

Strafford

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

Negotiating Licensing Agreements: Risk Mitigation Provisions

Crafting Representations and Warranties, Indemnification,
Remedies and Limitation of Liability Clauses

TUESDAY, MAY 10, 2011

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

Today's faculty features:

Rebecca G. Bradley, Shareholder, **Whyte Hirschboeck Dudek**, Milwaukee
Howard Wettan, Counsel, **White & Case**, Palo Alto, Calif.

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service** at **1-800-926-7926 ext. 10**.

Conference Materials

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the + sign next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

Continuing Education Credits

FOR LIVE EVENT ONLY

For CLE purposes, please let us know how many people are listening at your location by completing each of the following steps:

- Close the notification box
- In the chat box, type (1) your company name and (2) the number of attendees at your location
- Click the blue icon beside the box to send

Tips for Optimal Quality

Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory and you are listening via your computer speakers, you may listen via the phone: dial **1-866-869-6667** and enter your PIN when prompted. Otherwise, please **send us a chat** or e-mail **sound@straffordpub.com** immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.



Whyte Hirschboeck Dudek S.C.



Challenging. Redefining. Advancing.

Negotiating Software License Agreements: Risk Mitigation Strategies in Representations, Warranties & Remedies



Rebecca Grassl Bradley

May 10, 2011



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

About Me

- Commercial litigator and transactional attorney, with a focus on technology industries and issues
- Former VP of Legal Operations for international software company
- AAA arbitrator



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Topics

- Representations
- Warranties
- Remedies
- Damages
- Negotiation Strategies



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Representation vs. Warranty

- What difference does it make?
 - A *misrepresentation* can undo the contract
- On certain issues, licensor will make neither:
 - Infringement (offer indemnification instead). Because licensor cannot know for certain whether any piece of code might infringe, it should not represent or warrant that software does not infringe
 - Knowledge or satisfaction of licensee’s business requirements
 - Software compliance with laws and regulations
 - Software cannot “comply;” it can only perform functions



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Representations by Licensor

- **At time of delivery** software will not include (or licensor will not activate) disabling code (No “self-help”)
- **As of date of Agreement**, not a party to litigation that would adversely affect ability to perform
- **As of date of Agreement**, not a defendant in IP infringement litigation
- Software does not include open source software
 - If you are the licensor, are you certain?
 - Licensees generally don’t need this rep (or warranty)



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Representations by Licensor

- Representations made in RFP response are true and correct
 - based upon licensor’s understanding of licensee’s requirements at the time response was made
 - May be inaccurate based on information subsequently obtained
 - Licensor should attach as an exhibit only the technical “guts” of the RFP response (if at all)
- Authority to enter into Agreement and right to license software



Often Overlooked Considerations For Licensor

- If you make a contractual representation, state the exclusive remedy if it proves false
 - Example: if the software contains disabling code, the exclusive remedy is removal at no charge to licensee
- If you make a contractual warranty, state the exclusive remedy if it is breached
 - Example: if the software contains a virus, the exclusive remedy is removal at no charge to licensee



Performance Warranties

- Understand what the licensor is providing
 - Just a software program?
 - A system (software, hardware, integration services)
- Duration/Timing
 - At time of execution/delivery
 - During a specified period or term
 - Length of warranty period may impact licensor's ability to recognize revenue
 - From date of delivery or first live use



Software Performance Warranties

- Software will perform substantially in accordance with documentation/ specifications
 - Who determines whether software has an “error”?
 - “Licensor determines”
 - “Licensee determines/notifies”
 - Objective vs. subjective standard
 - Compromise: silence



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Software Performance Warranties

- Software is free of errors that would have material adverse impact on software/system performance
- Response times
 - Licensor will not warrant unless selling complete system (including all hardware) or hosting the application or under SaaS model
- Compatibility and interoperability of modifications and third party software with base software



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Remedies for Software Performance Warranty Breach

- Repair: Correct the error vs. use reasonable/best efforts to correct
- Replace: with conforming software
- Provide workaround
- Refund: license fees paid
(in total or for affected application)
- Certain specified “direct damages”
- Termination



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Other Considerations Regarding Remedies

- Licensor may offer different remedies for different categories of errors
- Most remedies available only during warranty and maintenance periods
- Who elects remedy?
 - Licensor may prefer refund over repair where licensee reports error that cannot be reproduced or that other customers have not experienced
- Cure periods
- Exclusivity



