
The New Australian Government Standard Contract for ICT Procurement, SourceIT Part 2: Product and Service Related Issues – A Question of Balance?

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Background

The new Australian Government standard ICT contracts (SourceIT) set out model terms and conditions for the procurement of commercial off-the-shelf software, hardware and simple information technology consultancy services.

At the Australian Information Industry Association's seminars on the SourceIT model contracts held in Sydney and Canberra on 19th and 20th June 2007, there were mixed reactions to the model contracts. Some suppliers commented that for global companies, passing on obligations such as the SourceIT warranties and indemnities makes contracting costly and impractical. Other companies had already accepted orders using the SourceIT contracts without amendment.

In our article featured in the previous edition of *Computers & Law* entitled "The New Australian Government Standard contract for ICT Procurement, SourceIT: The New Benchmark" we provided an analysis of the SourceIT model contracts. This included an analysis of the structure, scope and purpose of the contracts and the legal terms and conditions that are common to all the model contracts.

Capitalised terms are used throughout this article to reflect the defined terminology and headings used in the various SourceIT contracts.

What this Article will Tell You

This second article analyses the key terms and conditions specific to the product or service that is the subject matter of each of the contracts. We

discuss the extent of the specific product and service warranties, whether they are time bound by a warranty period, the obligations to rectify defects and the extent to which industry standard exclusions apply. For instance, we consider questions such as, "*does the warranty apply if the Customer does not use the product in accordance with the manufacturer's instructions?*"

The article also provides guidance on how to complete the "Contract Details" and the various other Schedules to the contract. The Contract Details set out the specific variables for the product or service being purchased. The other Schedules include the Statement of Work, Payment details, Designated Confidential Information, Customer Requirements, Change Order, Agency Order Form, Open Source Licence and Confidentiality and Privacy Undertaking.

It is important that changes to the model contracts are made in the correct place, as the priority of documents clause gives priority to the Agreed Terms (the terms and conditions in the body of the contract) over the Schedules. The Australian Government Information Management Office (AGIMO) has issued some User Notes to accompany SourceIT. These User Notes suggest that the impact of the priority of documents clause is, for example, that a clause in a Statement of Work which seeks to exclude the warranty in the Agreed Terms that the "*Hardware will comply with the Specifications and Documentation*" would be ineffective.

As many key legal and business issues are included in the Contract Details and the Schedules, completing the Contract Details and/or the Schedules accurately becomes paramount.

This article explains some of the key issues that need to be documented in the Contract Details and Schedules, and highlights potential amendments that the parties may wish to consider to the terms and conditions themselves.

Key obligations relating to Products and Services

Key obligations specific to the products and services provided under the SourceIT contracts will be discussed in the following order:

- Licence and Support Contract;
- Hardware Acquisition and Maintenance Contract;
- Licence Contract;
- IT Consultancy Services Contract;
- Open Source Software; and
- Completing the Contract Details and Managing Risk.

Licence and Support Contract

This model contract can be used to provide commercial off-the-shelf software, installation services and Support Services, such as Updates, New Releases and technical support. The Licence and Support contract can also be used to provide training and other additional services. The User Notes state that it is not intended to be used for complex licensing, managed services, hosted services or software development. The Licence and

The New Australian Government Standard Contract for ICT Procurement, SourceIT Part 2: Product and Service Related Issues – A Question of Balance?

Support contract includes the following provisions.

Grant of Licence

The default position is that the supplier grants the Customer a perpetual, irrevocable, worldwide, non-exclusive licence to:

- install the Software;
- adapt and modify the Software to the extent necessary to enable it to be used on the Customer's Existing System;
- use and communicate each part of the Software; and
- make copies of the Software for back up and security purposes.

The Customer has the right to assign these rights (without payment to the supplier) to other Agencies and to third parties, including any outsource supplier.

Unlike GITC version 2, where suppliers could describe the "class of licence" to include for example a "single user", "concurrent user" or "any other type of licence", the SourceIT Licence and Support contract does not include a "class of licence" or a "scope of licence" provision.

If suppliers want to add to or vary the scope of the licence from the usage rights set out above (for example to provide for "named users", "time based licences", "geographic restrictions" or "project licences") they must do this by incorporating the revised scope of licence usage rights in the Contract Details.

Suppliers providing software under a third party licence agreement may be limited in their rights to on-license the Software to the Customer and will need to consider the licence rights granted to the Customer under SourceIT when agreeing arrangements in their back to back licences with their third party licensors.

