

U P D A T E

Information Technology

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## BPOs - practical tips

### Introduction

What do you need to do to achieve a successful Business Process Outsourcing (BPO)? We look at some of the lessons learnt over the many BPOs we have done.

It is useful to contrast a BPO with an IT outsourcing (ITO), simply to highlight differences between the two. A large part of why they are different flows from the fact that unlike ITOs, BPOs are relatively new and undeveloped in Australia. But many of the disciplines which apply to undertaking an ITO can also be applied to a BPO.

The key ingredients that you need in place to achieve an effective BPO are:

- a clear description of the product or service you are acquiring;
- matching what you think you are buying with what the outsourcer is selling;
- a well developed pricing model;
- robust performance remedies;
- effective risk allocation; and
- ensuring regulatory compliance (particularly in the financial services sector).

Also you must keep an eye on managing the negotiation process itself.

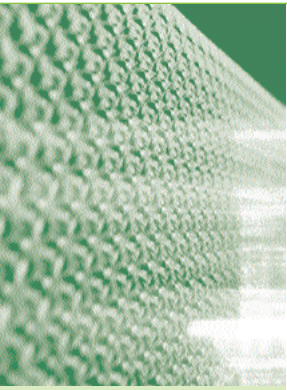
### What is being outsourced?

The first rule about a BPO is to know what "service" or "product" you are buying.

This does raise challenges. BPOs are about taking internal business processes and putting them outside the organisation. These are usually processes which are ad hoc and have been developed organically over time. They were probably never designed to be taken out of an organisation and split up, and may not even have been documented before.

Unlike ITOs, BPOs are not mature. They are not like a standard desktop or midrange service which can be purchased "off the shelf". Each organisation's HR, purchasing, processing, accounting or other back office functions are unique to that organisation. Everyone does things differently.

Often, you have to start from scratch and re-define the end-to-end process for the function you are outsourcing. As part of this, you must identify the handoff points



## “Common understanding is vital.”

between you and the outsourcer. These will define the boundaries of accountability - what you are responsible for and what the outsourcer is responsible for. Clearly, you want to minimise these handoff points - the more there are in any single process, the more blurred the lines of accountability will be for the overall result.

But, it's not enough that you define the current service. You actually need to consider the following types of issues for each service:

- What do you expect your outsourcer to provide?
- How will you calculate the price (per outcome? per task? resource based?)
- Who is going to be responsible for compliance with rules which are specific to your organisation? (for example, regulations or trust deeds?)

One by-product of this exercise is that you often identify hidden costs and resources that you were allocating to a task or responsibility in your existing processes. Outsourcing requires these costs to be explicit and you have to ask yourself - is this something we really want or need given this identified price?

### Matching Services and Products

When you know what you want to buy, you then need to know what the outsourcer is selling. That sounds obvious, but outsourcers base their business around scalability and they will be reluctant to vary their standard processes to accommodate you because that increases their costs.

You also need to spend a lot of time ensuring that you and the outsourcer actually understand what each other wants. Very often, terminology is a

stumbling block. You call something by an industry name which the outsourcer may associate with something completely different. Common understanding is vital.

In IT contracts, it is usual to specify an outcome and if it's not met, the outsourcer is accountable. In other words, you don't care how the outsourcer achieves the outcome provided that it is correct, on time and doesn't cost you any more.

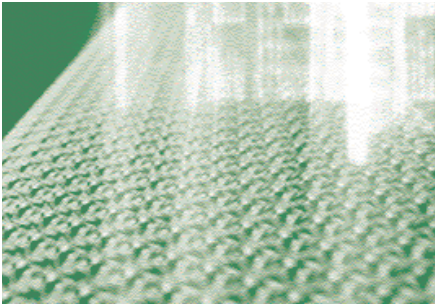
In the BPO world this is not always the case. Sometimes service providers will simply want you to look at and approve their processes for performing functions. Once they have your approval, they claim not to be responsible if the processes do not lead to the outcomes you want. This is a fundamental issue in relation to risk allocation.

You need to establish early on who takes the accountability for this process compliance.

### Pricing

Pricing is usually negotiated in the pre-documentation RFI/RFT stage, although it is often finalised later.

