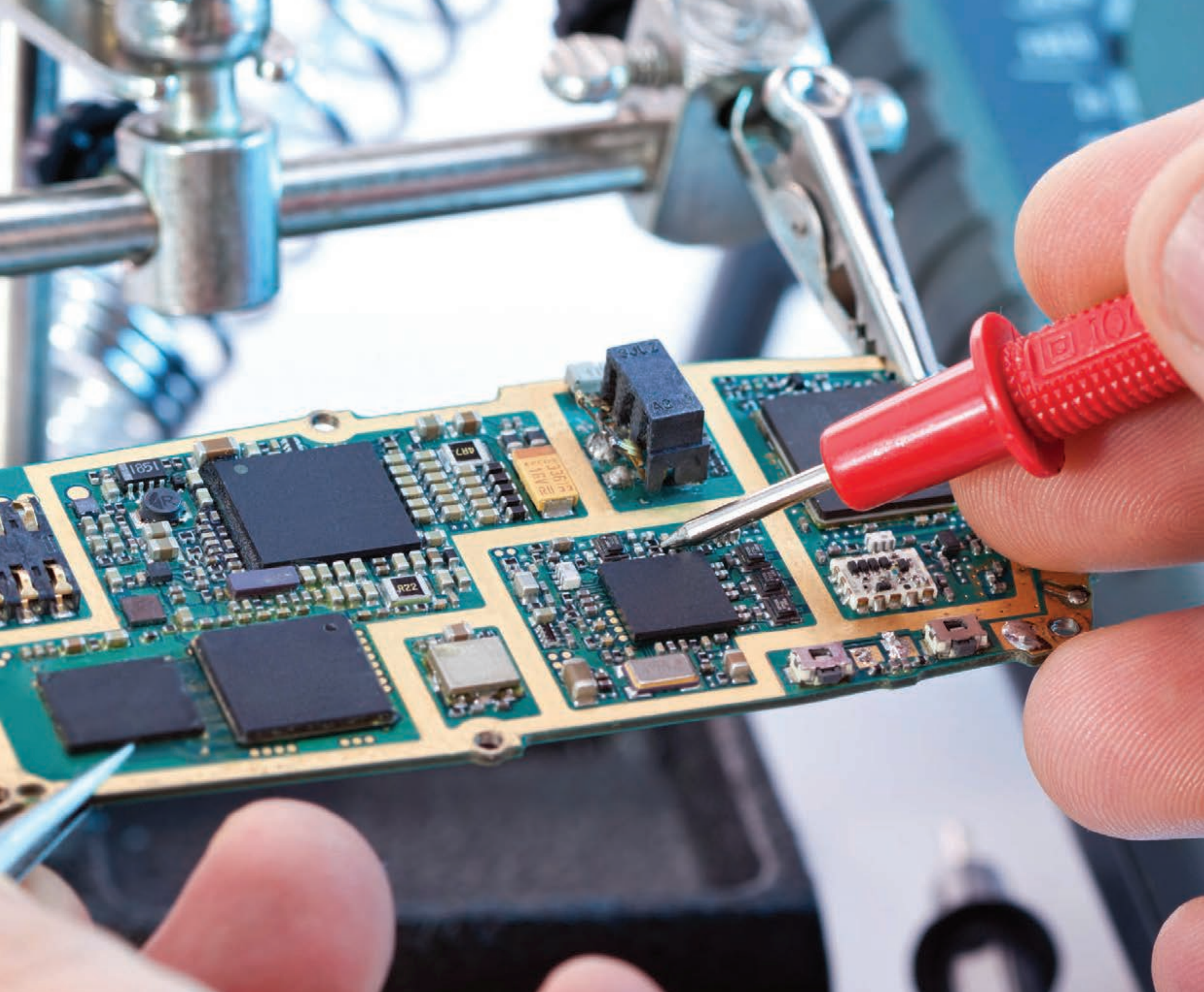

TRAVELERS

An essential guide for the technology sector

LIFESTAGES AND RISKS

Contents

Travelers has developed this essential guide for the technology sector, Lifestages and Risks, together with law firm Reynolds Porter Chamberlain.

Reynolds Porter Chamberlain is a London-based law firm with a large and growing technology and intellectual property practice.

Reynolds Porter Chamberlain is widely recognised for practical, commercial advice and high levels of client service. The firm's client base ranges from start-ups to household names, and advice is provided on the full spectrum of technology and IP matters including acquisition, licensing, e-commerce, a wide range of other internet issues and outsourcing. The firm has extensive expertise in dispute resolution, and regularly advise on issues of quality, conformation to specification, negligent advice, insolvency issues and intellectual property disputes.

The firm has eight Partners undertaking technology work. Alongside its technology and intellectual property practice, RPC is also well used to advising on intellectual property and technology cases where there is an insurance interest involved.

Travelers is a leading global insurance specialist providing a range of solutions offering peace of mind and security to technology companies at every stage of their development, from start-ups to large corporations. Travelers UK, is the UK-based business of The Travelers Companies, Inc, based in London and Redhill, Surrey with offices in Manchester, Birmingham, Leeds, Glasgow and Dublin providing a range of property and casualty insurance products that are distributed primarily by brokers to a range of industries and professions. For further information visit travelers.co.uk.

Introduction

Welcome to the Lifestages and Risks report from Travelers Insurance

Technology in the UK is broad and varied. As well as the many companies supplying information and communications technology and services, it also includes electronics designers and manufacturers, and companies involved in consumer electronics and industrial electronics for aerospace, defence and other sectors. It is a major enabler of economic growth. Recent research shows that its 1.1 million highly productive and flexible staff generate around 12 per cent of UK GDP. The wider digital sector, of which technology plays a major part, employs 3 per cent of the UK workforce, contributes nearly £69 billion of gross value added and has seen employment figures grow 5.5 per cent between 2009 and 2012.

