

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

Structuring Software and Technology Reseller and Distributor Agreements

Guidance for Corporate and Technology Counsel for Drafting and Negotiating Contracts

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Scope of Distribution / Resale Rights

- What is the scope of the distribution rights that are being granted by the Owner to the Distributor/Reseller?
- What is the software product? Is there a right to sell services along with the product being distributed? If maintenance services, technical support or training, what type of service will be provided?
- Can reseller / distributor manufacture or modify the software product?
- Where can it be distributed? Specific Territories v. Worldwide
- Is it an exclusive or non-exclusive right?
- Is it limited to a certain distribution chain?
- Is there a right to create derivative works of the code, or improvements upon the technology, and distribute a developed product?

License Grant Issues for Software / Technology

- Time Period - What is the term of the license rights?
- Assignable v. Non-Assignable License → Tying the license grant to the assignment provision - Note: While a contract is freely assignable unless the agreement says it cannot be assigned, a non-exclusive license is personal to the holder and may not be deemed assignable by a court unless agreement expressly provides that it may be assigned.
- Type of License for Software - Object Code v. Source Code
- Geographic Restrictions and Other Restrictions
- Sub-licensable - software licenses sold should be subject to written license agreements between the reseller / distributor and the end user Note: Reseller should be responsible for end user breach or Supplier needs to have third-party beneficiary rights under them to recover against end users for their breach

Scope of IP Rights

- What type of IP Rights exist and need to be granted with respect to the distribution rights?
- Is there a right for the reseller /distributor to manufacture product under a patent?
- Is there a right under copyright for the reseller / distributor to use, copy, reproduce, access, maintain, store, exploit, sublicense, perform, distribute, administer, transmit, modify or enhance the Software Products?
- Is there a trademark right for the reseller / distributor to use the owner's brand or will the reseller / distributor products be private labeled?
- Is there a need to create new products and/or derivative works?

Territory, Exclusivity, Field of Use

- Territorial Grants - world-wide, EMEA, industry?
- Exclusivity - territorial? product?
- FOU - distributor? value-added reseller? OEM?
- Restrictions
 - A. Not a problem *per se*
 - B. Antitrust concerns

Pricing Restrictions

- General Rule - *free market at each distribution tier (i.e., between you & reseller, between reseller & end user)*
 - A. Rare exceptions
- Examples of pricing restrictions
- Potential “Gotchas!”
 - A. Sherman Act
 - B. Robinson-Patman Act
 - C. GSA, etc.

IP Ownership

- Patents → specific settled idea or solution to the problem that is definite / permanent enough that one skilled in the art could understand
- Copyrights → fixed in a tangible medium of expression
- Work for Hire v. Assignment
- Derivative Works
- Ownership Rights Structure -
 - Supplier owns Everything / Can't use Reseller Confidential Information / Reseller may request residual rights
 - Reseller owns what it creates (but preexisting materials subject to Supplier's license) & Supplier asks for right to use/covenant not to sue if develops same

Joint Ownership

- Owners and resellers should avoid contractual provisions that state that the parties will jointly own any materials created.
- Joint ownership gives each party rights, but it also prevents each party from controlling IP that it may wish to control exclusively.
- Copyright - unless stated otherwise, a joint owner needs to provide accounting to the other owner
- Patent - a joint owner needs participation of other owner in any patent litigation, and the other owner can grant a license to the infringing party without consent of the joint owner
- Copyright/Patents - No right to grant exclusive rights without consent of the co-owners.

Confidential Information

- Types of Confidential Information
- Exceptions
- Non-Disclosure and Non-Use →
 - sharing with contractors
 - synch with license grant and end users
 - government orders
 - sharing agreement with third-parties → investors, lawyers, accountants
- Period of non-disclosure obligations
- Remedy

Covenants, Representations and Warranties

- Differences between them
- Types of Warranties
- Does a breach of warranty increase the amount of damages?
- Does breach of warranty give rise to an implied indemnification claim?
- Does a breach of warranty give rise to consequential damages in addition to direct damages?
- Failure of Essential Purpose - keep warranty separate from LOL and state that LOL will apply even if warranty fails of its essential purpose

Limitation of Liability – What are Direct/General Damages?

- Losses that naturally and usually flow from the breach itself - *Suburban Propane v. Proctor Gas Inc.*, 953 F.2d 780 (2d Cir. 1992)
- **Buyer's Damages for Breach in Regard to Accepted Goods - UCC § 2-714**
 - (1) Where the buyer has accepted goods and given notification, he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner that is reasonable.
 - (2) The measure of damages for breach of warranty is the difference between the value of the goods accepted and the value they would have had if they had been warranted by the Seller, unless special circumstances show proximate damages of a different amount.
 - (3) In a proper case, any incidental and consequential damages under the next section may also be recovered. **UCC § 2-714**

Limitation of Liability – What are Direct/General Damages?

