

Presenting a live 90-minute webinar with interactive Q&A

Floating Terms in Vendor Contracts: Cloud Services, Software Licenses and Telecommunications Agreements

Mitigating the Risk of Unilateral Vendor Changes to Key Terms

WEDNESDAY, SEPTEMBER 27, 2017

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Floating Terms in Vendor Contracts

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Agenda




- **What is contract float?**
- **A little history**
- **What types of contracts float?**
- **What kinds of terms float?**
- **The problem of expectations**
- **Alarming trends**
- **Perform a risk assessment**
- **The importance of diligence**
- **Approaches to mitigating risk**

What is Contract Float?

- **When is a contract, not a contract?**
- **One party can unilaterally modify**
- **How are modifications made**
 - Blanket rights to amend
 - Web sites/URLs
 - Later presented overriding click-wrap and other terms
 - Software updates with additional terms
 - Order document labrynth
- **Is a floating contract binding?**

A Little History


- 
- Floating contracts were born in the telecommunications industry
 - Highly regulated industry
 - Constantly changing regulatory obligations
 - Slowly found its way into mainstream technology contracts

What Types of Tech Contracts Float?




Everything

What Kinds of Terms Float?

- 
- Almost every key element of a technology contract can float.
 - Common areas:
 - Specifications/functionality
 - Support obligations
 - Service levels
 - Information security
 - Privacy
 - Service locations/host facilities
 - Fees (example regarding compliance changes)

The Problem with Expectations

- 
- Historical separation of expectations in tech contracts
 - The move toward reasonableness
 - Widening gap in last 18-24 months
 - Importance of setting expectations on both sides

Alarming Trends




- **Where in the world is my data?**
 - Frequently no controls whatsoever
 - (Impossible) compliance burden shifted to customer
- **“Contract float”: SLAs, Service Description, Support Program**
- **New trend in liability**
- **“Virtual Cloud Vendors”**
- **The non-negotiable agreement – NIST**

Perform a Risk Assessment



- **How important is the proposed engagement?**
 - Business critical?
- **Will the vendor have possession of key operational data? Regulated data?**
- **Are substantial start-up, configuration, etc. costs involved?**
- **Are overall fees substantial?**
- **Time to implement?**
- **Can the customer find a ready alternative**

The Importance of Diligence

- 
- What to do if a transaction must be done with floating terms
 - The importance of conducting diligence
 - Documenting use of reasonable care in moving forward without fixed contractual protections
 - Develop a paper trail of the decision making process
 - Identify risks

Key Diligence Activities



- Meet with existing clients, including those that are not listed as official references
- Site visit at vendor
- Review vendor audit reports
- Review vendor security, DR, BCP plans and policies
 - When were those plans and policies last updated?
 - When were the plans last tested?
- Use of diligence questionnaire

Due Diligence



- From the outset, Vendors must be on notice that the information they provide as part of the company's due diligence will be (i) relied upon in making a vendor selection; and (ii) part of the ultimate contract.
- To ensure proper documentation and uniformity in the due diligence process, companies should develop a “Vendor Due Diligence Questionnaire.”

Questionnaire Advantages



- Provides a uniform framework for due diligence
- Ensures “apples-to-apples” comparison of vendor responses
- Ensures all key areas of diligence are addressed
- Provides an easy means for incorporating due diligence information into the final contract

Questionnaire Use



- The Questionnaire will address security standards with which Vendors will be required to comply under the laws (e.g, HIPAA, FCRA/FACTA, GLB, etc.). Many Vendors will lack true understanding of these requirements.
- The Questionnaire will be a tool to educate your Vendors about your compliance expectations.

Questionnaire Use



- The Questionnaire should be presented to potential vendors at the earliest possible stage in the relationship.
- Include as part of all relevant RFPs. If no RFP is used, submit to the vendor as a stand-alone document.

Questionnaire Key Areas



■ Financial condition

- Example from ASP and hosting industry

■ Insurance coverage

- Cyber-Crime Coverage
- Blanket Bond

■ Responsibility

- Criminal convictions
- Litigation
- Regulatory enforcement actions
- Breaches of security, health information
- Adverse audits
- Affiliates, Subsidiaries, contractors outside the US

Questionnaire Key Areas



- **Where will the services be performed and data hosted?**
 - Don't neglect help desk providers
- **Offshore transmission of data**
- **Intended use of subcontractors**
 - Potential need for further due diligence

Questionnaire Key Areas



■ Personnel Security

- Screening procedures/Background check
- Training
- Ongoing education
- Termination procedures

■ Information Security Policy

- Electronic communication monitoring

Questionnaire Key Areas



■ Business Continuity/Disaster Recovery

- Essential to ensuring availability of critical services
- Understanding of the vendor's plans will also provide valuable due diligence information regarding information security (e.g., where is the recovery site, is the site operated by a third party, how will the data at the site be secured, how will the data be securely transmitted to the site)
- Security of data at the site impacted by the disaster

■ Data destruction procedures

Questionnaire Key Areas



- **Organizational security procedures**
 - Information handling policies
 - Dedicated information security team
 - Incident response team
 - Information security practices with contractors and agents
- **Physical security procedures**
- **System access controls – Limiting information access to only those personnel are specifically authorized.**

Questionnaire Key Areas



- **Development and Maintenance Procedures**
 - Security controls during development lifecycle
 - Security testing
 - Separate environments for testing and production
- **Privacy Policy**




