Representations, Warranties and Indemnities for Technology Agreements

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Introduction

This paper explores the nature and scope of representations, warranties and indemnities related to technology transactions. While all of the possible representations, warranties and indemnities cannot be covered, this paper examines the most common ones found in typical technology contracts, such as performance and quality related warranties for software and services, intellectual property ("IP"), open source software, subcontractors, legal compliance, data protection and security.

This paper will also discuss remedies for breach, which if not specifically provided for in the agreement, will be affected by the type of term being breached, i.e. different remedies depending upon whether the term is a representation, warranty, condition, covenant or some other type of term in the agreement.

This paper will also examine typical contractual remedies for breach of warranty, such as indemnities, termination rights and credits.

It is important to note that all of the provisions referred to herein are often subject to intense negotiation between the parties. There is no standard one-size-fits-all, and in most cases the wording will be customized to meet the specific deal requirements. Usually, the party that is most likely to be able to mitigate the relevant risk, will accede to giving an appropriate warranty or remedy.

Representations and Warranties

In addition to the usual representations and warranties given by parties to a contract, such as that each party has the authority, organization and power to enter into the agreement and that the agreement does not and will not conflict with any other agreement or obligation that a party may have, technology agreements require some additional representations and warranties to minimize the unique risks and liability exposure that arise in the provision of technology and related services.1

In conjunction with negotiating and drafting contractual representations and warranties, it is also important to ensure certainty of the contract by having the agreement contain a disclaimer of other representations, warranties and conditions that are not intended to form part of the contract, whether express or implied, including, but not limited to, implied warranties or conditions of merchantable quality and fitness for a particular purpose and those arising by statute or otherwise in law or from a course of dealing or usage of trade. A general disclaimer of "any other warranties, guarantees and representations" will not be sufficient to exclude the implied conditions of merchantable quality and fitness for purpose under provincial Sale of Goods legislation, unless expressly disclaimed.2

Where a party to the technology agreement is reluctant to give broad representations and warranties, it may be necessary to consider limiting the warranty, to the extent permissible. The following are some examples of qualifiers and limitations often sought by the party requested to give a representation or warranty:

a) To the best of the party’s knowledge (which would imply having done reasonable due diligence).

b) To the best of the party’s knowledge without having conducted searches.

c) Limited to a specified jurisdiction or territory.

1See also L. Abe, Internet and E-Commerce Agreements 2nd Ed, (Toronto: Butterworths Lexis Nexis, 2004), for a more detailed discussion of the different risks arising under each type of technology agreement and the types of representations, warranties, indemnities, limitations on liability and disclaimers commonly used to address those risks. A new edition of my book, with expanded content to deal with mobile and cloud computing, is expected to be available in 2011.

2Such disclaimers may be void in the consumer context pursuant to local consumer protection legislation. Also, care should be taken to ensure such disclaimers do not override, or conflict with, any contract terms. In addition, depending on the intention of the parties, it is prudent to specifically disclaim the provisions of the International Sale of Goods Act.
d) Restricted to specific subject matter, e.g. scope, unmodified, uncombined and current of technology or services.
e) Carve-outs for other party’s or third party’s material or if the technology or service was based on their requirements.
f) Limited to a specified duration or point in time.
g) Applicable only to registered, valid intellectual property.
h) Materiality thresholds and dollar limits (note that it is not uncommon to exclude breach of ownership warranties, non-infringement warranties and corresponding indemnities from caps on liability).
i) Other specified exceptions, as listed in schedules.

Supplier Warranties

When acting for the customer, it is recommended that the following warranties be considered to be sought from the supplier, to the extent they are relevant and help protect the customer from a risk that is better managed by the supplier:

(a) Performance and Quality Warranties

- That the technology and services will be provided in a good and professional manner in accordance with industry practices. The supplier may also agree to use reasonable efforts, commercially reasonable efforts, reasonable best efforts or best efforts to perform the services.

- In the case of a high-speed service or technology access, that the technology or service is of a certain speed, requiring clarification of demarcation points and a formula for how the speed is calculated.

