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COUNSEL TO GREAT COMPANIES

Cloud Computing Legal Issues

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Agenda

- Implementing and Modifying Online Terms
- Commonly Negotiated Cloud Terms
 - Legal Limits on Cloud Contract Provisions

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Implementing and Modifying Online Terms

Online Contract Formation - 1

Clickwrap Agreements

- Terms and conditions are provided when a purchased item is installed or downloaded, or when a site is accessed or service is requested. Terms are usually presented with an “accept” button
- Courts routinely enforce click-wrap online contracts See, ***Vernon v. Qwest Communications Int'l, Inc.***, 925 F.Supp. 2d 1185, 1191 (D.Colo. 2013) (“click-wrap agreements are increasingly common and ‘have routinely been upheld’”); See Also, ***Hauenstein v. Softwrap Ltd.***, No. C07–0572MJP, 2007 WL 2404624 (W.D. Wash. 2007)

Generally, the more prominent the terms, the more likely a court will enforce such terms, so a scrolling text box would offer the strongest presentation rather than a hyperlink

Online Contract Formation - 2

Meyer v. Uber Technologies

The screenshot shows the Uber app's payment screen. At the top, there's a status bar with LTE, signal strength, and a battery icon at 6:00. Below that is a navigation bar with a back arrow, the Uber logo, and the word "Payment". To the right of the navigation bar is a "PROMO CODE" field. The main form area contains a "Credit Card Number" field with a camera icon and the word "SCAN" to its right. Below this are three fields for "MM", "YY", and "CVV". There's a dropdown menu for "U.S." with a flag icon and a "ZIP" field. A large grey button labeled "REGISTER" is positioned below these fields. Underneath the "REGISTER" button is the word "OR" flanked by horizontal lines. Below "OR" are two buttons: "PayPal" and "Google Wallet". At the bottom of the screen, there is a small text line: "By creating an Uber account, you agree to the [TERMS OF SERVICE & PRIVACY POLICY](#)".

By creating an Uber account, you agree to the
[TERMS OF SERVICE & PRIVACY POLICY](#)

Online Contract Formation - 3

Meyer v. Uber Technologies, Inc., No. 16-2750 **(2d Cir. 2017)**

“a reasonably prudent smartphone user knows that text that is highlighted in blue and underlined is hyperlinked to another webpage where additional information will be found”

“**As long as the hyperlinked text was itself reasonably conspicuous** -- and we conclude that it was -- a reasonably prudent smartphone user would have constructive notice of the terms. While it may be the case that many users will not bother reading the additional terms, that is the choice the user makes...”

Online Contract Formation - 4

Browsewrap Agreements

- Placement of a link to the terms of use on a webpage but requiring no affirmative action to manifest acceptance by a user.
- Assent to the terms is shown by using the website or service after notice of the existence of the terms of use, no other action is required.
- Courts often do not enforce browse-wrap online contracts, unless the website can demonstrate that the user had actual or constructive knowledge of the contract prior to being bound. *See, Southwest Airlines Co. V. BoardFirst, LLC* 2007 WL 4823761, at *5 (N.D. Tex. Sept.12, 2007).

Are Contracts that Allow Unilateral Modification Illusory? -1

Contract permitted Dow Jones to change the fees or add new fees at any time by giving advanced notice to the subscribers. The court refused to find the contract was illusory, finding that New York courts would impose an obligation of reasonableness on Dow Jones in exercising its discretion, and that Dow Jones had acted reasonably. ***Liebowitz v. Dow Jones & Co.***, 847 F. Supp. 2d 599 (S.D.N.Y. 2012)

Are Contracts that Allow Unilateral Modification Illusory? - 2

Facebook had an arrangement where customers who rented videos from Blockbuster would find their choices broadcast to that customer's Facebook friends. The plaintiff sued Blockbuster, claiming this practice violated the federal Video Privacy Protection Act. Blockbuster attempted to invoke an arbitration clause in its terms and conditions, which had been accepted by the customer. Blockbuster's terms and conditions also contained a clause where Blockbuster reserved the right to modify the terms and conditions at any time, with or without notice, upon posting the modifications on its website. The court found that the entire contract was "illusory" and refused to enforce the arbitration provision. ***Harris v. Blockbuster, Inc.***, 622 F. Supp. 2d 396 (N.D. Tex. 2009)

Modifying Online Terms

Traditional contract doctrine forbids the unilateral modification of contracts and treats a proposed modification as an offer that is not binding until accepted.

Traditional Contract Law has three requirements:

- 1) Offeree must have proper notice of the proposed modification.
- 2) Offeree must manifest assent (explicitly or implicitly).
- 3) Modification must be supported by consideration (or in UCC-2 must be entered into in good faith 2-209 cmt 2).

Modifying Online Terms - 2

Traditional Contract Notice Cases – Insufficient Notice

Offeree did not receive proper notice of new arbitration provision when the proposed change was printed on an insert in the monthly bill and nothing otherwise called the change to anyone's attention. ***Badie v. Bank of America***, 67 Cal. App. 4th 779 (Cal. Ct. App. 1998).

Providing a complete set of the proposed revised terms, without any indication as to which terms had been changed, was not sufficient notice. ***DIRECTV, Inc. v. Mattingly***, 829 A.2d 626 (Md. 2003)

Company was unable to enforce a notice of a contract modification that was printed on its invoice where the notice was the fifth item on the second page of the invoice, in ordinary type. ***Manasher v. NECC Telecom***, No. 06-10749, 2007 U.S. Dist. LEXIS 68795 (E.D. Mich. Sept. 18, 2007).