The Software Licence and Support contract provides that the Software is subject to Acceptance by the Customer. The default position is that

the Software will be Accepted on the date the supplier delivers the Software in accordance with the requirements set out in the Statement of Work. If the parties want to change this position they will have to do so in the Contract Details.

Warranties

Under the Licence and Support contract, the supplier's warranties in relation to the Software include that:

- the Software will comply with the Specifications and the Documentation;
- the Services and Software will be fit for the purpose set out in the Statement of Work;
- the Software and Documentation will be complete, accurate and free from material faults in design;
- the media on which the Software is furnished will be, under normal use, free from defects in materials, design and workmanship and Harmful Code; and
- the supplier will not, nor will it permit any third party under its direction or control to introduce any Harmful Code (viruses, Trojan horses etc) into the Customer's system or any Deliverables.

These warranties are not limited by a specific warranty period, nor are they limited to compliance "in all material respects".

There is no prescribed remedy for breach of many of these warranties. However, the supplier must use all reasonable efforts to notify the Customer if Harmful Code is introduced into the Customer's system and if the Harmful Code is introduced as a result of a breach of the supplier's warranties in relation to Harmful Code, the supplier must take all necessary action to eliminate and, at its own cost, repair any harm or destruction caused by that Harmful Code.

Unusually, there are two obligations on the supplier to ensure that the Software complies with the

Specifications and Documentation. Each obligation uses different language with a slightly different result. One is a warranty that the Software must comply with Specifications and Documentation without a reference to any limit by way of a warranty period. The other obligation is that when the Software is installed and implemented, and for so long as it is maintained under the contract, the supplier must ensure that the Software provides the functions and meet the performance and other requirements of the relevant Specifications and Documentation. This obligation is not limited in time but does depend on the Software being maintained. We assume the drafter's intention is that the reference to "maintained" should be interpreted as being "subject to Support Services".

Unlike the "Licence only" SourceIT contract, this model contract does not provide a supplier with the common exclusions from the warranty arrangements, such as the warranty not applying to the extent that a defect is caused by the Customer not using the Software in accordance with the Documentation or where the Customer has modified the Software.

Suppliers who re-license software under third party licensing arrangements should review the warranty arrangements to see if they are consistent with the warranties that are available from the third party.

Escrow

The escrow requirements are another area that may cause supplier's concern as we suggest they are likely to be incompatible with most supplier's internal requirements and are difficult to back to back with third party licensors.

The default position in the contract is that the Source Materials must be held in escrow on terms approved by the Customer. Such arrangements may potentially result in suppliers inadvertently giving the Customer access to their source code. "Source Materials" are defined as "*the source code of, and all relevant*

The New Australian Government Standard Contract for ICT Procurement, SourceIT Part 2: Product and Service Related Issues – A Question of Balance?

documentation, notes and other materials required to support the Software”.

Following Acceptance of the Software the supplier must deposit the Source Materials with an escrow agent approved by the Customer and on terms approved by the Customer. The terms of the escrow agreement will include the trigger events for release of the source code.

Suppliers and their third party licensors are unlikely to accept Customers dictating the terms of the escrow agreement.

Support Services

During the Warranty Period (which is defined to be 90 days from the date the Customer accepts the Products or Services under the contract, unless specified otherwise in the Contract Details) Support Services must be provided to the Customer free of charge.

The Contract Details would need to be amended by suppliers whose business model includes charging for Support Services from delivery or installation of the Software.

Support Services include the following at a minimum (unless specified otherwise in a Statement of Work):

- supply of telephone or other electronic support to the Customer;
- maintaining an electronic mail communication facility to enable the Software to be downloaded in softcopy;
- correcting any failure of the Documentation to provide adequate and correct instruction;
- correcting any Problem in accordance with the relevant Service Levels. (We note that the definition of Resolution Time states that the supplier must “resolve” a Problem. In our experience, industry practice is that suppliers do not guarantee to resolve defects within a defined time period);

- providing free Updates to rectify Problems or to comply with regulatory changes relating to the Software;
- supplying all New Releases, enhancements and other changes;
- replacing the Software at no charge if the media becomes destroyed or damaged; and
- provide any training or additional services as set out in the Statement of Work.

Suppliers can vary these services by specifying the varied arrangements in a Statement of Work.

