Dispute resolution in IT contracting*

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1 Introduction

I was recently involved in the drafting and negotiation of an agreement which arose out of the sale of a part of the client's business. This particular agreement governed the provision of services by the vendor to the purchaser to ensure an uninterrupted supply of IT and Human Resources services and the accurate migration of data to the purchaser's business. The agreement contained a dispute resolution clause which stated that in the event of any dispute, the parties should use their best efforts to settle the dispute using good faith, consultation and negotiation. After 30 days, if necessary, the dispute could be referred to the relevant chief executive. If the parties were unable to reach a settlement within 60 days, the dispute would be referred for settlement by arbitration in Hawaii.

This type of clause provides a clear incentive for the parties to resolve the dispute between them in an effort to save costs. It also gives some certainty, since in the event that a dispute cannot be resolved, the parties will submit to an arbitration procedure.

However, many dispute resolution clauses are not so certain. Consider a clause which provides that:

> "if the dispute cannot be resolved within five business days of referral to senior management for negotiations the dispute will be referred for determination by way of alternative dispute resolution".

This type of clause is present in many agreements, but what does it mean? What do the parties really want and is such a clause enforceable? What about the powers of the Supreme Court?

This article considers:

- practical points to bear in mind when drafting an agreement so as to minimise the potential for future disputes;
- the Court's treatment of contractual obligations to undertake alternative dispute resolution; and
- New South Wales legislation regarding compulsory alternative dispute resolution.

This article will not consider arbitration, as there is a legislative regime applicable to this procedure.

2 Risk management

2.1 Assessment

When negotiating a dispute resolution clause, a risk matrix should be established to determine and evaluate potential risks which may arise. The matrix should identify potential problems, consider what steps may be taken to avoid or minimise problems and if problems arise, how to resolve them. The following factors will generally be relevant to IT contracts:

- the expectations of the parties;
- the resources available;
- personnel restrictions;
- implementation costs;
- who will implement the project or arrangement;
- the right equipment and technology;
- contract deliverables;
- payment plans (for example, up front payments should be specified clearly, as well as payments related to deliverables);
- IT specifications;
- timetable of activities/project plan;
- acceptance testing of developed software;
- reliance on third parties to perform functions; and
- market contingencies.

This article considers specific issues relating to dispute resolution clauses. When carrying out a risk assessment, it is important to determine what matters should be subject to the dispute resolution procedure and the timing to apply once the procedure has been initiated.

2.2 Communication

Communication is a key element to the avoidance of disputes and dispute resolution. In the negotiation and performance of any agreement, both parties should have a clear understanding of the lines of communication to be used. The crux of an effective communication system involves a determination of:

- the manner in which processes are communicated;
- who the decision makers are;
- how these people are to be kept informed;
- the obligations of each party to communicate to the other parties;
- the hierarchy through which information must travel internally for the parties to make informed decisions and reports;
- to whom disputes will be referred. It may be better not to refer a dispute to the operational manager, so as to remove some of the emotion from the decision making process; and
- the documentary process. Often people have a different recollection of the outcome of meetings. When resolving a dispute it is important to get sign off on the resolution in the meeting.

In performing the contract, there should be a continual audit process which involves monitoring and reporting on the current status of deliverables and expenses. An audit system should be established which defines:

- the structure of the compliance system;
- tools of evaluation to monitor the performance of the parties;

- any penalty/sanctions for non compliance; and
- the personnel involved in the performance of the monitoring system.

A clear system to report on the results of the auditing system should also be established.

Three benefits flow from effective communication in relation to the auditing program:

- it promotes an acute awareness of the need for parties to adhere to their obligations and to monitor and report on the performance of those obligations accurately;
- issues in the relationship may be identified and dealt with more quickly; and
- barriers to communication and the amount of disputes are likely to be reduced.

2.3 Warranties and liabilities

Any risk analysis should include an assessment of warranties and liabilities. As shown in the recent case of RACV Insurance Pty Ltd v Unisys Australia Ltd [2001] VSC 300 representations and "Requests for Information" can be key documents in IT contracting. Each party must be clear about what warranties are given. Consider the following examples:

- "the software must operate in accordance with the specification." How much leeway is given? How detailed is the specification?;
- "the software will be free from material errors or viruses." When is an error or virus "material"?; and
- "the supplier owns the software being licensed." What about third party software used in any developments? What other software is needed to make the system operational?

