
Dealing with Application Service Providers

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APPLICATION SERVICE PROVIDERS – THEIR MARKET NICHE

An Application Service Provider (“ASP”) provides software-based services in real time, from a remote data centre. The ASP can be crudely described as “renting” an application to the customer.

ASP services are growing rapidly in popularity and are being offered by numerous organisations ranging from the very large (for example IBM Global Services and Qwest Cyber.Solutions) to the relatively small. The packages offered by ASPs likewise include major applications (SAP, Oracle and the like) through to small, industry-specific applications.

According to a story published in Computerworld on-line magazine on 18 January 2000, a study conducted by Evans Marketing Services in December 1999 indicated that, “Over one-third of information technology and development managers at large [US] corporations expect to rent applications from application service providers this year”. Over 400 development or IT managers, responsible for more than 2,000 employees, were polled (story available through www.computerworld.com).

A perceived benefit of ASP arrangements is the evening out of cash flow resulting from the pricing arrangements which usually revolve around a monthly, per user fee – although some ASPs also charge a one-off set-up fee.

The ASP provides a scaleable solution (i.e. the customer can add more users readily, subject to paying increased fees) which reduces the investment required by the customer

in software licensing, hardware, infrastructure, labour and training. At the higher end of the market, ASPs provide services integrating several software applications along with comprehensive support and maintenance services (and associated training and help desk services) and other specialist services.

From the ASPs’ point of view the intention is to derive economies of scale from providing a single solution to numerous clients, although at the higher end of the market ASPs are prepared to offer significant degrees of customisation for particular customers.

Frequently ASP services are provided over the Internet through a World Wide Web interface. Drawbacks of ASP services compared to the customer licensing software and installing the software on its own servers include:

- business reliance on a third party (i.e. the ASP), who cannot be controlled except to the extent that the legal and commercial relationship with the ASP can be managed;
- reliance on external telecommunications links; and
- reliance on the Internet with its inherent speed and security issues.

The performance of software provided through ASPs can also be inferior to software licensed directly by the customer if the web-enabled versions provided by ASPs are adaptations of pre-existing software rather than software which has been designed specifically to be accessed over the Web.

CHECKLIST – MAKING AN AGREEMENT WITH AN APPLICATION SERVICE PROVIDER

Set out below is a brief checklist which may be used by customers or their advisers as a guide in considering what needs to be included in an agreement with an ASP.

Term

- What is the period of the agreement?
- Does the customer have a right to extend the term?

Licence

- There should be a clause licensing (or to be precise, in many cases, sub-licensing) the customer to use the software hosted by the ASP.

Warranties

At the least, the customer will want the ASP to warrant that:

- the software being made available by the ASP complies with the agreed specifications;
- the ASP has the right to grant the licence; and
- the software and its use by the customer will not infringe any third party intellectual property rights.

Liability and exclusion clauses

- The ASP should not be allowed to limit its liability for breach of contract or negligence unreasonably. If a liability cap is agreed upon it should reflect the risk to the customer if something goes wrong. Liability caps should not bear some arbitrary relationship to the value of the ASP contract or to the amount paid to date under the ASP contract.

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Preferably the ASP's liability for intellectual property infringement, confidentiality breach, personal injury or damage to property should not be capped and the ASP's liability for consequential losses should not be entirely excluded.

Price

- Be sure to check how long the price will remain fixed and what adjustment mechanisms apply.

Acceptance testing

- The customer should reserve the right to acceptance test the software provided by the ASP and if acceptance testing consistently fails, to terminate the agreement and obtain a refund of any fees paid.

Confidentiality and security

- These are particularly important clauses in the context of an ASP contract, because the ASP will probably be hosting at least some data which is confidential to the customer.

Termination

Consider:

- the customer's rights to terminate (at least the usual rights to terminate for persistent breach and upon the ASP's insolvency should be included);
- the ASP should not be able to terminate arbitrarily (i.e. without cause); and

- the assistance the ASP is required to provide on termination, while the customer makes the transition to having its applications reside elsewhere. This is very important.

Support

It is important to conclude support and maintenance terms at the same time that the other aspects of the ASP "deal" are negotiated, so that the customer preserves its bargaining power. The numerous support-related issues to consider include:

- the ASP's willingness to commit to an uptime percentage;
- the ASP's willingness to commit to response times to address and resolve problems (i.e. any deviation from the agreed specifications);
- whether the customer can decide the severity level of a problem in the event of doubt or dispute;
- whether the ASP will provide on-site, or only remote, resolution of problems;
- making part of the fee for the next month depend on achievement of uptime and response time targets;
- whether the customer is entitled to terminate if support targets are not met;
- what help desk and similar resources are provided;

- whether the ASP is required to consult with the customer concerning any planned downtime;
- whether the customer has a choice about taking a software upgrade offered by the ASP (ASPs may well resist allowing their different customers to be using different versions of software, as this obviously reduces the economies of scale achievable by the ASP);
- what disaster recovery measures the ASP has in place;
- whether the ASP commits to providing the customer with regular reports of software usage, uptime and any problems and their resolution (including resolution times); and
- what training the ASP provides.

How hard a customer chooses to negotiate with an ASP regarding the above points depends of course on a pragmatic weighing up of the need to "get the deal done" against the benefits of comprehensively negotiating the legal issues outlined above so as to minimise the customer's exposure to risk.