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Work-Outs of Technology and Services Agreements Challenged by COVID-19

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In early February 2020, before most of us were truly aware of the implications of COVID-19, a well-respected IT consulting group predicted a $4.3 trillion global spend on information technology in 2020. Drivers of the projected activity included cybersecurity, outdated infrastructure, mobile accessibility needs, cloud and SaaS transitions, and on-premises technology requirements. In late 2019, another well-respected consulting group had predicted that, in 2020, "[t]here will be increasing opportunities for technology vendors and service providers to grow their businesses, and for technology buyers to innovate and upgrade their infrastructure, software, and services." In fact, as 2020 began, many deals for technology development, implementation and related services were signed and technology providers, consultants and related service providers (collectively referred to in this post as "vendors") and their customers were busy building, implementing and testing new systems.

Then came COVID-19. Most people in the United States and in many other parts of the world are now working from home. Capital markets are volatile. The global economy came to a screeching halt and recessions are forecast. As a result of these and other factors, many deals that were humming along nicely are now facing significant and unanticipated challenges. For example:

- In many cases, neither the vendor nor the customer community is "in the office." While it is not uncommon for software developers to work remotely, many important aspects of a complex implementation – e.g., hardware installation, software testing and user training – are most effective when done on site. Obviously, given the work-from-home and no-travel environment that we are in, this is not possible.
- Key individuals from both the vendor and customer community may be less available, either due to their own illnesses or due to pressing family issues or other concerns related to the pandemic.

- Some customers may experience significant and unanticipated financial distress, and as a result, the payment obligations associated with the initiative may become particularly burdensome for them. Vendors may also be facing similar financial distress.
- Due to the downturn in the business climate resulting from the pandemic, the business volume assumptions on which the ongoing initiative was based may no longer be realistic.

This blog post is intended to suggest a practical approach that both technology vendors and their customers might take to find amicable solutions to challenged deals.

Self-Assessment

As an initial step, vendors and customers must independently assess their respective legal positions. They should review the underlying agreement and applicable law, as well as evaluate the status of the work to be performed under the agreement. This is essential in order to understand their legal strengths and weaknesses going into a renegotiation, to identify areas of potential compromise and renegotiation, and to preserve rights and ultimately be prepared to take action in the event an amicable resolution is not accomplished.

Communication of Specific Concerns

After understanding respective positions, vendors and customers should communicate their specific concerns. Naturally, these will be a function of the facts and circumstances of the particular situation, the nature of the services and the specific governing agreement. However, some concerns may include the following:

Financial:

Simply put, both the vendor and the customer may have significant financial concerns:

- Customers may be concerned about the financial burden that the agreement represents at a time when some of the basic assumptions underlying the financial structure of the deal may no longer be valid.
- Vendor cash flow assumptions and financial plans may assume full payment from the customers with which they are engaged. Any financial difficulties from its customer base therefore may adversely impact the vendor’s financial position. Further, the vendor’s investors, creditors and shareholders may react in negative ways to an unexpected decrease in revenues. Vendors may also be experiencing

independent financial distress associated with other parts of their business.

Slippage in Implementation Plans:

A slippage in implementation may also be of significant concern to both vendors and customers.

Customer concerns may include some of the following:

- The completion of the implementation may be a dependency for another initiative in the organization. A delay in its implementation may result in delays in other projects.
- The implementation may be intended to strengthen the organization's cybersecurity practices. A delay may leave the organization exposed to threats and possibly could raise compliance issues under emerging and evolving laws and regulations.
- The implementation may be a replacement for an incumbent system. To the extent the incumbent system is being made available under an agreement that is expiring, is no longer being maintained or is not functioning in accordance with the customer's needs or expectations, the delay in the new system could cause operational challenges for the business.
- A delay in implementation may result in the slippage of a seasonal window for the implementation of new technologies.
- Resources may have been expended on hardware and other assets with the expectation that the new implementation would be operating on or close to schedule. In particular, the costs associated with obtaining those assets may have been justified based on an assumption that they would be in operational use in accordance with the anticipated timeframes. With a delay, those assets are not effectively being utilized.

Vendors may have similar concerns, including some of the following:

- Staffing, resource and workflow plans, forecasts, business plans and related allocation of resources may be based on assumptions regarding timetables of ongoing streams of work. Any slippage in schedule may adversely impact those assumptions.
- A delay or stall in project implementation could lead to employees who are not fully engaged.

- Certain personnel may have been hired specifically to staff the customer's project, and the stalling of that project could put pressure on the vendor to let go orfurlough those personnel, even though the vendor will ultimately need to fill those roles again if the project resumes in the future.
- Assumptions regarding the development of know-how that could be deployed for other clients may be in jeopardy.

After each party understands the other party's concerns and each party has privately analyzed its position under the agreement, they are ready to engage to find a solution. Some general ideas for approach include the following:

Contract Provisions

Are there any provisions of the underlying agreement that might be helpful in this situation?

Statement of Assumptions and Change Control

Often, technology-related agreements include a statement of assumptions that shape the expectations around the agreement's scope of work. Typical assumptions include staffing resources, assets and services provided by each party, levels of on-site activities, etc. A failure of an assumption often serves as a catalyst for a renegotiation of related terms through a change control process. In most cases, assumptions and the change control process are used when the assumptions fail primarily with respect to one of the parties, with the other party invoking the process to address such failures. In this case it is likely that many of the assumptions associated with both parties will no longer be valid. Thus, while the change control process theoretically could provide a useful framework for the renegotiation of terms, the failure of significant assumptions related to both parties suggests that the parties will have to be flexible in how the mechanics of change control are applied in this case.