A related issue is who will be liable if things go wrong, and to what extent. Termination of a contract is rarely the best option in the first instance, and damages are not necessarily of value when time and energy has already been spent on a particular project with a particular team. Responsibility for fixes, work arounds, modifications and improvements should be spelt out clearly in the contract, as well as any associated cost impact. This clarifies expectations at the beginning of an engagement and is a useful tool when disputes arise. As well as allocating responsibility, limitations on that responsibility should be considered. For example, a supplier of software will not want to give unlimited support and fixes. A resolution procedure should be devised to cover the situation where there is no fix: does the contract terminate on the payment of a set sum?

3 Dispute resolution and stay of proceedings

Effective dispute resolution clauses should be included in all contracts to provide a mechanism for the contract to remain operative and to allow parties to resolve the dispute without affecting the performance of obligations. Examples of these mechanisms are:

- informal negotiations;
- placing a committee in charge of dispute resolution;
- mediation;
- providing for a contractually nominated independent arbiter (nominated by position or individual) to resolve the dispute; or
- an agreement between the parties to settle their conflict before a private institution (for example, the Chamber of Commerce or an industry union).

The Australian Commercial Dispute Centre (**ACDC**) has drafted a number of clauses which may be included in commercial contracts. These principally deal with mediation, expert appraisal and expert determination. The ACDC has also published guidelines which detail the procedures to be adopted when each form of dispute resolution is carried out. These clauses and information can be a useful guide when drafting dispute resolution clauses, or they may be used in their entirety.

An alternative dispute resolution clause encourages parties to take that route prior to launching expensive litigation. Alternatively, if one party commences litigation, it may be the basis for the other to seek a stay of those proceedings. There is a considerable body of case law arising from applications to stay proceedings on the basis that the parties should abide by their contractual obligation to undertake alternative dispute resolution prior to taking further action. These cases give a guide to the elements needed for an enforceable dispute resolution clause.

Morrow v chinadotcom [2001] NSWSC 209 (**Morrow**) is a useful recent case which refers to many prior similar cases and the principles which have been established and applied. In Morrow, the court also considered an application in the alternative for an order to mediate under section 110K of the Supreme Court Act 1970 (NSW) (**the Supreme Court Act**).

This case is discussed below.

4 Morrow

4.1 Facts

In Morrow, the purchaser under a contract of sale was sued by the vendor. The purchaser sought orders from the court that:

- there be an interim stay of the proceedings to require the parties to pursue the dispute resolution process in their contract; or
- the dispute be referred by the court for compulsory mediation under s110K.

The contract of sale provided for dispute resolution in the following terms:

(a) The parties must attempt to settle any dispute by negotiation before resorting to external dispute resolution mechanisms.

(b) If the dispute was not resolved by the parties within a certain period of time, the matter would be referred to the ACDC for external dispute resolution.

(c) If the dispute was not resolved by the ACDC within two months, then the parties may institute legal proceedings.

(d) Notwithstanding the existence of a dispute, each party would continue to perform its obligations under the agreement, including payment.

4.2 Basis for stay

The court set out the three conditions to be satisfied prior to an order for a stay of proceedings:

(a) the alternative dispute resolution provision must operate as a *precondition* to the parties' freedom to litigate rather than a purported denial of that freedom;

(b) the relevant dispute must be within the scope of the contractual provision; and

(c) the agreed contractual process must possess such a degree of definition and certainty as to enable it to be meaningfully undertaken and enforced.

4.3 Certainty

The principal obstacle to the stay was the necessary degree of certainty of the referral to dispute resolution.

The court considered a number of other cases including.

(a) two cases where a stay of proceedings was granted:

 (1) Computershare Limited v Perpetual Registrars Limited [2000] VSC 223 (**Computershare**); and

 (2) Hooper Bailie Associated Limited v Natcom Group [1992] 28 NSWLR 194 (**Hooper Bailie**); and

(b) two cases where a stay was refused:

 (1) Elizabeth Bay Developments Pty Limited v Boral Building Services Pty Limited [1995] 36 NSWLR 709 (**Elizabeth Bay Developments**); and

 (2) Aiton Australia Pty Limited v Transfield Pty Limited (1999) 1 FLR 236 (**Aiton**).

Hooper Bailie

The court noted in Hooper Bailie that an order to submit to mediation did not force co-operation and consent to an outcome. Rather, it involved participation in a process from which co-operation and consent might come. Given the clear structure of the clause in question, a stay was granted.

Elizabeth Bay Developments

In Elizabeth Bay Developments, the dispute resolution clause was substantially similar to the dispute resolution clause suggested by the ACDC (although the ACDC guidelines have since been changed). The clause provided that:

> "...the parties agree to first endeavour to settle the dispute or difference by mediation as administered by the Australian Commercial Dispute Centre."

