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EDS Loses to BSKyB in Major Technology Case

In a major decision of London's Technology and Construction Court, which will have global repercussions, technology vendor Electronic Data Systems ("EDS" — now part of Hewlett-Packard ("HP")) has been found liable for a deceitful misrepresentation that induced broadcaster BSKyB to enter into a contract with it. Although the case did not create any new law, it is the clearest example of an English Court finding, in the context of the outsourcing and IT services industry, that pre-contract assurances and promises can amount to deceit. This case has led to a damages award well above the agreed liability cap. On 3 February, Mr. Justice Ramsey ordered the defendants to make an interim payment on account of £200 million by 4:30 p.m. Wednesday 17 February 2010. As at the date of publication the final award is still unknown.

As a result, the case will lead to IT and outsourcing service providers, both in the UK and globally, reviewing their pre-contract sales processes, and how they manage bids and promote their services to potential customers. Customers too will be more mindful of pre-contract discussions, and the potential for such discussions to be given greater weight in the event that the contract is unsuccessful. It is also possible that bid costs for major outsourcing contracts will increase as a result of the decision, and

that vendors will increasingly deem particularly complex IT projects as too risky.

What was the dispute about?

In July 2000, BSKyB chose EDS to run a new Customer Relationship Management (CRM) project, designed to create an advanced customer service system for its Scottish call centres. Less than two years later, BSKyB ended the contract after EDS failed to deliver. In the interim the parties had, in July 2001, signed a Letter of Agreement effecting a settlement of contractual liabilities up until June of that year. In March 2002 BSKyB stepped in and took over the CRM project. BSKyB commenced legal proceedings against EDS in August 2004. The project was eventually completed in 2006, five years late and at a cost of over £200 million, nearly six times the original quoted cost.

BSKyB claimed that EDS was deceptive in overselling the CRM system by describing the system as "proven" when it was not, by overstating its capabilities in relation to resources and implementation methodologies, and by understating the amount of time and cost required to implement the system. BSKyB claimed that these statements led to EDS being selected ahead of other bidders. BSKyB also alleged negligent misrepresentation and breach of contract. Under English law, BSKyB needed to successfully

establish fraudulent misrepresentation in order to circumvent the contractual limitation of liability provision and to enable it to claim wide, potentially unlimited, heads of loss (damages), including loss of profits. Under English law, a successful claim for fraudulent misrepresentation allows both foreseeable and unforeseeable damages to be claimed.

BSkyB said that, were it not for EDS's misrepresentation, BSKyB would have awarded the contract to PwC (Pricewaterhouse Coopers) instead of EDS. EDS, however, argued that BSKyB had no definite idea of what it wanted from the project and continually altered its requirements, resulting in delays and other problems. These are typical issues that arise in IT contract disputes, with many failed technology procurements relating to issues around the quality of the systems or services being provided by the vendor and to the changing requirements given by the customer.

While the contract capped EDS's liability at a maximum of £30 million, BSKyB alleged that the misrepresentations made by EDS were deceitful (as EDS had made the representations knowing they were false or at least being reckless as to their truth) and, as a result, the contractual liability cap did not apply.

Although the court rejected certain of BSKyB's allegations of misrepresentation (including as to EDS's costing of the project and capability), it found that EDS was deceitful, firstly, when it claimed that it had carried out a proper analysis of the time needed to complete the initial delivery and go-live and, secondly, when it claimed that it held (on reasonable

grounds) the opinion that it could and would deliver the project within the promised timescales. The court found that these representations were made dishonestly by EDS's key witness, the CRM Manager, who was discredited. The court held that the CRM Manager knew that there had not been the "proper analysis" and that there were not "reasonable grounds" for the opinion that the work would be completed on time, but that he nonetheless made the claims to BSKyB in an effort to win the business.

BSkyB successfully proved that EDS had breached the contract — and the court held in its favour in relation to contract damages up to the liability cap. BSKyB also proved that liability for non-fraudulent negligent misrepresentations made outside the contract were not properly excluded by the contract, but those again were subject to the liability cap.

EDS/HP has already indicated it is likely to appeal the judgment. The grounds for such an appeal, its duration and the outcome are all very uncertain at this time.

