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Negotiating Representations, Warranties and Indemnification Clauses in Technology Agreements

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Negotiating Representations, Warranties, and Indemnification Clauses in Software and Cloud Computing Contracts

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Overview

- Some Foundation
- Alignment of expectations
- Alarming Trends
- Representations and Warranties
- Indemnification Obligations
- Pulling it all together
- Questions/Discussion

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Some Foundation

- Customer-oriented discussion
- Concepts apply to a broad range of “technology contracts”
- Representations and Warranties don’t stand alone
- Tie to the limitation of liability
- Einstein saves the world – The importance of planning

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Some Foundation, cont’d

- Trial v. Warranties v. Acceptance Testing v. Support Obligations
 - Overview of relationships
 - Understand how these concepts work together
 - Understand how they are different
 - **None is a substitute for any other**

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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

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Drafting Warranties

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Initial Considerations

- What is the product and what does it do?
- Critical product?
- Magnitude of fees?
- Time to implement/productive use?
- Sensitive data at risk?
- Regulated industry?
- One size fits-all client form agreements

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Warranties

- Avoid stock warranties of performance in accordance with the “published documentation”
 - “Published documentation” is a moving target over which the vendor has complete, unilateral control.
 - Control documentation/functionality creep.

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Warranties [cont.]

- What does the warranty *really* cover?
 - Frequently overlooked issue
 - Make sure the warranties cover all of the following:
 - Licensed Software
 - Enhancements, releases, and new versions
 - Documentation
 - Hardware
 - Support and other professional services

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Warranties [cont.]

- What is the warranty period? What triggers the start? How long does it run?
 - Thirty days from initial delivery
 - How long to implement?
 - Greater of one year from Acceptance or the period in which support is purchased
 - Cloud engagements
 - Getting around the revenue recognition argument – bolster support.

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Warranties [cont.]

- Exclusive remedies should be avoided
 - Does the remedy even make sense (e.g., anti-virus, failure to comply with law)?
 - Time period for fix
 - Tolling of other remedies, but no waiver

Warranties [cont.]

Vendor Example: *In the event of a breach of the foregoing warranties, Customer's sole and exclusive remedy and Vendor's sole and exclusive liability shall be for Vendor to use reasonable efforts to repair or replace the defective software.*

Warranties [cont.]

Response: *In the event of a breach of [reference warranty of non-conformance only], Customer shall afford Vendor [thirty days] to remedy the breach before pursuing any other remedies hereunder.*

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Warranties [cont.]

- Types of warranties
 - Performance (Specifications, Service Levels)
 - Intellectual Property Infringement
 - Why is this important if you have an indemnity?
 - What is reasonable?
 - Services (professional and support)
 - General standard: professional, workmanlike, timely
 - Industry standard
 - Contractual standard: Statements of work and other specifications

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Warranties [cont.]

- Types of warranties
 - Legal compliance
 - Means to educate vendors
 - Privacy Laws and Regulations
 - Viruses and Disabling and Phone-Home Mechanisms
 - Understand these are three different protections.

Warranties [cont.]

- Types of warranties
 - Offshoring of data
 - Why do we care?
 - Intellectual property
 - Personal data
 - Pass through of third party warranties
 - Seldom applies

Warranties [cont.]

■ Types of warranties

- Open source/Third party software
 - Understanding open source
 - Know when it is relevant – Distribution?
 - Open source v. proprietary licenses
 - Beware proprietary licenses
 - Beware future product updates with new licenses

Warranties [cont.]

■ Types of warranties

- Known performance issues
 - Anticipate vendor pushback
- Authority
- Changes in functionality
 - Example of the Northern California Healthcare Provider
- Documentation
- Secure software development

Warranties [cont.]

■ Types of warranties

- Secure software development
 - Orphan code
 - Application development: Development environment represents best practices for assessing and testing security (e.g., Certified Secure Software Lifecycle Professional (CSSLP) or GIAC Secure Software Programmer certification)
 - Vulnerability testing: Check against most common security vulnerabilities (e.g., OWASP Top 10 Vulnerabilities; CWE/SANS Top 25 vulnerabilities)

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Warranties [cont.]

Performance Warranty

Vendor Example: *For a period of thirty days from the Effective Date, the Software will materially conform to its then current Documentation.*

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Warranties [cont.]