Our study further concluded the UK technology sector is the largest and fastest-growing in Europe. Combined with the availability of skilled staff and innovative technology, this makes the UK the destination of choice for investors and a favourite place from which to expand internationally. 2013 saw the UK technology sector in improved health, with areas of strong growth and challenges. Recession often brings out the most innovative and dynamic changes in the market, and the industry has proved to be counter-cyclical to an extent with many of the best companies and innovations developing out of economic downturns. As the economy slowly but surely emerges from recession, showing small but real signs of growth, it is providing exciting opportunities for the technology sector.

Nonetheless we found areas continue to be exposed to budgetary and spending pressures, such as the hardware and services sectors, are feeling the impact of the recession more keenly than others. In the software sector, the short term outlook is challenging as financially pressed IT departments are holding off on software refreshes. However, the medium term to long term growth prospects are better with the rise of "software as a service" (SaaS) a prominent feature, and the requirements for data integrity and compliance systems increasing in the wake of the financial crisis.

For those companies looking to grow as we climb out of recession there are many risks to be faced and in this report we tackle the six most prominent areas that all technology businesses may face at differing stages of their lifecycle. These are:

- The value of contracts
- The overselling risk
- Unwitting exports – the perils of trading on the world wide web
- Contracting with a US partner
- Sourcing and outsourcing
- Buying or selling a business

Wherever you are in the technology sector we hope that you enjoy reading this report and that you find the content useful. Remember, however, that our report is written in general terms. It is not legal advice and many issues have been simplified for ease of communication. You should always consider your own circumstances with your legal advisers before implementing any change to your business.

Keith Purvis
General Manager, UK

"As the economy slowly but surely emerges from recession, showing small but real signs of growth, it is providing exciting opportunities for the technology sector."

The value of contracts

The contract is the foundation of the relationship between the technology company and its customer. The use of properly formulated contract terms is not only sensible from a commercial perspective to assist in regulating the relationship between the company and its customer, it is also a risk management tool. By crystallising the rights and obligations of the parties in a contract, the scope for future disputes is considerably reduced. Even where a dispute transpires to be unavoidable, the contract can still serve to assist by setting out a dispute resolution process that may avoid costly and time-consuming litigation.

Save in the case of straightforward supply contracts, it is likely that a contract will be subject to change during the course of the relationship. It is important to record these contract changes with the same rigour that is applied to the initial contract. Not doing so risks undoing the benefits conferred by the contract in the first place.

Contract terms may be bespoke. Alternatively, in the case of a straightforward business supply, standard terms and conditions may be used. In the latter case, care must be taken to ensure that the supplier's standard terms and conditions of sale are incorporated into the contract with the customer and not the customer's conditions of purchase. To achieve this, careful attention must be paid during the correspondence leading to the conclusion of the contract to ensure that the correct terms and conditions are incorporated.

The final terms will be a matter of negotiation. Where one party is obliged to accept the terms of the other, it is sensible to carry out a review of those terms so that any specific risks entailed can be identified and provided for in the performance of the contract.

In the absence of express contract terms, the parties will subject themselves to the law on implied terms deriving from common law and statute. This is a risky course to adopt. Therefore, so far as possible, every effort should be made to ensure that a contract includes all terms necessary to govern the relationship between the parties.

While it is not practicable to set out here a comprehensive list of all the terms that might usefully be included in a technology supply contract, some of the more important terms, particularly from a risk management perspective, are as follows:

Specification

A clear agreed specification of the product to be supplied is an essential element of any contract. An accurate and technical description of the subject matter of the contract will crystallise what may have been the subject of less specific discussion during the course of negotiations. The process of defining the specification of the product may be straightforward in relation to an "off the shelf" sale. The position will be more difficult where the subject matter of the contract is a newly developed product or a system requiring customisation.

The customer will seek a specification that reflects his requirements; the supplier will seek a specification that may be limited to certain technical parameters. However, the importance of a proper negotiated specification cannot be overstated since the contents of that specification will inevitably come under very close scrutiny if a dispute subsequently occurs.

Key points

- Ensure that a properly negotiated contract is entered into wherever possible
- Refer to the contract during the course of the project; ensure any necessary changes are properly documented
- Ensure that the subject matter of the contract is clearly defined in the specification, and that the customer's obligations are also addressed
- Pay proper attention to clauses that can assist to limit your liability, such as entire agreement,exclusion and limitation clauses
- Provide for a dispute resolution process to prevent any claim escalating unnecessarily.

Entire Agreement Clauses

Entire agreement clauses are used in order to avoid disputes that might be based upon statements, representations or side agreements that may be alleged to have been made during the course of discussions prior to the contract itself. Such a clause will provide that the contract constitutes the entire agreement between the parties and accordingly supersedes all prior agreements, negotiations and discussions. It should also provide that the parties to the contract confirm that they have not relied upon any statement or representation other than those that may be recorded in the contract itself.

The clear value of an entire agreement clause is, so far as possible, to restrict the scope of any subsequent dispute between the parties solely to the terms of the contract itself.

Exclusion and Limitation Clauses

A properly drafted clause excluding or limiting the liability of the supplier is fundamental to any contract and a key aspect of risk management in any business transaction. Care must be taken in the formulation of such clauses since the courts will tend to construe them narrowly like any exception clause. Generally, such clauses will also have to satisfy the requirements of the Unfair Contract Terms Acts 1977, which imposes a test of “reasonableness”. The reasonableness of the relevant clause will be considered under various criteria set out in the Act dealing with issues such as strength of bargaining position, inducements, bespoke orders and course of dealing. Any ambiguity in the clause is likely to be construed against the party seeking to rely upon it. However, with care, it is quite possible to achieve a clear, unambiguous and effective clause.

In the ordinary course, such a clause will seek to limit the total financial liability that may flow from a breach of the contract. It will also seek to exclude liability for financial losses, particularly loss of profits. Exclusion clauses should, so far as possible, be drafted in a form such that, if a particular element is regarded as unreasonable by the court, that element can be easily severed from the remainder of the clause, leaving that remainder enforceable.