One important issue is price reviews. If you don't get a good long term price, then you need to protect yourself against unfavourable price reviews during the term of the contract. One way is to try and cap increases to CPI or less, or alternatively you can try to ensure that the outsourcer shares technology and productivity gains with you. Of course, the more locked in you are to the outsourcer (for example, if the cost of changing outsourcers is too high), the more at risk you are if you have short term pricing.



### Performance Remedies

Before you can address potential failures to perform, you need to define service levels. Developing service metrics and being able to measure them is always an art in itself. Nonetheless, if you cannot set clear and measurable service levels for the services you are being provided, you cannot determine whether or not you are getting the right quality of service.

Inevitably there will be some things which are hard to measure objectively, but which are really important to you. This is where methods such as a customer satisfaction survey is useful. It is entirely subjective, but can be carried out in a way which provides quantifiable results. Once you can measure a score against this, then you can set remedies for a failure to meet the expectations.

### Different industries have different approaches to remedies for performance failures.

In the IT industry, it is generally accepted that there is a proportion of the monthly spend that could be put at risk. A failure to meet performance standards means that through, for example, a credit mechanism, some or all of the at risk money is refunded. Sometimes, the outsourcer is able to earn this money back

through over-performance which leads to identifiable business benefits.

As BPOs are still developing, and some service providers in this market come from different industries, they may have difficulty with this concept. Part of the negotiation process therefore must be to clearly understand what you want from a service provider in terms of performance remedies, then ensure that these are negotiated at the right time. To do this, you need to consider:

- What performance remedy will be useful in the context of your BPO?
- What profit margin is the outsourcer working with?
- What other methods can be used to incentivise performance?
- What is the cost to your business of non-performance?

### Risk Allocation

Risk allocation is a large part of why you outsource. You want to move risk from your business and transfer it to the outsourcer. Outsourcers prefer to avoid risk which is not outweighed by returns.

The normal contractual rule is that if you are promised something, and the supplier fails to perform, then you are put in the position you would have been in had the supplier in fact performed.

This is fairly common in the IT industry. However, in some cases, service providers will want to limit this in BPOs. It is not uncommon to limit exposure to only negligent breaches. Will this extend to other breaches (eg confidentiality and privacy), or just for service breaches? This can be a fairly fundamental issue and one which you need to analyse carefully in your circumstances to determine whether or not it is acceptable. This analysis may

turn on whether or not indirect loss is excluded and liability is capped.

### "Indirect and consequential" loss

Nearly all suppliers will want to exclude their liability for "indirect and consequential loss". While often used in contracts, in fact, indirect or consequential loss is not a clearly defined concept in Australian law.

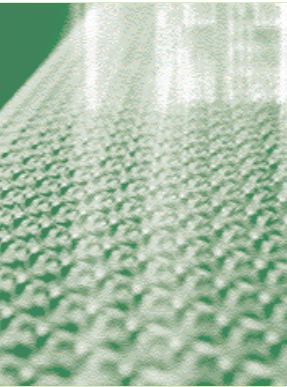
So, when someone in the financial services industry excludes indirect and consequential loss, what are they actually excluding? This is when you need to think carefully about your particular circumstances, and what loss is most likely to flow from the breach in a particular industry.

For example, consider a mistake in the financial services sector in respect of unit pricing which results in unit holders being paid too much when they redeem units, leaving a shortfall in the fund. The shortfall in the fund is a loss that naturally and directly flows from the breach. In other words, it is arguably a direct loss, not an indirect one.

It may be that you decide that there are very few circumstances in which you will suffer loss which is not a direct loss, in which case the exclusion of the "indirect" loss is not an issue. However, the wiser course may be to list all major categories of likely loss as "direct" to avoid the risk of exclusion. Regulatory risk is also an interesting issue. Who should bear the cost of fines? If it is the outsourcer's fault, then arguably they should reimburse you for any penalty. Again, this is likely to be a "direct" loss.

### Liability Caps

In the IT industry, everyone caps their liability, usually to contract value, or a multiple of contract value.



“Few, if any, ‘legal’ issues do not have real commercial impact.”

You should not automatically accept this in a BPO. Again, you should look at the risk involved if the outsourcer fails to perform. Take the unit pricing example again: a mistake in unit pricing could cost millions of dollars irrespective of the value of the services received. To accept a liability cap which does not reflect your business risk means that while you have outsourced the function, you have retained the overall performance risk.