- Examples of direct damages:
 - Expenditures incurred before the breach occurred and in reliance on the contractual warranties - *Am. Tel. & Tel. Co. v. New York City Human resources Admin.*, 833 F. Supp. 962 (S.D.N.Y. 1993)
 - Repair Costs - Fees paid for consulting services to determine the means of repairing the faulty product - *Canal Elec. Co. v. Westinghouse Elec. Co.*, 756 F. Supp. 620 (D. Mass. 1990)
 - Lost Profits - Courts have found that lost profits are something that could be deemed to be in the “ordinary course of the seller’s breach.” See *Computrol*, 203 F.3d 1064 (8th Cir. 2000)

Limitation of Liability – What are Consequential Damages?

- Those that do not ordinarily flow from the seller's breach and are not recoverable unless they result from the general or particular requirements and needs of the buyer, which the seller had reason to know at the time of contracting. See *White and Summers* § 6-5 at 320.
- Consequential damages must include damages that were reasonably foreseeable by the breaching party at the time of contracting. See *Suburban Propane*, 953 F. 2d 780 (2d Cir. 1992)

Limitation of Liability – What are Consequential Damages?

- UCC 2-715 - Buyer's Incidental and Consequential Damages

(2) Consequential Damages resulting from Seller's breach include:

- (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had a reason to know and which could not reasonably be prevented by a reasonable substitute otherwise; and
- (b) an injury to person or property "proximately resulting from a breach of warranty" - see UCC § 2-715(2). If the defect is one that can be discovered by a buyer inspecting the goods, then the buyer may not be entitled to consequential damages. UCC § 2-715(2)
- Courts have interpreted consequential damages to be those damages that stem from losses incurred by the non-breaching party in its dealings, often with third parties, as a proximate result of the breach. See *Petroleo Brasileiro*, 372 F. Supp. 503 (E.D.N.Y. 1974).

Limitation of Liability – What are Consequential Damages?

- Does a breach of warranty give rise to a right for consequential damages under the UCC?
 - Under UCC § 2-715(2), it does.
 - However, under the UCC, consequential damages are not recoverable if there is a clause that expressly limits them. See UCC §§ 2-712(2), 719(3).

Limitation of Liability – What are Consequential Damages?

- There is support for the proposition that UCC § 2-715 provides an incomplete definition of consequential damages.
- Comment 3 to UCC § 1-305 states that the concept of consequential damages is not defined under the code, but is used in the sense given to the term “consequential” outside of the UCC. *See Hadley v. Baxendale*, 9 Exch. 341 (1854).
- There is a silent presumption that consequential damages are not in the ordinary course.

Limitation of Liability – What are Incidental Damages?

- 2-715 - Buyer's Incidental and Consequential Damages
- (1) Damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation, and custody of the goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach. See UCC § 2-715(1).

Example of a Limitation of Liability for Type of Damages Provision:

- Supplier Limitation of Liability for Type of Damages:
 - IN NO EVENT SHALL SUPPLIER BE LIABLE TO RESELLER, ITS EMPLOYEES, SUBCONTRACTORS, AND/OR AGENTS, OR ANY THIRD-PARTY, FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL, PUNITIVE DAMAGES OR LOST PROFITS FOR ANY CLAIM OR DEMAND OF ANY NATURE OR KIND, ARISING OUT OF OR IN CONNECTION WITH THIS AGREEMENT OR THE PERFORMANCE OR BREACH THEREOF[, EVEN IF IT KNEW OR SHOULD HAVE KNOWN OF THE POSSIBILITY OF SUCH DAMAGES].
- Mutual Limitation of Liability for Type of Damages:
 - NEITHER PARTY IS LIABLE TO THE OTHER FOR ANY INDIRECT, CONSEQUENTIAL, EXEMPLARY, SPECIAL, INCIDENTAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION LOSS OF USE OR LOST BUSINESS, REVENUE, PROFITS, OR GOODWILL, ARISING IN CONNECTION WITH THIS AGREEMENT, UNDER ANY THEORY OF TORT, CONTRACT, INDEMNITY, WARRANTY, STRICT LIABILITY OR NEGLIGENCE, EVEN IF THE PARTY KNEW OR SHOULD HAVE KNOWN OF THE POSSIBILITY OF SUCH DAMAGES.

Example of a Limitation of Liability Cap on Amount of Damages Provision:

- **Supplier's Cap:**
- SUPPLIER'S MAXIMUM CUMULATIVE LIABILITY ARISING OUT OF OR RELATING TO THIS AGREEMENT, WHETHER BASED UPON WARRANTY, CONTRACT, TORT, OR OTHERWISE, SHALL NOT IN ANY EVENT EXCEED IN THE AGGREGATE THE AMOUNT PAID BY RESELLER TO SUPPLIER DURING THE LAST TWELVE (12) MONTHS OF THE AGREEMENT PRIOR TO THE CLAIM.
- This Supplier Limitation above will increase based upon the amount that has been actually paid. The result is that the amount paid might be lower at the outset
- SUPPLIER'S MAXIMUM CUMULATIVE LIABILITY ARISING OUT OF OR RELATING TO THIS AGREEMENT, WHETHER BASED UPON WARRANTY, CONTRACT, TORT, OR OTHERWISE, SHALL NOT IN ANY EVENT EXCEED IN THE AGGREGATE THE GREATER OF (A) FIVE HUNDRED THOUSAND DOLLARS AND (B) THE AMOUNT PAID BY RESELLER TO SUPPLIER DURING THE LAST TWELVE (12) MONTHS OF THE AGREEMENT PRIOR TO THE CLAIM.