Customer Obligations

While the focus of any technology contract will obviously be the supply itself, it is equally important to ensure that the contract also addresses the obligations of the customer. For example, no implementation of any new IT system or software can be completed without the full co-operation of the customer. This co-operation will be particularly required in relation to acceptance testing and any necessary change of business processes. Consequently, the obligations of the customer should be addressed with the same rigour as the obligations of the supplier to ensure that the customer’s role in the implementation of the contract is clearly set out and to avoid any expectation gap arising in relation to the responsibility for particular aspects of the implementation. Many projects fail because it transpires that the customer was not prepared or sufficiently resourced to undertake the burden of their necessary contribution to the implementation.

Acceptance Testing

From the supplier’s perspective, acceptance testing is another key aspect to be addressed in any contract. Once acceptance has occurred, the customer no longer has the ability to reject the product. Its remedy is limited to one of damages. Any provisions addressing acceptance testing should set out an appropriate timetable and the elements of functionality and performance that are key to the customer’s requirements. Successful completion of acceptance testing may also have a bearing on the response of any insurance held by the supplier in the event of a subsequent dispute.

Warranties

A warranty is a contractual promise, breach of which may give rise to a claim in damages. A customer will seek to secure warranties as to the performance of the system or products supplied. Great care should be taken in providing such warranties. Certainly they should not be provided in general terms but should be tied to specific aspects of any functionality or specification, with clear provisions (ie by way of acceptance testing) which will enable compliance with that warranty to be established. If a company agrees to a warranty that imposes upon it particularly onerous obligations in terms of contract performance, that may well have implications for any applicable insurance policy. Careful attention to the terms of warranties can also serve to avoid subsequent disputes. For example, a warranty provision might specify the remedy for any breach, such as the provision of a software update or patch, thus avoiding any more wide-ranging claim.

Dispute Resolution

It is common for any dispute resolution provision simply to provide for the applicable law and the courts of the jurisdiction where the company has its place of business. Such a provision is adequate, so far as it goes, to avoid potentially complex disputes on law and jurisdiction where a contract has an international element. However, the court system is not always an ideal first port of call, particularly at the early stages of a dispute. It may, therefore, be advisable to include provisions for alternative dispute resolution. Such provisions will compel dialogue between the parties, escalating, where a resolution is not achieved, through the management hierarchy of the parties. If senior management are unable to reach agreement, then provision may be made for mediation or informal arbitration before an independent third party. If these alternative dispute resolution methods are unsuccessful, then proceedings may be unavoidable. In that event, provision may be made for arbitration of any dispute rather than defaulting to court proceedings. Depending upon the parties' preferences, arbitration can provide benefits such as the ability to set one's own procedure. Arbitration also has the important advantage of being a confidential process.

There are a host of further terms that may be provided for in order to regulate the parties' rights and obligations. Some may be critical, such as providing for the ownership of intellectual property rights. Others may be less important; dealing, for example, with the extent to which the transaction may be used by the parties in subsequent publicity. This chapter, however, seeks to address those provisions that, from a risk management perspective, merit close and careful attention.

Case Study

A company developing equipment for factory production lines ("E") had discussions with a potential customer ("C") about the supply and integration of certain equipment into C's factory. Lengthy negotiations took place but no single, finalised contract was ever executed by both parties. As a consequence of commercial pressure C placed on E to supply the equipment, it was supplied early. Subsequently it was alleged that the equipment had caused loss by damaging C's product as it passed through. A substantial dispute followed as to the terms of any contract and liability for loss. That might have been avoided if E had resisted the pressure and not allowed supply prior to appropriate contractual terms being properly agreed.

The overselling risk

Sales are the lifeblood of any business. In the ordinary course, sales teams will have targets. They may also be paid on a commission basis. Commercial and financial pressures can in certain circumstances cause legitimate positive sales messages to become careless misrepresentations.

It is almost inevitable in any serious dispute following the failure of a technology project, that allegations of overselling will be made. These may concern issues of functionality, ability to fulfil a contract, timescale, cost and anticipated business efficiencies. Such allegations may centre around sales brochures, statements made during pre-contract negotiations, the terms of responses to invitations to tender and other statements that may have been made collateral to the contract itself.

Overselling has been a contributory factor to many of the reported cases arising from technology disputes. If such allegations are proven, it is very likely to influence the court in its view of other aspects of the supplier's conduct. The more notable cases referred to below, illustrate the issue of overselling risk and appear in the context of IT supplies. However, the same risks exist in relation to any technology product or component.

Southwest Water v ICL

This case concerned a project to implement a system for dealing with customer billing and customer enquiries. An ICL subsidiary had a billing system product that offered much of the functionality sought by Southwest Water. Further development of the product was, however, required in order to meet the full requirements of Southwest Water and a tender was submitted on this basis.

The court had to consider the extent to which the offered product in fact required modification. It was found that representations had been made by ICL in relation to the amount of bespoke programming that would be required. Statements were also made by ICL that the modification work would be carried out by its subsidiary in a back-to-back contract that mirrored the project's tight deadlines. Such statements were made by ICL despite warnings from its subsidiary that it was not prepared to commit the necessary time and resources to the project. As negotiations progressed a revised tender was submitted by ICL which set out an even lower estimate of the modification work that would be required to the existing product.

As might have been expected, the project failed, with ICL eventually revealing that it was unable to complete the contract within any specified time, let alone the tight deadlines agreed in the initial contract.

In the event, the court held that ICL had made an actionable representation that its subsidiary would enter into an appropriate back-to-back agreement. That representation was, however, made without any basis, since it transpired that the subsidiary had notified ICL expressly that it should not enter into any contract with Southwest Water without its prior approval. The judge accordingly found that ICL had acted recklessly. The court held that Southwest Water was entitled to rescind the entire contract. It also held that ICL was unable to rely on a limitation of liability clause in the contract on the basis that, in the circumstances, it was manifestly unreasonable.