#### The Negotiation Process

One of the key tools you have in maintaining leverage in any deal, particularly an outsourcing deal, is a competitive process. It is remarkable how much people will sharpen their pencils when they know that they have real competition. So, one of your aims in designing a negotiation process to get to a deal is to keep it competitive for as long as you can.

#### Request for Tender (RFT) process

A typical procurement process involves issuing an RFT to get specific proposals for a service offering, selecting a vendor, and then eventually negotiating a contract with them.

The ITO world has taken this RFT process and modified it so that the RFT contains fairly well developed service offerings on which vendors have to bid. There is no reason why it can't be done in the BPO world, although perhaps not to the same extent (because the service that you are buying is usually less well defined). A well structured requirement does require more time and proper structuring up front before you issue an RFT, but you can save time in the negotiation process as a result. This will increase the competitive pressure to not just offer "standard" supplier positions.

If you are going to use an RFT process, you should attempt to provide detailed contracts (or if not, at least detailed risk allocations) and require bidders to bid according to those contracts or risk positions.

#### Letter of Intent (LOI) / Memorandum of Understanding (MOU)

Sometimes you do not have time to use the RFT process, so you may be tempted to use an LOI or MOU which tries to lock the outsourcer into agreed positions while you develop full documentation. This can be an effective tool, but one key element to include is the ability to terminate negotiations if they are not progressing. Sometimes this does put a lot of psychological pressure on a supplier to agree to your point of view.

#### Timetable and Team

Try to plan your timetable for negotiations realistically. Usually, you will have to have at least three sets of face to face negotiations on the documents once they are fully drafted. At the same time, be aggressive in timetabling. If you do not set a stretch target, you may miss your real timeframe.

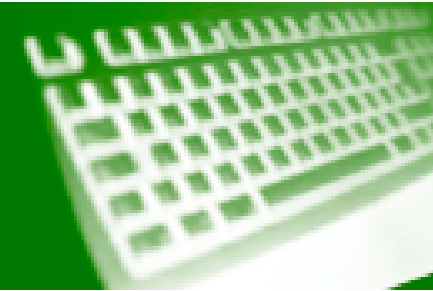
Composition of negotiation teams is vital. Commercial managers, especially senior ones, often do not want to spend days locked in a room with lawyers. But try to resist the temptation to let them off - they are essential to resolve commercial issues. Few, if any, "legal" issues do not have real commercial impact.

The final timing factor is to consider the time it takes to finalise technical details. These seemingly non-contentious schedules are at the heart of what you are buying, and usually take two to three times longer than the actual "legal" terms.

Like any great concerto, they must all be done in harmony.

# GEC Marconi v BHP IT

## Does a "variation in writing" clause always work?



In the previous IT Update (Autumn 2003) we looked at the recent Federal Court decision in *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* and the doctrine of constructive termination for convenience. In this instalment we continue to look at the case and the court's findings in relation to the variation of contracts which contain a "variation only in writing" clause.

### Why have a "variation in writing" clause?

Most contracts contain a clause to the effect that the terms can only be varied by agreement between the parties in writing. These provisions are routinely included in contracts to ensure that the benefits of the negotiated agreement are not lost (often unwittingly) as a result of the way in which the contract is managed (or mis-managed!).

### The issue

The issue before the court was whether a contract that contains such a clause can in fact be varied orally or by conduct.

### The relevant facts

The Department of Foreign Affairs and Trade (DFAT) operates a secure network for communication to and from Australian government agencies. In 1994, DFAT contracted the upgrading and enhancement of the secure network to BHP-IT. In turn BHP-IT subcontracted work to GEC Marconi.

The subcontract between BHP-IT and GEC Marconi:

- provided that it could not be varied except by agreement in writing signed by BHP-IT and GEC Marconi; and
- specified the procedure to be followed by the parties to effect a written variation.

There was a risk that during the upgrading and enhancement of the secure network that some of DFAT's classified data might be sent to less secure networks. To prevent this, DFAT was required under the head contract to provide special security devices called 'STUBS' to BHP-IT. BHP-IT would in turn supply the devices to GEC Marconi for integration into the upgraded network.