Supporting old versions

In GITC v4 (the other standard Federal Government ICT contract), if the Customer rejects an offer by the supplier to provide an update or new release for licensed software, the supplier only has an obligation to maintain the old version of the licensed software for 18 months or an alternative period specified in the Contract Details. It is important to note that there is no similar provision in the SourceIT model contracts.

This model contract creates an obligation for the supplier to maintain the version of the Software that was originally installed for the entire period of the contract. As the contract can be extended at the option of the Customer, the time that the old version may have to continue to be supported may be extended by the Customer for significant periods. Suppliers will need to bear this in mind if agreeing to the provisions giving the Customer the right to extend on notice.

Issues with definition of Software

Software is defined as “*software provided by the contractor under the contract, as specified in the Statement of Work and includes any Updates and New Releases adopted by the Customer*”.

As the definition of Software includes the commercial off-the-shelf Software, customisations, Updates and New Releases, the obligations in the model

contract need to be read in that context. Potentially this means that the supplier has to:

- install all Updates and New Releases free of charge;
- provide Support Services to custom code;
- provide Updates and New Releases to custom code; and
- provide Upgrades and New Releases that comply with the original functional and technical requirements in the Specifications and Documentation.

Again, the supplier’s warranties in this model contract are not limited in time to the Warranty Period.

We recommend that suppliers discuss these warranty obligations and the obligation to provide free support during the Warranty Period with their finance and accounting personnel to consider the impact of recognising revenue on the licence and support fees.

Hardware Acquisition and Maintenance contract

This model contract can be used to provide Hardware and hardware related services, including Preventative and Remedial Maintenance. The User Notes suggest that this model contract should not be used for the purchase of office equipment such as photocopiers, electronic whiteboards or projectors that do not have network capability.

The Hardware Acquisition and Maintenance contract includes the following provisions.

Transfer of Title and Risk

The Customer accepts the risk of loss of or damage to the Hardware on delivery. However, ownership of the Hardware passes to the Customer on Acceptance.

The default position for Acceptance of the Hardware is that the Hardware will be Accepted upon the date the supplier delivers the Hardware in accordance

The New Australian Government Standard Contract for ICT Procurement, SourceIT Part 2: Product and Service Related Issues – A Question of Balance?

with the Statement of Work, unless specified otherwise in the Contract Details.

Suppliers re-selling third party hardware will need to review their reseller agreements to ascertain when title and risk passes from the original equipment manufacturer to the supplier. Suppliers should ensure they have the necessary insurance cover for the period the Hardware is at the suppliers' risk, and that title does not pass to the Customer prior to the supplier obtaining title to the Hardware from the original equipment manufacturer.

Consideration should be given as to whether Acceptance testing is required for the Hardware. This will depend on the complexity of the Hardware and whether it is to be integrated with the Customer's system. If configuration or integration is required, details of any Acceptance tests should be set out in the Statement of Work.

Contractor Warranties - Hardware

The supplier warrants that on the Delivery Date (defined as the date or dates specified in the Statement of Work for delivery of the Hardware) the Hardware will:

- not introduce any Harmful Code into the Customer's systems or any contract Materials (defined as any Material created by the supplier which includes software, and firmware and a number of items of documentation);
- be newly manufactured, unless otherwise agreed;
- be free from any material defect in workmanship, design and materials;
- be fit for the purpose as set out in the Statement of Work; and
- be compliant with the Specifications and Documentation.

Unusually, the contract includes two provisions dealing with the obligation to provide Hardware that is newly manufactured, free from material

defect in workmanship and design and compliant with the Specifications.

Each provision uses slightly different language and extends for a different duration. The Hardware and Acquisition contract has one clause where these obligations apply without reference to any time frame, and another clause where similar warranties are given on the Delivery Date.

Where the supplier is not the original equipment manufacturer of the Hardware, the supplier may not be able to provide these warranties as many reseller agreements restrict the type of warranties that suppliers can give when re-selling the Hardware to end users.

Warranty Period

During the 90 day Warranty Period (defined as 90 days from the Acceptance Date or as otherwise specified in the Contract Details), the supplier must remedy:

- all failures, faults or difficulties with the Hardware either by repair, modification or replacement; and
- pay all costs incurred in performing these obligations including repair, modification, disassembly and reassembly costs.

The only exception to the obligation to pay all costs, arises if the failure, fault or difficulty with the Hardware is caused by the Customer's negligence.

To change the obligations in this clause the supplier will need to amend the Agreed Terms. This obligation cannot be varied by using the Contract Details.

