PERKINSCOIE

COUNSEL TO GREAT COMPANIES

Reviewing and Drafting IT Agreements

March 10, 2015

Peter J. Kinsella
303/291-2328

The information provided in this presentation does not necessarily reflect the opinions of Perkins Coie LLP, its clients or even the author

There is a difference between IP rights and the item that is protected by the IP rights

Intellectual property rights = rights to sue to stop others from engaging in certain “infringing” activities

- The nature of each right to sue differs depending on the intellectual property right at issue (see next slide)
- Some types of licenses (particularly patent licenses) are simply a complex covenant not to sue, and nothing more

Everything else in a license agreement can generally be thought of as a transaction involving goods, information and/or services (albeit sometimes very complex)

Peter J. Kinsella 303-291-2300

Grant Clause

What precise rights are included in the license grant?

- Patents:
  - 35 U.S.C. §271(a): make, use, sell, offer for sale, and import.
- Copyrights:
  - 17 U.S.C. §106 - reproduce, prepare derivative works, distribute, perform, display and transmit
- Uniform Trade Act:
  - Access, Use & Disclose
- Trademarks are more fuzzy: "use"

Potential Solution: use language such as “otherwise practice”

Peter J. Kinsella 303-291-2300

Services Contract Format - 1

Goods/Software vs. Services Models

- Many current cloud service contracts have evolved from a software licensing/UCC model
  - UCC often imposes warranties on delivered software but not on a pure services contract
- Cloud computing contracts more closely resemble hosting or strategic outsourcing agreements
  - Knowledgeable customers will demand express warranties and remedies to cover services
- A software license grant clause may cause confusion

Peter J. Kinsella 303-291-2300

Services Contract Format - 2

- Compare:
  - Provider hereby grants customer a non-exclusive right to use the software [services]
    - License grant language may cause confusion in a services setting
  - Provider will use commercially reasonable efforts to provide access to the services set forth in Exhibit A.

Peter J. Kinsella 303-291-2300

Reservation of Rights

Typically used to reserve any right for the grantor that has not been expressly granted to the licensee;

- e.g., All rights not expressly granted by Licensor are hereby reserved, including but not limited to …

Also used when the grantor desires to reserve certain rights that would otherwise be granted to the licensee;

- may be needed to carve out prior licenses that have been granted; or
- e.g., the right to use technology in a particular field of use when granting an exclusive license (e.g., reservation of rights for research and development purposes)

Peter J. Kinsella 303-291-2300

Related Tangible Assets and Services

What "tangible" items and “services” need to be delivered under the agreement?

- Software
- Services
- Equipment
- Technical assistance, information and data
  - Designs, drawings, engineering information
- Production information
  - Assembly processes and packaging tools
- Testing information and tools
- Business and marketing information

Peter J. Kinsella 303-291-2300

Pricing

Fixed Price - Perpetual License / Subscription Price

Price Increases (notice & magnitude)

Benchmarking

MFN? Notice?

Cloud

- Many service providers will seek annual payment in advance (may need to address refund issues for certain breaches and termination issues)
- Pay for use - How is “use” determined?
- Actual use / number of users/ number of employees

Peter J. Kinsella 303-291-2300

Tax Payments in International Deals

Payments that cross country borders may be subject to local withholding taxes paid to the government in which the payment originates

- Withholding rates vary from 0% to 30% or more
  - Tax treaties reduce the rate
  - Rate may differ for royalties, services, dividends
- Licensor gets tax deduction equal to withheld amount

Peter J. Kinsella 303-291-2300

Software/Service Description

What is included in the description ?

- Specifications?
- Published materials? FAQs?
- Bug and technical reports?

Peter J. Kinsella 303-291-2300

Software/Service Evolution

What is the process for changing the software or service?

- Can the customer refuse or delay a change?
- How much notification needs to be given?
  - Different notice periods for routine vs. emergency changes?
- Will a test environment (service) or software be provided prior to implementing a change?
- How does pricing work?
- Are the number of changes in a given time (e.g., 6 month period) limited?

