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UK Utility Billing Mess a Salutary Reminder for ICT projects

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The UK's largest gas and electricity supplier (Centrica aka British Gas) has brought a £220M claim against system integrator, Accenture. The claim arises out of a large SAP-based billing implementation. Centrica alleges it went badly wrong as Accenture breached its contract obligations. In a November 2009 judgment,[1] the High Court in England raises a number of points that are salutary for ICT suppliers and customers. Included are contract drafting issues and the extent to which a supplier limits its liability under a typical clause excluding consequential loss. On this last point, the dividing line between "consequential loss" (not recoverable) and "direct loss" (recoverable) would surprise many.

Overview of the claim

Accenture agreed to design, build and maintain a complex system for Centrica.[2] This included an automated SAP-based billing system, to replace three separate legacy billing platforms.

Heavily lawyered and detailed agreements were signed between Accenture and Centrica.[3]

After millions of customers were migrated to the system, there were many problems, causing, for example, rejection of automated billing. This happened as the system produced – alleges Centrica – many millions of Work Items. The Work Items under the SAP software are exceptions that are processed manually rather than automatically. Work Items are aimed at routine events such as an erroneous meter reading. But, claims Centrica, the excessive Work Items were caused by problems in the system. This type of problem led to a massive backlog of manual billing, help desk queries, customer complaints, additional expense, unrecovered revenue, and so on.

This judgment was a preliminary decision before the full trial. It deals with how the contract is to be interpreted, and the related issue of damages entitlement.

Contract terms

The court looked closely at questions such as when there is a "fundamental defect", as defined in the contract. This is largely not a general law issue (such as the fundamental breach doctrine). Rather it is one of contract interpretation. A "fundamental defect", as defined in the contract, comprises a situation which makes a considerable difference to Accenture's responsibilities and outcomes.

The court also looked at other issues such as (a) the level of detail needed in notices under the contract and (b) whether individual breaches can cumulatively make up a "fundamental defect" (under this contract, they can, which is not a surprising outcome).

Those issues closely revolve around the specific words in the contract, so we won't go into detail as to the Court's conclusions, save to note that the Judge found against Accenture on all grounds, leaving the way open to claim at full trial.

It appears that Accenture will argue, at the full trial, that the problems were not caused by them.

[1] *GB Gas Holdings v Accenture (UK) Ltd and others* [2009] EWHC 2734.

[2] Other named parties are involved but the case, and therefore this note, refers mainly to Centrica.

[3] This included a further agreement after the project started to reflect resolution of disputes.

(Centrica has said it will appeal this preliminary judgment).

Some key points emerge of general significance:

- In interpreting a contract, the Courts, following well established authority, consider, where necessary, much of the factual background at the time (the so-called "matrix of facts"). An ICT project will generally have a large "matrix of facts", often based on extensive dealings between the parties beforehand.

- Here there was a specific focus on the recitals in the contract: the introduction that sets out the background to the contract. Recitals often don't get a great deal of attention at the drafting stage. Here's an example of where they were used to interpret the body of the contract.

- This case is a reminder that, even though contracts are rarely sued on, they do have an important role. Mostly the contract is relevant without litigation: the parties turn to it to work out their positions, negotiate outcomes, etc. Here, the wording of the contract, and debate over interpretations, is making a large difference to the parties' respective positions.

Parties to commercial deals often say they don't need to worry about the detail of the contracts. This can be quite a source of tension between lawyers (in-house and external) and their commercial clients.

Sir Richard Branson has a clear view about this. Recently, he wrote:[4]

> Back in 1971, when I was more gung-ho, I wrote in my notebook: 'We don't need lawyers'. But over the years, stating our agreements in clear and unambiguous terms has proved, time and again, to have been vital to our success…

The lesson from all this is the need to get business contracts properly sorted out. It's always worth getting the contract right in the first place particularly where risk and benefit is high. There will be times when a more barebone agreement is fine. But that should be carefully assessed.

Limitation of Accenture's liability

The relevant contract between Centrica and Accenture contained a relatively standard sort of limitation of liability clause in favour of Accenture. The contract excluded liability for loss of profits, indirect loss, etc. The court had to assess whether Accenture would be exposed to paying certain categories of damages, in the event Accenture was found to have breached the agreement.

The Judge's decision, although consistent with other English decisions, would surprise many. It should encourage a re-think about the sorts of potential liabilities in supply agreements. Subject to compliance with legislation, such as the English Unfair Contract Terms Act, the parties can relatively freely choose who carries the risk of breach under an agreement.