The supplier must also pass on all third party warranties to the Customer.

Support Period

The default Support Period, (unless specified otherwise in the Contract Details), starts at the end of the 90 day Warranty Period and will continue

until the end of the initial contract and for any renewal period.

However, as noted above, during the Warranty Period the supplier must remedy all faults, failures or difficulties with the Hardware either by repair, replacement or modification and provide Preventative and Remedial Maintenance free of charge.

Suppliers whose business model involves charging for Maintenance Services from delivery or installation of the Hardware, should seek to amend the Contract Details.

The supplier must also make replacement parts available for the Hardware for 3 years from the Delivery Date.

Preventative Maintenance

The model contract sets out some minimum standards for Preventative Maintenance which include:

- maintenance of the Supported Hardware in good operating condition;
- Problem detection and resolution;
- replacement of unserviceable or faulty parts;
- cleaning and, where possible, lubrication; and
- adjustment of any mechanical or similar devices.

If the supplier wants to improve the standards, they can include those additional services in a Statement of Work.

Remedial Maintenance

Unless specified otherwise in the Contract Details, the supplier must provide Remedial Maintenance as set out in the Statement of Work and technical support including telephone, fax and e-mail and on-site contact to resolve a reported Problem.

If the supplier is notified of a Problem, they must, at a minimum:

- replace or repair parts to rectify the Problem;

The New Australian Government Standard Contract for ICT Procurement, SourceIT Part 2: Product and Service Related Issues – A Question of Balance?

- comply with the Response Times set out in the Statement of Work;
- implement measures to minimise disruption to the Customer's operations during the provision of Remedial Maintenance;
- keep the Customer informed of the status while rectifying the Problem;
- where any part of the Supported Hardware containing Customer Data is replaced, take steps to remove and return that Customer Data; and
- comply with any other requirements in the relevant Statement of Work.

Maintenance

The Hardware Acquisition and Maintenance contract states that when providing services to the Customer, the supplier must supply the Services:

- with due skill and care and to the best of the supplier's knowledge and expertise;
- in accordance with relevant industry standards, best practice and guidelines or, where none apply, relevant international industry standards and best practice guidelines;
- in accordance with applicable Laws and Commonwealth policies;
- so as to meet the Milestones and other project plan requirements;
- in accordance with the Service Levels;
- using the Specified Personnel; and
- in accordance with any reasonable directions of the Customer.

The obligation to provide the Services in accordance with relevant international standards could be very onerous on the supplier, as it may include voluntary as well as mandatory international codes. In the context of the supply of ICT Hardware, for example, there are many "voluntary" electrical standards

many of which are not followed by international ICT companies.

Supplier Warranties – Services and Maintenance Services

Under the model contract, the supplier warrants that in supplying the Services:

- it and its Personnel have the necessary experience, skill, knowledge and competence to perform its obligations under the contract; and
- the Services will be fit for the purpose set out in the Statement of Work.

The supplier also warrants that in supplying the Maintenance Services:

- replacement parts for the Supported Hardware will comply, at the date of delivery, with the requirements for the Hardware warranties previously discussed in this article;
- it will not, nor will it permit any third party under its direction or control to, introduce any Harmful Code into the Customer's systems or any Deliverables; and
- if Harmful Code is introduced in breach of the warranty described in the above bullet point, it must eliminate the Harmful Code and, at its own cost, repair the damage caused by the Harmful Code.

These warranties are not limited by a warranty period.

The supplier is not required to perform Maintenance Services (unless specified otherwise in the Contract Details) in respect of:

- Hardware that has been altered, damaged or modified by a person other than the supplier;
- Problems caused by the Customer's negligence, abuse or misapplication of the Hardware or failure to use the Supported Hardware as specified in the Documentation;

- Problems caused by electrical failure, air conditioning or humidity control on the Customer's premises;
- accessories, attachments, supplies or items associated with the Supported Hardware, other than those provided by the supplier; and
- performance issues resulting from changes in the Customer's operating environment not approved or agreed with the Customer.

These exclusions only apply to the supplier's obligations to provide Maintenance Services and not to the supplier's warranties in respect to the supply of the Hardware, as discussed previously in this article. Generally, suppliers would expect a series of exclusions from the warranties relating to the supply of Hardware, for example, an exclusion if the Customer does not use Hardware in accordance with the Specifications and Documentation.