Force Majeure

Another part of the underlying agreement that may be relevant is the *force majeure* clause – if the agreement has one. These provisions are not always identified as such, and the *force majeure* concept may not always be found only in one place in an agreement. As such, agreements should be reviewed for any provisions that may relieve a party of responsibility or liability due to the impact of unexpected external circumstances. A detailed discussion of *force majeure* is beyond the scope of this blog post, but you can read more on *force majeure* here. For purposes of this post, we will note that *force majeure* concepts are typically premised on one of the parties to the agreement experiencing the *force majeure* event. In the case of COVID-19, both parties are experiencing the event. Therefore, in this context, the logical application of force majeure might mean that both parties are excused from obligations under the agreement (subject to a common exception with respect to the payment of fees.). This may not be a practical blueprint for the parties to move forward. While it is important for a party to understand *force majeure* to assess its ultimate exposure under the agreement, it may not be that helpful in leading the parties to a practical work-out to the current situation.

To the extent an agreement lacks a *force majeure* clause, the doctrines of impossibility or frustration of purpose may be relevant and should be considered. However, like *force majeure* clauses, in most cases the body of law around these principles will be most relevant in evaluating liability, as opposed to finding a path forward.

Schedule Slippages

As schedule slippages are not uncommon in technology implementations, most technology development contracts will anticipate them and include provisions that address them. However, it is unlikely that these provisions consider slippage caused by the external factors like COVID-19 impacting both parties, and, therefore, the remedies and procedures that they provide may not be practical in this situation. For example, a common provision that addresses schedule slippage – tying credits or offsets in payments to failures to meet an implementation schedule – does not seem to address the underlying problem, as the delay is not under the control of either party. Similarly, a provision which requires the dedication of more human resources does not help when the human resources simply are unavailable or cannot be on site as the implementation schedule might call for.

Termination Rights and Limitations of Liability

An agreement may offer checkpoints and off-ramps in favor of either the customer or the vendor. The parties should evaluate those provisions to determine whether they provide a graceful way for the engagement to end or be paused. For example, in some cases, a customer might have a termination for convenience right which may or may not be associated with a termination payment.

In the absence of a contractually predetermined wind-down protocol that is helpful, the parties may negotiate a managed termination of the agreement, which could include certain "bells and whistles," such as intellectual property licenses, a right to restart the engagement within a specific period of time, non-competes (or releases therefrom) and other points that may be relevant.

While the limitation of liability provision is obviously useful for each party to understand its own exposure under the agreement, it may also be helpful in structuring such a managed termination of the contractual relationship. Each party can understand the maximum exposure that the other party was willing to accept under normal circumstances. In that way, in negotiating a managed termination, the parties can form reasonable expectations as to the limits of what the other party is likely to accept under these unusual circumstances.

Renegotiation of Key Terms

It is most likely that key provisions of the agreement will have to be renegotiated as part of a solution. For example:

- *Scope of Work* – The parties may seek to renegotiate and narrow or phase the "scope of work" and make adjustments to the related implementation plan and fees. The objective would be to identify and front-load the customer's "must haves" that may be accomplishable within the desired time frame and budget, in a manner that addresses some of the vendor's concerns. This may be a difficult process, as it could require the customer's internal user base to make some difficult choices. This will also require flexibility from vendors. While some of the less important pieces of the project may be rescheduled for longer term attention, customers may seek to negotiate optional termination rights in the event business does not justify that work in the future. Customers should recognize that, as a result of the renegotiation of the scope of work, vendors may be forced to reallocate resources and customers may lose the continuity of the team assigned to their project.

- *Customer Commitments* – In exchange for a renegotiation of the scope of work, vendors may seek longer-term commitments and other consideration from the customer to address the vendors' issues and concerns.
- *Vendor Limitations* – In exchange for a renegotiation of the scope of work, vendors may seek relief from certain contractual provisions that limit their ability to do similar projects for others (e.g., provisions addressing continuity of staffing, exclusivity and non-compete obligations, intellectual property provisions and license restrictions, etc.). Of course, even if such terms are renegotiated, both parties will likely require confidentiality obligations to stay intact.
- *Financial Terms* – A customer may view the renegotiation of an agreement's payment structure as essential to addressing its financial distress, while a vendor may have conflicting business needs. Accordingly, a number of practical issues will need to be considered. If the arrangement is structured on a fixed-fee basis, are payments tied to milestones? If so, as the scope of work is renegotiated, can the milestones and related payments be adjusted in a way that is more manageable to the customer yet still acceptable to the vendor? If the payments are structured on an hourly basis, can a renegotiated scope still provide for enough work for the vendor to keep its teams intact? To the extent the scope of work is revised, will vendors be able to keep their employees engaged in other matters? In some cases, and depending on the financial situation and risk profiles of the parties, it may be productive to negotiate financing terms to allow the scope of work to stay largely in place.

Retention of Incumbent Systems

To the extent a customer anticipated the results of the interrupted development or implementation effort to replace an incumbent system, the customer should consider the possibility of remaining on the incumbent system for longer than initially planned. For this reason, while addressing issues related to the implementation of its replacement platform, the customer should simultaneously be engaged with the providers of its incumbent systems – whether they are internal or third parties – to evaluate whether it is at all possible, as a contingency plan, to remain on some or all elements of the current platform until the COVID-19 challenges are resolved.

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These can be difficult times for both vendors and customers. If a tech deal has encountered COVID-19 troubles, both parties need to work together to find a mutually acceptable resolution. While one party may try to hold the other to the existing agreement, it is very possible that such a position could lead to mutual unhappiness, disputes and litigation, payment and cost problems, and ultimately, a less than superior product that neither party is happy with. To find reasonable solutions, vendors and customers must approach these situations with a thorough understanding of their underlying legal position, a little creativity, business awareness and good faith.

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