Performance Warranty

Response: *For the greater of six months or the period during which Customer purchases Support Services, the Software will materially conform to the requirements of this Agreement, including any statements of work, and, **to the extent not inconsistent with the foregoing**, the Documentation.*

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Warranties [cont.]

Infringement Warranty

Vendor Example: None.

Response #1: *The Software will not infringe the intellectual property rights of any third party.*

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Warranties [cont.]

Infringement Warranty

Response #2: *To the best of Vendor's knowledge as of the Effective Date, Customer's licensed use of the Software will not infringe the intellectual property rights of any third party.*

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Warranties [cont.]

Service Warranty

Vendor Example: *The Services will be performed in material accordance with this Agreement.*

Response #1: *The Services will be performed in material accordance with this Agreement and in a timely, workmanlike manner.*

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Warranties [cont.]

Service Warranty

Response #2: *The Services will be performed in (i) material accordance with this Agreement, (ii) a timely, workmanlike manner , and (iii) in accordance with industry best practices for services of this kind.*

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Warranties [cont.]

Legal Compliance Warranty

Vendor Example: *Vendor will comply with all laws and regulations applicable to its business in the performance of the Agreement.*

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Warranties [cont.]

Legal Compliance Warranty

Response: *Vendor will comply and will ensure its Software and Services comply with all applicable laws and regulations. Vendor shall, at no additional charge, promptly furnish all updates to the Software necessary for compliance with any change in laws or regulation during the term of this Agreement.*

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Warranties [cont.]

Legal Compliance Warranty

Example general warranty: *Vendor further represents and warrants it shall, in connection with its performance hereunder, comply with all applicable laws, ordinances, rules, regulations, building codes, electrical codes, business licenses, visas, work permits, court orders, and governmental or regulatory agency orders (collectively, "Laws"), including, without limitation, laws relating to non-discrimination, human rights, child labor, and other employment and labor laws and applicable foreign export laws, and laws pertaining to health, safety, the environment, and hazardous materials.*

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Warranties [cont.]

Privacy Laws and Regulations

Vendor represents and warrants that at all times during and after the term of the Agreement it will comply, at its sole expense, with all applicable local, state, federal, and international privacy, confidentiality, consumer protection, advertising, electronic mail, data security, data destruction, and other similar laws, rules, and regulations, whether in effect now or in the future, including, but not limited to the Gramm-Leach Bliley Act and its implementing regulations (all of the foregoing will be collectively referred to as the "Privacy and Security Requirements"). Vendor acknowledges that it alone is responsible for identifying, understanding, and complying with its obligations under the Privacy and Security Requirements as they apply to its performance of this Agreement and possession of the Personal Information.

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Warranties [cont.]

Anti-Virus Warranty

Basic Version: *Vendor shall use industry practices to scan and remove from the Software all viruses, Trojan horses, worms, key loggers, and other similar code.*

Alternate: *Vendor has taken every commercially reasonable precaution to ensure and to the best of Vendor's knowledge, the Software does not contain any virus or similar code that may destroy, modify, alter, or cause the destruction, modification or alteration, in whole or in part, of any of Customers, data, equipment, devices, networks, or software.*

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Warranties [cont.]

Anti-Virus/Disabling Mech. Warranty

Extended Version: *Vendor shall not insert into any Software any Destructive Mechanisms, as defined below, and shall use industry best practices to scan and remove any such mechanisms created by third parties from the Software. Vendor shall not invoke such mechanisms at any time, including upon expiration or termination of this Agreement for any reason.*

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Warranties [cont.]

Anti-Virus/Disabling Mech. Warranty

“Destructive Mechanisms” means computer code that: (i) is designed to disrupt, disable, harm, or otherwise impede in any manner, including aesthetic disruptions or distortions, the operation of the Software or any other software, firmware, hardware, computer system or network (sometimes referred to as “viruses” or “worms”); (ii) would disable or impair the Software or any other software, firmware, hardware, computer systems or networks in any way where such disablement or impairment is caused by the passage of time, exceeding an authorized number of copies, advancement to a particular date or other numeral (sometimes referred to as “time bombs,” “time locks” or “drop dead” devices); [cont’d]

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Warranties [cont.]

Anti-Virus Warranty

(iii) would permit Vendor to access the Software or any other software, firmware, hardware, computer systems or networks to cause such disablement or impairment (sometimes referred to as “traps,” “access codes” or “trap door” devices); or (iv) which contains any other similar harmful, malicious or hidden procedures, routines or mechanisms which would cause such programs to cease functioning or to damage or corrupt data, storage media, programs, equipment or communications or otherwise interfere with operations.