Pegler Limited v Wang

Wang contracted with Pegler to provide computer hardware and software and associated services of project management, consultancy and business process management. The system was intended to enable Pegler to move to a demand driven manufacturing system. The judge concluded that Wang had misrepresented the system that it was selling; had failed to deliver modules on time or at all; had closed its business management process department (which was essential to the success of the project); had ceased to sell, and had become unable to support the relevant software; and had finally abandoned the project altogether.

Wang had represented to Pegler that their system was far more suitable to Pegler's purposes than in fact it was. Plainly, Wang had failed to resource the contract properly or at all. Again, on the facts of the case, Wang was held unable to rely on the exclusion and limitation clauses contained in its contract.

BSkyB v Electronic Data Systems Limited

BSkyB sought tenders for a contract to design, build and implement a new customer relationship management system. EDS were awarded the contract. The contract was subsequently terminated having run into successive difficulties.

Various allegations were made against EDS in relation to its conduct prior to the conclusion of the contract. These included representations that:

- The personnel required for the project, with the necessary skills and experience of the technology and methodologies to be used, were available
- That EDS had carried out a proper analysis of the amount of time needed to complete the initial delivery and 'go live' of one aspect of the project when in fact they had no reasonable grounds for the representations made regarding the timescale for the project
- That they had carried out a proper estimate of the cost of completing the project, when again there were no reasonable grounds for that estimate.

In the event, the court held that the representation that EDS could and would deliver the project within the timescales put forward was false. There had been no proper analysis carried out by EDS, nor were there reasonable grounds for the statements made by EDS. Such statements were in fact made dishonestly by the relevant employee who knew them to be false but made them intending that BSkyB should rely on them when entering into the contract. Again, in the circumstances, EDS were held unable to rely upon their contract terms to prevent BSkyB from advancing a claim for the full amount of their loss.

All the above authorities demonstrate the need for time and money to be spent in responding to invitations to tender to ensure that all statements made are accurate and can be supported by plans and analysis. They further emphasise the need to ensure that adequate resource for any project exists and can be committed in accordance with any agreed project timescales. These cases also show the importance of drafting properly both entire agreement clauses and clauses limiting liability.

Preventative Measures

While the above cases exemplify the risks of overselling, certain risk management measures may be adopted to avoid or mitigate these risks:

- Consider the basis upon which sales staff are motivated or remunerated. Do targets or commission arrangements carry a risk that sales staff may be over-zealous in achieving a sale?
- Consider whether sales staff are sufficiently trained in relation to the specification of the product being sold so that they are in a position to make a reliable assessment of its ability to meet customer requirements
- Ensure that there is a defined process for responding to invitations to tender. Ideally, that process should include the participation of technical, financial, legal and senior management personnel in order to ensure that the product can be delivered in accordance with the requested specification and timescale. Such procedures will also enable the team as a whole to identify any areas where any stated customer requirements cannot be met
- Any response to an invitation to tender should be subject to either an independent review, or to further review following a 'cooling-off' period to enable an objective assessment of its contents
- Similar processes should be in place for negotiating and agreeing contracts to ensure that the company's obligations are clearly defined and that the company has the technical ability and resource to meet the product specification and the agreed project timescale
- Internal processes should allow for independent review of contracts before signature and provide for signature by personnel other than sales staff
- Ensure that any project team is adequately resourced with a designated manager
- Designate an independent person or committee with responsibility for monitoring and reviewing progress on material projects to ensure that any identified issues are resolved
- Provide for a defined escalation procedure where problems cannot be resolved within the project management team
- Ensure that there is a dedicated quality assurance function that includes defined quality assurance procedures to be followed in relation to any project

Key points

- Ensure that the specification and functionality of any product are properly understood
- Avoid making over-ambitious claims for the performance of any product
- Provide for suitable contract provisions, particularly an entire agreement clause, to avoid disputes relating to pre-contract discussions
- Ensure that all contracts are properly resourced
- Where practicable, submit sales documents, tenders and contracts to independent review to minimise any overselling risk

Unwitting exports – the perils of trading on the world wide web

There is always a risk that a supplier of technology products may find itself inadvertently subject to the laws of a foreign jurisdiction. A component supplier, for example, has little control over the final destination of any product that contains his components, no matter where the original supply was made. However, the issue of 'unwitting exports' is particularly acute in the context of a business's web activities.

As a website will be accessible from almost anywhere in the world, a website owner can attract liability for his online business activities in unexpected ways. Examples include:

- The provider of an online news service who, by accepting subscribers from a particular US state, was alleged to have infringed trademarks held by a company in that state
- The provider of an online TV service found itself subject to injunctive proceedings in India due to the content and target audience of one of its subscription channels
- Operators of an online auction site featuring certain military memorabilia found themselves subject to the provisions of the French Criminal Code under which the exhibition of such memorabilia is a criminal offence
- Operators of the website of a nightclub became subject to proceedings for damages for bodily injury in Austria following injuries sustained at the nightclub

These examples demonstrate the need for awareness of the perils of online business activity, whether or not that activity may be specifically directed at an overseas market.

As a first step, a website owner should have terms and conditions for his website on which he may rely in relation to the sale of any product or service offered. Those terms will include the usual provisions generally found in a supplier's standard terms and conditions, such as conditions dealing with the supply itself, payment, limitation of liability, copyright and other general provisions.

Those terms will also need to address issues specific to contracts made 'at a distance', including provisions clarifying the situation in relation to contracts with overseas customers.

To ensure that they are legally binding, website terms and conditions must be properly incorporated into the contract between the supplier and the customer. Terms and conditions will only be incorporated if they are brought to the customer's attention prior to the contract being made. This can be done by using a link to a website page where the terms and conditions are set out or by requiring the customer to scroll through all the terms and conditions before he is allowed to proceed with his order. From a risk management point of view, an online supplier runs the risk that his terms will not be properly incorporated if he relies on the link option alone since he cannot be sure that his terms will have been brought to the customer's attention.

However, the supplier's position can be improved by the use of additional steps as part of the ordering process. Customers may, for example, be required to tick a box indicating that they accept the fact that the contract will be governed by the website terms and conditions, before being able to place their order.

