

# Drafting software contracts in Germany – ten general considerations

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**Drafting a software contract in Germany is a delicate task. It demands a lot of experience and specific knowledge of the peculiarities of German contract law. The following considerations demonstrate risks which need to be taken into account in order to avoid the contract's unenforceability.**

## First: Germans will be Germans

Germans stick to their nature. The German understanding of legal concepts often leads to every sentence in the contract being interpreted in the categories of the German legal system. Even if the contract is to be governed by foreign law it is going to be re-structured according to German legal concepts. Although German advocates tend to have sound Anglo-American language skills, their brains are nevertheless bound by their traditional continental European legal background.

## Second: Be aware of the German unfair contract terms regulation

The German unfair contract terms regulation is unique in the world. It is regulated in Sect. 305 – 310 of the German Civil Code and is applicable to both business to consumer and business to business contracts.<sup>2</sup> Although there is no doubt in controlling standard terms set up between major enterprises like IBM and Siemens, it ought to be done in Germany according to the German Civil Code, leading to a lot of challenges when drafting a contract. Avoiding that control mechanism is nearly impossible. It applies to all standard contracts as well as every clause created individually for specific use.<sup>3</sup> The only instances in which the so-called "dispositivrecht" may be avoided are exceptional situations in which each clause was agreed upon after there has been a discussion for an open discussion, i.e. a specific clause is necessary as the basis for negotiation.<sup>4</sup>

## Third: A sale is a sale is a sale

For decades IT lawyers have discussed the controversial question of whether a contract for standardized software should be regarded as a license or as a sale of goods.<sup>5</sup> The ECJ has recently decided that a contract concerning the download of software should be regarded as a sale of goods within the copyright doctrine of exhaustion.<sup>6</sup> In Germany, the decision in favor of the sale solution has been made years ago.<sup>7</sup> A sale is a sale is a sale, or as my favorite teacher once said "You can label a donkey a horse; it remains a donkey". The nature of the contract is objective and not at the parties' discretion.

This affects, most importantly, the consideration of clauses under the unfair contract terms regulation. Sect. 307 (2) of the German Civil Code provides that any clause is to be regarded as inappropriate and invalid which contradicts the nature of the contract or its main contractual duties under law. Usually the main underlying rationale of German Civil Code statutes is to ensure "fairness" to both parties. If software contracts are considered to be sale agreements, the buyer of the software product is entitled to behave like the owner of the copy notwithstanding copyright restrictions.<sup>8</sup> The buyer may therefore be entitled to resell, internally copy within the RAM of his computer or test his copy. Any standard term prohibiting him from doing so will be void under German law.<sup>9</sup> This quasi-mandatory position on the part of the buyer also exists in the business to business environment, rendering Sect. 307 (2) of the German Civil Code the most frightening regulation especially for US software companies.

## Fourth: It is almost impossible to understand the German law on the sale of goods

When the Civil Code entered into force in 1900, regulation on the sale of goods was limited in number and very easy

5 E.g. Müller-Hengstenberg, *Bemerkungen zum Software-Gewährleistungsrecht*, *Computer und Recht* 1986, 441 (443) in favor of license; Köhler, *Rechtsfragen zum Softwarevertrag*, *Computer und Recht* 1987, 827 (835) in favor of sale of goods.

6 CJEU, judgment of 3<sup>rd</sup> July 2012 – C-128/11, ECLI:EU:C:2012:407 = *Neue Juristische Wochenschrift* 2012, 2565 – *Used Soft GmbH vs. Oracle Inter-*

7 *Federal Court of Justice*, judgment of 18<sup>th</sup> October 1989 – VIII ZR 32/88, *Neue Juristische Wochenschrift* 1990, 320; *Federal Court of Justice*, judgment of 4<sup>th</sup> November 1987 – VII ZR 314/86, *Neue Juristische Wochenschrift* 1988, 406.

8 *Regional Court Hamburg*, judgment of 25<sup>th</sup> October 2013 – 315 O 449/12, *Multimedia und Recht* 2014, 102 (103); Hoeren in: von Westphalen/Thüsing, *IT-Verträge*, ref. 27.

