Wigley & Company

BARRISTERS and SOLICITORS

$4.6M CLAIM AGAINST CLEAR FOR INTERNET SERVICE FAILURE; WHAT CAN SUPPLIERS LEARN?

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Technology and communications services can carry multi-million dollar exposure. Clear Communications narrowly avoided this after a three week court trial in 2002 on a claim against it for $4.6M. The case, *Pronet v. Clear*, has lessons for suppliers' sales and marketing processes. Wigley & Company address these.

Care should be taken in the sales process to make sure that performance claims are sustainable and statements made are true. Contracts need to be in optimal form and correctly signed up. But this is the real world and sometimes this won't happen. All that can and should happen is to reduce not eliminate risk. The more that can be done to tie things down, the better.

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1 Introduction

1.1 Technology and communications services can carry multi-million dollar exposure. Clear Communications narrowly avoided this after a 3 week court trial last year on a claim against it for $4.6M.

1.2 The case, *Pronet v. Clear*, has lessons for suppliers' sales and marketing processes.

1.3 In *Pronet*, Clear's service provided wholesale upstream internet access for ISPs and corporate customers. Clear failed to meet 2 of its service promises for several months.

1.4 Clear was fortunate that the judge could wade through lousy pre-contract and contract paperwork and limit liability to $99,000.

1.5 In its internet access contract, Clear had made 2 key promises to ProNet:

1.5.1 99.8% availability measured over 90 days.

1.5.2 Clear would:

"….use all reasonable efforts to provide a high quality reliable service to the Customer…. but does not guarantee that …… Services will be continuous or fault free."

1.6 Although measurements and evidence were patchy, there was enough to show that:

1.6.1 Clear had not taken reasonable efforts to provide a high quality reliable service (it didn't do enough to sort things out sufficiently quickly);

1.6.2 It failed to meet the 99.8% availability target.

2 Limitation of liability in a document not signed by the customer

2.1 What saved Clear was its contractual limitation of liability. This limited liability to the value of the services in each affected month (totalling $99,000).

2.2 The limitation clause was included in a standard Clear document. Pronet signed a short form of agreement that cross-referenced to but did not include, those standard terms. This raised the question of whether those terms – possibly never seen by the customer - were effectively incorporated in the contract.

2.3 Generally a signed short agreement cross-referring to other terms will be effective as to most of those terms. But an issue arises about onerous and unusual terms. The judge (correctly we believe) followed English rather than New Zealand cases. He said that specific reference had to be made, in the short signed agreement, to terms that are *"….particularly onerous or unusual"*.

3 Was the limitation of liability "particularly onerous or unusual"?

3.1 Clear was fortunate that the judge said that the limitation of liability in this context was not onerous or unusual. So it was validly incorporated in the contract and liability was capped at $99,000. Clear's customer was a significant commercial operator, and would have expected there to be some form of limitation of liability in an internet context. The term was not onerous or unusual.

3.2 While that conclusion may be right, it is debatable. We think a supplier would be most unwise to rely on that approach always being taken by the courts. It is not difficult for a court – seeking to impose widespread liability on a major supplier such as Clear – to decide that a limitation of liability clause (or another important clause for the supplier) is "onerous

or unusual". It is too risky not to refer to such a clause in a document like a signed order form. A carrier should not rely on *Pronet v. Clear* for comfort on this point.

4 Commercial reality and the move on-line

4.1 It's great there's a move to simplifying documents and putting them on-line. There is much to be said for a **hand signed** order form or short agreement for larger deals which cross-refers to terms located on the website. But the order form or short agreement must refer to what could be onerous/unusual terms, such as limitation of liability. The reference must be "in your face". A small print approach won't work.

4.2 It is also best to (a) have the standard terms in a clearly identified location on the website and (b) avoid providing hard copies of the terms to the customer. Clear ended up in an unnecessary and risky debate in court (involving conflicting evidence between its sales people and the customer) as to whether or not Clear had attached its standard terms to the order form. A supplier is much less likely to face a hassle if there is a specific reference to terms sitting on a website instead.

5 Service commitments must be supportable

5.1 Particular care is needed when a supplier makes service commitments. This is highlighted by *Pronet v. Clear*. Clear argued that the "99.8% availability" was breached only when the service was unavailable outright. The judge quickly concluded that reduced performance was enough for there to be "unavailability" for this purpose. Packet loss, slow service and increased error rate meant the service was "unavailable" even though traffic could get through.