Overseas Trading

Online suppliers must consider carefully whether they are willing to deliver goods or services to customers overseas, where they may have to submit to the jurisdiction and comply with the legislation of the customer's country of residence. Website owners must ensure that they comply with the laws relating to sale of goods, product safety, consumer protection and any special legal requirements applicable to the goods supplied by them.

Even where the terms and conditions governing the contract provide for English law and jurisdiction, this will not deprive a consumer of the protection afforded to him by the mandatory rules of the law of the country in which he has his residence.

A specific condition in the website terms and conditions will allow the website owner to limit the countries from which orders will be accepted. By limiting his intention to contract only with certain specified countries, the online supplier makes it clear That the is not intending to direct sales to any other country. For those countries with whom he does intend to trade, the online supplier should obtain local legal advice on applicable legislation.

In respect of orders received from outside the UK, the online supplier should reinforce this contractual approach with website technology that will enable him to determine the country from which any order originates and, accordingly, to decline orders received from places other than the countries with which he wishes to trade.

Trading with the US

The US is one jurisdiction to which a UK business may easily become exposed. There are mandatory US laws that will overrule a choice of law clause including laws relating to competition, intellectual property, data protection and federal and state laws on warranties and guarantees and product-related consumer protection laws.

By way of example, data protection laws in the majority of US states require notification to the individuals affected in the event of a security breach. One estimate is that the average cost of this notification process is approximately $200 per compromised data record. Consequently, the costs of responding to a data breach can be very significant.

In the US, the exercise of jurisdiction over a matter is determined by the law of the individual states and by Federal law. Most states have "long arm" statutes that are written broadly so they provide for any exercise of jurisdiction not prohibited by the US constitution. Generally, though, the long arm statutes grant jurisdiction over non-residents who conduct business within the jurisdiction or commit a tort resulting in a harm within the state.

There are also a number of features of the US legal system that increase the potential exposure of defendants that come before it:

- Damages may be assessed by a jury who may find themselves to be in sympathy with a US claimant
- The US courts have the ability to impose punitive damages in certain circumstances
- There is no general right to recover legal costs in the event of a successful defence to a claim. US litigation is notoriously expensive
- Class actions are permissible, potentially generating substantial claims out of contracts that individually may be of low value. For example, a class action was recently filed over alleged unauthorised auto-dialler calls to cell phones. Because of their representative nature, class actions afford claimants the prospect of recovering substantial damages and present defendants with the threat of enormous damages exposure. These factors place pressure on defendants to settle, irrespective of the merits of any claim.

Key points

- Be aware of the risk of trading overseas inadvertently
- Where a decision has been taken not to engage in online trade with a particular jurisdiction, ensure that contractual and technical measures are taken to achieve this
- Take advice on the relevant local laws in the jurisdictions where you do intend to trade
- Be familiar with the potential exposures based on local laws and jurisdictions when trading or otherwise conducting business in the US

Restricting Liability for Website Trading

A website owner would be wise to take the following steps in order to avoid risking unnecessary additional liability that may arise from potentially inadvertent trading overseas:

- Ensure that key terms, including any disclaimers or limitations of liability, choice of law and jurisdiction clauses, are properly incorporated into contracts entered into with customers online
- Notwithstanding their incorporation, consider whether terms limiting liability are compatible with applicable unfair contracts, consumer protection and distance-selling legislation
- Keep apprised of law and regulation applicable to websites and business done on the internet, including in foreign jurisdictions in which visitors and customers may potentially be based
- Comply with applicable law and regulation, considering whether modification to the content of the site or other steps may be appropriate, such as including appropriate disclaimers or restricting access to specified classes of customer
- Monitor developments in law and regulation on an ongoing basis, responding to any developments
- In order to mitigate against the risk of being subject to foreign laws, regulations and jurisdiction, consider whether access should be limited to customers in certain favoured markets rather than worldwide
- If access is to be geographically restricted, implement suitable technical measures to enforce this.

Contracting with a US partner

Contracting with a US partner gives access to what is, at the moment, the largest technology market in the world. Any technology company would be pleased to “crack” the US market and open up for itself the considerable possibilities that the market provides. However, it brings with it its own special risks, some of which are touched on in the previous section. This article aims to highlight, in a very general way, some of the points that will need to be considered when dealing with a US counterparty.

The USA is not an homogenous entity. It is comprised of 50 states, each of which has its own laws, over the top of which sits a layer of federal laws.

The Culture Gap

US companies may take a US orientated approach when negotiating with companies outside the US. Negotiating with a US company may also expose one to uncompromising negotiating techniques.

For all these reasons, a clear written contract is important when contracting with a US entity. If possible, it assists to keep control of the process of contract documentation. You may otherwise be presented with a long and wordy contract that will be both biased in favour of the US company and provide for home-state law and jurisdiction over disputes.

Where sale of goods is involved (and software can be goods for some purposes) the Uniform Commercial Code will apply and remedies for any breaches of contract are set out in this code. This is a specialist area on which you may need local advice.

Jurisdiction and Disputes

Establishing the law applying to the contract and the jurisdiction in which any dispute is to be resolved often becomes an issue because you have been unable to persuade your American counterparty to agree to English law and jurisdiction. Arbitration may be an acceptable compromise to the jurisdiction issue, but a law must be chosen. Ultimately these issues are resolved in favour of the party with the strongest bargaining power.

If you are bound to accept US law and jurisdiction, you should consider engaging your own local lawyer. This is essential for large contracts but can be expensive for lower-value agreements. In that case, it may be better to negotiate the agreement using an experienced English lawyer who can guide you through the process in your own time-zone and then have the agreement checked over locally prior to signing, or when the outstanding issues have been reduced to those that depend on the chosen law and jurisdiction.

When concluding an agreement where you have had to concede law and jurisdiction to a particular US state, you can and should consider electing in the agreement that any dispute is to be tried by judge alone (if legal in the state which has jurisdiction) or arbitrated. Jurors are still used in civil trials in the USA and can be an unpredictable element in US proceedings. They may award large sums in damages that then require further litigation should they be disproportionate to the actual loss that has occurred.