However, DFAT ran into difficulties in providing the STUBS devices. After some discussion, DFAT approved a variation to the head contract requiring the development of emulation software that would imitate the functionality of the STUBS devices. The emulation software was to be developed by GEC Marconi. The development of the emulation software would allow GEC Marconi to continue with its development work on the remainder of the system.

GEC Marconi was notified of this change, but BHP-IT and GEC Marconi did not formally vary the subcontract to reflect the change of scope of work to include development of the emulation software. Ultimately, GEC Marconi was not able to create the emulation software, and as a result failed to meet milestones in the subcontract.



## “A relational contract . . . establishes an ongoing relationship between parties.”

However, far from accepting any fault on its part, GEC Marconi served BHP-IT with a notice stating that:

- BHP-IT had breached its obligations under the subcontract to supply the STUBS devices to GEC Marconi; and
- the purported variation requiring GEC Marconi to develop the emulation software was invalid since it did not comply with the variation process specified in the subcontract.

### The question for the court

The court had to determine:

- whether a contract that requires any variation to be in writing could be varied subsequently verbally or by implication from the conduct of the parties; and
- if so, then what were the terms of the varied contract between BHP-IT and GEC Marconi.

### The judgment

Justice Finn found that writing is not a pre-requisite to vary a contract even when the contract includes a clause prohibiting changes other than in writing, unless the contract is required by law to be in writing.

On the second question, whether a variation had been agreed by BHP-IT and GEC Marconi, Justice Finn held that the agreement between the parties was a "**relational contract**". A relational contract is a contract that establishes an ongoing relationship between contracting parties and not simply a one-off transaction.

Justice Finn said that in determining whether an agreement was a "relational contract" one must look at the surrounding circumstances, subject matter, nature of the relationship and conduct of the parties.

He identified two types of relational contracts:

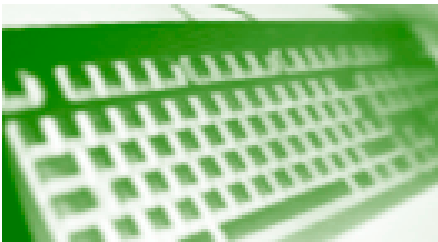
*replacement contracts* - where parties agree to be bound by terms in the first contract and to negotiate further terms in another contract that will replace the first; and

*additional contracts* - where parties contract for discrete steps or stages leading to an anticipated relationship, and the later contract is an additional and different contract rather than a substitute for the first contract.

Justice Finn concluded that BHP-IT and GEC Marconi were in a continually evolving relationship that confronted changing circumstances requiring complex responses. The communications, actions and correspondence between BHP-IT and GEC Marconi indicated a different state of affairs than was contemplated in the subcontract. He concluded that the creation of the emulation software by GEC Marconi was a "distinct self-contained contractual arrangement", and that GEC Marconi and BHP-IT intended to perform the subcontract subject to the agreed "alterations".

Justice Finn held that inconsistencies between the written subcontract and the parties' actions should be resolved by looking at the real intention of the parties, and any part of a contract that prevents this is invalid.

## “Good contract management should reduce the risk of contracts wandering into this vague new contractual world...”



Here, the parties' intention was for GEC Marconi to develop and use the emulation software instead of the STUBS devices, so BHP-IT was no longer contractually obliged to provide the STUBS devices even though it was expressly provided in the subcontract. Justice Finn held that the variation itself contained an implied term that BHP-IT and GEC Marconi would amend the subcontract to reflect this intention.

### So, what does this mean?

Complex IT projects (eg systems development/integration projects or IT outsourcings) provide ample scope for the parties' behaviour to depart from the terms of the written contract. Sometimes this departure will be deliberate - sometimes it will be inadvertent. The decision in GEC Marconi v BHP-IT tells us that we cannot rely on a "written variation" clause to save us when we try to insist on written contract terms in circumstances where we have dealt with the other party quite differently.