9 Hoeren in: von Westphalen/Thüsing, *IT-Verträge*, ref. 27; Bartsch, *Weitergabeverbote in AGB-Verträgen zur Überlassung von Standardsoftware*, *Computer und Recht* 1987, 8 (13).

to understand. However, in 2001 the German legislator introduced a comprehensive reform – the so-called Schuldrechtsreform. The law of obligations' reformation caused a unification of default regulations. Different contract types (sales contract, contracts of work and labor etc.) are now all subject to the same default regulations in Sect. 280 et seq. These provide for the seller to be obliged to deliver the good free from material and/or title defects (Sect. 433 (1) of the German Civil Code). A definition of material defects can be found in Sect. 434 of the German Civil Code. The good has to offer the agreed quality. Has there been no agreement concerning the quality, the good is free from material defects, if it is suitable for the use intended under the contract or if it is suitable for customary use. In case of a defect, the buyer may claim rights listed under Sect. 437 of the German Civil Code. According to this provision he may demand cure (in accordance with Sect. 439 of the German Civil Code), revoke the agreement (in accordance with Sect. 440, 323, 326 (5), 346 of the German Civil Code), reduce the price (in accordance with Sect. 441 of the German Civil Code) or he may demand damages (in accordance with Sect. 440, 280, 281, 283, 311a of the German Civil Code) or reimbursement of futile expenses (in accordance with Sect. 284 of the German Civil Code).

#### **Fifth: The contract-for-work law is not an adequate answer for the complex problems of software contracts**

In Germany, contracts on individually developed software fit into the category of contracts for work under the Civil Code (Sect. 631 et seq. of the German Civil Code). Originally, these provisions were established at the end of the 19<sup>th</sup> century with respect to the work of masons or tailors.<sup>10</sup> These manual workers were able to formulate clear objectives for the works with their customers when drafting the contract. The legislator could therefore create a plain legal framework tailored specifically to the problems of liability, errors or the termination of the contract. Software development contracts, however, are far more complex and based on long-term relationships.<sup>11</sup> The customer's needs are not always evident from the outset; they can often only be articulated from an ex post perspective at the end of the project. Different solutions have been developed to tackle the challenge of this complex situation in the last decades. One could alter the structure of the contract to integrate more flexible definitions of obligations, for instance by using change request elements.<sup>12</sup> Yet change requests ultimately do not help in defining the party allowed to make these determinations and changes. Moreover, one could add service level agreements to the main contract, but again this strate-

10 Raab in: Dauner-Lieb/Langen, BGB-Schuldrecht, preliminary note to sect. 631 ff. German Civil Code, ref. 2.

11 See Nicklisch, Komplexe Langzeitverträge für neue Technologien und neue Projekte, Heidelberger Kolloquium Technologie und Recht 2001.

12 Conrad/Schneider in: Auer-Reinsdorff/Conrad, Handbuch IT- und Datenschutzrecht, § 11, ref. 60; Schneider in: Schneider, Handbuch EDV-Recht, Erstellung von Software – das Softwareprojekt, ref. 9.

gy helps only to the extent that some work is done by technicians without solving the main problem of who shall have the final say. In this unusual situation, German IT lawyers often resort to using building law solutions;<sup>13</sup> in fact, there are no major differences between contracts concerning the construction of a chemical plant in Iran and those concerning the development of a major software solution for a big Dutch company.

#### **Sixth: Maintenance issues are only dealt with in contract law and have not really been solved by the courts**

German lawyers feel rather insecure with respect to software maintenance contracts. The legal nature of these arrangements is as mysterious as the main legal obligations in combination with the term maintenance. The word is linked to updates, upgrades, escrow of source code, individual services for abolishing software bugs.<sup>14</sup> In parallel, the legal nature of these contracts varies from service contract, work contract, sale of goods to insurance contract.<sup>15</sup> This legal insecurity stems from the fact that the borderline between maintenance and liability is unclear. Maintenance is normally regarded as the gold of the IT industry and is very often combined with the banana principle which states that software ripens on the customer side. However, German law forbids software companies to ask for money when a software bug falls under liability.<sup>16</sup> Maintenance contracts must not be mixed up with issues covered by contractual liability which companies owe to their customer free of charge.