- Service levels or key performance indicators (KPIs) with respect to availability/uptime, downtime, system response time, throughput, support response time, delivery time, percentage of services/deliveries completed on

3 In practice, suppliers will seek to have minimal warranties, narrow remedies and broad disclaimers. Customers will seek the opposite. It is important to note that warranties should be specific, objective, meaningful, relevant, verifiable and not redundant. Customers tend to demand warranties that are subjective (e.g., the product works to the customer’s satisfaction), irrelevant, redundant and difficult to verify. Suppliers, on the other hand, may provide warranties that are specific, objective and verifiable, but from the customer’s point of view, they may not be meaningful or even relevant to the customer’s needs. Therefore, prudent customers will spend significant time in conducting due diligence in respect of both the supplier and the product or service being acquired and may attempt to negotiate acceptance testing provisions or even test licenses. Also, in transactions involving products that are not off-the-shelf products, as in the case of custom development or system integration, there tends to be a greater opportunity to negotiate meaningful warranties, particularly if a competitive procurement process is involved.

4 It is important to note that some of these warranties apply to both technology products and services. In the context of services, the drafting should be clear as to whether they apply to the underlying components of the system that support the services or to the service itself, or both.

5 Such warranties may even provide that services will be best of class, top quartile or in accordance with highest industry standards. All of these are very generic in nature and difficult to define. Although there is some case law on some of these concepts, just how these concepts apply will, to a large degree, depend on the particular transaction or product, the circumstances of the transaction, the intention of the parties and industry custom. Specifically defining any of these concepts can often lead to greater uncertainty and the parties are usually more able to define the circumstances in which these attributes are not present rather than defining what they actually are.

6 Virtually any service can have a service level attached to it, although it is best to limit the number of service levels to a level that is manageable.

7 Response time in a product context refers to the time it takes a particular calculation or transaction to be completed. Response time may apply to turnaround over an entire system or over a specific application or system component. Response time in connection with services can mean the same thing – how long does it take to perform a transaction or request? It may also refer to call-back times and repair times. Response time will vary according to the complexity of a request or transaction, the volume of concurrent transactions and the presence of other applications on the system. Therefore, it is conventional to define the environment or conditions under which response time is to be measured. In addition, much time is spent defining the components in respect of which response time is to be measured and the exact size and characteristics of a test transaction to be performed. For example, response time may or may not include network time. It is important not only to define how response time is to be measured but also to be satisfied that it can actually be measured in the manner agreed. If response time is being measured as
time, correction time, percentage of calls answered, percentage of calls or transactions handled, user language/interface, amount of error free operation (e.g., error rates), and mean time between failure. These may be set forth in separate service level agreements or specifications documentation, and tied to the master technology agreement and available remedies for breach. Consideration should also be given as to when these types of warranties take effect. The warranties may be different depending upon the point in time, for example, during transition periods, testing periods, disaster recovery periods, partial or full production periods.

- Detailed warranties as to programming and timing for downloadability and viewability, e.g., by the current common web browsers.
- In the case of dedicated services, that the service and/or technology being used to provide the service (or storage), as the case may be, is not shared with other customers.
- Location of the services and any data storage. No cross-border transfer.
- In the case of data storage, the amount of storage space or capacity available for the customer.
- That the technology or service meets the functional and technical specifications, standards or other performance criteria as outlined in the agreement. Sometimes these details would be set out in extraneous documents, such as a supplier’s published on-line documentation or a third party manufacturer’s specifications. It is important for the customer to be kept informed of and review any and all documents that are being cross-referenced in the agreement and to ensure that the terms in such documents remain fixed throughout the term of the agreement (or at minimum throughout the term of use of the applicable technology or service). Otherwise, there is a risk that the supplier may be able to unilaterally change the terms of the agreement.

Screen response, for example, it can make a significant difference as to whether the response is deemed to have been received when the first character of the response reaches the user’s monitor or the last character. This has become more and more of an issue with respect to web-based services.

Given the inherent complexities of software programming and IT operability, it is unrealistic to expect a supplier to warrant its product or service as free from errors or defects. An exception may apply to hardware, which could be free from (material) defects in materials and manufacture. However, most technology contracts contain disclaimers as to error-free operation. The problem with such a blanket disclaimer is that customers do require some minimum assurance as to performance. Fundamental breach aside, the contract could be of little value to a customer and pose business and operational risk if a supplier is excused for a critical breach simply by pointing to an “error”. Therefore, it is common to see a carve-out for such broad disclaimers which states that “except as provided in this agreement” there are no warranties with respect to error-free operation. This type of carve-out allows the parties to carefully consider and negotiate the types of functional and operational provisions that are necessary and which would be expressly included as either warranties, covenants or conditions in the agreement. For software which is generally inexpensive and involves a single-user license, there are likely to be few, if any, representations and warranties except, perhaps, a warranty to the effect that the physical media upon which the software is recorded will be free from defects.