Exceptions to Limitation of Liability - Amount and Type of Damages

- Indemnities
- Breach of Confidentiality
- Misappropriation of IP
- Violation of Law
- Fraud, Gross Negligence and Willful Misconduct
- Tort Actions - death, personal injury or property damages

Limitation on Amount / Type of Damages

- What other types of breaches are red-lined outside of the limitation on type/amount of damages? Gross Negligence - Should Supplier leave it to a court to decide whether gross negligence should be outside cap?

Gross Negligence - NY generally prohibits parties from contractually exculpating or limiting liability for gross negligence. *Sommer v. Fed. Signal Corp.*, 79 N.Y.2d 540, 554, 593 N.E.2d 1365, 583 N.Y.S.2d 957 (1992) ("It is the public policy of this state . . . that a party may not insulate itself from damages caused by grossly negligent conduct."). However, in a contract between sophisticated parties, not implicating public health or safety, New York applies a more exacting standard of gross negligence than it would in other contexts. *Id.* The New York Court of Appeals has held that to avoid enforcement of a limitation of liability provision, the evidence must approach reckless indifference or intentional wrongdoing: "Gross negligence, when invoked to pierce an agreed-upon limitation of liability in a commercial contract, must 'smack[] of intentional wrongdoing' . . . It is conduct that evinces a reckless indifference to the rights of others. . . ." *Id.* (citing *Kalisch-Jarcho, Inc. v. City of New York*, 58 N.Y.2d 377, 385, 448 N.E.2d 413, 461 N.Y.S.2d 746 (1983) and Restatement [Second] of Contracts § 195[1]).

Limitation on Type of Damages – Identifying Direct Damages

- Due to a lack of clarity with respect to whether a damage is a direct or consequential damage, the reseller will often also request that specific types of damages be outside the limitation on type of damages or be identified as a direct damage
 - Reasonable costs for recreating or reloading data that is lost or damaged;
 - Reasonable costs of implementing a workaround in respect of a failure to provide the services;
 - Reasonable costs of replacing lost or damaged equipment, software or materials
 - Reasonable costs and expenses incurred to procure services from another source or re-procure services on expedited basis
 - Any costs that the supplier has agreed to incur for performance or re-performance
 - Any amounts that supplier has specifically agreed to pay under other sections of the agreement;
 - Any payments or penalties imposed by a governmental body or regulatory agency for failure to comply with requirements or deadlines.

Indemnification

- What is the purpose of it?
 - (1) provides a contract remedy to supplement other remedies, including any tort or common law remedies;
 - (2) can be used to shift the risks; and
 - (3) allows for the recovery of reasonable attorneys fees, defense costs, investigation expenses, and discovery and court costs.
- Direct claims v. Third-Party Claims → avoiding an indemnity for direct claims

Common Indemnities for Third-Party Claims

- Violation of Law
- Breach of Confidentiality
 - Inadequacies in the physical and data security control systems
- Death, bodily injury or personal property damage
- Acts or Omissions of Supplier as Employer
- Claims brought by other subcontractors
- Government claims for regulatory fines / penalties
- Claims arising from or related to the inaccuracy, untruthfulness or breach by supplier of any of the representations, warranties or covenants

IP Infringement Indemnity

- Scope → Patents, Trademarks, Copyrights, Trade Secrets
- Jurisdiction → United States v. other jurisdictions
- Coverage → Other parties, including end users
- Exceptions → Third-Party Equipment and Software; Carve outs of Responsibility (i.e. compliance with specs, modifications, combinations)
- Cross-Indemnity from Reseller
- Supplier's Settlement / Mitigation of Infringement Claim - modify, repair or replace to the same or comparable functionality - be careful with Supplier's right to terminate

Non-Compete Clauses

- General Rule - *competition is good*
- Exceptions to the General Rule:
 - A. protecting intellectual property
 - B. protecting confidential/proprietary information
 - C. protecting goodwill
- Restricting the Exceptions
 - A. Sherman Act (again)
 - B. Patent Law concerns

U.S. Export Controls

- Broad Jurisdiction - if the product originates or passes through the U.S.
- Regulations (15 CFR, parts 300-799)
 - A. Restrict export of certain products &/or
 - B. Restrict export to certain locations/entities
- Foreign Corrupt Practices Act (15 USC §§78dd-1, et seq.)
 - A. anti-bribery
 - B. public company accounting obligations

Other Issues for Discussion

- Termination
- Audits
- Force majeure
- Arbitration v. Litigation for dispute resolution

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