It is quite common to see in US agreements a provision that attorneys’ fees be payable in any litigation. The purpose of this is to overcome the usual rule in the USA (to which there are numerous exceptions) that attorneys’ fees are not payable by the losing party. Depending on whether you are expecting to sue or be sued, you will want to think about whether such a provision is appropriate.

Liability and Indemnities

Liabilities and indemnities are particular areas of concern when contracting with a US partner, particularly a larger company. Both of these issues concern your possible exposure to the litigious business culture of the USA.

Limiting Liability

You will want to limit your liability whereas your counterparty will be seeking indemnities against any loss it suffers in the event of future breaches of the contract.

When putting limitations into an agreement for US use, it is usual to put the limitations in capital letters and sometimes also in bold script. This is to satisfy various state laws that limitations of liability have to be expressly and noticeably drawn to the attention of a contracting party. If they are not sufficiently prominent, then they may not be enforced in any subsequent disputes.

Leaving aside the formalities, it is always best to limit your liability so far as you can. You may have to accept in return that your counterparty also limits its liability. A judgment has to be made about the risks and benefits that any limitation entails.

Indemnity

Indemnity is an emotive term and frequently leads to difficulties in contract negotiations. An indemnifier is required to meet all the consequences of the breach of contract for which indemnity is given, even if these would not give the other party a right to damages in a breach of contract case. This means that the normal contract rules that limit what consequences of a breach of contract will be compensated in damages do not operate. In many cases, there will be no significant difference in liability between ordinary damages for breach of contract and what is due under an indemnity. Nevertheless, you will want to limit your exposure to indemnities and will want limitations on liability clearly and expressly to cover indemnities. An indemnity may pose no real problem if it is capped at a manageable sum. However, when negotiating indemnities, you should always check whether you have insurance cover for the liabilities that you will be taking on. This is particularly important when you are taking on liabilities in the USA.

Enforcing a Judgment

The enforcement of US judgments in the UK is also something that should be considered. Unless you have offices in the USA, the English courts will only treat you as susceptible to a US judgment if you have submitted to the jurisdiction in the USA. Agreeing a US jurisdiction clause is one way of submitting to a jurisdiction. Taking part in US proceedings would also count as submitting to the jurisdiction. If you have played no part in litigation and simply allow judgment to be entered against you in default, then a US judgment cannot be enforced against you. Even if you do take part in US proceedings, thereby "submitting to the jurisdiction", the UK courts are not permitted to enforce penal damages awards. Your American counterparty will, therefore, only be entitled to that part of a damages award that represents genuine compensation.

Price-fixing

Finally, care should be taken to avoid any conduct that might be misconstrued as price-fixing or cartel participation. Price-fixing and cartel behaviour are illegal in most jurisdictions, but nowhere more so, nor with worse consequences, than in the USA. Since cartel participation became a crime in the UK, it has been possible for the US authorities to obtain extradition to the USA of UK nationals, with limited evidence of the alleged criminal behaviour.

Conclusion

Making inroads into the US market will be a milestone in any company's development. However, any company doing business in the USA needs to understand that all the cultural similarities that exist in the US and UK business sectors hide differences in approach that can cause problems. The time to recognise those differences and put in place a system that reduces the potential for problems as far as possible, is at the contract formation stage. When things have already started to go wrong it will be too late to avoid the chance element that exists when resolving disputes in US jurisdictions.

Key points

- Be prepared for the culture gap
- Get it in writing
- Think about law and jurisdictionissues – take advice
- Limit your liability
- Find insurance for US risks you cannot limit

Sourcing and outsourcing

At some point in its existence, a technology company is going to want to enter into an outsourcing arrangement. At its simplest, outsourcing might involve bringing in a contractor to supply particular expertise or to fill capacity that the purchaser does not have; for instance, a company might have its manufacturing requirement provided by outside companies – nowadays often in China – but sourcing manufacturing expertise from outside is well-established behaviour. At its more complex, outsourcing can involve handing complete responsibility to a third party for some important aspect of a business's infrastructure, such as its IT and telecommunications system.

Due Diligence

As with a company acquisition, a soundly-based outsourcing arrangement will start with a due diligence exercise. This may be a somewhat different and less formal process than that involved with the purchase of a company. Nevertheless, it remains important to check that the proposed supplier has the capacity to do what it promises to do and has a reputation for handling such projects competently so that it has satisfied clients.

Know What You Want

As important as carrying out due diligence on the proposed supplier, is the need for the buyer to produce a clear specification of what it expects the supplier to do. Sometimes this specification requires engagement of a consultant familiar with the services to be supplied, to ask the right questions and assist the purchaser in putting together the specification.

Without a specification, the supplier has no clear idea what it is to do and will surely trim the services it supplies to the price that it is being paid. This can lead to a mismatch of expectations and ultimately a dispute. A buyer's specification also helps to prevent "mission creep", that is a situation where the buyer keeps adding requests for ever more elaboration of the services that it wants, with the consequent upward creeping of the price it pays for its services.

Dealing with Change

Changes to the services being provided do however have to be permitted, because the business environment of the buyer is itself likely to be in a state of perpetual change. A good outsourcing agreement will set a clear structure for specifying, pricing and implementing change. This is a particular area where due diligence on the supplier will assist the buyer in understanding how user-friendly the buyer will find the proposed supplier.

The very largest outsourcing arrangements go out to tender with a carefully crafted specification against which the supplier can tender its price and the bids from various tenderers can be evaluated on a like-for-like basis. This also allows the buyer to control the contract process; this is rarer in agreements reached other than by tender, which are often negotiated around the supplier's term of business.

Service Level Agreements

Where services are to be supplied on a continuous basis, such as IT maintenance services or the complete outsourcing of IT systems to a third party, then as well as the specification, there should be a clear and unambiguous service level agreement (SLA). The SLA may overlap or even, in some cases, replace the specification.