It is always a good idea to include a written variation clause in IT contracts - but we need to enforce them. The contract needs to be understood, and simple and effective systems put in place to track compliance. The contract cannot be consigned to the bottom drawer - no matter how much the supplier may encourage us to do so! If we decide to depart from written terms (eg because they no longer make commercial sense or because we have had a better idea) then the contract should be subject to a written variation. This discipline will ensure that

we are not living under a contract that is gradually being "honoured in the breach". More importantly, it will ensure that variations are fully thought through and that consequential effects (eg on price, milestones, schedule etc) are addressed and captured.

Good contract management should reduce the risk of contracts wandering into this vague new contractual world being developed by Justice Finn. Our next IT Update will include a more detailed article on "good contract management" practices.



# SPAM - the problem that won't go away?

“'SPAM' is unsolicited and unwanted commercial electronic messaging, particularly email. Internet users around the world have real problems with it...”

Users around the world have to deal with SPAM daily. Its content, (particularly when it involves pornography, financial scams and dubious products) is of concern. It also wastes computer storage, users' time and costs business real money.

## The NOIE review

In February 2002, Senator Richard Alston, Minister for Communications, Information Technology and the Arts, requested the National Office for the Information Economy (NOIE) to review the extent of problems caused by SPAM, the adequacy of current measures to counter the problem and possible additional measures that may be necessary. The NOIE review published its final report in April 2003.

## Key Findings

The NOIE review made the following key factual findings:

- SPAM represents at least 20% of all email traffic and this proportion is growing rapidly;
- the biggest single factor leading to SPAM growth is the low cost of sending such material; and
- there is growing demand for some form of specific legislation by the Commonwealth with regard to SPAM that limits the sending of Australian sourced SPAM. However, national legislation is not a comprehensive answer to the problem because of the difficulties in identifying spammers,

lack of jurisdiction over offshore offenders and competing priorities faced by law enforcement and regulatory agencies.

## Recommendations

In its final report, the NOIE review recommends that, like most policies involving regulation of internet-based activity, the issue of SPAM is best dealt with by a range of measures involving governments, business, users and technical experts. The review recommends that Australia should pursue a SPAM reduction strategy which balances legislation, self-regulation, technical and consumer information elements. The review also recognises that the global nature of SPAM requires any Australian strategy to be supplemented by co-operation with other countries at both the policy and operational levels. The specific recommendations are:

### 1 Legislation

The NOIE review recommends that national legislation be introduced that:

- a) prohibits commercial electronic messaging from being sent without the prior consent of the end user, unless there is an existing customer-business relationship;
- b) requires all commercial electronic messaging to contain accurate details of the sender's name and physical/electronic addresses;
- c) creates a co-regulatory approach with industry including the implementation of codes of practice; and
- d) introduces appropriate enforcement sanctions.

## “Toothless legislation and rhetoric will not stop SPAM.”



### 2 Industry regulation

The NOIE review recommends that industry bodies such as the *Internet Industry Association*, the *Australian Information Industries Association* and their members should implement codes of practice to ensure compliance with proposed national legislation. The review also recommends that these associations and their members should require internet service providers to make filtering options available to clients. These options should be from an approved schedule of SPAM filtering tools. They should be provided at reasonable cost and the associations should evaluate and publicise these filtering options and products. In addition, servers should be configured appropriately and action taken to close down identified SPAM servers.

The review also recommends that the internet industry generally should develop and use a list of known spammers so that internet service providers can make more informed decisions about dealing with customers who have a record of spamming.

### 3 International co-operation

The NOIE review recommends that Australia should work with the OECD, APEC and other relevant multilateral bodies, or bilaterally where appropriate, to develop international guidelines and co-operative mechanisms which aim to reduce the total volume of SPAM and control content aspects of SPAM.

### 4 Partner agencies and other legislation

The review recommends that the *Australian Competition and Consumer Commission*, the *Australian Securities and Investment Commission* and the *Office of the Federal Privacy Commissioner* should ensure that the relevant legislation is fully applied to SPAM.

The review also recommends:

- consideration of the application of Schedule 5 to the *Broadcasting Services Act 1992* (which sets up a system for regulating certain aspects of the internet industry) to SPAM;
- a review of the *National Privacy Principles in the Privacy Act 1988* to see if they can be used to help counter the SPAM problem; and
- the creation of a new offence of using a carriage service to commit any Commonwealth offence.

