Client Alert: The 8 Gotchas of Technology Contracting – Part 3

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This is the 3rd of 4 installments on tips when contracting for technology products and services.

Every business runs at least in part on technology – and when contracting for technology products and services, the "gotchas" don't discriminate based on size or industry.

Contracts for providing and obtaining technology establish important, often long-term, relationships. When they involve mission-critical products and services, the impact of a flawed contract can be devastating. Imagine, for example, if it became impossible for a company's customers or representatives to place orders. Or imagine if a company invested in new infrastructure and hired new personnel, only to have a related software implementation fail.

Although buyers and users are more directly affected than sellers and providers, all parties can benefit from avoiding these gotchas.

Prior installments addressed the *1st Gotcha, Using the Wrong Agreement to Structure the Deal; the 2nd Gotcha, Not Making Specifications Enforceable*; *the 3rd Gotcha, Scope Creep and Billing Surprises; and the 4th Gotcha, Paying for Non-Performance.*

Here are two more gotchas:

5th GOTCHA: GETTING LOST IN THE "BERMUDA TRIANGLE" OF REPRESENTATIONS, INDEMNITIES, AND LIMITATIONS OF LIABILITY

You'll need a map to navigate through the Bermuda Triangle of three key, interrelated provisions in nearly every technology agreement: representations, indemnities, and limitations of liability.

Representations (corner 1): Customers should strongly consider asking their vendors, providers and contractors to commit that:

- the technology product or service being provided doesn't and won't infringe a third-party's intellectual property
- it has rights to grant any licenses
- it will comply with all applicable laws
- it has appropriate data security, if any important data is being exchanged or hosted

Not surprisingly, there are a number of common variations and exceptions to these, and other, less common representations that may apply depending on the type of deal. And, if in a technology project or service the customer is also providing its proprietary materials to the provider, then the provider will also want to ask for its own variations of the above.

Indemnity and Defense (corner 2): Think of the indemnity provision like a type of insurance for the more important risks. It can cover damages, losses and even attorneys' fees associated with breaches of representations (like those listed above) or other events. And, like insurance, indemnities are only as good as the company making them.

There are always intellectual property (IP) rights that ride along with technology – and the licensee, customer or user has some risk that a third party may find out about and object to that use as infringing the third-party's rights. While it may seem unfair, those third parties can bypass the licensor-vendors and come straight to the licensee-customers with a claim. An indemnity and defense provision can shift this risk back to the licensor-vendor.

Limitations of Liability . . . and Exceptions (corner 3): Typically one of the more heated parts of a negotiation, limitations of liability provisions don't have to be in agreements. If they're not, then a party who brings a claim and can show liability and prove damages can recover that amount. But it's rarely that simple.

Commercial parties can agree, upfront in their agreement, that their liability is capped at some dollar amount. If liability exists (usually because something wrong or bad has happened) and if damages can be proved, then they can recover – but only for amounts up to the agreed cap. Sometimes these are mutual; other times, one-way. Sometimes one simple amount (e.g., fees paid or $100,000); other times, different amounts for different types of breaches.

The other common limitation in these provisions is an express exclusion of certain types of damages – typically consequential (e.g., lost profits). For simplicity, think of these as damages that are not directly incurred to replace or complete the contractually committed product or service.

Express exceptions to these limitations of liability in effect take the agreement back to where it'd be if there was no limitations of liability provision in the first place. *And here's where the triangle corners get connected, for example:*

- A licensee (worried about exposure if a third party comes after it for infringing copyright or patent) wants an exception to liability caps in the event the licensor has an obligation to indemnity and defend for licensor's breach of its IP representations.

- A contractor that possesses the user company's data wants an exception to liability caps in the event the user has to indemnify because it doesn't have the right to provide the data.
- A merchant that arranges for its customers' credit card information to be transmitted or held by a service provider wants an exception to liability caps in the event the service provider has an obligation to indemnify and defend for non-compliance with the payment card industry's data security standards.

Although not always encompassing both of the other triangle corners, two other important exceptions to the limitations of liability:

- A party breaches its confidentiality commitments to the other party.
- Personal injury or property damage due to the other party's negligence or misconduct.

Think of it this way: **This 5th gotcha will get you if you fail to answer these questions:** ***What's my maximum recovery if the other party breaches, and what's my maximum liability if I breach?***

6th GOTCHA: ALLOWING INTELLECTUAL PROPERTY AND CONFIDENTIAL INFORMATION TO ESCAPE

IP and confidential information are the "crown jewels" of companies providing or obtaining technology products and services. For IP, the big four areas are:

- Copyright
- Patent
- Trademark
- Trade secret

These are personal property rights that can be sold, assigned, and licensed. Think proactively about protecting them in your agreements.

While there are different legal frameworks for each IP type, here are some of the more important requests:

- Licensees will often want to extend use rights to corporate affiliates or third-party personnel.
- Licensors should take great care in crafting the license scope and term – if it is too broad or open-ended, you may give away technology without compensation, create a competitor, or handcuff yourself.
- If a customer wants to own the IP created by an independent contractor (such as copyright in materials or software developed), then the customer needs to get a written assignment from the contractor. *This requirement is non-intuitive and applies even though the customer has paid the contractor to create the IP.*

Most people know that trade secrets, data, and other confidential information must be protected with non-disclosure commitments. But you need to expressly restrict use too. For example, you can say: the confidential information may not be used except "solely to provide the Services" or "only to perform this Agreement." If you don't take steps to protect your trade secrets, then you can lose your ability to enforce them later.

Want to attract investors, borrow, or sell your company? Then know that hard questions will get asked about how you protected your IP. For example, you don't want a future buyer holding up the deal because you can't produce simple documents proving that your past independent contractors assigned their IP rights to you.

Think of it this way: **This 6th gotcha will get you if you fail to answer the question: *Have I sufficiently protected my* IP *and confidential information*?**

Prior installments addressed:

1st Using the Wrong Agreement to Structure the Deal

2nd Not Making Specifications Enforceable

3rd Scope Creep and Billing Surprises

4th Paying for Non-Performance

Look for the next installment soon on the final two Gotchas of Technology Contracting:

7th Inadequately Covering Data Security Standards

8th Missing Important Exit Strategies

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