Licence (only) Contract

The Licence only contract can be used to provide and license standard commercial off-the-shelf software. According to the User Notes, it is not to be used for complex licensing arrangements or where the supplier is also providing support services.

The Licence only contract includes the following provisions:

Grant of Licence

The supplier grants the Customer a similar licence to the one granted under the Licence and Support contract, except:

- it is limited to the contract Period which is defined as the Initial contract Period plus any extension;
- there is less transferability of the Software licence; and
- the use of the Software is as specified in the applicable "Scope of Licence", which can be used, for example, to limit the number of

users, limit use to a specific location or CPU.

If a transferable and/or perpetual licence is required, the Scope of Licence can be amended in the Schedules to specify those requirements.

Warranty Period

One of the key differences between the Licence only contract and the Licence and Support contract is the limitation of the product warranties to a 90 day Warranty Period under the Licence only contract. Under the Licence only contract, the supplier warrants that the Software:

- will comply with the Specifications and Documentation;
- be fit for the purpose set out in the Specification;
- be complete, accurate and free from material faults in design; and
- the media on which the Software is furnished will be, under normal use, free from Harmful Code.

This warranty is limited to a 90 day Warranty Period from the Delivery Date, unless otherwise specified in the Contract Details.

The drafter's intention appears to be that the supplier will not be liable for defects in the Deliverables which are caused by the Customer or a third party using the Deliverable other than in accordance with the Specifications or the Documentation. However, there appears to be an incorrect cross reference to the relevant clause in the contract¹,

The supplier has the same obligations as in the Licence and Support contract to notify the Customer if Harmful Code is introduced into the Customer's system or any Deliverables. Further, if the media on which the Software is delivered includes Harmful Code, the supplier must repair any damage caused at its own cost.

IT Consultancy Services Contract

Simple information technology consultancy services can be provided under this contract. Examples of the type of services that the contract could be used for are provided in the User Notes and include preparation of statements of work, assistance with processes, procurement, training and reports on the Customer's systems.

The IT Consultancy Services contract includes the following provisions.

Provision of Services

The supplier must supply the Services:

- with due skill and care and to the best of the supplier's knowledge and expertise;
- in accordance with the Performance Criteria; and
- in accordance with Australian industry standards, best practice and guidelines or, where none apply, relevant international industry standards including any specified in the Contract Details.

Each element of the Services is subject to Performance Assessment against the relevant Performance Criteria. However, the timing and criteria for the Performance Assessments is not clear. Do they occur upon supply by the supplier of the deliverable to the Customer or some other time? It appears that the Customer can assess the Services against the Performance Criteria at any time during the term of the contract. While it is not defined in the Agreed Terms of the model contract, the Performance Criteria can be specified in a Statement of Work.

Warranties

The supplier warrants that the Services will be:

- fit for the purpose set out in the Statement of Work; and
- complete, accurate and free from material faults.

The model contract does not provide a time limit on the warranties provided by the supplier.

Personnel

The IT Consultancy Services contract does not distinguish between Services that are provided under the direction, control and supervision of the Customer and "consultancy" style services which are not supervised by the Customer. Accordingly, where a supplier is providing "body shopping" services, the model contract does not provide any protection for the supplier where the suppliers' personnel make a mistake that should have been identified by the Customer.

The definition of Personnel includes each party's employees, agents,

professional advisers and, in the case of the supplier, its sub-contractors. As the supplier is responsible for services provided by its personnel, it will need to ensure that professional indemnity insurance covers all the services, whether performed by the supplier or by its employees, agents or sub-contractors.

The model contract does not include a "no-poaching" clause.

Open Source Software

The Licence and Support contract, Hardware Acquisition and Maintenance contract and Licence (only) contract allow for the Customer to licence Open Source Software. This is the first time that standard Australian Government contracts have recognised the use of open source software. It follows the release of the *Guide to Open Source Software for Australian Government Agencies*² which provides guidance on what constitutes open source software, typical concerns with acquiring open source software, preparing a procurement plan, risk analysis and risk management of open source software, understanding the legal context and sharing open source software solutions.

The New Australian Government Standard Contract for ICT Procurement, SourceIT Part 2: Product and Service Related Issues – A Question of Balance?

To the extent that the Software is licensed under an Open Source Licence, the applicable Open Source Licence prevails over the inconsistent terms and conditions in the model contract. The Open Source Licence should be attached as a Schedule.