Modifying Online Terms - 3

Traditional Contract Notice Cases – Insufficient Notice via email

Employer attempted to modify an employment handbook by sending its employees a mass company-wide email message containing hyperlinks to the proposed changes (which included a binding arbitration clause). Court held that the modification was not effective, because the mass e-mail message did not communicate its importance and that employment changes were usually communicated in person by means of a signed writing.

Campbell v. General Dynamics, 407 F.3d 546 (1st Cir. 2005)

Modifying Online Terms - 4

Online Terms –Insufficient Notice

Attempted modification was ineffective when a phone service provider changed its online terms to add new service charges, a new arbitration clause, and a class action waiver without notifying its customers of the changes and simply posted the changes to its website. ***Douglas v. U.S. District Court***, 495 F.3d 1062 (9th Cir. 2007).

Company posted changes to online terms on its website but made no attempt to notify its customers of the changes. Court refused to impose a duty on website users to continually check for changes to online terms. ***Rodman v. Safeway, Inc.***, 2015 U.S. Dist. LEXIS 17523 (N.D. Cal. 2015)

Modifying Online Terms - 5

Traditional Contract Notice Cases – Sufficient Notice

Providing prominently announced modified terms in its monthly bill, with an Internet address and telephone number where the customer could access the revised terms, was found to have successfully put the customer on notice of the changed terms. ***Ozormoor v. T-Mobile USA, Inc.***, 2008 U.S. Dist. LEXIS 58725 (E.D. Mich. June 19, 2008).

Notice was enforceable where Sprint printed “Important Notice Regarding Your PCS Service From Sprint” in bold letters immediately below the amount due on the invoice. The notice also prominently discussed the changes in the contract terms and provided both a telephone number and a website where the revised terms could be found. ***Briceno v. Sprint Spectrum, L.P.***, 911 So. 2d 176 (Fla. Dist. Ct. App. 2005).

Modifying Online Terms - 6

Online Contract Notice Cases – Sufficient Notice

Google amending the forum selection clause for its AdWords service, and AdWords members were required to click their assent to the modification. The court found that the terms were reasonably communicated to and accepted by TradeComet. The opinion did not address the length of the terms or the ease (or lack of ease) of finding the modification. ***TradeComet, LLC v. Google, Inc.***, 693 F. Supp. 2d 370 (S.D.N.Y. 2010), *aff'd*, 435 Fed. App'x 31 (2d Cir. 2011)

Modifying Online Terms - 7

Online Contract Assent Cases – Sufficient Assent

Instagram unilaterally modified changes to its terms of use and announced such changes to its users a month in advance. The new terms stated that continued use of the website amounted to consent to the modifications and that users who did not accept the modifications must stop using Instagram. The court found that, by continuing to use Instagram, users agreed to the new terms, and that users could simply have stopped using Instagram if they did not want to be subject to them. The court pointed out that users could not possibly have had a reasonable expectation of perpetual use of Instagram's service under the original terms, which included an express modification right for Instagram. ***Rodriguez v Instagram***, CGC-13-532875 (San Francisco Sup. Ct. Feb 28, 2014).

Online Terms Best Practices

- Online terms should be implemented using clickwraps that give clear notice and require affirmative assent.
- Service providers should collect sufficient information (including identification of the specific version of the terms of service) to prove that users actually accepted the online terms.
- Providers should obtain express acceptance of any updated terms, if possible.
 - Otherwise, users should be provided with clear advance notice of any changes and a statement that continued use of the website following implementation of the updated terms constitutes acceptance of those terms.

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Commonly Negotiated SaaS and Cloud Terms

License vs. Services

- Compare:
 - Provider hereby grants customer a non-exclusive right to use the software/services.
 - Provider will provide Customer, in accordance with the Service Level Agreement, non-exclusive access to the Services.

Goods/Software vs. Services Models

- Software licenses are governed by the UCC while pure service agreements are not.
 - UCC imposes implied warranties on delivered software.
 - No such warranties in a pure services contract.
 - **Less decisions concerning Unconscionability and Failure of Essential Purpose in a pure service setting**
- Contract Acceptance - Mirror Image Rule Applies to Service Agreements
 - Requires that acceptance be on precisely the same terms as the offer.
 - UCC rejects common law “mirror image” rule, as valid contracts between merchants can be formed without all terms matching doesn’t apply.

Pricing/Payment

- Many service providers will seek payment in advance (may need to address refund issues for certain breaches and termination issues) or multi-year arrangement with monthly payments.
- Pay for use - How is “use” determined?
 - Actual use/number of users/number of employees
- Price Increases
- Benchmarking
- MFN

Services Description

What is included in the description ?

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

Common Rule of Thumb: A more detailed description of services is typically better than a description with less detail.

- It reduces arguments about whether a failure has occurred.

Service Evolution

What is the process for changing the Services?

- 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 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?

Example Change Notice Obligation

Vendor will provide at least thirty (30) days advanced notice to Customer (via e-mail to Enterprise Customer Administrator(s)) **of any material changes to the Service** (each, a “**Modification**”) and permit Customer **to test such Modification in its Sandbox** for such time. If Customer objects to Vendor in email or other written form to a Modification within thirty (30) days of the date it is first identified to Customer and Vendor nonetheless proceeds or already has proceeded with the applicable Modification, Customer will have the right to terminate this Agreement as set forth in...