During software testing (e.g., Beta test licenses), supplier’s generally disclaim all representations, warranties and conditions. This is because the test versions of the product have not been fully debugged and are often being made available for the purpose of identifying errors and possible defects. In this regard, agreement may contain an obligation on the part of the customer to identify errors and defects that it encounters and may provide that the test product not be used in live production.

Suppliers of technology and services will often warrant that a product or service will conform in all material respects. However, from a customer’s point of view, the materiality threshold can be too high-level or superficial or may not deal with specific features, functions or requirements that are relevant to the customer. If certain quality or performance requirements are important to a customer, they should be clearly enunciated in the warranty.

In many transactions, for example in cloud computing or off-the-shelf products, the technology is marketed by the supplier as a standardized product without interaction with a customer about the customer’s requirements or its intended use. It is unlikely that these customers will be able to insert additional requirements or specifications on which to base the supplier’s warranty. For business-critical software or services that are developed specifically for, or exclusively supplied to one customer, such interaction is more likely to occur. In such case, the customer may be able to specify its own functional specifications or a specification may be created based on a gap analysis performed in connection with the supplier’s existing product or service.
• That the technology or service is interoperable and compatible with other products and services.\textsuperscript{13}

• With respect to hardware products, that there are no defects in materials and manufacture, that they conform to specifications, including capacity, power requirements, speed and high-level features. Manufacturers also may agree to warrant that the hardware is new and unused, or that it is in good working condition and is eligible for maintenance by the manufacturer.

• That the technology or service has the required ability to handle a certain volume (e.g. of transactions or users), also referred to as capacity, without encountering degradation (e.g. in function or response time).\textsuperscript{14}

• That the technology or service is designed such that it has the ability to handle higher volumes or expansion (e.g. of transactions or users), whether anticipated or unanticipated, also referred to as scalability.\textsuperscript{15}

• That performance of the services under the agreement will be done in a competent manner by qualified personnel; may want to specify level of training and tie into “key personnel” provisions of the agreement.

• That the supplier is highly skilled and has the experience needed to develop and provide the customized software, work product or service described in the agreement. This warranty may be accompanied by an acknowledgement that the customer is relying upon the skill and expertise of supplier for the performance of the services under the agreement.

• In service transactions, in particular, software development and system integration, that the underlying methodology and standards are adhered to in connection with the service.\textsuperscript{16}

• That the supplier will, without additional charge to the customer, use reasonable commercial efforts to make such corrections, additions, modifications, or adjustments to the technology and related documentation as may be necessary to ensure the technology operates in accordance with the applicable specifications. This type of performance warranty may be limited in duration, e.g. for 90 days (i.e. a warranty period) from the date of acceptance of the technology by the customer. It is important to ensure the specifications are clearly drafted and that any exclusions to the warranty (e.g. for customer’s misuse of the technology) are considered.

• That the technology will conform to, and perform in accordance with, the applicable specifications and that the documentation accurately describes the operation, maintenance, performance and functionality of the technology. This type of performance warranty may be limited in duration, e.g. for 90 days (i.e. a warranty period) from the date of acceptance of the technology by the customer. It is important to ensure the specifications are clearly drafted.

• That the technology, when delivered to the customer, is the most current version that the supplier makes available to its customers. This will help customer maintain competitiveness in the marketplace and is often tied to quality improvement covenants in the agreement.

\textsuperscript{13} In the past, this has been a serious problem as developers and manufacturers tended to create proprietary or closed systems or architectures. More recently, developers and manufacturers have realized the importance of open systems and architectures and are embracing industry standards, particularly for commodity-type products. However, interoperability is still an issue relative to custom development, particularly where the product being developed is required to communicate with or serve as a bridge between a customer’s legacy systems. Similarly, interoperability is one of the more important warranties in connection with a system integration project where the supplier is engaged to combine the hardware and software products of several third parties.

\textsuperscript{14} Capacity is more of a static concept whereas scalability is dynamic.