Open source software that is downloaded for free does not generally include the same warranties and indemnities for breach of third party intellectual property rights that may be offered by vendors of proprietary software.

The model contracts do not expressly deal with how Open Source Software will be supported. Accordingly, if the Open Source Licence does not deal with support, the model contract will have to be amended to specifically address the support issues. In addition, there are some complex intellectual property rights issues associated with the customisation of software based on open source software which will not fit easily with the intellectual property rights arrangements contained in the model contracts (see our article in the last edition of *Computers & Law* for details). We recommend that specific consideration be given to these issues where open source software is being customised.

Completing the Contract Details and Managing Risk

The Contract Details enable the parties to vary the model contracts in the event that a particular default term or condition is not applicable to the transaction.

If either party wants to amend a clause or add an obligation, then it must be done in the correct place to ensure that the amendment is enforceable, given the precedence of documents clause discussed above.

The issues to be covered in the Contract Details and Schedules include the following general issues:

- liability amount, and whether it is in aggregate or a "per occurrence" amount;

- service level rebates (up to 100% of the service fee);
- levels of insurance;
- intellectual property ownership model;
- any changes to the Intellectual Property Rights clause to manage third party products or requirements such as fees for Documentation and training materials;
- consent to use sub-contractors (which includes Related Bodies Corporate);
- Confidential Information and any additional items that are agreed as being confidential;
- governing law;
- Specifications and requirements (this affects the warranty and "fit for purpose");
- Warranty Periods, (if not covered, the default warranty period is 90 days);
- whether Support fees can be charged during the Warranty Period;
- payment of fees and expenses;
- Acceptance arrangements;
- if contract extensions are allowed and any price increases or other qualifications (such as not providing support for old versions);
- provision of assistance free of charge at the end of an outsourcing; and
- any additional services such as training.

Product and Service specific issues that should be dealt with in the Contract Details or Schedules include:

- Software licence terms (for example, the number of users and other license restrictions);
- If the escrow provisions are not to apply (or if they do, what terms

and conditions apply to the release of the source code);

- definition of Business Hours (8.00 a.m. to 6.00 p.m.) may need to be amended as it may impact the daily charge out rate for consulting and support services);
- Service Levels;
- Deliverables and Services;
- Support Service details, Updates, New Releases, Preventative and Remedial Maintenance;
- installation and integration arrangements;
- project schedule and delivery dates.

Summary

Overall, the model contracts have raised the bar for suppliers, requiring significantly more demanding warranties and obligations. These new warranties and obligations may not be acceptable to suppliers, both in relation to their own products and services and particularly when they are re-selling or re-licensing third party products or services.

As the model contracts include numerous default provisions, it is necessary to complete the Contract Details and all relevant Schedules carefully to avoid being bound by unwanted default positions. As is to be expected, most default positions protect the government.

While the Contract Details allow the Customer and supplier to manage risk by varying the terms and conditions of the model contracts, it is not intended that there be protracted negotiations for the procurement of simple ICT products and services. It remains to be seen whether suppliers will seek significant amendments to these model contracts.

If suppliers or Agencies have suggestions on how to improve the model contracts, they should send them directly to AGIMO. AGIMO is actively seeking feedback on these model form contracts, and will take

The New Australian Government Standard Contract for ICT Procurement, SourceIT Part 2: Product and Service Related Issues – A Question of Balance?

feedback into account in any subsequent revisions of these model contracts, and in creating any future model contracts for other ICT products and services.

This article is based on a presentation by Mike Pym at AIIA's seminars on the SourceIT Model contracts in Sydney and Canberra 19/20 June 2007. Mike Pym provided substantial advice to the AIIA on the AIIA's submission to AGIMO during the consultation process, and has been heavily involved in assisting the AIIA in the consultations and negotiations with various State and Federal Governments on ICT procurement over the past decade or more, especially GITC v4, GITC v 5 (Qld), ProcureIT (NSW) and SourceIT. Mike Pym is the director at Pym's Technology Lawyers. Jacinta Bayard is a senior lawyer with Pym's Technology Lawyers. Both lawyers have worked in-house and in private practice advising customers and suppliers in relation to ICT contracts. www.pyms.com.au

¹Under clause 8.5 of the Licence only Contract, reference to "The Contractor will not be liable under clause 8.3.....", we believe should be a reference to clause 8.2.

² Australian Government, Department of Finance and Administration, Australian Government Information Management Office, April 2005, "A Guide to Open Source Software for Australian Government Agencies".