Sandbox provisions

“**Sandbox**” means the non-Production testing and development environment and any ancillary environment(s) provided by Vendor to Customer for access to the Service;

“**Service**” means the provision by Vendor of an online, web-based service for access and usage by Customer via designated production and Sandbox services and associated offline components such as toolkits, programs, and other desktop utilities

Service Level Agreements

- Sets expectations between provider and customer
 - An SLA may provide an objective basis for determining whether the service is deficient.
- May establish remedies for service failures such as procedures and service credits

Common Topics Addressed in SLAs

- Scope of Services
- Hours of support (basic vs. extended hours)
- Error reporting mechanisms
- Resolution efforts and time frames
 - Escalation
 - Metrics
- Credits
- Reporting and Management

Common Customer Obligations when an Error has Occurred

- Validate and attempt to recreate the issue.
- Report the problem.
- Provide additional analysis and reasonably cooperate with provider to resolve the issue.

Service Metrics - 1

- 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 Provider 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?**

Service Metrics -2

- Multiple service metrics can be measured, not just service uptime. For example:
 - time between reporting a problem and acknowledging the report (response time)
 - incidents resolved in time (resolution time)
 - data bandwidth and latency issues
 - timeliness of reports
 - reporting and meetings

Example of “Downtime” Definition

- **“Downtime”** means any period, [greater than ten minutes], within the Scheduled Available Time during which the Customer is unable to access or use the Service because of an Error, excluding any such period that occurs during any Scheduled Downtime.
- **“Scheduled Downtime”** means: (i) ___ hours per [day][week][month] from _____ to _____ [Day/time zone], [and, (ii) the time period identified by Provider in which it intends to perform any planned upgrades and/or maintenance on the Service or related systems and any overrun beyond the planned completion time.]
 - Is notice needed prior to scheduled downtime?

Exemplary Definitions of “Error”

- More Provider Friendly: “**Error(s)**” means any failure of the Service that renders the entire Service unavailable.
- More Provider Friendly: “**Error(s)**” means the material failure of the Service to conform to the material specifications.
- More Customer Friendly: “**Error(s)**” means any event occurring within or caused by a component of the Service that causes or is likely to cause a disruption to the Service **or any part of the Customer’s operations (including services provided to Customers).**

Example – Error Exclusions

- Unauthorized modification of the Service –**by whom?**
- Third party hardware or software issues – **on what side of the demarcation?**
- Improper operation by customer
- **Services, circumstances, or events beyond the reasonable control of the Service Provider**
- **Any issue if a customer has outstanding past due amounts**

Resolution Times

Priority Level	Target resolution Time
Level 1 – Major	Within 48 hrs of acknowledgement
Level 2 – Significant	Within 5 Business Days of acknowledgement
Level 3 – Restricted	Within 20 Business Days of acknowledgement
Level 4 – No Impact	Will be determined by action plan

Consider whether the resolution times are aspirational goals or firm contractual commitments.

Sample Credit Calculations

Uptime Credit Mechanism (Availability Example)

Availability Percentage (during a Contracted Month)	Compensation (% of monthly subscription fee* for contracted month that is the subject of a claim)
98.0% - 99.2%	5%
97%-97.999%	7.50%
96%-96.999%	10.00%
95%-95.999%	12.50%
94%-94.999%	15.00%
93%-93.999%	17.50%
Less than 93%	20%

Sample Support Scorecard

Priority 1 (High)

Targeted Initial Response Time	within one (1) hour of the receipt of an Incident Report
Targeted Repair period	[X] hours from the time of Acknowledgment.

- Note use of the word “Targeted”
- Issue: Does a workaround constitute a valid repair?

Sample Credit Calculations - 2

Mechanism Involving Multiple Factors

Number of Key Performance Metrics (KPIs) breached in applicable reporting period	Service Credit percentage of the monthly Support Service Fee
Breach of one (1) KPI	4 %
Breach of two (2) KPI	8 %
Breach of three (3) KPI	16 %
Breach of four (4) KPI	32 %
Breach of five (5) KPI	64 %

Termination Right for failing to meet SLA

- What severity levels count towards termination?
(Severity 1, Severity 2?)
- How many issues need to occur in what period of time?
 - 2 in 6 months?
- Is there a right to terminate if issue lasts beyond a certain amount of time?
 - Severity 1 isn't resolved within 24 hours?
 - Severity 2 isn't resolved in 48 hours?

What is the process for reporting and fixing errors?

- How is a problem reported?
 - E-mail? Website? Telephone call?
- What information is submitted?
 - Description of incident?
 - Requested severity level?
- What is the process for determining that a problem has been fixed?
 - When the customer or provider says it is fixed?
- When does the clock start and stop?

Reporting Procedures

- What reports does the provider supply?
 - Usage Statistics?
 - Errors?
 - Downtime?
 - Resolution?
 - Root Cause Analysis?
- When are the reports supplied??

End User Conduct

- Contracts often allow the provider to suspend or terminate service for bad user conduct (and for other reasons).
- The customer will want to make sure that such right may only be exercised in well-defined situations, preferably with advanced notice. The customer will want to limit suspension:
 - To breaches that significantly threaten the security or integrity of the cloud service
 - To the user accounts in which the breach occurred, rather than all of customer's accounts

Exemplary Cloud User Restrictions

Customer will not: (i) use the Service in violation of applicable Laws; (ii) send or store infringing, obscene, threatening, or otherwise unlawful or tortious material, including material that violates privacy rights in connection with the Service; (iii) send or store Malicious Code in connection with the Service; (iv) damage, disable, overburden, impair, interfere with, or disrupt the Service; (v) attempt to gain unauthorized access to any systems or networks that connect thereto or otherwise interfere with the operation of the Service or in any way with the use or enjoyment of the Service by others; (vi) permit more users to access or use the Service than are permitted in the Order Form; (vii) allow more than one individual to use a user account; (viii) make the Service available to any third party (via a services arrangement, service bureau, lease, sale, resale, or otherwise); and, (ix) exceed any applicable bandwidth limit or storage capacity limit, if any.