Approaches to Mitigating Risk



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Mitigating Risk

- 
- **Conduct diligence**
 - **Identify fall-back vendors/suppliers**
 - **Maintain negotiating leverage, however small**
 - **How will the customer know a floating term has changed?**
 - **Some vendors refuse any notice, placing the burden on the customer**
 - **Generic web site notices**
 - **Specific notice via e-mail or other means**

Mitigating Risk



- **Possible approaches to floating terms:**
 - Main agreement precedence
 - Fix and attach
 - Prevent material diminution in protection from that existing as of the effective date
 - Ensure changes apply across entire customer base
 - Permit termination

Mitigating Risk, Example



This Agreement contains several references to and incorporates certain web sites (e.g., the Technical Support Portal). In the event of a conflict between the body of this Agreement and those web sites, the body of this Agreement will prevail.

Mitigating Risk, Example



During the Term, Vendor will not materially decrease the overall protections, functionality, or performance described in the web sites referenced in this Agreement from those existing as of the Effective Date or modify such web sites to impose any additional material obligations on Customer. Vendor shall provide clear written notice to Customer of any material changes to the foregoing web sites.

Mitigating Risk



■ Focus on termination rights

- Use in SLAs for repeated or egregious failures
- Changes that materially impact the customer's enjoyment of the contract
- Changes that impose a material new obligation on the customer
- Changes that change a material term of the existing agreement.

■ Beware start-up costs

- Potential prorated refund for termination in early days of contract

Mitigating Risk, Example



In the event any change to terms furnished through web sites materially adversely impacts Customer's enjoyment of the Agreement or relevant Service, Customer may, in its sole discretion, terminate this Agreement or the relevant Service Order(s), without payment of any termination fees or penalties.

Mitigating Risk, Example



In the event termination occurs in the initial twenty-four months of the Term, Vendor will promptly issue to Customer a prorated refund of all one-time fees paid hereunder and any pre-paid fees.

Mitigating Risk



- **Beware unusual terms in online terms**
 - Audit rights
 - Broad rights to use customer data
 - Differing limitations of liability
 - Undefined and broad indemnity obligations

Mitigating Risk, Example

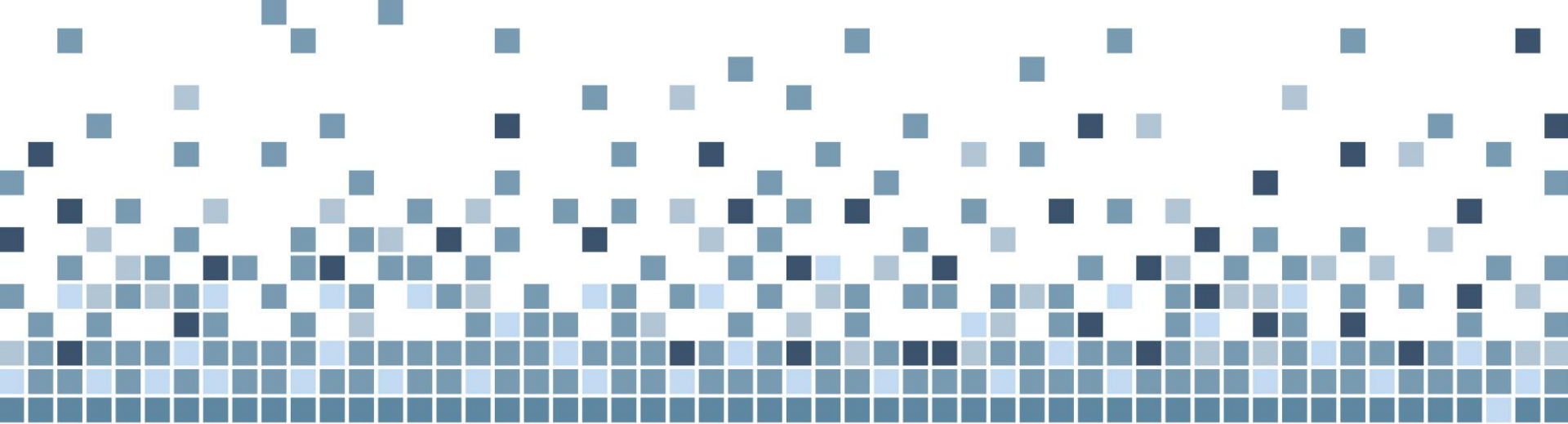


To the extent any terms provided through referenced web sites contain indemnity obligations of Customer, all such indemnification obligations are amended as follows: (i) indemnification shall only apply to claims by third parties that are based on the actual fault of Customer; (ii) Vendor shall give Customer prompt written notice of any indemnified claim; (iii) Customer shall have sole control of the defense and any negotiations; and (iv) Vendor shall reasonably cooperate with Customer (at Customer's expense) in the defense.

Mitigating Risk



- **Avoid long term commitments**
- **Initial term of 1-3 years**
- **Unilateral renewal rights for 2-3 years**
- **Price controls during renewals**
- **Automatic v. affirmative renewal**



Key Take Aways



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Key Take Aways



- Understand inherent risks involved in engagements with floating terms
- Perform an appropriate risk assessment
- Conduct and document due diligence
- Use techniques to mitigate risk
- Avoid long term commitments
- When all else fails, focus on termination rights

Questions?



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