It had been intended by the parties that the clause would incorporate the ACDC's published guidelines for mediation.

The mediation guidelines referred to a mediation agreement which was required to be signed by the parties. However, the guidelines did not otherwise identify the form of the agreement except by reference to its consistency with the guidelines. The court therefore could not find that the parties had committed themselves to a process of mediation of sufficient certainty to be legally recognised.

Aiton

In this case, the alternative dispute resolution clause was extensive and thorough. However, the court held that it failed because there was no provision for determination of the costs of the mediator, or who was to pay them.

The court stated that the following criteria must be met in order for a dispute resolution clause to be effective:

(a) the process established by the clause must be certain. There must not be stages in the process where agreement is needed on some course of action before the process can proceed. In the case that the parties cannot agree, the clause would amount to an "agreement to agree";

(b) the administrative processes for selecting a mediator and determining the mediator's remuneration should be included in the clause. The clause must also provide for a mechanism for a third party to make the selection in the event that the parties do not reach an agreement; and

(c) the clause must set out in detail the process of mediation to be followed, or incorporate these rules by reference. These rules must state with particularity the mediation model which will be used.

The court also commented that its role is not to assess whether matters which fall within a dispute resolution clause are likely to be resolved within the time frame stipulated by the clause.

Computershare

In contrast to the detailed clause in Aiton, the alternative dispute resolution clause in Computershare simply provided that:

> "...the parties must endeavour in good faith during the following 10 days:
>
> (a) to resolve the dispute;
>
> (b) to agree on a process to resolve all or at least part of the dispute without arbitration or court proceedings (eg mediation, conciliation, executive appraisal or independent expert determination)....".

The trial judge held that the parties had agreed to subject themselves to an obligation to establish a detailed framework within which a solution could be achieved between them. A stay was therefore granted to enable the parties to carry out their contractual obligation.

4.4 Conclusion in Morrow on stay

In Morrow, the court held that the role of the ACDC was not to resolve disputes or to direct parties to one or other of the various categories of dispute resolution available through the ACDC. Nor was the ACDC a third party appointed to complete an incomplete element of the parties' agreement. The court held that the disputer resolution clause did not define the role of the ACDC, and that

it therefore lacked certainty. No stay was granted.

4.5 Summary

In order to draft a dispute resolution clause which can be effectively used to stay any legal proceedings until the provisions of the clause have been carried out, it is important to ensure that:

- the clause is expressed as a pre-condition to litigation;
- the clause clearly specifies which disputes it applies to (for example, disputes in relation to the specification or acceptance testing may be best referred to an IT expert, whereas disputes in relation to payment and other commercial matters may not require an expert); and
- the agreed contractual process is sufficiently certain so as to enable it to be meaningfully undertaken and enforced:

  (a) there must not be stages in the process where agreement is needed on some course of action before dispute resolution can proceed;

  (b) the process for selecting a mediator and determining the mediator's remuneration should be included in the clause; and

  (c) the clause should set out in detail the process of mediation to be followed or incorporate these rules by reference.

5 Compulsory mediation

5.1 Supreme Court Act

Section 110K of the Supreme Court Act provides that:

(1) If it considers the circumstances appropriate, the Court may, by order, refer any proceedings, or part of any proceedings, before it (other than any or part of any criminal proceedings) for mediation or neutral evaluation, and may do so either with or without the consent of the parties to the proceedings concerned

(2) The mediation or neutral evaluation is to be undertaken by a mediator or evaluator agreed to by the parties or, if the parties cannot agree, by a mediator or a evaluator appointed by the Court, who (in either case) may, but need not, be a person whose name is on a list compiled under this Part.

Additional provisions require the parties to participate in good faith and permit the parties to agree on costs. If no agreement on costs can be reached between the parties, the court has the power to make an order in relation to costs.

The above provisions were enthusiastically embraced by the New South Wales parliament, principally on the basis of reducing delays in court proceedings and legal costs. However, many commentators objected to compulsory alternate dispute resolution on the ground that alternative dispute resolution lost its defining characteristic of voluntariness when made mandatory.

5.2 Morrow

In Morrow the court was asked to consider the following factors:

(a) whether the parties had shown a predisposition towards alternative dispute resolution;

(b) alternatively, whether any argument based on the dispute resolution clause must fall away because it was not enforceable; and

(c) whether a dispute must be 'out of the ordinary' to justify subjecting parties to the financial and administrative burden that mediation involves.