Exemplary Cloud User Restrictions (edited)

Customer will: (i) not use the Service in violation of **Laws applicable to Customer**; (ii) **not knowingly** send or store infringing, obscene, threatening, or otherwise unlawful or tortious material, including material that violates privacy rights in connection with the Service; (iii) **use commercially reasonable efforts to prevent sending or store** Malicious Code in connection with the Service; ~~(iv) damage, disable, overburden, impair, interfere with or disrupt the Service~~; (v) **not knowingly** attempt to gain unauthorized access to any systems or networks that connect thereto ~~or otherwise interfere with the operation of the Service or in any way with the use or enjoyment of the Service by others~~; (vi) **not** permit more users to access or use the Service than are permitted in the Order Form; (vii) **not authorize** more than one individual to use a user account; (viii) not make the Service available to any third party (via a services arrangement, service bureau, lease, sale, resale, or otherwise), **except with respect to contractors and customers of Company**; and, (ix) **not knowingly**, exceed any applicable bandwidth limit or storage capacity limit, if any.

Common Data Issues

Define "data"

- Stored data, usage metrics, aggregate or 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?

Providers will typically want warranties from the customer concerning ability to have provider process customer information.

Data Ownership – Pro-Customer Vendor Restrictions

To the extent that any Personal Data is collected or accessed through the Services, Customer owns all right, title, and interest to all such Personal Data, and Vendor will: (a) not use or collect Personal Data for any purpose other than as necessary to perform Vendor's obligations under this Agreement; (b) treat Personal Data as Customer Confidential Information in accordance with the confidentiality provisions of this Agreement [**Note - Does confidentiality provision have separate PII Clause?**]; (c) not disclose Personal Data except as expressly permitted in this Agreement; and, (d) keep all Personal Data compartmentalized or otherwise logically distinct from, and in no way commingled with, other information of Vendor or its employees, suppliers, customers, or other third parties.

Sample Prohibition on Data Transfer

Vendor covenants during the Term of this Agreement that: (i) Customer Data will not be transferred or exported outside of the United States; (ii) Vendor will perform the Services hereunder using data centers solely located within the United States; (iii) any and all Services provided to Customer under this Agreement, including but not limited to technical support, will be provided from within the United States. **[address foreign nationals?]**

Sample Data Return and Destruction Clause

Upon the earlier of Customer's request or the expiration or termination of this Agreement, Vendor will provide Customer with all Customer Data contained in the Services or otherwise in the possession or control of Vendor in a format and media reasonably acceptable to Customer.

Question: When is data actually deleted?

Data Access – sample provision

Customer will have unrestricted access to, and has the right to review and retain, the entirety of Customer Data contained in the Services or otherwise held by Vendor, including all computer or other files containing Customer Data. At no time will any such files be stored or held in a form or manner not immediately (if retained online) or promptly (if retained in another medium) accessible. Vendor will provide to Customer all passwords, codes, comments, keys, and documentation necessary for such access and as necessary to utilize the Services. **Without limiting the generality of the foregoing, Vendor will comply with the Data Access Rider attached hereto as Exhibit D.**

Underlying Hosted Service/Co-Location Issues -1

Can the provider use an underlying hosted service or co-location center and still comply with its customer's SLA obligations?

- Consider:
 - Response times
 - Reporting obligations
 - Subcontracting and assignment provisions

Does the provider have sufficient recourse against the Data Center?

- Will the provider pay the customer more credits than it will receive? (not an atypical situation)

Underlying Hosted Service/Co-Location Issues -2

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.

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

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?

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)

Data Retention Issues

- Customers may 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.**

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.

Confidentiality Clauses

- May impose a back door security obligation on the service provider.
 - Is the service provider obligated to keep a customer's information protected from unauthorized access use or disclosure?
 - **Compare:**
 - Provider will not copy, disclose, or permit unauthorized access, use or disclosure of Confidential Information.
 - Provider will keep all Confidential Information confidential.
 - Provider will use commercially reasonable efforts to protect Confidential Information.

Subcontractors -1

- Are subcontractors used to provide the service?
 - Can the service provider impose contractual obligations on the subcontractors?
 - Are flow down obligations required under law (e.g., HIPAA, GDPR)?
- Can vendor identify the subcontractors?
- Does the customer have a right to approve new subcontractors? Or a termination right?
 - What is the approval/disapproval process?
 - Service providers are reluctant to provide approval right, but may provide a termination right.

Subcontractors -2

Vendor will not subcontract or otherwise delegate all or any portion of its obligations under this Agreement to any third party (“**Subcontractor**”) without Customer’s express written consent. Vendor will ensure each Subcontractors’ compliance with the terms of this Agreement and will be liable to Customer for any act or omission of a Subcontractor to the same extent Vendor would be liable had the Vendor committed such act or omission.

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?
- What events cause the service provider to engage in data recovery operations?

Disaster Recovery - 2

- 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?

Disaster Recovery Plans

Vendor will maintain during the Term, a Business Continuity Management Program that includes all aspects of Business Continuity Planning and Disaster Recovery Planning. The Business Continuity Management Program and the resulting Business Continuity Plan will cover all the Services to be performed under this Agreement. Vendor will provide Customer with the opportunity to review and evaluate the Business Continuity Management Program, including the Business Continuity Plan and will remediate any findings. Such review and evaluation may include participation in Customer's: (a) vendor testing and assessment process including the completion of online and/or on-site assessment(s), as appropriate; and, (b) recovery testing of a mutually agreed upon scope and frequency. Vendor will conduct at least annual internal information security audits of its Business Continuity Plan and certify the results of each such audit to Customer within ten (10) days of completing each such audit.