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Other Remedies for Licensee to Consider

- Extend cure period where a refund is unacceptable remedy
- Accept partial refund where error doesn't materially impact use of software
- Engage third party (at licensor's expense) to fix error where licensor cannot
- Post-termination right to use software during transition period



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

#1 Warranty Ambiguity

- Software is warranted for 90 days after delivery
- Licensor delivers modification one year later
- Definition of “Software” includes “Modifications”
- Does a new warranty period start for that modification? Is modification covered under maintenance/support agreement? Is modification covered under services warranty/remedy scheme of repair or replace?



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.



Remedies: Warranty Period vs. Maintenance & Support Period

- Usually the opportunity to receive full refund of license fees expires with the warranty period
- During maintenance and support period, remedies restricted to no-charge error correction and possible partial refund of services fees



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

What Does “Best Efforts” Really Mean?

- Some courts interpret it to be the onerous standard licensors fear
 - *Kroboth v. Brent*, 215 A.D.2d 813, 814 (N.Y. App. Div. 1995) (“‘[B]est efforts’ requires more than ‘good faith,’ which is an implied covenant in all contracts...”)
- Other courts interpret it to be a reasonable/good faith efforts standard
- Best practice: Define it



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.



Exclusions From Software Performance Warranty

- Errors caused by:
 - Unauthorized use of software
 - Use of software other than as specified in or contemplated by documentation
 - Licensee-modified code (unless authorized by licensor or “reasonably contemplated” by SLA/documentation)
 - Hardware/third party software defects (unless recommended/authorized/provided by licensor)
 - User error
 - Use of non-current versions
- Third party software
 - Licensor should pass through warranties to licensee but may facilitate claims



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Services Warranties/Remedies

- Conformance with service level agreement
 - Fee credits
- Conformance with prevailing industry standards and practices
 - Re-perform services or refund
- Adoption of security protocols to protect data held or hosted by licensor
 - Direct damages



Services Warranties/Remedies

- Use of qualified personnel with technical competence and experience
 - Replace unqualified personnel without charging for replacement personnel learning curve
- Compliance with all applicable laws
 - What if employee jaywalks? Licensor already obligated to comply with the law; should it be a contractual obligation too? Consider indemnification if licensee adversely affected by licensor's non-compliance
 - Export laws
 - Supply of software/technical services may be lawfully made to licensee in specified countries



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Licensee's Other Remedies For Licensor's Breach

- Licensee's right to withhold payments in the event performance is delayed or deficient
- Liquidated damages
 - Service level agreement (fee credits)
 - Breach of response time commitments (fee credits)



Remedies: Pre-Litigation Dispute Resolution

- Escalation provisions
- Meeting between each party's senior executives



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Remedies: Direct Damages

- Every party seeks to eliminate exposure to consequential and incidental damages
- Consider defining recoverable “direct damages” to include what some courts may otherwise classify as excluded “indirect damages”
 - reasonably foreseeable
 - arise naturally or ordinarily from a breach



Types of “Direct” Damages

- Internal employee time spent addressing errors or implementing workarounds
- Damage to property
- Restoration of lost data
- Costs of cover
- Costs to operate prior software/system



Types of “Direct” Damages

- Costs in transitioning to new provider
- Government penalties incurred as a result of software error or other breach
- Out of pocket expenses incurred as a result of software not performing in accordance with documentation/specifications
- Expenses incurred to mitigate or prevent damages



Licensors' Remedies for Licensee's Breach

- Termination
- Damages
- Withholding services
- Security interest in software/hardware
- Replevin
- Injunctive Relief



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Licensors's Remedies: Termination

- Breach of confidentiality/IP rights
 - If determined by court or arbitrator(s) to be an appropriate remedy
- Non-compliance with use restrictions
- Non-payment
- Should not be exclusive



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Licensors Remedies: Damages

- Lost profit
 - Is entire license fee profit?
 - R&D fully depreciated
 - Sales commissions
- Liquidated damages
 - For breach of non-hire provision
 - For premature termination of services contract where licensor dedicated personnel to licensee's project
- Recovery of attorneys fees for actions to collect unpaid fees