### 5 Information campaign

Finally, the NOIE review recommends that an information campaign on SPAM, co-ordinated by NOIE in conjunction with relevant government and non-governmental bodies, be conducted for an initial period of 12 months. This campaign should provide a clear explanation of avenues of complaint about SPAM under existing legislation, as well as simple technical advice and a basic guide to anti-SPAM products.

### Conclusion

While the final report of the NOIE review gives a comprehensive account of the scope of the problem, it remains to be seen how effective the review's recommendations will be. It seems accepted wisdom that any legislative scheme introduced to curb the flow of SPAM will operate more effectively in combination with self-regulatory industry bodies and consumer awareness programs. However, the fact that SPAM is a global problem means that Commonwealth legislation to curb the problem may only drive spammers to move elsewhere.

If the recommendations are going to work they will need some bite. Toothless legislation and rhetoric will not stop SPAM.



## Newsflash

Senator Alston announced on 23 July 2003 that the government plans to introduce legislation that would:

- ban the "sending of commercial electronic messages without the prior consent of end-users unless there is an existing customer-business relationship";
- impose a range of civil penalties for breaking this law including fines, infringement notices and the ability to seek injunctions;
- require all commercial electronic messages to include a working opt-out mechanism and the sender's accurate contact details;
- ban the use of e-mail address harvesting software; and
- aim to cooperate with overseas organisations to develop international guidelines and mechanisms to battle SPAM.

The legislation would be enforced by the *Australian Communications Authority*.

The government stressed its commitment not to harm legitimate e-mail direct marketing as long as it was "in line with the requirements of the *Privacy Act*".

The legislation would include a 120-day "sunrise period" after it was enacted to allow businesses to ensure their practices were in line with its requirements.

The *Internet Industry Association* has also responded that the civil sanctions under the proposed legislation should be tough if it is to work at all.

However, the proposed legislation would only apply to SPAM originating from Australia - currently estimated to be only 0.5% of all SPAM received in Australia.

Consequently, this initiative alone is unlikely to stop the SPAM problem, but at least it's a start.

# Are Finalised Contracts Important?



“If key terms were still being negotiated, then (the contract) could by definition not be agreed.”

## The pitfalls of starting work without a contract - a cautionary tale...

A recent UK case of *Co-Operative Group v International Computers Ltd* has starkly illustrated the risks associated with proceeding with IT projects without an agreed contract.

### What happened

The background to the case is the merger of two supermarket co-operatives, to form a joint company - Co-operative Group. A priority after the merger was to integrate the IT systems of the merged entity and develop the infrastructure for a new customer loyalty system. After some discussion, that integration and development work was awarded to International Computers Ltd (ICL) who already had an agreement with one of the merger parties for a series of phased developments. A feature of that agreement was that if the project was not completed, then ICL could increase the fees for phase one.

Under UK legislation that governed the merger, Co-operative Group took over the contracts of the 2 merger parties. As the new integration project would mean that development work ICL had been retained to do would now no longer be necessary, Co-operative Group began negotiations with ICL for a new agreement to cover the integration work and to terminate the previous development agreement.

However, the new agreement was never finalised. The major sticking point was that Co-operative Group wanted liquidated damages for ICL delays. ICL refused. Most other terms were agreed (e.g. scope of services, timings and price).

Nevertheless, the integration work was started even though the new agreement had not been finalised. Software was developed by ICL according to the agreed specifications and the work was progressively paid for by Co-operative Group. However Co-operative Group became increasingly dissatisfied with performance, in particular ICL's timeliness, quality control and capacity to deliver. The problems got so bad, that Co-operative Group eventually decided to terminate the project and sue ICL for breach of contract.

### Negotiating is not agreeing

Co-operative Group took the view that an unwritten contract had been reached between the parties about the work in dispute. ICL argued that there was no contract governing the integration and development work because of the deadlock over the key issue of liquidated damages. The court agreed with ICL. As a result, no damages could not be awarded to Co-operative Group.

The court did not accept the argument that a contract can exist in the absence of a firm offer by one party which is unequivocally accepted by another. If key terms were still being negotiated, then it could not by definition be agreed.

The critical factor supporting the result that there was no contract, was the intention of the parties. Courts are unwilling to be business people. They will not assume responsibility for making business decisions - such as finalising the terms of an agreement when negotiations are still in progress. The fact of continuing negotiations indicated an intention to be bound if, and only if, the negotiations were finalised and the agreement signed.