Peter J. Kinsella 303-291-2300

Intellectual Property License /Ownership

- Cloud Services – it is difficult for the vendor to convey IP ownership of any service feature, because all customers must use the same service
  - This is the tradeoff for obtaining the efficiency of using a cloud service model

- Software- customer ownership of improvements is at least possible, as the customer is able to use a personalized instance of the software

Peter J. Kinsella 303-291-2300

Restrictions -1

Restrictions are used to prohibit activities that could fall within the activities authorized by the grant clause or are otherwise authorized by law

Peter J. Kinsella 303-291-2300

Restrictions – 2

Common Software License Restrictions

- reverse engineering (Note EU issues)
- modifying, adapting, altering, creating derivative works
- merging software with other software
  - combining software with open source software
- sublicensing
- performing service bureau work
- removing, altering or obscuring notices

Peter J. Kinsella 303-291-2300

Restrictions – 3

Common Services Restrictions

- Can’t make the Service available to any third party
- Can’t circumvent any usage or access limits
- Can’t interfere with or disrupt the Service or attempt to gain unauthorized access to any systems or networks that connect thereto
- Can’t use the service for illegal purposes

Peter J. Kinsella 303-291-2300

Service Suspension

Vendor may attempt to retain the right to suspend services (without notice or consequence)

From a contract perspective, the customer will want to make sure that such right is only exercised in well-defined situations, preferably with advanced notice

- Vendor will try to reserve the right to immediately suspend service in egregious situations

Peter J. Kinsella 303-291-2300

Termination and Transition - 1

- Every contract will end at some time
  - It is important to plan for termination issues prior to contract execution
- Customer will want the contract to address
  - Transition assistance
    - Data migration
      - Format of data?
      - It may not be easy to copy or download the data
  - Continued provision of services until transition completed
- Vendor will want payment for post-termination services

Peter J. Kinsella 303-291-2300

Termination and Transition - 2

Beware of termination obligation that includes an agreement to agree

Example termination obligations

- Continue to provide services during the transition
- Assist with transition
  - Deliver data
  - Delivery ancillary information
- Securely destroy records

Peter J. Kinsella 303-291-2300

Service Levels

- How are service metrics defined?
  - Does entire service have to be unavailable, or only particular portions?
- How are service metrics reported?
  - Does the customer need to have access to vendor tools to understand or obtain metrics?
  - Does the customer need to complain to get the credit?
- Is there a process for strengthening service metrics over time?
- Are service credits the sole and exclusive remedy arising from a performance breach?

Peter J. Kinsella 303-291-2300

High Level Elements of an SLA

SLAs may have two different components:

- A Service Component – identifies the services that are going to be provided
- A Management Component – identifies the process for managing the delivery of the services or for changing the services

Peter J. Kinsella 303-291-2300

Common SLA Service Components

- Identifies the services that are provided
- May clarify the services that are not provided
- Identifies assumptions underlying service availability
- Establishes service standards (e.g., the timeframes in which services will be provided)
- Defines the responsibilities of both parties

Peter J. Kinsella 303-291-2300

Common SLA Management Components

- Establishes how service effectiveness will be tracked
- Identifies procedures for reporting service issues
- Identifies procedures for resolving service issues
- May identify procedures for revising services or service metrics

Peter J. Kinsella 303-291-2300

Disaster Recovery - 1

- Does the service provider:
  - have a business continuity plan?
  - provide redundant operations from different sites?
  - routinely test its back-up capability?
  - routinely attempt to restore data?
- It is important to consider the impact of bankruptcy on the ability to access data and the ownership of back-up media (next slide)

Peter J. Kinsella 303-291-2300

Disaster Recovery - 2

- What events cause the service provider to engage in data recovery operations?
- Does the contract contain data recovery goals?
- What are the consequences if the data is not recovered within the specified time frames?
- Who takes priority if multiple customers of the service provider are affected?
- How will a force majeure event impact contractual obligations? (next slide)

Peter J. Kinsella 303-291-2300

“Force Majeure” Events

- Parties can bargain for effects of “FME”
- Consider scope and wording (what is/is not considered FME)
- What form of relief is granted (excused from performance, suspension of performance, termination, etc.)?
- What are the disaster recovery obligations during an FME?
  - Are some customers contractually prioritized?

Peter J. Kinsella 303-291-2300

Escrow Issues

- Some types of contracts may be appropriate for escrow
  - May not be appropriate for services agreements
- Consider software licenses -- if Buyer significantly invests in Seller's technology, Buyer does not want to be without recourse in the event Seller fails to perform, goes bankrupt or discontinues business
- Escrow puts Seller's property at risk of exposure in the event of release; protects Buyers from dependency on unsupported technology
- Terms (e.g., release conditions, scope of use, etc.) can be negotiated