Licensors' Other Remedies for Licensee's Breach

- Withholding services for non-payment of maintenance/support or professional services for software development
- Injunctive relief for breach of confidentiality
- UCC remedies may fill gaps where parties are silent--if court deems software a “good”



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Warranty/Remedy Scheme

- The issue is balancing risk and reward--
fundamentally a business decision
- Be specific: parties need to know their
rights and obligations



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Negotiation Strategies

- Ask why a party needs a particular provision
 - “help me understand your concern so that we can address it”
 - Sometimes a party believes certain language will address its concern but you may have a more palatable means of addressing it
- Be able to explain why you cannot agree to a demand/request
- Always maintain your composure (let your opponent look unreasonable)
- Let the other side walk away (they may return)
 - “Necessity never made a good bargain”
 - Benjamin Franklin



QUESTIONS?



Rebecca Grassl Bradley
Technology Attorney
Whyte Hirschboeck Dudek, S.C.
414.978.5785
rbradley@whdlaw.com



Whyte Hirschboeck Dudek S.C.

Challenging. Redefining. Advancing.

Howard Wettan
White & Case LLP

WE'VE GOT YOU COVERED:
*AVOIDING COMMON PITFALLS
IN INDEMNITY DRAFTING*

WHAT MATTERS IN AN INDEMNITY PROVISION?

- Who?
- What?
- When?
- How?

WHO?

Example: “Each Party will perform the activities under the Project at its own risk and responsibility and will indemnify and hold the other Party harmless from and against any third party claims in this respect.”¹

This language has two major problems:

- **Who is covered?**
- **Who is indemnifying who?**

¹ The examples in this presentation are generally used to illustrate what *not* to do, not as a model or recommended form.

WHO?

Example: “Each Party will perform the activities under the Project at its own risk and responsibility and will indemnify and hold the other Party harmless from and against any third party claims in this respect.”

Who is being indemnified?

Affiliates?

Directors?

Officers?

Employees?

Agents?

Customers?

Successors?

Assigns?

WHO?

An indemnified party should draft the provision to include all potential persons or entities who may seek an indemnity provision, including possible successors or assigns. One way to do this is to define “related parties” to include these categories.

Example: “‘Related Parties’ with respect to either Party, shall mean all Affiliates, employees, officers, directors, agents, contractors, successors or assigns.”

“Vendor shall indemnify, defend, and hold Customer and its Related Parties harmless . . .”

An indemnifying party may want to keep this list more narrow. In particular, an indemnifying party may want to avoid indemnifying an indemnified party’s customers.

WHO?

Example: “Each Party will perform the activities under the Project at its own risk and responsibility and will indemnify and hold the other Party harmless from and against any third party claims in this respect.”

Who is indemnifying who in any given situation?

An event that involves both parties may occur, but the provision provides no guidance as to which party should take on responsibilities and obligations on behalf of the other.

WHO?

Make it clear who is indemnifying by either:

- Drafting separate indemnity provisions for each party; or
- Including language that sets clear conditions for when one party and not the other shall have to indemnify.

Example: “A Party (the ‘Indemnifying Party’) shall indemnify, defend and hold the other Party and its Related Parties (the ‘Indemnified Party’) harmless from all Losses resulting from third party claims arising out of the Indemnifying Party’s gross negligence or willful misconduct, except to the extent such Losses arise from the Indemnified Party’s own gross negligence or willful misconduct.”

WHAT?

What types of harm are to be reimbursed?

Example: “Licensee shall indemnify, defend, and hold harmless Licensor, Licensor, Affiliates and its officers, directors, or employees, for any and all claims, damages, liabilities, **reasonable costs and expenses, including attorneys fees** and costs of litigation, resulting from Proceedings brought by third parties . . .” (*emphasis added*)

- Note that **all** attorneys fees are lumped in as “reasonable costs and expenses,” making it harder, not easier, to challenge an unreasonable attorney bill.
- Make sure attorneys’ fees and costs of litigation are always directly modified as “reasonable” or “reasonable and customary.”

WHAT?

Is the language limited to third party claims?

Example: “Supplier agrees to indemnify, defend, and hold Customer, and each of their respective affiliates, officers, directors, employees, agents, and successors and assigns (each, an Indemnified Entity), harmless from and against any Loss that they suffer or incur . . .”

