Emerging Issues in Third Party Contract Negotiation

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Topics

1. Unilateral Changes to Contractual Terms
2. Use of Customer Data for Broad Purposes
3. Sole and Exclusive Remedies
4. Carve-outs to Limitations on Liability
5. Exceptions to Infringement Indemnities

Contract Negotiation

Contract Negotiation

"Just to get the negotiation off on the right foot,
I don't intend to concede anything."

Unilateral Changes to Contractual Terms

Example Language

"Vendor may modify this Agreement from time to time, and the modified version will replace the prior versions. Vendor will post the most current version of the Agreement on the website, and the changes are effective on the date Vendor posts the new Agreement."

"Vendor's data security program is subject to change at any time without notice."

Why does the Vendor want this language?

- It makes the Vendor's life easier.
- It allows the Vendor to quickly update the agreement in the event there are changes to law, regulations or the industry.
- The Vendor may be providing a one-to-many service (*e.g.*, a cloud-based application).

Why should the Customer be concerned?

- The Vendor can make any changes it wants, potentially without notice and without any remedy.
- The Customer's expectations regarding the services or data security can be undermined.
- It may be difficult to keep up with the Customer's obligations (*i.e.*, need to have a process to ensure the most current version of the agreement is reviewed for changes).

Proposed Revisions to Language

- Strike the language entirely, and require all changes to the agreement to be mutually agreed to by the parties in writing:

"No amendment, waiver or modification to the Agreement shall be valid or enforceable unless it is in writing and executed by both parties."

Proposed Revisions to Language

- Require notice of any changes and add a termination right:

"Vendor may modify this Agreement from time to time, and the modified version will replace the prior versions, ***provided that Vendor gives Customer prior written notice of such modifications at least 30 days before such modifications become effective. Customer may terminate this Agreement within 30 days of receipt of such notice in the event Customer objects to any such modifications****."*

Proposed Revisions to Language

- Exclude certain types of provisions from unilateral modifications:

> *"Vendor may modify this Agreement from time to time, and the modified version will replace the prior versions,* ***provided that no such modifications to any provisions herein regarding the parties' limitations of liability, indemnities, warranty obligations or other provisions that allocate risk between the parties shall be effective with respect to Customer****."*

Proposed Revisions to Language

- Establish a floor (*i.e.*, the terms will not get worse):

*"Vendor's data security program is subject to change at any time without notice, **provided that any change shall not materially diminish or degrade Vendor's data security obligations described herein as of the Effective Date**."*

Explaining the Proposed Revisions

- If the Vendor can modify the contract unilaterally, the contract may be ***illusory***:

"One of the commonest kind of promises too indefinite for legal enforcement is where the promisor ***retains an unlimited right to decide later the nature or extent of his performance****. This unlimited choice in effect destroys the promise and* ***makes it merely illusory****."*

1 Walter H. E. Jaeger, *Williston on Contracts* § 43, at 140 (3d ed. 1957) (emphasis added)

Explaining the Proposed Revisions

- The parties are spending time and money negotiating this agreement – it is in everyone's interest to ensure those provisions remain in place.
- At a minimum, the agreement should not get ***worse*** over time.

Use of Customer Data for Broad Purposes

Example Language

"Customer agrees that Vendor may analyze and store Customer Data after expiration or termination of this Agreement to provide the Services and for other business purposes."

"Vendor shall have the perpetual right to use and disclose Customer Data in its aggregate form for its business purposes (including for benchmarking and product marketing purposes)."

Why does the Vendor want this language?

- Data is ***valuable***!

Why should the Customer be concerned?

- Why should the Vendor be able to continue to make money off the Customer's data, ***even after the relationship ends***?

- Using Customer Data for purposes beyond providing the Services ***may*** increase the likelihood of an unauthorized disclosure of confidential information.

- Must understand (1) what data the Vendor will collect, and (2) how the Vendor plans to use the data.

Proposed Revisions to Language

- Limit use of Customer Data solely during the term:

*"**Solely during the Term,** Vendor shall have the ~~**perpetual**~~ right to use and disclose Customer Data in its aggregate form for its business purposes (including for benchmarking and product marketing purposes)."*

Proposed Revisions to Language

- Limit use of Customer Data to internal uses only:

"Vendor shall have the perpetual right to use ***~~and disclose~~*** *Customer Data in its aggregate form for its* ***internal*** *business purposes* ***only*** *(including for benchmarking and product marketing purposes)."*

Proposed Revisions to Language

- Ensure Customer Data is fully aggregated and anonymized:

"Vendor shall have the perpetual right to use and disclose ***aggregated and anonymized*** *Customer Data* ~~***in its aggregate form***~~ *for its business purposes (including for benchmarking and product marketing purposes);* ***provided that such aggregated and anonymized Customer Data does not (and cannot be reverse engineered to) disclose Customer, its Confidential Information, or any other information regarding an individual****."*

Explaining the Proposed Revisions

- Customer Data is owned by the Customer, not the Vendor, so it is not appropriate for the Vendor to have a perpetual right to use Customer Data for any purpose.