The court concluded that the relevant circumstances for the exercise of its discretion were those circumstances existing *at the time of the proceedings* and not the circumstances which existed at the time the parties contracted. Thus the previous "agreement" in respect of an alternative dispute resolution was of marginal value. At the time of the proceedings, one party was clearly opposed alternative dispute resolution. The court was not prepared to order compulsory mediation in the face of what appeared to be a balanced commercial decision by one party to pursue litigation.

5.3 Idoport Pty Limited v National Australia Bank Limited [2001] NSWSC 427 (Idoport)

In Idoport, the final hearing had commenced. However, there had been 18 judgments in interlocutory matters handed down and only one witness had been cross examined. The hearing was scheduled to continue until early 2003. The plaintiff applied for an order for compulsory mediation under s110K. The defendant's grounds for resisting mediation included:

(a) the measure of the plaintiffs' claims, which were in excess of $50 billion; and

(b) the difference between the parties' perceptions as to the plaintiff's prospects of success. The defendants were of the view that the plaintiff's claims were extravagant and baseless.

The principal factors accepted by the court as favouring an order for mediation were as follows:

- the issues between the parties had been identified;
- interlocutory disputes had been largely resolved;
- the anticipated length of the trial and the significant expense and resources that would be involved;
- the trial was still in its relatively early stages and would not need to be interrupted for mediation;
- resolution of the matter through mediation could encompass matters which could not be the subject of relief by the courts;
- an early resolution of the proceedings would assist court resources and other litigants; and
- mediation may well achieve a sensible commercial compromise for all parties concerned.

It was also convenient that court timetabling had provided a three week space in the litigation which could be extended to provide for the mediation without jeopardising the Court's control of the continued hearing.

5.4 Summary

In the exercise of its discretion, a Court will take the following factors into account when evaluating whether a s110K order for compulsory mediation is appropriate:

- the circumstances at the time of the proceedings, rather than the circumstances at the time the contract was entered into;
- whether the issues between the parties have been identified;
- whether the interlocutory disputes have been largely resolved;
- the anticipated length of the trial, expenditure, and court costs;
- the stage to which the proceedings have progressed;
- whether mediation can offer resolution to matters that the court cannot provide relief for;
- the public benefit in compulsory mediation to the legal system and process; and
- whether mediation may offer the parties a more commercially attractive solution.

6 Conclusion

A key factor in the performance of any contract is the avoidance of disputes. An effective way to minimise disputes is to plan for them in advance by conducting a risk analysis of the particular project. Establishing clear responsibilities, liabilities, remedies and lines of communication is vital to implement and maintain a healthy contractual framework.

Dispute resolution clauses must be clear enough to be carried out by the parties or enforced by one party if the other brings court proceedings without following the agreed procedures. Whilst a court has the ability to order mediation, it will exercise its discretion in the circumstances. A clear, workable contract is always the better option.

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Copyright Amendment (Parallel Importation) Bill 2002 (Cth)

Under the current Copyright Act 1968 (Cth) (**the Copyright Act**), it is an infringement of copyright to import non-infringing copies of software and, in limited circumstances, books for sale, hire, distribution, or trade exhibition without the permission of the copyright owner or an exclusive licensee.

In 1998, the Federal Government amended the Copyright Act to permit the parallel importation and sale of legitimate copies of sound recordings. In order to extend the application of a policy of limiting parallel importation restrictions, the Copyright Amendment (Parallel Importation) Bill 2002 (**the Bill**) was introduced to the House of Representatives on 13 March 2002.

The Bill proposes to amend the Copyright Act to enable the legal parallel importation and subsequent commercial distribution of non-infringing computer software products (including interactive computer games but excluding "feature films"), books, periodical publications and sheet music. If the Bill is introduced in its current form, where a copyright owner brings an action for copyright infringement in relation to such works, there will be a presumption that the relevant work is a non-infringing copy in the country in which the work was made.

The objective of the Bill is to counteract the perceived market control which copyright owners exert over the distribution of imported copyright material. According to Senator Alston, the Minister for Communications, Information Technology and the Arts, the current copyright law creates a lucrative distribution monopoly for foreign multinationals and prevents local retailers from sourcing cheaper copyrighted materials from overseas, even though individuals may make purchases directly over the internet. The Australian Competition and Consumer Commission has found that Australians pay significantly higher prices than international consumers for software and electronic books. For example, Australians have paid 27% more than US consumers for packaged business software, 33% more for personal computer games, and 23% more for electronic books.

The Bill has been deferred for consideration.

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