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Warranties [cont.]

Phone Home Functionality

Example: The Software will not contain any “phone-home,” metering, or other feature designed to periodically transmit usage, statistical or other data to Licensor. Licensee may prevent access to the internet with regard to any such features or functionality and doing so will not adversely impact operation of the Software.

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Warranties [cont.]

Offshoring of Data

Example: All Services shall be performed and rendered within the continental United States; and Vendor shall not transmit or make available any Customer Confidential Information, including Personal Data, to any entity or individual outside the continental United States.

Warranties [cont.]

Open Source and Third Party Software

Example: *Vendor represents and warrants that it shall not deliver to Customer any third party software, including open source software, **that would require Customer to accept and be bound by any third party terms and conditions**, except to the extent such terms and conditions are expressly identified in and attached to Exhibit A. Except as provided in Exhibit A, Customer hereby rejects all such third party terms and conditions.*

Warranties [cont.]

Pass-Through Warranties

Example: *Vendor shall assign and pass-through to Customer all representations, warranties, and indemnities provided to Vendor in its contracts with third party licensors and suppliers relating to the Software.*

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Warranties [cont.]

Known Performance Issues

Example: There is no existing pattern or repetition of customer complaints regarding the Software, including functionality or performance issues, and that Vendor's engineers have not currently identified any repeating adverse impact on the Software, including functionality or performance, for which the root cause is believed to be a flaw or defect in the Software.

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Warranties [cont.]

Authority

Example: *Vendor has the full power, capacity and authority to enter into and perform this Agreement and to make the grant of rights contained herein, including without limitation, the right to license any ancillary or third party programs licensed to Customer under this Agreement, and Vendor's performance of this Agreement does not violate or conflict with any agreement to which Vendor is a party; Vendor further represents that there is no pending or threatened litigation that would have a material adverse impact on its performance under this Agreement.*

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Warranties [cont.]

Changes in Functionality

Example: *Vendor shall not modify or change the Software to reflect a material diminution in the form, features or functionality of the Software from that existing as of the Effective Date, and, accordingly, Vendor shall not change the form, features or functionality of the Software in any material adverse manner from that originally licensed under this Agreement.*

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Warranties [cont.]

Documentation

Example: *The Documentation shall be complete and accurate so as to enable a reasonably skilled Customer user to effectively use all of its features and functions without assistance from Vendor and, on each date on which Vendor delivers it to Customer, the Documentation is Vendor's most current version thereof.*

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Warranties [cont.]

- Be mindful of broad disclaimers that could override specific warranties (“as-is”; no liability for errors; not interrupted or error-free)
- Search for any other qualifications or limitations on warranty obligations.

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Warranties [cont.]

- Beware of extensive customer warranties
- Use as leverage for greater vendor warranties
- Disclaim all other warranties of the customer
 - Where appropriate, disclaim representations, warranties, and **guarantees as to vendor revenue** (e.g., in processing or other transaction agreements)

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Drafting Indemnities

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Indemnities

- What is an indemnity? Think third party claims
- Compare warranties
- Common law right to seek indemnity
Why is a contractual indemnity so important?

Indemnities

- Interplay with limitation of liability
 - Exclude all
 - Selective exclusion
 - If cap, exclude attorney's fees and costs
- Danger of capping an indemnity obligation
 - Control of defense and settlement
 - Opt out

Indemnities

- What is the vendor's financial status?
- Is an indemnity even worthwhile?
- Guarantee from related entity
- Indemnity bond

Indemnities [cont.]

- Key terms:
 - hold harmless, defend, and indemnify;
 - all types of damages and costs, including attorney's fees and expert costs
 - Fines and sanctions
 - Beware "final" awards only
- Who is indemnified?
 - Licensee and directors, officers, employees, affiliates, agents, assigns, customers

Indemnities [cont.]

- What is indemnified?
 - Breach of confidentiality
 - Breach of warranty
 - Infringement of intellectual property rights
 - Injury to persons and damage to tangible and **intangible** property
 - Violation of law
 - Employment claims
 - Gross negligence and willful misconduct

Indemnities [cont.]