Case Study

An example of an outsourcing exercise where some due diligence would probably have saved a later dispute is the story of Company G that developed and published computer games. G decided to sub-contract an element of design of a particular game to outside programmers P. The project did not proceed smoothly and when G tried to involve other programmers to complete the game, a dispute over copyright in the work that P had done ensued. Here, due diligence would have involved checking with other customers of programmers P that their work had been satisfactory and that they were able to deliver on the sort of project contemplated. Furthermore, once due diligence had been done, a clear and comprehensive agreement could be entered into, setting out issues of title.

The SLA should typically set response times for queries and set out the timetables for how services are to be supplied, and what is to happen if things go wrong. A typical remedy in a service level agreement is a service credit, which is a rebate of some percentage of the fee where the supplier has failed to meet the required service levels. It is always in a supplier's interest to set a service level agreement that is not too demanding of the supplier. This is where it is important for the buyer to have a specification. If there is no specification and the supplier sets its own service level at a place that is comfortable to the supplier, then the buyer has lost control of the outsourced facility. If it subsequently finds that it cannot operate the agreement that is in place, there will be little that it can do until the contract comes up for renewal.

Key points

- Due diligence avoids problems later
- Know what you want and specify it
- Provide a mechanism for change
- Where applicable be careful with personal data
- Prepare for the end of the arrangement

Data Protection

One particular area to watch in outsourcing is data protection. This issue comes up when personal information (of, say, employees or customers) is physically held by the supplier. The classic example is the outsourcing by utility companies and banks of their call service facilities to companies. Those arrangements raise issues, not only of transferring personal information to third parties, but also sending the information outside the European Union. This is a specialist area where care needs to be taken to keep control over the supplier's activities, particularly as the responsibility for staying within the law will remain with the buyer of the services. The data protection watchdog has been given powers to levy fines of up to £500k for wrongful use of personal data.

Manufacturing

Manufacturing outsourcing, typically to eastern Asia, has its own set of challenges. One major problem for western outsourcers is the difference in culture. This can be a formidable obstacle and can often be alleviated with the help of a suitable local expert. Other less overarching but typical issues focus on quality control, a lack of insurance so that if things do go wrong you can claim against the manufacturer. The outsourcing party will generally be the party with ultimate liability in its home market. Sourcing from a cheap manufacturer of generic products or outsourcing bespoke designs to a cheap manufacturer will look less attractive financially if the result is products that lead to claims. Protection from piracy by the contract manufacturer is also an issue that deserves attention. Lead paint on toys, furniture treated with poisonous chemicals to protect from moisture and copy products turning up as part of the manufacturer's own generic catalogue are three recent examples of problems arising in sourcing or outsourcing to eastern Asia. The chance of effective recourse against the supplier in such circumstances is remote.

Preparing for the End

One area that always requires consideration in an outsourcing relationship is what happens at the end of the agreement. It is essential that a provision is put in place for a smooth handover of the functions that have been outsourced to the new provider of those functions, whether they be taken back in house by the buyer or passed to a new supplier. This may involve the transfer of contracts of employment under Transfer of Undertakings Regulations (the TUPE regulations). Consideration should be given at the outset to the likelihood that the TUPE regulations will apply at the end of the contract and suitable provisions made to deal with the effect of these regulations. Even where the outsourcing is a simple one-off contracting-out of say programming, the end of the contract and the consequences of it can usefully be spelt out. As shown by the case study on page 19, it is important to ensure that the buyer has the unfettered right to use the work that has been produced for it by any supplier of services.

Conclusion

Outsourcing is a good way for a company to increase its capacity quickly, and to get efficiency savings in aspects of business infrastructure that could better be provided by specialists than undertaken in-house. To make such arrangements work smoothly, it is important for the buyer to undertake due diligence on proposed suppliers, to know in detail what services are required, to ensure that there is a sound contract and where appropriate an SLA in place to hold the supplier to account during the contract, and to manage the transition away from the contract when it comes to an end.

Buying or selling a business

Making an acquisition (or being acquired) is part of the growing up process of any business.

Assets or Shares

Acquisitions generally take one of two forms; an asset (business) acquisition or a company (share) acquisition. The question of which type of transaction is appropriate to any particular deal is complex, but as a rule of thumb, an asset sale will be preferred by a buyer if it perceives the company operating the business has potential liabilities to which the purchaser does not want to be exposed, or if what is being sold is part of a larger business (as in, say, the sale of a division or of a particular piece of technology).

Due Diligence

Whatever the nature of the transaction, the first step in any acquisition process is due diligence. There is an old adage that "time spent in reconnaissance is rarely wasted".

There will usually be a non-disclosure agreement put in place first, to ensure that if the result of the due diligence is that the proposed deal collapses, the prospective purchaser does not misuse what it learns during the due diligence exercise. Following that, a series of questions will be asked covering every aspect of the business, including its accounts, assets, management, staff and, importantly, its intellectual property rights.

Due diligence is important and should not be omitted, as it often is in the general enthusiasm to do a deal. Due diligence is about gathering evidence that supports (or otherwise) the underlying commercial reasons for the deal and identifying any risks, such as existing liabilities that may transfer. At its most general, it involves checking that everything that is necessary for the deal to be consummated and to achieve the objectives of the acquirer is either in place or provided for. It is an important risk-management tool that, if properly applied, will give the parties sight of the risks they are taking, even if it is not possible to exclude those risks.

Page 15 demonstrates a real-life example of a case where no (or insufficient) due diligence took place serves to illustrate the importance of due diligence in nearly all technology acquisition transactions.

Identify Risks

If a seller is making a planned sale it will run its own due diligence exercise on itself, to ensure that it can answer all the questions likely to be asked of it by a prospective buyer. Where a company is approached to do a deal, this step will be missed and the seller will find itself launched straight into the acquirer's fact-finding process.

For the acquirer, the due diligence process is vitally important. It should identify any risk areas. If the risks identified are significant, they may be factored into the structure of the deal or the price to be paid. Sellers can be tempted into impatience over due diligence. They want to get the deal done and the money paid. This is a mistake. A deal on which insufficient due diligence has been done is more likely to break down when something unexpected is revealed or is likely to be on terms less advantageous to the seller. For instance, the price may be lower, a large retention may be held back, or all sorts of warranties and indemnities may be demanded to cater for the unexpected (or, more accurately, the unexplored).