Peter J. Kinsella 303-291-2300

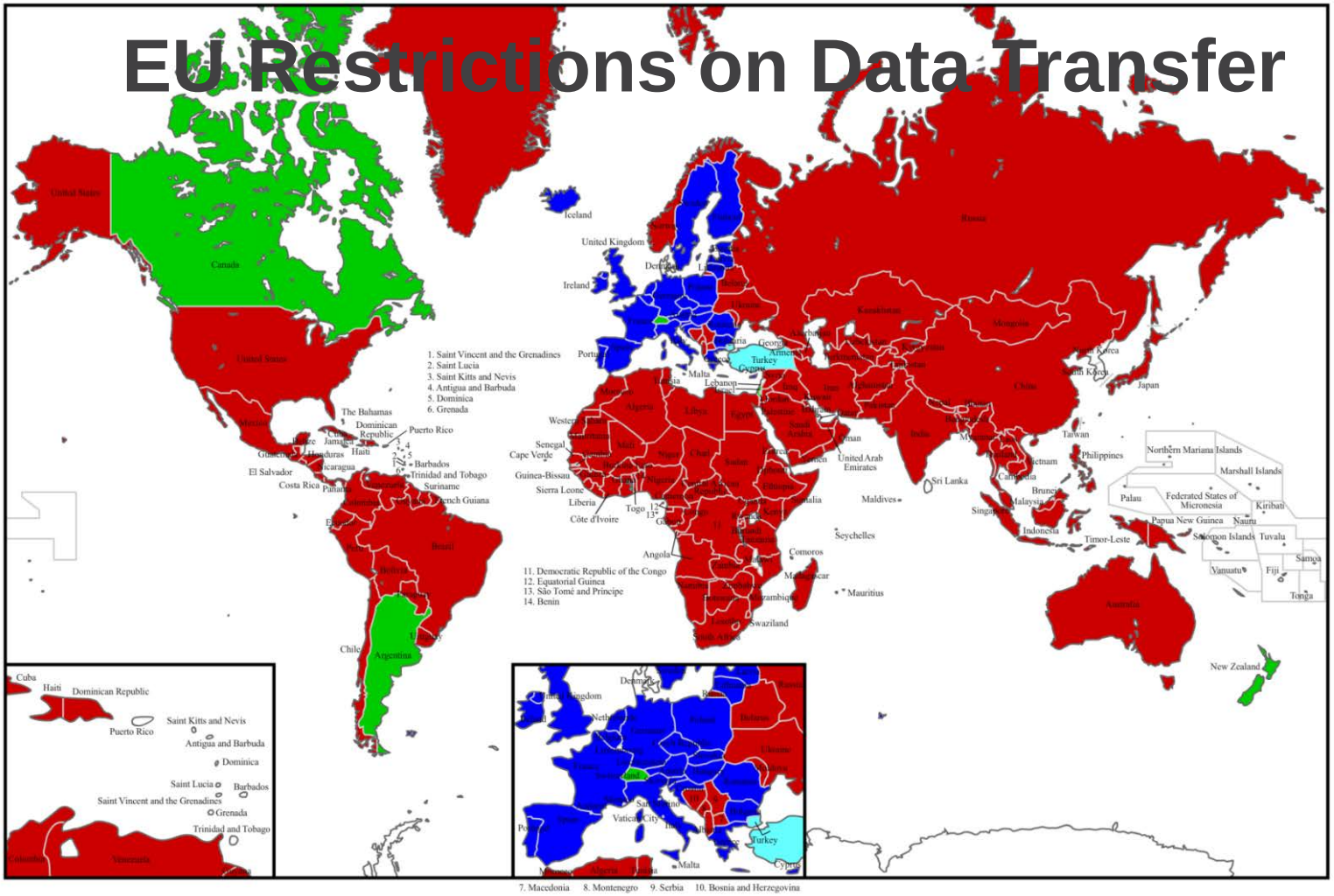
Privacy -1

Frequently implicated data protection laws:

- EAR/ITAR (prohibits "export" of information)
- Patriot Act and other laws (U.S. gov't can access data)
- Sarbanes-Oxley (controls over financial information)
- EU Data Protection Act (see next slides)
- Patchwork of Federal Laws, For example:
  - Gramm-Leach-Bliley (banking/insurance information)
  - HIPAA (employee or third party health information)
  - FERPA (information concerning students)
- Patchwork of evolving state laws