\textsuperscript{15} Sometimes just adding more servers or processing power is not enough. A system must be designed to handle fluctuations, e.g. through standard parameter changes or cloud computing.

\textsuperscript{16} Examples of standards include ITIL (IT Infrastructure Library), IEEE-SA (Institute of Electrical and Electronics Standards Association), ISO (including ISO standards for security), MOF (Microsoft Operations Framework), W3C (World Wide Web Consortium), CMMI (Capability Maturity Model Integration) and Six Sigma.
With respect to “flow through” warranties of third party suppliers that the supplier has disclaimed, a warranty from the supplier that the third party warranty does in fact flow through, and that the supplier takes responsibility for obtaining warranty coverage should something go wrong. If the supplier refuses to do this, the customer will need to satisfy itself that the warranty rights that are purported to flow through are enforceable against the upstream supplier. This may occur through the assignment or partial assignment of the contract by the supplier to the customer. Alternatively, the supplier may purport to acquire the product as agent on behalf of the customer, which would ultimately mean that, once ratified, the contract would be between the customer and the upstream supplier.

(b) Security and Data Protection Warranties

- That the security or firewall technology is of a certain standard.
- That the technology or service contains no disabling mechanisms, i.e. features that would impair in any way its operation in the manner for which it was designed including but not limited to time bombs (where “time-bombs” are defined as a routine, code or instruction that is designed to disable, delete, repossess, modify, damage, erase or otherwise cause the technology or service to not perform in accordance with the documentation or agreed upon specifications), access restrictions, deactivating code, locks or drop dead devices; or if it does, that such mechanisms are disclosed to the customer and/or that the customer is provided with appropriate keys, passwords or escrow to enable the customer to continue to use the services or technology without disruption to the customer’s business operations.
- That the technology or service is free from viruses, or that the supplier has applied requisite virus detection processes prior to delivery. The agreement may also contain a detailed covenant requiring the supplier, prior to delivery of any technology, to run it through the same anti-virus program used with respect to all of its other technology product releases, as well as use of the most recent anti-virus programs that are commercially available. An obligation to use commercially reasonable efforts to remedy any viruses that may be detected could also be included. The term “virus” should be defined to include, but not be limited to, components that are commonly referred to as “viruses”, “time bombs”, “Trojan Horses”, “worms” or “drop dead devices”.
- That the technology does not contain any unidentified content, scripts, programs or metatags.
- That the technology does not include any back-doors, where “back-doors” are defined as routines, codes or instructions that are designed or operable to permit unauthorized access to the technology.

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17 Should the supplier purport to “flow through” a warranty to the customer, the customer should verify that the warranty does, in fact, flow through.

18 As a general rule, in order to enforce the terms and conditions of a contract with an upstream supplier, there must be privity of contract. It is surprising how many transactions purport to confer contractual rights and impose contractual obligations on entities that are not parties to a contract. The Canadian position should be contrasted with the United States, where it easier to provide enforceable flow through protection without privity of contract due to the third party beneficiary legislation which has been adopted in most states.

19 It is customary in technology transactions for software and services to include a warranty dealing with viruses and disabling devices. These fall into two categories – designed devices and malicious devices. It is reasonable for a customer to demand a warranty to the effect that the supplier has not inserted any time locks or disabling devices. Often, however, these are designed into the product, and although a supplier may be willing to disclose that they exist, it may be unwilling or unable to economically remove them. In the context of custom development, the customer is more likely to achieve a satisfactory result.

20 Malicious viruses, worms, trojan horses and similar devices are created by third parties for the purposes of destroying or corrupting data, disabling systems, denying services or taking control of a system represent more of a challenge. Technically speaking, vendors are unable to guarantee that the products are invulnerable to virus attacks or even that communications and data received from the vendor from time to time will be 100% free from viruses. It is conventional for the parties in technology transactions to agree to apply up-to-date industry standard virus detection and prevention tools rather than providing an absolute guarantee against viruses.