- Customer Data is Confidential Information, so this provision should not override or limit the Vendor's confidentiality obligations.

NOTE: For certain types of services, there may be no way around this kind of language.

Sole and Exclusive Remedies

Example Language

"This Section states the indemnifying party's sole liability to, and the indemnified party's exclusive remedy against, the other party for any third-party claim."

"Vendor warrants that during the Term the Services will perform materially in accordance with the documentation. As Customer's exclusive remedy and Vendor's sole liability for breach of the warranty set forth in this Section, Vendor shall…"

Why does the Vendor want this language?

- The Vendor wants to ***limit*** its liability any way it can.

- The Vendor wants to ensure that if it addresses an issue (*i.e.*, fixes any non-conformance in the Services that breached a warranty), the Customer does not ***also*** sue the Vendor for damages.

Why should the Customer be concerned?

- If the remedy is very limited, the Customer may not be made whole by the sole and exclusive remedy.

- There may be a breach of the agreement that ***also*** results in a breach of the warranty, ***or*** a third-party indemnity, ***or*** a failure to meet applicable SLAs.

Proposed Revisions to Language

- Delete it entirely!

"Vendor warrants that during the Term the Services will perform materially in accordance with the documentation. ***~~As Customer's exclusive remedy and Vendor's sole liability for~~ In the event of a*** *breach of the warranty set forth in this Section, Vendor shall…"*

Proposed Revisions to Language

- Clarify that this limitation does not apply to damages related to other breaches:

> *"This Section states the indemnifying party's sole liability to, and the indemnified party's exclusive remedy against, the other party for any third-party claim* ***described in this Section****.* ***For the avoidance of doubt, the preceding sentence limits the indemnifying party's liability and the indemnified party's remedies solely with respect to third-party claims for which there is an indemnification obligation under this Section and shall not be interpreted to limit liability or remedies under the Agreement with respect to a breach that has, as one of its consequences, such a third-party claim.****"*

Explaining the Proposed Revisions

- Even if the Vendor provides the stated remedy (*e.g.*, cures the warranty breach), the Customer may incur other damages in connection with such breach.

- The Customer should have the right to ***at least try*** to recover such damages from the Vendor, if the Customer decides it is worthwhile.

NOTE: Consider if "sole and exclusive" language in another Section could benefit the Customer.

Carve-outs to Limitations on Liability

Example Language

"The limitations of liability set forth in Section [X] shall not apply to: (a) Customer's payment obligations; (b) Customer's violation of Section [X] or Section [X]; or (c) Customer's violation of Vendor's intellectual property rights."

Why does the Vendor want this language?

- The Vendor wants to ***limit its liability*** to the fullest extent possible.

- The Vendor wants to ensure the Customer's liability is as broad as possible.

Why should the Customer be concerned?

- Certain breaches or liabilities related to the agreement could result in very extensive damages.

- Certain risks/liabilities should not fall on the Customer because the Customer is not able to mitigate these risks/liabilities.

Proposed Revisions to Language

- Delete any carve-outs that effectively ***uncap*** the Customer's liability:

"The limitations of liability set forth in Section [X] shall not apply to ~~***: (a)***~~ *Customer's payment obligations* ~~***; (b) Customer's violation of Section [X] or Section [X]; or (c) Customer's violation of Vendor's intellectual property rights***~~*."*

Proposed Revisions to Language

- Expand carve-outs to cover material liabilities and damages that the Vendor should bear:

"The limitations of liability set forth in Section [X] shall not apply to: (a) Customer's payment obligations; (b) Customer's violation of Section [X] or Section [X]; ~~***or***~~ *(c) Customer's violation of Vendor's intellectual property rights;* ***(d) Vendor's indemnification obligations and liabilities; (e) any damages arising from Vendor's breach of its confidentiality or information security obligations; (f) any damages arising from Vendor's violation of applicable laws, rules and regulations; and (g) Vendor's fraud, gross negligence or willful misconduct****."*

Explaining the Proposed Revisions

- The carve-outs to the limitations on liability should ***not*** result in the Customer having (essentially) fully uncapped liability.
- There are certain liabilities that should ***not*** fall on the Customer.
- There are certain liabilities that will most likely be deemed to be indirect/consequential damages.

Explaining the Proposed Revisions

- Indemnities:
  - ✓ These damages will likely be deemed to be ***indirect***.
  - ✓ The Customer is ***not*** able to mitigate the risk that the products and/or services provided by the Vendor infringe a third party's intellectual property rights.
  - ✓ The Vendor ***can be sued directly*** by the third party and, in such case, would have to take all of the liability arising from the claim.

Explaining the Proposed Revisions

- Breaches of Confidentiality and Information Security:
  - ✓ These damages will likely be deemed to be ***indirect***.
  - ✓ Damages related to information security breaches could be ***very*** significant.
  - ✓ These are typically the breaches that are most concerning to the Customer (although this may vary based on the subject matter of the agreement).