Disaster Response

In the event of a disaster or any other disruption event that prevents or impairs Vendor from performing the Services, **Vendor will notify Customer and immediately implement its Business Continuity Plan to restore and continue providing the Services to meet the Recovery Objectives.** Upon cessation of the disaster or disruption event, Vendor will, as soon as reasonably practicable, provide Customer with an incident report detailing the reason for the disaster or disruption and all actions taken by Vendor to resolve the disaster or disruption.

“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?

Sample Force Majeure Clause

Except as expressly set forth in Section [X], neither Party will be liable for, or be considered to be in breach of or default under this Agreement on account of, any delay or failure to perform as required by this Agreement as a result of any cause or condition beyond such party's reasonable control, provided that the Party affected by such delay is using reasonable commercial efforts to mitigate or eliminate the cause of such delay or its effects and, if events in the nature of the force majeure event were foreseeable, used commercially reasonable efforts prior to its occurrence to anticipate and avoid its occurrence or effect. In the event of any such occurrence, the affected Party will promptly notify the other in writing.

Escrow Issues -1

- U.S. Bankruptcy Law 365(n) provides protection to licensees.
 - If licensor goes bankrupt, licensee can continue using rights.
- Many foreign bankruptcy laws do not provide similar protection.
- Escrow Issue: U.S. Bankruptcy Law likely prohibits exercise of springing license grant.

Therefore need a “present license” to use escrow materials.

Escrow Issues -2

- Some types of contracts may be appropriate for escrow.
 - Escrow Agents are now providing escrows for cloud applications that run in a standard environment (e.g., “app” running on Amazon or Azure platform).
- Data Escrows - Data stored with a third party that can be accessed separately by customer.
- Terms (e.g., release conditions, scope of use, etc.) can be negotiated. See next slide

Sample Customer Favorable Escrow Release Conditions

- Provider materially breaches this Agreement.
- Provider becomes subject to bankruptcy proceeding or insolvency or enters into any arrangement with its creditors.
- Provider is subject to a change of control.
- Provider permanently ceases operation of its business.
- Others? Fails to add competitive functionality?

Provider will want attempt to limit these release conditions.

Subpoenas/E-Discovery

- Who bears the costs associated with subpoenas and e-discovery?
 - Many vendors will attempt to make the data available to the customer and let them figure out what data is relevant.
 - May need special procedures if the system produces metadata.
- Vendor may not be able to disclose all subpoenas (e.g., national security subpoenas).

Risk Allocation

- Typically, the customer wants to impose a combination of the following obligations on the provider:
 - Operating procedures (cloud)/obligations
 - Warranties/Covenants
 - Indemnities
 - Audit
 - Insurance
- Typically, the provider 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.

Operating Procedures

- Customer will want to try to memorialize diligence results (including vendor procedures).
- DPA obligations
- Back-up and recovery procedures
- Compliance procedures
- Audit procedures

Warranties / Covenants

- If a Provider provides warranties, they are often “soft”:
 - Compare: “Provider will have a security policy” vs. “provider will have and comply with its security policy”
 - Compare: “Provider will prevent unauthorized access” vs. “ Provider has reasonable security measures in place that are designed to prevent unauthorized access”

If a warranty or covenant is breached, it can lead to damage claims and contract termination.

Integration clause can defeat extrinsic warranties

- Without a proper integration clause, extrinsic affirmations can be made part of a sales agreement.
 - Example: “This Agreement, including all exhibits and addenda hereto and all Order Forms, constitutes the entire agreement between the parties with respect to the subject matter hereof.”

Integration clause may not prevent fraudulent inducement claims.

Indemnification - 1

- Indemnities
 - Providers will typically try to provide very limited, if any, indemnification obligations.
 - Indemnification obligations will usually not trigger contract termination unless an express termination provision is linked to the indemnity.

Providers may push to provide a capped indemnity obligation rather than a warranty to avoid termination issues for breach.

Indemnification - 2

- Traditional exemplary indemnity clause

Provider will **indemnify, defend and hold** Customer, its affiliates and their principals, agents and personnel **harmless** against **all** costs, fees, expenses, damages and liabilities (including attorneys' fees and other defense costs) suffered, incurred or awarded against Customer **as a result of any third party claim, suit or dispute** relating to or arising from:

Indemnification - 3

- Defend and Pay Awarded Damages

Provider will **defend** Customer against any third party claim, action, proceeding or suit, and **will pay** for the resulting costs and damages **finally awarded** against Customer to such third party **by a court of competent jurisdiction** or agreed to in settlement by Vendor, arising from:

Indemnification - 4

- IP Indemnity - Providers will typically:
 - Defend and pay finally awarded judgment
 - Want to exclude effects of combinations used by or activities of the customer
 - Observation: The customer creates a combination in most cloud arrangements.
 - Potential compromise: Provider indemnifies for a combination, unless a reasonable non-infringing combination was available.
 - Want to exclude certain customer data issues

Categories of Damages

Direct (basic measure of damages)

- Damages which a reasonable person would expect to naturally and necessarily result from a breach

Incidental damages

- Expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or breach

Consequential damages

- Damages that arise out of special circumstances, not ordinarily predictable

Lost Profits – Direct or Consequential? -1

Courts have held that “lost profits” can be either direct or consequential damages. Compare:

- ***Moore v. Boating Indus. Ass’ns***, 745 F.2d 698, 717 (7th Cir. 1985) (“Lost profits are considered to be general or direct damages in a breach of contract case”)
- ***Fishman Org., Inc. v. Frick Transfer, Inc.***, No. 11-cv-04598, 2013 WL 1655984, at *3 (E.D. Pa. Apr. 17, 2013) (“Lost profits are considered a form of consequential damages.”)
- ***SOLIDFX, LLC v. Jeppesen Sanderson, Inc.***, 841 F.3d 827, 839 (10th Cir. 2016) (noting that lost profits can be either direct or consequential, depending on their nature)

Lost Profits – Direct or Consequential? -2

Best practice from a provider perspective -
Disclaim lost profits in addition to consequential
damages.