Peter J. Kinsella 303-291-2300

Privacy -2



Peter J. Kinsella 303-291-2300

PERKINSCOIE

EU Data Protection Laws - 1

EU Data Protection Laws Issues

- Rule: Data must not be transferred to countries outside the EU that do not offer an “adequate level of protection”
  - Currently only: Andora, Argentina, Canada, Faroe Islands, Guernsey, Isle of Man, Israel, Jersey, New Zealand, Switzerland, Uruguay.
- Exceptions:
  - ask permission from every “data subject” involved
  - for US - Dept. of Commerce “safe harbor” registration
  - EU model contract clauses
  - “Binding Corporate Rules”

Peter J. Kinsella 303-291-2300

EU Data Protection Laws - 2

- Legislation makes fundamental distinction between:
  - **data controller**: party that defines the purpose and the means of processing the data
  - **data processor**: the party performing the tasks
- Data controller is liable towards the “data subjects”
- Data controller is obligated to select appropriate data processors, and must obtain adequate contractual protection from them

Peter J. Kinsella 303-291-2300

EU Data Protection Laws - 3

EU law will apply when:

- A “controller” is located in its territory; or,
- When a “controller” outside the EU uses “equipment” within the EU territory

Applied to cloud computing:

- using an EU-based data center triggers legal compliance obligation
- Many authorities interpret “equipment” in an extremely broad way (e.g., browser cookies)

Peter J. Kinsella 303-291-2300

Common Data Issues

- Define "data"
  - Stored data?
  - Who owns usage metrics, aggregate de-identified data?
- Specify ownership rights in the data
- Specify purposes for which the data may be used
  - Is the service provider permitted to use the data (or aggregate data) for other purposes?

Peter J. Kinsella 303-291-2300

Privacy and Security Issues - 1

Subcontractors

- Are subcontractors used to provide the service?
  - Can the service provider impose contractual obligations on the subcontractors?
- Can vendor identify the subcontractors?
- Does the customer have a right to approve new subcontractors? (or a category of subcontractors?)
  - What is the approval/disapproval process?
  - Service providers are reluctant to provide approval right, but may provide a termination right

Peter J. Kinsella 303-291-2300

Privacy and Security Issues - 2

Data Location and Data Center Issues

- Data Segregation
  - Public vs. Private Cloud
  - Encryption?
    - Transmission? Rest?
    - Who has the keys?
  - Where and how is backed-up data stored?
- Does the system have software and other access controls to prevent unauthorized access?
- Is penetration testing routinely performed?

Peter J. Kinsella 303-291-2300

Privacy and Security Issues -3

Target Boosts Card Security After Data Breach

2 Text

By Richard Davies
@daviesnow

Apr 30, 2014 8:41am

Peter J. Kinsella 303-291-2300

Commonly Used Security Standards

- SSAE-16 requires management to provide a written assertion concerning the organization's systems, suitability and effectiveness
- ISO-27002 – comprehensive controls in areas such as access control, asset management, business continuity and how to handle security breaches.
- PCI DSS – credit card security
- HIPAA – security requirements for health information

Peter J. Kinsella 303-291-2300

Security Obligations – 1

- Are physical and logical security procedures required?
- Employee background screening?
- How is security verified?
  - Note that a customer audit may not be permitted under law or under other provider contracts
- Is a separate Data Protection Agreement needed?
  - Often used when handling EU data

Peter J. Kinsella 303.291.2300

Security Obligations – 2

- Data Protection Agreement - May cover a wide range of topics, such as:
  - Organizational measures, such as: security officer; security plan; staff functions
  - Technical measures, such as: authorization, identification, authentication, access controls, management of media
    - Note: may specify different measures based on sensitivity of data
  - Record Keeping

Peter J. Kinsella 303-291-2300

Security Events

- Agreements may distinguish between "Security Issues" and "Security Incidents" and provide different rights, obligations and remedies for each category.
  - Security Issues – issues that could give rise to a security breach
  - Security Incidents – actual breach of security

Peter J. Kinsella 303-291-2300

Security Issues

- How are security issues defined?
  - Objective vs. subjective definition
  - Are issues in the vendor's control and those in the control of its subcontractors differentiated?
  - Does every problem need to be investigated?
  - Does every problem need to be fixed?
- What is the process for fixing the issue?
  - Is there a specified time frame?
  - How is the time frame adjusted for fixes that take longer to implement?