“Loss” defined as “any loss, liability, claim, penalties, fines, damage, death, injury, cost (including legal and other professional costs) or expense of whatever nature whether based in contract, tort, law, equity, or otherwise.”

- Note that this language is not limited to third party claims. Attorneys will often argue that this has the effect of making direct damages recoverable under this provision. This makes it possible to avoid an agreed cap on monetary liability where liability for indemnity is carved out.
- On the other hand, some courts have held that it is implied that indemnity provisions only apply to third party claims. See *Travelers Indemnity Co. v. Dammann & Co.*, 592 F. Supp. 2d 752 (D.N.J. 2008); *Michael v. Huffman Oil Co., Inc.*, 661 S.E.2d (N.C. Ct. App. 2008)
- Consider language limiting recoveries to final judgment awards.

WHEN?

When are claims covered by the indemnity?

Beware of provisions that have broad grounds for indemnity claims.

Example: "Supplier agrees to indemnify, defend, and hold Customer and each Customer Affiliate (each, an Indemnified Entity), harmless from and against any Loss that they suffer or incur . . .that arises or may be attributable to (either directly or indirectly): (i) any act, error, **omission** or gross negligence of Supplier, its officers, employees, agents, contractors, licensees, or servants; (ii) a **breach of any obligation, representation, or warranty** of Supplier." (*emphasis added*)

This language puts the Supplier on the hook for anything that goes wrong, not just any breach of the contract, but **any other omission**.

WHEN?

Breach of contract is often viewed by indemnifying parties as grounds which are too broad to provide indemnity for third party claims.

- It is too easy to construct a chain of causation from a minor breach of contract to a major problem that occurs in the indemnified party's business.
- Think of the "Butterfly Effect" or *Palsgraf v. Long Island Railroad*.

Be wary of indemnities for "breach of representation or warranty."

- There may be representations in the contract for areas that parties are otherwise unwilling to indemnify, such as intellectual property infringement or regulatory compliance.

WHEN?

Some provisions state that a party owes an indemnity obligation, unless the other party owes an indemnity obligation for the same occurrence.

This can work, but it will become circular if used for both parties.

Example: “Vendor shall indemnify, defend, and hold the Customer and its Related Parties harmless for any third party claim arising out of a breach of contract, unless the Customer owes the Vendor an indemnity obligation.”

“Customer shall indemnify, defend, and hold the Vendor and its Related Parties harmless for any third party claim arising out of a breach of contract, unless the Vendor owes the Customer an indemnity obligation.”

If a third party claim arises in a situation where neither party has fully performed under the contract, who indemnifies whom?

WHEN?

Exclusions

An indemnifying party may also carve certain scenarios out of their obligation such as:

- the indemnified party has modified the product or specified a change;
- the indemnified party has rejected an upgrade; or
- the indemnified party has used the product in combination with other products where no infringement would have otherwise occurred without such combination.

WHEN?

Parties giving indemnity coverage should seek to enumerate specific grounds for claims.

Other important items that may be covered or are commonly covered:

- Product liability, particularly for trademark licensors
- Infringement claims
- Employment claims, particularly in outsourcing and vendor contracts
- Government regulatory or enforcement actions
- Personal death, injury, and property damage

HOW?

What are the consequences of not having indemnification procedures?

- An indemnified party could proceed to defend the suit, on its own, at great expense and force the indemnifying party to intervene or otherwise pay for legal fees that they cannot control; or
- The indemnified party could pay a large settlement on the indemnifying party's dime.

HOW?

Indemnification Procedures

Notice: What are the consequences if the indemnified party does not notice the indemnifying party of a claim in a timely manner?

Does the indemnifying party get damages? Are they free from the indemnity obligation?

Example: “To the extent the Indemnified Party fails to meet its notice obligations under this Section, the Indemnifying Party is only relieved of its obligations to the extent such failure actually prejudices the Indemnifying Party or prevents the Indemnifying Party from performing its obligations as set forth in this Section.”

HOW?

Indemnification Procedures

Taking Control: What if the indemnifying party fails to assume the defense immediately?

Can they assume it later? Is the indemnified party's freedom to defend and settle a claim absolute once an indemnifying party has failed to assume a defense?

Example: "If the Indemnifying Party declines to or fails to take control of the defense against a third party claim . . . the Indemnifying Party shall forfeit the right to assume the defense if it declines to do so within one hundred eighty (180) days of receiving notice of the claim."