What are the key issues for vendors and customers?

→ **Will this "open the floodgates" to similar claims?** This is unlikely. The case breaks no legal ground, meaning that fraudulent misrepresentation is still a difficult test for an aggrieved customer to satisfy. A customer seeking to bring a claim similar to BSKyB's will still need to establish that a vendor knowingly or recklessly misrepresented its capabilities during the bidding process, as well as the requisite elements of reliance and damage. Given

that IT disputes are inevitably complex and extremely expensive to litigate anyway (and therefore rarely reach the Courts) this decision is unlikely to lead to any significant increase in similar claims, although we would expect that customers who are in dispute with their IT vendors will increasingly look to the pre-contract discussions to see whether any misrepresentations might have been made. If so, such representations can be used to give the customer significant leverage in the dispute, given the potential liability that could follow.

- **Should IT vendors now impose protocols and constraints on their sales staff?** This is an approach likely to be adopted by many IT vendors in an attempt to minimise risk at the source through the introduction of new sales behaviours rather than having to subsequently rely on legal defences. Bid teams are likely to be more closely monitored and all aspects of their bids first subjected to internal legal scrutiny.
- **Will the decision lead to customers seeking only to contract with the larger vendors and on a more defensive contractual basis?** Customers are likely to want to obtain sufficient validation for claims made by vendors prior to the contract being signed. It may only be the larger vendors with longer track records that can satisfy these stricter requirements. In addition, customers may seek to contract more defensively, and shift even more risk onto vendors relating to the vendor's understanding of the scope of

the project and the customer's requirements. In the aftermath of this judgment, vendors may find that unless they are able to give confident and demonstrable assurances around claims made prior to a contract being signed, they will score poorly during the tender process.

More specifically:

→ **Vendors** will need to:

- introduce increased monitoring of sales staff and pre-contract behaviours in order to avoid the risk of misleading their customers. Vendors will need to be able to vet communications with a potential customer to eliminate any hasty or poorly-considered assurances or promises that could provide ammunition for a future deceit claim. Vendors will err on the side of caution, and where customers are proposing a particularly complex project, or one that involves business-critical services, vendors may be reluctant to provide customers with a prediction of success;
- utilise their legal team at an early stage in the contracting process to audit the sales process much more closely than has previously been the case, especially on large or complex projects. Marketing and bid documents should all be reviewed by legal advisers;
- try to ensure the "entire agreement" clause in the contract is

clear about excluding liability in relation to pre-contractual representations. The provision as drafted between the parties in this case stated that the Agreement superseded pre-contractual discussions, but did not have the effect of withdrawing such representations and therefore B SkyB was still able to rely on them. There is much English case law around entire agreement clauses and vendors will need to be clear about the effect they want the contract and any pre-contractual discussions to have;

- avoid commencing provision of the services subject to a Letter of Intent, as during these early phases of a project, it is not unusual for the parties to make numerous oral and written representations about the nature of the project;
- conduct an appropriate level of due diligence on the project to ensure that any risks are fully understood;
- look at options around insurance for liability for fraudulent or negligent misrepresentations;
- be realistic with customers about the potential for a complex IT project to go wrong — even if this means that more vendors will pull out of procurements if it appears there is even a small risk of it going wrong; and
- ensure staff are trained on the implications of this case, and

understand the potential for massive liabilities to result from incorrect or misleading statements made to a customer.

→ **Customers** may:

- now seek to bring in arguments of deceit and misrepresentation against service providers. Even if they are unlikely to pursue such claims, it will raise the threat of a claim above the liability cap in the contract;
- exercise more due diligence when running tenders (during the RFP process), and obtain sufficient evidence in support of specific promises made by vendors; and
- fully document the process for selection so that any promises or statements made by the vendor that were important for the selection process are recorded.

The cumulative effect of this case may be to increase the overall cost of IT and outsourced services contracts, as both customers and vendors devote a greater amount of time to understanding the project, assessing risks and conducting detailed and lengthy due diligence exercises.

However, it is certain that vendors will now be far more cautious about their pre-contract sales processes knowing that Courts will award significant damages against anyone who has been dishonest.