Explaining the Proposed Revisions

- Violations of Law:

  - ✓ The Customer has ***no*** ability to mitigate these damages, even where the Customer has oversight rights.

  - ✓ If the Customer operates in a regulated industry or if the Vendor is acting as the Customer's agent, a Vendor's violation of law could be very damaging.

Explaining the Proposed Revisions

- Fraud, Gross Negligence, Willful Misconduct:
  - ✓ The Customer fundamentally should not be liable for damages related to these types of actions by the Vendor.
  - ✓ Many jurisdictions do not permit parties to limit their liability for fraud, gross negligence and willful misconduct.

More Proposed Language

- It may be acceptable to include an enhanced cap for breaches of information security – *for example*:

"Notwithstanding anything to the contrary set forth herein, the Vendor's aggregate liability in connection with a breach of its information security obligations hereunder (including any indemnification obligation arising from such breach), shall not exceed..."

Exceptions to Infringement Indemnities

Example Language

*"Vendor will defend Customer from all claims, demands, suits, or proceedings brought against Customer by a third party alleging that the Services, or Customer's use thereof infringe, misappropriate or otherwise violate any intellectual property right of such third party (each, an "**Infringement Claim**"). The foregoing indemnification obligations do not apply if…the Infringement Claim arises from the use of the Services **in combination with any software, hardware, data or processes not provided by Vendor**."*

Why does the Vendor want this language?

- It gives the Vendor an excuse (or at least the option) not to defend a third-party infringement claim.
- Infringement claims are ***very*** expensive to defend ($2.3 to $4 million on average).

Why should the Customer be concerned?

- This exception “swallows the rule” – it makes the indemnity basically worthless.
- Again, infringement claims are ***very*** expensive to defend ($2.3 to $4 million on average).
- The Customer has very little practical ability to defend an infringement claim.

Proposed Revisions to Language

- Add an exception to the exception:

"The foregoing indemnification obligations do not apply if… the Infringement Claim arises from the use of the Services in combination with any software, hardware, data or processes not provided by Vendor ***(except for any such software, hardware, data or processes that are necessary to use, or reasonably anticipated to be used with, the Services)****."*

Proposed Revisions to Language

- Add specific examples:

*"The foregoing indemnification obligations do not apply if… the Infringement Claim arises from the use of the Services in combination with any software, hardware, data or processes not provided by Vendor**, except for any such software, hardware, data or processes necessary to use the Services (e.g., the Internet; general use computers, computing devices or servers; commercially available operating systems and browsers; or telecommunication networks)**."*

Proposed Revisions to Language

- Add “but for” language:

“The foregoing indemnification obligations do not apply if…the Infringement Claim arises from the use of the Services in combination with any software, hardware, data or processes not provided by Vendor, ***if the Services or use thereof would not infringe but for such combination****.”*

Explaining the Proposed Revisions

- The Customer will ***inevitably*** use the Vendor's products/services with third party products, software, services, *etc*. – for example:
  - ✓ the Internet;
  - ✓ a general use computer; or
  - ✓ an operating system.
- Without the exception, the Vendor has a good argument that it is ***not required to indemnify***.

Explaining the Proposed Revisions

- Courts construe indemnity provisions narrowly.

"When a claim is made that a duty to indemnify is imposed by an agreement, that agreement must be strictly construed so as not to read into it any obligations the parties never intended to assume."

Haynes v. Kleinewefers, 921 F.2d 453, 456 (2d Cir. 1990)

- The Vendor will argue the exception is not necessary or that it would require the Vendor to defend claims related to third party products/services.

Explaining the Proposed Revisions

- *American Family Life Assurance Co. v. Intervoice, Inc.*, 560 Fed. Appx. 931 (11th Cir. 2014).
  - ✓ Aflac used an IVR system provided by Intervoice in its customer call center.
  - ✓ Aflac was sued by an NPE alleging that the IVR system and other components of Aflac's call center (*e.g.*, its computers and corporate mainframe), when used together, infringed the NPE's patents.
  - ✓ Aflac tendered the claim to Intervoice for defense.

Explaining the Proposed Revisions

- *American Family Life Assurance Co. v. Intervoice, Inc.*
  - ✓ The contract between Aflac and Intervoice stated:

*"Intervoice shall have **no obligation** with respect to any such claim of infringement based upon Customer's modification of any System or Software **or their combination, operation or use with apparatus, data or computer programs not furnished by Intervoice**."*

  - ✓ Intervoice refused to defend the claim; the district court granted Intervoice's motion for summary judgment.

Explaining the Proposed Revisions

- *American Family Life Assurance Co. v. Intervoice, Inc.*
  - ✓ The Eleventh Circuit agreed with the district court that the infringement claims fell "***unambiguously***" into the exception and affirmed.
  - ✓ Both Aflac and Intervoice acknowledged that the NPE's claims arise only when the IVR system is combined with one or more components not provided by Intervoice.
  - ✓ The Eleventh Circuit noted that the IVR system is "***only one (albeit an important one) of the necessary elements of the claims***".

Questions?


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