- In addition to indemnity for intellectual property infringement, also need remedy in the event of a claim:
 - Modify the services or software to be non-infringing, **while still conforming to all requirements of the Agreement, including those relating to functionality and performance;**
 - Obtain license permitting continued use; or
 - As a last resort, terminate and refund

Indemnities [cont.]

- Timing of remedy is key
 - Continued use could increase damages, including for willful infringement
 - May undermine enforceability of contractual indemnity
- What fees are refunded?
 - License, professional services, pre-paid support, one-time fees, etc. Compare transaction fees or recurring fees
 - Prorated over useful life of services/software/product

Indemnities [cont.]

- Carefully review all exclusions from the indemnification obligation:
 - Common: combinations with third party products not provided or authorized by vendor; modifications made to the customer's specifications; failure to implement an update (provided at not charge and vendor has provided notice implementation would avoid the infringement).
 - Beware: exclusions of third party software and other intellectual property embedded in the licensed software; new carve-outs for business method patents; other broad exclusions.

Indemnities [cont.]

- Look for geographic limitations
- Notice and cooperation – relieves obligation only to extent vendor prejudiced.
- Beware exclusions for admissions
 - Truthful responses to lawful discovery requests.

Indemnity: Vendor Example

Vendor warrants to Customer that the Services and Information as and when delivered by Vendor, will not infringe upon any United States copyright, trademark, or trade secret of any third party (collectively, an “Infringement”), unless such Services or Information are (i) provided or performed to meet any specific requirement and agreed by Vendor in writing provided by Customer, or (ii) altered, modified, or revised from the form originally provided by Vendor. Subject to the terms and conditions contained herein, Vendor will indemnify Customer from and against any costs, damages, and judgments finally awarded against Customer in any suit or action brought by any third party based on a breach of the foregoing warranty.

Indemnity: Suggested Revision

Knowledge-Based Non-Infringement Warranty: *Vendor represents and warrants that, to the best of its knowledge as of the Effective Date, Customer's authorized use of the Software and Services will not infringe the intellectual property rights of any third party.*

Indemnity: Suggested Revision

Intellectual Property Indemnity: *Licensor shall defend, indemnify, and hold harmless Customer and its officers, directors, employees, agents and Affiliates from and against any claim, action, liability, loss, damage, cost, or expense, including, without limitation, attorneys' fees, experts' fees and court costs, arising out of any claim by a third party that Customer's authorized use of the Software and/or Services infringes that third party's intellectual property rights. Customer shall: (i) give Licensor prompt written notice of such claim; and (ii) allow Licensor to control, and fully cooperate with Licensor (at Licensor's sole expense) in, the defense and all related negotiations. **Licensor shall not enter into any stipulated judgment or settlement that purports to bind Customer without Customer's express written authorization, which shall not be unreasonably withheld or delayed.***

Indemnity: Suggested Revision

Infringement Additional Remedy: *If the Software or Service becomes or is likely to become the subject of an infringement claim, then, in addition to defending the claim and paying any damages and attorneys' fees as required above, Licensor shall, at its option and in its sole discretion, either (a) immediately replace or modify the Software or Service, without loss of material functionality or performance, to make it non-infringing or (b) immediately procure for Customer the right to continue using the Software or Services pursuant to this Agreement. Any costs associated with implementing either of the above alternatives will be borne by Licensor. If Licensor fails to provide one of the foregoing remedies within forty-five (45) days of notice of the claim, this Agreement shall terminate and Licensor shall refund to Customer all sums paid by Customer hereunder, pro rated over five (5) years.*

Client Indemnities

- Beware overbroad, poorly defined indemnities running from the client.
- Pay particular concern to referenced URLs
- Who controls the defense?
- Is the indemnity based on fault?
- Does the language mirror the vendor's own obligations?

URL Indemnity: Mitigation

Various terms and conditions are referenced herein through URLs. In the event of a conflict between those terms and the body of this Agreement, the body of this Agreement shall govern. Certain of the terms include an indemnification from Customer to Vendor. In such cases, 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.



Pulling It All together

Summary

- Plan your approach. Think about all potential areas of concern and address them.
- Understand the interplay of trials/acceptance testing/warranties/support.
- Beware floating contract terms.
- Understand the deal.
- Ensure warranties and indemnities are drafted to reflect relative risk of the engagement.
- Avoid excessive and vague client warranties and indemnities.



Questions

Contact Information

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