#### **Seventh: Agile programming projects are the peak of legal insecurity for German lawyers**

German lawyers feel quite insecure when it comes to the point of scrum and agile programming.<sup>17</sup> How can a project be realized without a clear framework, definite project plan and fixed budget? Most standard software development contracts are designed for use with the waterfall model and can be difficult to reconcile with the principles that underpin agile working practices. In Germany only one court, the Court of Appeals of Frankfurt, has given an opinion on the legal nature of these new contracts so far. The judges had to decide whether the performance of the software team had been technically accepted by the customer. However, the requirement of technical acceptance depends on the existence of a work contract in the first place. The court extensively considered the legal nature of the agreement and eventually decided a judgment of Solomon that the customer had in

13 See Hoeren in: Gedächtnisschrift für M. Wolf, 61 (61).

14 Meents in: Beck'sches Formularbuch Zivil-, Wirtschafts- und Unternehmensrecht, 2. Softwarepflege- und Unterstützungsvertrag – Software Maintenance and Support Agreement, ref. 1.

15 Hoeren in: von Westphalen/Thüsing, IT-Verträge, ref. 172.

16 Hoeren in: von Westphalen/Thüsing, IT-Verträge, ref. 132f.

17 Cf. Hoeren/Pinelli, Agile Programmierung – Einführung und aktuelle rechtliche Herausforderungen, Multimedia und Recht 2018, 199.

fact technically accepted the work irrespective of the legal nature of the agreement. Therefore, the legal nature of an agile project still remains unclear so that important questions such as the liability for software bugs or the obligation to pay the developer is still open for consideration.

### **Eighth: Germans and their fanatic approach to data protection**

Due to the dark times of the Nazi regime Germans are horrified and fascinated by data protection. This leads to curious peculiarities regarding software contracts. Software developers require access to real time data and are thus subject to data protection problems.<sup>18</sup> Customers from Germany seek to solve these problems by incorporating a specific provision on data protection in software project agreements.<sup>19</sup> They include a specific order processing arrangement within Art. 28 GDPR.<sup>20</sup> Furthermore they face the problem of Sect. 203 of the German Criminal Act which prohibits medical doctors, advocates or insurance companies to open their files to third persons without consent of the person concerned. Fortunately, the German Federal Parliament (Bundestag) has recently opened that strict regulation to allow third-party maintenance on the condition that the provider has been instructed and has agreed to consider this data as strictly confidential.<sup>21</sup> However, the provider is then bound by criminal law to guarantee the confidentiality of this data.<sup>22</sup>

### **Ninth: Don't trust the courts**

In light of these considerations, it may be dangerous to bring a case in software law before German courts. The courts are generally old-fashioned and not very eager to read nerdy texts in English or with many anglicisms. They take a lot of time to decide upon the specifics of a case and carefully avoid to ask technical experts for help (I know what I am talking about as I have been a member of the Court of Appeals of Düsseldorf for more than fifteen years). I would therefore recommend choosing an arbitration court at least in cases in which high values of money are at stake. However, *Arbitration courts cannot be the overall solution as they are costly and time-consuming.* Nevertheless, at least arbitration courts like the one in Zurich or Stockholm work more flexibly regarding evidence, technical knowledge and economic considerations.

### **Tenth: Don't say you have not had the chance to read further details**

There are only a few books on German IT law,<sup>23</sup> IT law is not a subject of university lectures, of the exams of German lawyers, of the education of legal counsels. It is taught on practice, in drafting an agreement, in going to court. The only way thus consists of reading, drafting, fighting in court as much as possible.

18 See <https://www.suedwest-datenschutz.com/datenschutz-in-der-softwareentwicklung-im-lichte-der-dsgvo/> (last access October 2018).

19 Schug/Rockstroh, BeckOF Vertrag, 9.1.1 Software-Projektvertrag, ref. 37.

20 With regards to the provision previous to Art. 28 GDPR (§ 11 BDSG): Schug/Rockstroh, BeckOF Vertrag, 9.1.1 Software-Projektvertrag, ref. 37.

21 Hoeren, Betriebsgeheimnisse im digitalen Zeitalter – Die Neuordnung von StGB und StPO, Multimedia und Recht 2018, 12 (14).

22 Hoeren, Betriebsgeheimnisse im digitalen Zeitalter – Die Neuordnung von StGB und StPO, Multimedia und Recht 2018, 12 (18).

23 The best ones are *Marly*, Praxishandbuch Softwarerecht and *Redeker*, IT-Recht. See my ebook on IT contract law [https://www.uni-muenster.de/Jura.itm/hoeren/itm/wp-content/uploads/Skript\\_IT\\_Stand\\_oktober-2018vf.pdf](https://www.uni-muenster.de/Jura.itm/hoeren/itm/wp-content/uploads/Skript_IT_Stand_oktober-2018vf.pdf) (last access October 2018).