IN NO EVENT WILL VENDOR BE LIABLE FOR
DAMAGES **FOR LOSS OF PROFIT OR REVENUE**,
LOSS OF GOODWILL, OR ANY SPECIAL,
INCIDENTAL, INDIRECT, PUNITIVE, OR
CONSEQUENTIAL DAMAGES...

Claims that commonly give rise to consequential damages

- IP Infringement
- Breach of Confidentiality
- Data Security Breach
- Claims that may impact reputation (product liability etc.)

Security Breach – Deemed Direct Damages

Exemplary Language

These following items will be classified as direct damages and will not be limited by section [X]: (a) conducting necessary and appropriate investigative and/or forensic activities to determine if your data was subject to unauthorized access, misappropriation, damage, or destruction; (b) your reasonable costs for breach notifications to individuals whose personal information was misappropriated that you are legally required to provide; (c) your reasonable costs for twenty four (24) months of credit monitoring for such individuals; and, (d) any fines or penalties that you must pay to government entities.

Damage exclusion clauses can backfire

Piper Jaffrey & Co. v. SunGard Systems International, Inc., No. 04-2922, 2007 U.S. Dist. LEXIS 11399 (D. Minn. Feb. 16, 2007).

- Consequential damage exclusion clause in software license limited the software owner's copyright infringement claims arising from the customer's unlicensed use of the software following termination of the license agreement.
- Court rejected the argument that the copyright infringement claim arose outside of the agreement and was therefore not limited by the consequential damage exclusion clause contained in the license agreement.
- Court held that since the software company was seeking indirect damages based upon the customer's unlicensed use of the software, such damage claims were barred by the agreement's prohibition on consequential damages.

Common Limitation of Liability Clauses 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.
- Caps on remedies
- Exceptions to one or both of the caps?
 - See preceding slide

Unconscionability -1

Courts consider several factors when determining whether a contract is unconscionable.

The specific factors and procedure varies widely, based on jurisdiction. *Compare, Lincoln General Ins. Co. v. Bailey*, 224 P.3d 336, 341 (Colo. App. 2009) (citing *Davis v. M.L.G. Corp.*, 712 P.2d 985, 991 (Colo.1986); *Delfingen U.S.-Tex., L.P. v. Valenzuela*, 407 S.W.3d 791, 797-98 (Tex.App. 2013); *Zuver v. Airtouch Communications, Inc.*, 153 Wn. 2d 293, 304 (2004); *NEC Techs., Inc. v. Nelson*, 478 S.E.2d 769, 771 (Ga. 1996)

Some jurisdictions will examine procedural and substantive unconscionability issues separately

Unconscionability - 2

Colorado factors (a mix of substantive and procedural factors):

- 1) the use of a standardized agreement executed by parties of unequal bargaining power;
- 2) the lack of an opportunity for the consumer to read or become familiar with the document before signing it;
- 3) the use of fine print in the portion of the contract containing the provision in question;
- 4) the absence of evidence that the provision was commercially reasonable or should reasonably have been anticipated;
- 5) the terms of the contract, including substantive fairness;
- 6) the relationship of the parties, including factors of assent, unfair surprise, and notice; and
- 7) the circumstances surrounding the formation of the contract, including setting, purpose, and effect

Lincoln General Ins. Co. v. Bailey, 224 P.3d 336, 341 (Colo. App. 2009) (citing *Davis v. M.L.G. Corp.*, 712 P.2d 985, 991 (Colo.1986)).

Unconscionability -3

Sanchez v. Valencia Holding Company, LLC, California Supreme Court August 3, 2015

The “.. unconscionability doctrine is concerned not with “a simple bad bargain,” but with terms that are “unreasonably favorable to the more powerful party.” These include “terms that impair the integrity of the bargaining process or otherwise contravene the public interest or public policy; terms (usually of an adhesion [sic] or boilerplate nature) that attempt to alter in an impermissible manner fundamental duties otherwise owed by the law, fine-print terms, or provisions that seek to negate the reasonable expectations of the non-drafting party, or unreasonably and unexpectedly harsh terms having to do with price or other central aspects of the transaction.”

Unconscionability -4

Two important CA caveats. *Sanchez v. Valencia Holding Company, LLC*

- Because commerce depends on the enforceability of written contracts, “[n]ot all one-sided contract provisions are unconscionable; hence the various intensifiers in our formulations: ‘overly harsh,’ ‘unduly oppressive,’ ‘unreasonably favorable.’”
- Unconscionability must be decided in context, with reference to the “‘commercial setting, purpose, and effect’ of the contract or contract provision.” Contracts properly may favor the stronger party when there is a “legitimate commercial need” for a “margin of safety.”

Unconscionability – 5

Example. *Lincoln General Ins. Co. v. Bailey*, 224 P.3d 336, 341 (Colo. Ct. App. 2009)

A standardized rental car agreement's liability exclusion was held not to be unconscionable despite the unequal bargaining power of the consumer, the fine print agreement, and the rental car employee's incorrect description of the insurance coverage, because the unconscionability factors were common in the rental car industry and met the reasonable expectations of the parties.