One of the major areas that will be explored in the sale of a technical business is the intellectual property rights for that business. The buyer will want to know what intellectual property rights the company owns, what third-party intellectual property rights the company uses under licence, the quality of the intellectual property rights (for instance, whether any patents are strong or weak), where the know-how is to be found and what risks there are that a third party will allege infringement of its IPR by what the seller is doing.

These can be demanding questions and some of them may not be susceptible to easy answers. Some, but by no means all, transactions include technical evaluation of the technology, as well as the legal evaluation of the IPR protecting the technology.

Particular care needs to be exercised when buying from a company that is in some form of insolvency process. The insolvency practitioners who will be liquidators or administrators of the company are unlikely to have any particular knowledge about the intellectual property rights and obligations of the company and a purchaser buys very much "as seen".

Key points

- Start with Non-disclosureAgreement
- Due diligence – know what you are selling/buying
- Identify any risks, particularly if buying shares
- Secure the Intellectual Property Rights
- Know what you want from the deal

Agreements and Warranties

Once the due diligence process is underway the parties start to negotiate the sale agreement. The two processes generally proceed together. The form of the agreement will depend on the nature of the transaction being undertaken, but whatever form it takes, there will be a series of warranties demanded by the buyer from the seller about the state of the assets, and in particular the intellectual property rights. Warranties are contractual promises that, if breached, give a remedy only in damages. These promises are usually qualified so that the buyer is taken to know what has been disclosed in the due diligence exercise, which is used as a basis of a disclosure letter, which sets out, in full, the exceptions to the warranties.

Any breach of the warranty by the seller is likely to give rise to a claim by the buyer against the seller. Usually warranties are both capped and collared – that is, that there is a certain minimum of warranty claim that has to be reached before the buyer can take action, and there is a maximum amount which the seller may have to pay to the buyer if there are any breaches of warranty. It is at this stage that due diligence becomes particularly important for the seller. The chances of the seller being embroiled in a warranty claim are considerably reduced if all the risks associated with the seller's assets, including the intellectual property rights, have been disclosed to the buyer as part of the due diligence process.

Insurance and Indemnities

An important issue here may be insurance. The buyer will be concerned to ensure that any right of recourse in respect of unforeseen prior liabilities that are the subject of warranties will be adequately secured in the event of a breach. Warranty and Indemnity insurance may be used to provide this security.

Where particular risks have been identified with some aspect of the seller's business, indemnities will usually be sought. The risk of the seller's business infringing the intellectual property rights of third parties is nearly always the subject of an indemnity (except where buying from an insolvent company). The seller's own market intelligence is important here because it will enable the seller to measure the risk it is taking in giving an indemnity.

Conclusion

All acquisitions are different, so no two ever follow the same path. It has only been possible to touch on some of the issues here, there are many other complex issues, such as employment issues that can be involved, and each presents its own particular risks and challenges. It is well worth having an experienced professional advise on an acquisition whether one is the buyer or the seller to try and avoid the many pitfalls that exist.

Case Study

Company A needed some particular algorithms to use in programming its hardware product. It acquired these from Company B by way of a licence to use the algorithms Company B had created. Although the algorithms were Company B's property, they were covered by a patent application which was not wholly owned by Company B. Company B shared ownership with a University. Where a patent is jointly owned like that, any of the owners can use the patented technology itself (as Company B had done in developing its algorithms), but they must all agree to the grant of a licence. A formal licence for the algorithms was negotiated with Company B, in which Company B warranted that it could grant the licence. It later turned out that the University demanded a large fee for its consent under the patent applications and that the warranty of Company B was worthless because it was essentially a shell company.

Conclusion

In these early years of the 21st century the UK's economy has grown increasingly dependent on the technology sector, as many of the more traditional industries are being lost to overseas competition, and changes occur in the way people live and interact with each other. The technology sector now employs over 1.1 million people and accounts for around 10 per cent of the UK's GDP. It is widely anticipated that the cyber security, mobile technologies, green IT and cloud computing markets will experience significant growth over the coming years. The UK is seeing an increasing number of exciting new technology businesses emerge, with many being supported by steps by the Government to support SMEs. More established technology businesses are continuing to innovate as the wider economy shows positive signs of growth.

Travelers' UK Technology team has worked closely with customers in the technology industry for over 20 years. During that time we have seen businesses succeed whilst others have failed, and we've learned many lessons from what we've encountered. Our experience has shown us where and when the key decisions come during a technology firm's business lifecycle, and we've seen cases where a more informed decision would have led to a greater productive outcome for the business concerned. This report has been written as a guide for burgeoning technology firms to assist them through their life stages, because we believe emphatically in the value of technology businesses and the need to see them prosper.

We live in a complex world inhabited, in part, by lawyers and potential litigants. This creates challenges for the fast-moving technology business with an eye on expansion, which in turn creates risk. This is especially true when supply chains are becoming longer and more complex, resulting in businesses having less control over the use of their product. One of the great strengths of the technology market is its speed and flexibility, but this can also be its achilles heel. The desire to rush ahead is expected more readily than in other, more traditional industries. With the need to keep up with the pace of competitors and technological advances, the pressure to make quick decisions can be overwhelming. A company may be placed in a vulnerable position if options have not been fully weighed up and advice has not been taken. Every decision is a unique balance of risk and reward, and that is where this report and the services of the risk industry come into play. Insurance is one way to reduce exposure to the risks these decisions create; taking care of the issues mentioned in this report is another. Remember, this is only general guidance. You should always take specialist advice on your own situation.

Technology companies can grow rapidly from a UK base, stretching the limits of their senior team's experience of law and contracts. Small companies are taking big steps into the unknown every day, and we want those steps to be sound. This report highlights some important areas. Areas which, if considered, will help both businesses and in turn the UK economy.