HOW?

Indemnification Procedures

Typically, an indemnified party can participate in a lawsuit with separate counsel at their own expense and its obligated to provide cooperation.

What should cooperation entail?

Example: “Upon the Indemnifying Party’s request and expense, the Indemnified Party shall, where necessary or otherwise useful, (i) provide documentation; (ii) make any current or former employees, officers, directors, or other agents or advisors with relevant knowledge or expertise reasonably available to assist or to testify, orally or in writing, as required; and (iii) execute stipulations, motions, or other documents or instruments.”

HOW?

Indemnification Procedures

Settlement: Should the indemnified party have a right to consent to a settlement in its name?

*What if they are left on the hook for a cost or an affirmative obligation?
What if the indemnifying party forfeits an important right?*

Example: “The Indemnified Party shall retain the right to give prior written consent, not to be unreasonably withheld, to any settlement that imposes any obligations, duties, or responsibility on the Indemnified Party.”

HOW?

Indemnification Procedures – Capped Indemnities

If an indemnifying party's exposure is limited, things get more complicated:

- When can an indemnified party retain control of the lawsuit if the indemnified party retains some exposure to the claim?
- When can an indemnified party require a settlement?
- Can an indemnifying party's attorney fees count toward a cap?

HOW?

Termination for Alleged Infringement

- Either party may require right to license termination in order to protect itself from trebled damages for willful infringement.
- Licensor will want to limit the right to terminate license to when it acknowledges there is infringement and it cannot repair or replace.

LIMITATIONS ON LIABILITY

Some Things to Keep In Mind

- *Exclusions*
- *Caps*

LIMITATIONS ON LIABILITY

EXCLUSIONS

- Typical provisions exclude “ALL INDIRECT DAMAGES, INCLUDING CONSEQUENTIAL, SPECIAL, INCIDENTAL, PUNITIVE OR EXEMPLARY DAMAGES OR LOST PROFITS.”
- It is good to exclude recovery for indemnity from this limitation; however, courts may follow the UK approach which treats such recoveries as direct damages rather than excluded of consequential damages.
- Parties often also seek exclusions for gross negligence, fraud, willful misconduct, or breach of confidentiality.

LIMITATIONS ON LIABILITY

EXCLUSIONS

- Many common law jurisdictions such as the United Kingdom, will not enforce an exclusion of all damages, including direct damages.
- Such jurisdictions may also allow equitable remedies as well, including monetary equitable remedies, if they are not expressly disclaimed. Consider adding to an exclusion: "ALL OTHER MONETARY REMEDIES, INCLUDING THOSE IN EQUITY."
- Suppliers will often limit remedies to its repair and replacement obligations under the contract for defective goods or services.
- Suppliers and licensors may disclaim liability for use of their technology in an unanticipated manner or not in accordance with user documentation.

LIMITATIONS OF LIABILITY

CAPS

- Some provisions exclude certain types of claims from caps, most commonly third party indemnity claims, but also sometimes claims for death, physical injury or property damage or breaches of law or regulation.
- Be careful with caps based on the amount of payments received under the contract during some set period.

Example: "IN NO EVENT SHALL THE LIABILITY OF THE VENDOR EXCEED THE AMOUNT RECEIVED IN FEES IN THE TWELVE (12) MONTHS PRECEDING AN EVENT GIVING RISE TO LIABILITY."

In the first month of the Agreement, the cap may be very low.

- Exclusion and cap should apply to remedies for "ALL CLAIMS, WHETHER IN LAW OR EQUITY, IN TORT, CONTRACT, STATUTE, OR OTHERWISE."

SOME NEGOTIATING STRATEGIES

- Always ask “why”
- Always try to offer a rational baseline for your position that is independent of what your client simply wants
- If possible, establish that certain concessions cannot be made without extensive internal review
- If possible, cite to prior deals or practices as authority for your position
- If your counterpart’s position is unreasonable, make them state it explicitly

White & Case Around the World – Offices by Region





Howard Wettan
White & Case LLP
5 Palo Alto Square
3000 El Camino Real
5 Palo Alto Square, 9th Floor
Palo Alto, CA 94306
Tel: (650) 213 0354
Fax: (650) 213 8158
hwettan@whitecase.com