▪

Mandatory Arbitration -1

Federal Arbitration Act of 1925 preempts state laws that prohibit contracts from disallowing class-wide arbitration, ***AT&T Mobility v. Concepcion***, 563 U.S. 333 (2011).

- “The final phrase of §2 [of the FAA], however, permits arbitration agreements to be declared unenforceable “upon such grounds as exist at law or in equity for the revocation of any contract. This saving clause permits agreements to arbitrate to be invalidated by “generally applicable contract defenses, such as fraud, duress, or unconscionability,” but not by defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue.” citing ***Doctor’s Associates, Inc. v. Casarotto***, 517 U.S. 681, 687 (1996)

Mandatory Arbitration - 2

In paper contracts, courts generally require the arbitration clause to be conspicuous to charge a consumer with constructive knowledge of these terms ***Janda v. T-Mobile, USA, Inc.***, No. C 05-03729, 2006 WL 708936, at *5-6 (N.D. Cal. Mar. 17, 2006) (placing arbitration clause on page 49 of 60-page “Welcome Guide” is procedurally unconscionable)

“[A]ssent to a website’s terms and conditions is governed by whether the website provides ‘reasonable notice’ to the customer of the terms and conditions.” ***Fagerstrom v. Amazon.com, Inc.***, 141 F. Supp. 3d 1051, 1069 (S.D. Cal. 2015)

Arbitration clause contained in the terms of service for Uber’s smartphone app, were not sufficiently “conspicuous” for a user to know that he or she had agreed to be bound by them. ***Cullinane v. Uber Technologies, Inc.*** No. 16-2023 (1st Cir. 2018)

Mandatory Arbitration - 3

Best Practices in Pro-Provider Consumer Arbitration Clauses

- Provide conspicuous notice of arbitration provision.
- Expressly prohibit class action suits.
- Allow consumer to have a limited period of time to opt out.
- Online provider pays for costs of arbitration - except for an initial filing fee that is in approximately the same amount as an individual would be required to pay to commence court proceedings.
- Venue of the arbitration to either be by telephone or in the location where the consumer resides.
- Permitted small claims court actions exception as an alternative to arbitration, but only if pursued on an individual basis
- Do not expressly provide for awarding attorneys' fees to the prevailing party.

Exemplary Public Policy Violations -1

New Jersey's Truth-in-Consumer Contract, Warranty and Notice Act (N.J.S.A. § 56:12-14, *et seq.*)

- Prohibits sellers of products and services from including terms in any written consumer contract, warranty notice or sign that violate any “clearly established legal right” of a NJ consumer
- Prohibits sellers from presenting savings clause language (e.g., “void where prohibited”) without specifying which provisions are unenforceable in NJ – except in the context of warranties
- \$100 per violation or actual damages, plus attorneys’ fees and court costs

On April 16, 2018, the New Jersey Supreme Court answered the questions and ruled that a “consumer who receives a contract that includes language prohibited by [the Furniture Delivery Regulations], but who suffers no monetary or other harm as a result of that noncompliance, is not an ‘aggrieved consumer’ entitled to a remedy under the TCCWNA.

Plaintiffs have alleged that the following clauses violate consumer's established rights

- Disclaimers of punitive damages;
- Broad disclaimers of liability arising from ordinary negligence, gross negligence, fraud, and intentional, willful, malicious, or reckless misconduct;
- Consumer contracts stating that some terms or provisions are void, unenforceable, or inapplicable in some jurisdictions, without specifying which are inapplicable in New Jersey;
- Disclaimers of product liability claims;
- Disclaimers of remedies provided under the U.C.C.;
- Disclaimers of cybersecurity liability or for consumer data and privacy protection;
- Indemnification provisions that extend to instances of third-party misconduct;
- Indemnification provisions that require consumers to indemnify the seller's negligence or intentional, willful, malicious, and wanton misconduct;
- Disclaimers of attorneys' fees and costs for statutory claims;
- Indemnification provisions that shift attorneys' fees;
- Caps on damages;
- Contractual reductions of statute of limitations periods; and
- Choice of law provisions that specify non-New Jersey jurisdictions, unless they are clear and conspicuous.

Some Jurisdictions Require Limitations of Liability and Warranty Disclaimers to be negotiated

General disclaimers of negligence are disfavored and enforceable only if specifically agreed to in negotiations between a commercial seller and commercial buyer. ***United States Aviation Underwriters, Inc. v. Pilatus Bus. Aircraft, Ltd.***, 358 F. Supp. 2d 1021, 1024 (D. Colo. 2005) citing ***See Hiigel v. General Motors Corp.***, 544 P.2d 983, 989-90 (Colo. 1975)

In Washington, "[d]isclaimers of warranty are not favored in the law.... [A] disclaimer or waiver of warranty is ineffective unless (1) it is explicitly negotiated between the buyer and the seller, and (2) it sets forth with particularity the qualities and characteristics that are not being warranted." ***W. Rec. Vehicles, Inc. v. Swift Adhesives, Inc.***, 23 F.3d 1547, 1554 (9th Cir. 1994) (applying Washington law) (citations omitted).

How to address negotiation requirement?

- Make the LOL and disclaimers mutual, with appropriate carve outs...

EXCEPT WITH RESPECT TO CLAIMS OF INDEMNITY, BREACH OF CONFIDENTIALITY, BREACH OF DATA SECURITY OBLIGATIONS, OR THE UNAUTHORIZED USE OF A PARTY'S INTELLECTUAL PROPERTY RIGHTS,
IN NO EVENT SHALL EITHER PARTY BE...