21 As a result of focus by the market on security and internal controls due to the advent of Sarbanes-Oxley Act, it is essential that the customer also receive assurances that the software does not contain any back doors or other devices that could be used to circumvent or permit unauthorized or undetected access.
That the supplier has in place a written and comprehensive set of information security policy documents, which act as the rules and guidelines for dealing with the Confidential Information of the customer and its affiliates, and includes appropriate administrative, technical and physical safeguards to: (a) ensure the safety and confidentiality of Confidential Information of the customer and its affiliates, including when supplier’s business continuity and disaster recovery plans are required to be implemented, (b) protect against any unanticipated threats or hazards to the security or integrity of Confidential Information of the customer and its affiliates, (c) protect against unauthorized access to or use of Confidential Information and will only provide Confidential Information of the customer and its affiliates to those with prudent access levels or have been need to have a “need to know” as referred to in this agreement, (d) properly dispose of Confidential Information of the customer and its affiliates (printed or stored) so that the Confidential Information is not able to be used maliciously or fraudulently against the customer, its affiliates or their respective employees or customers.

That the supplier shall promptly provide customer with notice and information regarding any failure of security measures, any security breaches or any security incidents related to Confidential Information of customer or its affiliates that may materially affect customer, its affiliates or their respective employees or customers. Details as to where all incidents should be reported with a written notice should be set out in the agreement (e.g. in the provisions dealing with notices).

That the supplier engages in planning, providing and executing periodic, regular audits of supplier’s physical, logical and information security controls commensurate with the services being provided under the agreement and promptly provides customer with written advice of the audit results.

As at the Effective Date, supplier’s existing information security processes and procedures, along with supporting standards and operating directives at a minimum, comply with information security requirements as set out in the agreement.

Continuously for the term of the agreement (and during any transition period) supplier will comply, at a minimum, with the information security requirements and such further additional security requirements as may be set out in the agreement.

Continuously for the term of the agreement (and during any transition period) supplier shall protect all Confidential Information of customer and its affiliates, while in the possession of supplier, in accordance with the information security requirements as set out in the agreement.

Supplier shall make available to customer, or at the request of customer, to any Government Entity and to persons authorized by or acting on behalf of customer, including its independent public accountants, its internal practices, books and records relating to use, processing, disclosure, copying, modification, disposal and destruction of Confidential Information of customer and its affiliates. In addition, customer is entitled, on not less than twenty-four (24) hours prior written notice to supplier and subject to supplier’s reasonable security requirements, to attend at one or more facilities of supplier at which the services are being provided to inspect Confidential Information of customer and its affiliates, and supplier’s compliance with the information security requirements as set out in the agreement. Customer may be requested to provide supplier with a written confirmation of the names of customer’s representatives who will conduct the audit.

Where services are being provided to customer in the United States, a Government Entity having jurisdiction over customer and subject to supplier’s reasonable security requirements, is entitled to attend at one or more facilities of supplier at which the services are being provided to verify supplier’s compliance with Government Entity legal and regulatory security requirements.

Annually during the term of this agreement, upon customer’s written request, supplier shall provide written confirmation from a senior officer of supplier, confirming that supplier continues to comply with the information security requirements set out in the agreement, if applicable; provided that supplier expressly acknowledges and agrees that this written confirmation in no way diminishes any audit requirements or other remedies available to customer in the event of supplier’s breach.
(c) Intellectual Property Warranties

Before drafting intellectual property warranties, ensure that the intellectual property rights are properly defined and identified. The following are some examples of IP warranties:

- That the supplier has the right to provide the technology or service, including any third party intellectual property, confidential information or trade secrets.
- That the supplier owns or has authority (without further consent of any third party) to grant to the customer the rights of use of the software and related documentation that it grants to the customer under this agreement.
- That the technology or service does not contain any third party intellectual property, confidential information or trade secrets, unless disclosed in writing to the customer in advance.
- Where software, patented inventions or other intellectual property is also being licensed as part of the technology agreement, warranties as to title, right to license or provide access (as the case may be).
- That the technology or services do not violate or infringe the rights of any third party in any applicable jurisdiction (i.e. where the customer will be using or accessing the technology or service, or where the customer is at risk of being sued for infringement), including any copyright, trade-mark, patent, trade secret, privacy, publicity, confidentiality or other proprietary right. However, suppliers will be relatively reluctant to give representations or warranties for any third-party items which were not created by the supplier (such as software or content supplied by the customer); which the supplier does not own; or over which the supplier has no control or has not received similar representations or warranties from its sub_contractors or licensors. As well, patent non-infringement warranties are difficult to obtain, given the risk of patent litigation. As a more reasonable alternative, one could seek a limited indemnity for third party patent infringement claims.22
- That the supplier is, and will continue to be, validly licensed to distribute any and all third party software that may be bundled with the software for the uses contemplated by the agreement; or that supplier will either: (a) provide, at no cost or expense to the customer, a replacement product that is materially equivalent in all respects (including functional terms) to such third party software; or (b) obtain a valid license for such third party software.
- If applicable, that the deliverables are original works of the supplier, or warranties as to who the developers were, their nationality and location. This is particularly important if any of the technology will be exported.
- If the supplier is assigning ownership in the technology to the customer, that the supplier has the right to make the assignment and has obtained assignments and waivers of moral rights from its employees and subcontractors, in favour of the customer, its licensees and subsequent successors and assigns.
- If the technology being delivered by the supplier contains any customized software or work product to be owned by the customer, that all rights, title and interest in and to the customized software or the work product (excluding any open source software components disclosed to and approved by customer in accordance with the provisions of the agreement), including literary and artistic rights pursuant to the Canadian Copyright Act (as amended and re enacted from time to time): (a) upon its creation, shall vest in the customer; and (b) remain the sole property of the customer. This provision may more appropriately be drafted as a covenant, with an obligation on the supplier to execute the required document to effect a proper transfer of ownership.