5.2 This highlights the need to be very careful in:

5.2.1 defining carefully what is meant by the commitment, such as availability;

5.2.2 having a high level of reassurance that the commitment is met.

5.3 A good approach is to have a rebate mechanism for failure to meet the commitment. Clear had such a regime, in addition to the clause that capped liability at $99,000. Well drafted, this limits liability, just like a liquidated damages clause in a building contract. Typical technology/communications SLAs and rebates provide small rebates: usually much less than the customer's actual loss. A customer may be happy with this though. Recognising a need for the supplier to limit liability, a service level with rebate is one way the supplier has some "skin in the game", so that it's encouraged to perform the contract.

6 Commercial benefits of SLA/rebate regimes

6.1 A commercial call can be made as to whether SLAs and rebates should be given (and how far they should extend). There are different views about this. Incidentally, they can be called liquidated damages instead of SLA/rebates.

6.2 The key point is that careful drafting is required. For instance, unlike the Clear agreement, there should be clarity about excluding - from any availability period - planned outages and *force majeure* events.

6.3 With good drafting, all of this can be achieved in short and simple language. The risk of SLAs and rebates might be commercially justified if care is taken. The customer gets what it wants (service levels and modest rebates so that the supplier has some "skin in the game") yet ironically the supplier's potential liability is limited considerably.

7 Clear's messy paperwork hindered its debt recovery

7.1 *Pronet* shows all the signs of Clear suing for around $¼M fees arrears, leading to a defensive counterclaim of $4.6M. Poor paperwork can create unnecessary problems for defensive debt recovery. This is a **very** common problem for technology/communications suppliers.

8 Pre-contract and Fair Trading Act risk

8.1 In *Pronet*, the court looked at whether there could be liability under the Fair Trading Act. The Act of course requires accuracy in sales/marketing material and activities. It is fundamental to all suppliers' risk. Pronet said there was a pre-contract written commitment by Clear (stated as a "guarantee") that there would be 99.8% availability. They also said there was a similar verbal statement by a Clear sales person.

8.2 The judge concluded that this commitment did not apply to the defective service. But he said that, even if the "guarantee" applied to the subject matter of the claim, there was no breach of the Act. His reason for this? The guarantee was a statement of present intention, the Act enforces only that present intention, and there was no evidence that Clear had no such present intention.

8.3 While in many cases this conclusion will be right, where someone "guarantees" service performance for the future, there is a high risk the Act will be applied to confirm there is liability if the guarantee is not met. This issue is not clearly resolved in the cases. In any event, the guarantee might be enforced under some other head of claim.

8.4 Importantly, the limitation of liability in the contract (limiting the liability to $99,000 in this case) would not work to limit Fair Trading Act liability. It's a statutory liability and it's unlikely a contract limitation can overcome that liability. The *RACV* case is an example of

this. So Clear's exposure could have been much greater. The fact the contract can't limit this liability is one reason why it is so important – especially for high $ value/$ risk products – to "get it right" in marketing collateral.

8.5 Take a common example. A supplier pitches for a project. The proposal contains the supplier's standard service levels which, when put in a contract, contains key restrictions on their applicability. But, in the proposal, the key restrictions are stripped out (the sales people don't worry about the detail). The Fair Trading Act applies to the proposal and there could be unlimited and unwanted liability.

8.6 Of course, sales people need to know of and reduce these risks when pitching (verbally or in writing).

8.7 This is yet another illustration of the point that performance claims in marketing collateral, in discussions with customers, etc., must be sustainable. For large deals, breach could lead to multi-million exposure (as happened to Clear). Clear's approach in this area was loose. It was fortunate to avoid liability.

9 Conclusion

9.1 Care should be taken in the sales process to make sure that performance claims are sustainable and statements made are true. Contracts need to be in optimal form and correctly signed up. But this is the real world and sometimes this won't happen. All that can and should happen is to reduce not eliminate risk. The more that can be done to tie things down, the better.

Wigley & Company is a specialist technology (including IT and telecommunications), procurement and marketing law firm founded 11 years ago. With broad experience in acting for both vendors and purchasers, Wigley & Company understands the issues on "both sides of the fence", and so assists its clients in achieving win-win outcomes.

While the firm acts extensively in the commercial sector, it also has a large public sector agency client base, and understands the unique needs of the public sector. While mostly we work for large organisations, we also act for SMEs.

With a strong combination of commercial, legal, technical and strategic smarts, Wigley & Company provides genuinely innovative and pragmatic solutions.

The firm is actively involved in professional organisations (for example, Michael is President of the Technology Law Society and Stuart van Rij its secretary).

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