- Add Basis of Bargain Language

Basis of Bargain. EACH PARTY RECOGNIZES AND AGREES THAT THE WARRANTY DISCLAIMERS AND LIABILITY AND REMEDY LIMITATIONS IN THIS AGREEMENT ARE MATERIAL, BARGAINED FOR BASES OF THIS AGREEMENT AND THAT THEY HAVE BEEN TAKEN INTO ACCOUNT AND REFLECTED IN DETERMINING THE CONSIDERATION TO BE GIVEN BY EACH PARTY UNDER THIS AGREEMENT AND IN THE DECISION BY EACH PARTY TO ENTER INTO THIS AGREEMENT.

- Take Phone Calls

Economic Loss Rule -1

The rule bars plaintiffs from recovering pure economic losses under a negligence theory without personal injury, property damage or a special relationship.

“[A] party suffering only economic loss from the breach of an express or implied contractual duty may not assert a tort claim for such a breach absent an independent duty of care under tort law.” ***Town of Alma v. AZCO Constr., Inc.***, 10 P.3d 1256, 1264 (Colo. 2000). See, ***Southern California Gas Co. v. Superior Court***, No. B283606, 2017 WL 6398546 (Cal. Ct. App. Dec. 15, 2017)

The rule “prevents recovery for negligence when the duty breached is a contractual duty and the harm incurred is the result of failure of the purpose of the contract.” ***Jardel Enterprises, Inc. v. Triconsultants, Inc.*** 770 P.2d 1301, 1303 (Colo. App. 1988).

Economic Loss Rule -2

Businesses that filed a class action against SoCalGas, asserting negligence based claims arising from a gas leak are barred from recovering negligence damages because they failed to allege any property damage or personal injury. Instead, they alleged that the gas leak and subsequent relocation of residents of the surrounding area caused purely economic injuries to their businesses. ***Southern California Gas Co. v. Superior Court***, No. B283606, 2017 WL 6398546 (Cal. Ct. App. Dec. 15, 2017)

Economic Loss Rule -3

In some jurisdictions, the economic loss rule does not apply where the defendant owes the plaintiff a duty of care that is independent of any contractual duty. ***Town of Alma***, 10 P.3d at 1263; ***Andrews v. Picard***, 199 P.3d 6, 10 (Colo.App. 2007). See ***Rhino Fund, LLLP v. Hutchins***, 215 P.3d 1186, 1191 (Colo. App. 2008) (economic loss doctrine was inapplicable to claims under the civil theft statutes, "because the agreements [did] not address remedies in the event the collateral [was] diverted" and because Hutchins also had independent duties in tort to avoid converting the collateral proceeds).

Failure of Essential Purpose -1

- Courts may not enforce limits on remedies if the only available remedy fails of its essential purpose.
- Doctrine is driven generally by concern that contracts should provide at least a fair quantum of remedy for breach of the contract.
- Many jurisdictions apply two-part test:
 - identify essential purpose of limited remedy.
 - identify whether or not limited remedy in fact failed to meet such essential purpose.

Failure of Essential Purpose - 2

Jurisdictions are mixed as to whether the Failure of Essential Purpose Doctrine (FEPD) applies to pure services agreement

Exemplary Cases declining to apply FEPD in a services context

- *Pichey v. Ameritech Interactive Media Services, Inc.*, 421 F. Supp. 2d 1038 (W.D. Mich. 2006)
- *Wells v. 10-X Manufacturing Company*, 609 F.2d 248 (6th Cir. 1979).
- *San Francisco Bay Area Rapid Transit v. GE Transportation Systems Global Signaling, LLC*, 2010 WL 2179769 (N.D. Cal. 2010).

Exemplary Cases applying the FEPD to a services agreement

- *Jacada (Europe), Ltd. v. International Marketing Strategies, Inc.*, 2004 WL 24267645 (W.D. Mich. 2003)
- *NetworkTwo Communications Group, Inc. v. Spring Valley Marketing Group and CommunityISP, Inc.*, 2003 WL 1119763 (E.D. Mich. 2003)
- *Adcock v. Ramtreat Metal Technology, Inc.*, 105 Wash. Ct. App. 1058 (2001).

Best Practices - Exclusionary Clauses

Generally speaking, in order to contractually limit damages the contractual language at issue must be: 1) clear, 2) unambiguous, 3) unmistakable and 4) conspicuous, in order to be enforceable.

A limitation of liability provision is at risk of not being enforced if it is: 1) contrary to public policy; 2) unconscionable; 3) results from unreasonable bargaining power; or 4) purports to relieve parties from their own willful, wanton, reckless, or intentional conduct.

Limitation of liability provisions are more likely to be enforced if it represents the parties' **bargained-for agreement** regarding allocation of risks

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.

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 agreement 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 early termination and for any post-termination services.

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

Sample Transition Services Obligation

If this Agreement expires or is terminated for any reason, then Customer may extend the Term of this Agreement for up to an additional twelve (12) months, at Customer's request and option, from the termination or expiration date ("**Transition Period**"). During any such Transition Period, Vendor will: (a) continue to provide the applicable Services; (b) provide the additional transition services reasonably requested by Customer; (c) coordinate communications to provide for an orderly transition of the Services to Customer or another service provider designated by Customer; and, (d) work with Customer promptly and in good faith to provide for an optimal and orderly transfer of such Services, including, but not limited to assistance in transferring services, equipment, licenses, all record layouts, data, data definitions and file structures (with definitions), data files in a format reasonably requested by Customer and any and all other information, resources and materials used to perform the Services to the extent necessary for a conversion from the Services to Customer or to any new service provider selected by Customer.

Thanks!

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