(d) Open Source Software

- That the technology does not contain any open source software or technology licensed under a public license; or if it does, the following warranties could be substituted.23
- That open source software and licenses are fully disclosed to the customer, usually in an attached schedule.

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22 See discussion on Indemnities in Section C below.

23 Many open source software licenses disclaim all representations and warranties. It is interesting to note that many open source software licenses do not disclaim implied “conditions” which may raise questions under Canadian law nor do they disclaim the provisions of the United Nations Convention on Contracts for the International Sale of Goods.
• That the customer's prior written consent for the supplier to use the particular open source software is obtained.

• That use by the customer of the technology or service will not adversely impact the customer's proprietary technology (e.g. loss of ownership rights due to viral nature of certain open source software license requirements).

• That the use of any open source software provided with, or embedded in, the technology or services by the supplier shall not create, or purport to create, obligations on the customer to grant license or usage rights with respect to any source code or object code belonging to the customer outside of this agreement.

• That any open source software used in the technology or service will not subject the customer to all or part of the license obligations relating to any open source software.

• Where open source software has been identified in a schedule and is a component of, or embedded within, the technology or services, that the supplier has the right to license, sub-license, distribute and support the open source software and any new releases.

• Where the technology being delivered includes open source software, a warranty that the scope of the license(s) for the identified open source software is no less than the scope of the license for the technology being delivered to the customer, in which the open source software (or any components thereof) have been incorporated.

• Where the technology being delivered includes open source software, a warranty that there are no additional or more onerous restrictions of the license(s) for the open source software than the restrictions of the license for the technology in which the open source software (or any components thereof) have been incorporated.

(e) Domain Names

• In the event of a domain name transfer, that the transferor has the authority and right to enter into the agreement, perform its obligations, and in particular, to transfer any and all title and ownership of the domain name (including trade-marks) to the transferee.

• That the domain name is free and clear of all encumbrances.

• That the domain name has not been assigned or licensed previously.

• That the domain name holder or transferor is the sole registrant of the domain name and sole owner of any trade-mark rights in it.

• That all domain name registration and renewal fees have been kept up to date and paid in full.

(f) Compliance Warranties

• That the technology service does not violate and will be performed in accordance with the applicable laws, statutes and regulations of the specified jurisdictions, such as privacy laws.

• That the services will be performed in accordance with the requirements of the agreement and any specified schedules. A supplier may be reluctant to enter into this warranty, as the obligation to perform should already exist if the contractual covenants have been properly drafted. However, sometimes the requirements documents are not drafted as clear obligations on the supplier and therefore a separate warranty may be needed.

• That the supplier is in compliance with any regulatory requirements that impact the customer. For example, OSFI B-10 outsourcing guidelines, or anti-money laundering rules and regulations.