Peter J. Kinsella 303-291-2300

Security Incident

- Notice requirement to other party
- Remediation efforts
  - Who does what?
  - Who pays for the remediation efforts?
  - Does the breach require end-user notification?
- Who has legal liability for the incident?
  - May want to address liability caused by third parties (e.g., hackers)

Peter J. Kinsella 303-291-2300

Confidentiality Clauses

- May impose a back door security obligation on the service provider
  - Is the service provider obligated to keep a customer's information "confidential"?
  - Some providers will state that they will employ "commercially reasonable efforts" to "protect" a customer's confidential information

Peter J. Kinsella 303-291-2300

Data Retention Issues – Cloud Services

- Customers tend to want two conflicting obligations
  - Vendor should keep the data as long as customer needs it
  - Vendor should promptly destroy it when it is no longer needed
- Depending on the service, vendor may not know the content of the data
- Contract should specify when data is destroyed

Peter J. Kinsella 303-291-2300

Compliance Requirements

- Customer may want the contract to contain procedures for auditing compliance issues:
  - Does the vendor data center facility allow visitors?
  - Will the audit disclose too much security information?
  - Will a customer's auditor have access to other customers' data?
- Customer may want to impose compliance obligations on the vendor

Peter J. Kinsella 303-291-2300

Risk Mitigation - 1

- From a customer perspective
  - Diligence
  - Audit pre- and post-contract execution
  - Contract risk allocation

Peter J. Kinsella 303-291-2300

Risk Mitigation - 2

- Typically, the customer wants to impose a combination of the following obligations on the service provider:
  - Operating procedures
  - Warranties
  - Indemnities
  - Insurance
- Typically, the vendor wants to minimize obligations (especially any obligation that slows its ability to make changes or causes "out of process" deviations) and impose other limitations on its liability

Peter J. Kinsella 303-291-2300

Risk Mitigation - 3

- Operating procedures
  - Back-up and recovery procedures
  - Compliance procedures
  - Audit procedures
    - Contract should contain procedures for addressing deficiencies discovered during audits

Peter J. Kinsella 303-291-2300

Risk Mitigation - 4

- Warranties/covenants
  - Obligations found in hosting and outsourcing agreements may not be included in cloud computing contracts due to the commoditized nature of the relationship
  - Customer will want to try to memorialize diligence results (including vendor procedures)
  - Vendors typically push to provide an indemnity rather than a warranty

Peter J. Kinsella 303-291-2300

Risk Mitigation - 5

Exemplary Types of Express Warranties/Covenants :

- Conformance with Specification/Documentation/Sales literature
  - Defects
- Security Measures
- Open Source Software
- Scalability
- Operating Performance (system response)
- Ownership/Non-Infringement (service and combinations)
- Data Conversion/Compatibility/Integrity
- Documentation
- Delivery Times/Methods
- Data Backup / Disaster Recovery
- Support and Response Times
- Lack of Viruses/Time Bombs/Disabling Code
- Qualifications of Employees

Peter J. Kinsella 303-291-2300

Risk Mitigation - 6

- Indemnities
  - Like warranties, vendors typically provide very limited, if any, indemnification obligations
  - Vendors will vigorously push back on typical liability caps (damage cap and consequential damages cap)

Peter J. Kinsella 303-291-2300

Risk Mitigation - 7

- IP Indemnity - Vendors will typically:
  - Defend and pay final awarded judgment
  - Want to exclude combinations created by the customer
    - Observation: The customer creates a combination in most cloud arrangements
    - Potential compromise: Vendor indemnifies for a combination, unless a reasonable non-infringing combination was available
  - Want to exclude certain customer data issues

Peter J. Kinsella 303-291-2300

Risk Mitigation - 8

- Software Escrows?
  - Typically, software escrows have little value in many cloud service arrangements, because the customer will not have the equipment/data center infrastructure to actually utilize the escrow
- Service Escrows: Situation may be different if service is an “app” running on commercial third party platform
- Data Escrows?
  - Data stored with a third party that can be accessed separately by customer

Peter J. Kinsella 303-291-2300

Risk Mitigation - 9

- Insurance
  - Contract may require a party to carry certain levels of insurance
  - CGL policy may not be enough to cover many cyber liability issues
  - Cyber liability policy may have lower limits for certain categories of damages (e.g., breach notification, credit reporting services)
  - Requires consultation with broker/agent

Peter J. Kinsella 303-291-2300

Limitation of Liability - 1

- Issues to consider:
  - Caps on the "type" of damages
    - Direct vs. Consequential vs. Incidental
  - Caps on the "amount" of damages
    - Different categories of damages may require different amounts
  - Exceptions to the one or both of the caps?
    - Indemnification
    - Security Breach

Peter J. Kinsella 303-291-2300

Thanks!

Peter J. Kinsella

pkinsella@perkinscoie.com

303-291-2300

PERKINSCOIE