“In the end, it all turned on what the parties really intended.”

The failure to agree on what the parties regarded as an essential term (such as liquidated damages for delay) indicated that the parties had not reached a final agreement. The inclusion of liquidated damages was a real sticking point between the parties, and it made it impossible to conclude there was a final contract.

In the end, it all turned on what the parties really intended. The court provided a helpful summary of principles to consider when looking at this issue in the future:

- To determine whether a contract has been concluded in the course of correspondence, you need to look at the correspondence as a whole.
- Even if the parties have reached agreement on all the terms, they may still intend that it does not become binding until a further condition is met - e.g. the formal signing of a written contract.
- Similarly, they might intend that the contract will not be binding until some further term or terms have been agreed.
- Alternatively, they may intend to be bound immediately even though there are still further terms to be agreed or some other formality to be met.
- If the parties fail to agree on some further terms, the existing contract is not invalid unless the failure to agree makes the contract as a whole unworkable (or void for uncertainty).
- It is for the parties to decide what terms are essential to agreement. The more important the term the less likely it is that the parties will leave it for future decision. In other words, if the term is critical to agreement, and is undecided, then there cannot be a contract.
- Finally, there is no obstacle standing in the way of the parties agreeing to

be bound now, while deferring important things to be agreed later.

#### What does all this mean for IT customers?

The outcome of the ICL dispute was a disaster for the Co-operative Group. It had paid for the work and had no recourse against the technology provider. Meanwhile, ICL had an entitlement (which arose without the need for a contract) to be paid for the work performed but had no contractual liability for the performance. As there was no contract, ICL had effectively excluded all liability and warranty obligations.

Plainly there is no substitute for negotiating and signing a contract before work begins on an IT project. Once work starts, the customer's power steadily ebbs in the absence of a clear agreement. Every dollar spent increases the provider's negotiating leverage.

If it is not possible to sign a contract before work starts then at least the essential terms need to be agreed and captured in a binding heads of agreement. This could include price, schedule, critical performance indicators, intellectual property and liability (both general liability and for any "specific risks" that need to be definitely covered to avoid the risk of being excluded as "indirect or consequential").

Timing is critical. Better and earlier integration of multidisciplinary project teams within customer companies can help avoid the problems that confronted the customer in this case - significant issues will simply not be able to remain outstanding before work starts. Another time saver, can be the use of standard form IT procurement contracts. If they are written in plain English, and have

“Well advanced negotiations are not a substitute for a finalised contract.”



reasonable commercial terms in the industry context, then they can decrease the risk of outstanding issues before the project must commence.

Well advanced negotiation are not a substitute for a finalised contract. The message is do it right at the beginning, and avoid the problems at the end.

## Banks win tax break in Outsourcing

On 9 July 2003 the Australian Taxation Office ("ATO") issued a new draft GST Ruling that is of major importance to financial institutions who outsource their processing services.

The draft Ruling sets out the views of the ATO regarding the application of the GST legislation that allow "financial supply providers" (eg banks and other financial institutions) to claim a reduced GST input tax credit on, amongst other things, certain "processing services" purchased from outsource suppliers. This is a significant advantage, as in many cases financial institutions lose the right to use input tax credits as so many of their own supplies are input taxed financial supplies.

Under the draft Ruling, financial institutions may be eligible for a 75% reduced input tax credit. The draft Ruling distinguishes between 2 types of processing services received from suppliers:

1 the provision of computer time or capacity ("capacity processing") - which does **NOT** get the 75% credit; and

2 the provision of "processing services" - which does get the 75% credit.

Financial institutions will be required to apportion the fee paid to suppliers on a "fair and reasonable basis" between the 2 categories.

The big issue will be to determine if the outsourced services come within "processing services" that attract the 75% credit. Current outsourcing arrangements will need to be carefully examined to see if they are indeed processing services. Equally, carefully considering this aspect for future outsourcings will secure the maximum advantages.

The ATO has called for industry and professional comment on the draft Ruling by 23 August 2003.

**For more information, please contact your Mallesons' representative or contact one of the team listed on page 14.**

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