Under the contract, Accenture's liability was excluded for:

> [A] loss of profits or of contracts arising **directly or indirectly**;…
>
> [B] loss of business or of revenues arising **directly or indirectly;**…
>
> [C] any losses, damages, costs, or expenses whatsoever to the extent that these are **indirect or consequential**…[bold added]

So, under A and B (loss of profits, contracts, revenue, or business) all direct and indirect loss is excluded. C excludes only indirect or consequential loss.

This clause was interpreted against the background of a particular interpretation "*rule*" that the English courts have developed. This "*rule*" may apply

[4] Business Stripped Bare (2009).

elsewhere too, although that is not clearly established, generally. [5] While in other jurisdictions, this point can be checked, the sort of approach in this case highlights some points to look out for.

The "*rule"* harks back to one of the original cases on contract and damages: an old case about a mill wheel called *Hadley v Baxendale*. That case divided heads of damages under contract into two limbs (the first reflected in the idea of direct loss and the second in the idea of indirect or consequential loss).

The parties to this case agreed that the first limb is reflected in the use of the word "*directly*" in the clause quoted above and "*indirectly"* is the second limb.

"*Directly*" (the first limb) is loss that arises naturally (according to the usual course of things) out of the breach.

"*Indirectly*" (the second limb) refers to damage "*as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the [breach*]"

The key development under the English cases, reflected in this case, is that the first limb ("*directly*") is much wider than was previously understood. It includes, for example, most of the biggest category of loss in many commercial cases: loss of profit. That's because lost profit usually "*arises naturally"* from most breaches. Special knowledge is not needed. For example, if a billing system is down a fortnight, both parties know this causes lost profit.

As it happens, this clause excluded liability for loss of profit under both the first and second limb, along with loss of contract, loss of revenue and loss of business. (That's A and B in the clause). Other types of losses are excluded only if they come within the second limb (indirect loss). (That's C in the clause).

So how did all this play out for Accenture, as to the particular categories of loss under review at this stage? There are other categories which weren't reviewed.

Accenture ended up being potentially liable for all loss categories under review. Many, without thinking closely about these, would otherwise regard them as excluded because they comprise indirect or consequential loss (or loss of profit or revenue). But that's not the case, and the categories have similarities in other fact situations. The loss categories include:

Compensation paid to customers (£8M)

Centrica said it paid this amount to customers as compensation to reflect billing difficulties and poor customer service.

Accenture claimed that this was second limb loss (indirect or consequential) and therefore excluded. The judge did not accept that. This was first limb loss and therefore recoverable from Accenture. He said that one of the purposes of the new billing system was to improve customer relations and services, and that, under the agreement, Accenture assumed responsibility for losses if the system didn't perform.

There was not even discussion about whether this in some way amounted to loss of profit or loss of revenue (which, if applicable, would have been irrecoverable from Accenture under A or B).

Overpayment of Gas wholesalers (£18M)

Centrica claims that, due to the automation error, it overpaid the companies that supplied wholesale gas to it. The price paid to the wholesalers was based on retail meter readings. As meter data was not available from about 15% of Centrica's customers, the wholesalers were overpaid, said Centrica.

The Court said the limitation of liability clause did not preclude this claim. The judge said, assuming there was an automation error,

> "…this item of loss has arisen as a direct result of the automation error and falls within the …first limb. Further it is not a claim for revenue but for charges that Centrica has paid which it would

[5] For example, a different approach has been taken in Victoria, Australia (in Environmental Systems v. Perrless (2008) 19 VR 26, and in New Zealand (Oceania v. Debonaire (High Court, Wellington, CIV-2008-485-1701; 27 August 2009)). In addition it is essential to interpret the specific words in the contract, in context.

> not have paid but for the alleged automation error."

Additional borrowing charges (£2M)

Centrica says that, due to late billing, or non-billing, it had to pay more in borrowing charges, as its revenue was reduced and delayed.

The court said that the billing system was at the heart of Centrica's business and revenues depended on it operating efficiently. Therefore this was recoverable first limb loss.

Conclusion

Without knowing the way the courts, at least in England, approach these issues, many would see these heads of claim as "consequential" or "indirect". Ultimately, except where a country's legislation overrides, this is often a matter of contract choice between the parties, and crafting the words to fit the parties' objectives. The law as to interpretation of contracts needs to be considered in each jurisdiction.[6] There are lessons for suppliers and for customers.

[6] See for example footnote 5 above. This issue has yet to be considered by the UK Supreme Court and it was not considered by the House of Lords. There is a real possibility that the Supreme Court would reverse the "rule".