(g) Subcontractors

• That supplier shall not delegate, assign or otherwise arrange for the provision of all or part of the services to be performed by an agent, contractor, supplier or vendor of supplier without the prior written consent of customer. Customer is entitled to withhold its consent. In the event that customer consents to such agent, contractor, supplier or vendor becoming a subcontractor of supplier, supplier’s written agreement with such subcontractor shall include provisions that: (a) ensure that such subcontractor have in place the technological, physical and
organization security safeguards to protect Confidential Information of customer and its affiliates against anticipated threats or hazards, loss, theft, unauthorized access, disclosure, copying, use, modification, disposal and destruction, (b) ensure customer and its affiliates Personal Information while in the possession of the subcontractor shall be protected in accordance with, and as required by, the information security requirements set out in this agreement, and (c) allow supplier, or at the customer's request, a Government Entity having jurisdiction over customer or its affiliates, to review subcontractor's internal practices, books and records relating to use, processing, disclosure, copying, modification, disposal and destruction of Confidential Information of customer and its affiliates, and to attend on not less than twenty-four (24) hours prior written notice, at one or more locations of the subcontractor at which the services are being provided to inspect Confidential Information of customer and its affiliates and subcontractor's compliance with the information security requirements set out in this agreement; provided that supplier expressly acknowledges and agrees that its obligations under this section do not relieve or otherwise diminish supplier's confidentiality, liability and indemnification obligations under this agreement in the event a subcontractor breaches the terms of supplier's agreement with the subcontractor as contemplated by this section.

- That customer shall have the right to revoke its prior approval of a subcontractor and direct supplier to replace such subcontractor: (a) if the subcontractor's performance is materially deficient; (b) if doubts exist concerning the subcontractor's ability to render future performance because of changes in the subcontractor's ownership, management, financial condition, or otherwise; (c) there have been material misrepresentations by or concerning the subcontractor; or (d) a subcontractor which at the time approved is a majority owner or affiliate of supplier and ceases to be an affiliate.

- That supplier shall remain responsible for obligations, services and functions performed by subcontractors to the same extent as if such obligations, services and functions were performed by supplier employees and for purposes of this agreement, such work shall be deemed work performed by supplier. For the avoidance of doubt, supplier expressly acknowledges and agrees that its obligations under this section do not relieve or otherwise diminish supplier's confidentiality, liability and indemnification obligations under this agreement in the event a subcontractor breaches the terms of supplier's agreement with the subcontractor as contemplated by this section.

- That supplier shall be customer's sole point of contact regarding the services, including with respect to payment.

Customer Warranties

When acting for the technology supplier, it is recommended that the following warranties be considered to be sought from the customer, to the extent they are relevant and help protect the supplier from a risk that is better managed by the customer:

- To the extent that the customer is providing the supplier with any technology, software, hardware, data, website, content or other materials, that the customer has the right to license or provide access to the same (as the case may be) and that such provision or materials do not violate any applicable laws.

- That any customer materials provided to or accessible by the supplier do not violate or infringe the rights of any third party in any applicable jurisdiction (i.e. where the supplier will be using or accessing the customer materials, or where the supplier is at risk of being sued for infringement), including any copyright, trade-mark, patent, trade secret, privacy, publicity, confidentiality or other proprietary right. However, customers will be relatively reluctant to give representations or warranties for any third-party items which were not created by the customer (such as third-party hardware, software or content); which the customer does not own; or over which the customer has no control or has not received similar representations or warranties from the customer's developers, suppliers or licensors.

- If the customer is an individual, that he or she is the end user of the technology or service and has reached the age of majority.

- That any customer provided content does not include any material that is illegal, harmful, pornographic, abusive, hateful, obscene, threatening, racist, discriminatory or defamatory or that encourages illegal activities.
• For technology licenses that are restricted by the scope of the licensee’s enterprise, jurisdiction or territory of its business operations, warranties about the licensee in respect of same.

• With respect to sole or exclusive licenses, that the licensee meets certain threshold requirements or benchmarks against which the sole or exclusive commitments will be evaluated. For example that the licensee has a minimum level of experience, knowledge, skills, pre-existing technology, number of established customers, distribution channels, market penetration, profits, etc. However, a licensee may be reluctant to give such representation or warranty if failure to meet the requirements could render it in breach, as opposed to merely terminating the exclusivity or sole aspect of the license.

• That the customer has and maintains certain technology, or uses the supplier technology or services in certain restricted environments.24

**Indemnities**

Indemnities are one type of contractual remedy. They raise many complex issues and require careful thought in light of the particular circumstances of each case. There is no standard indemnity that suits all purposes.

1. The first issue to consider in negotiating any indemnity, is who the indemnity applies to. Should it apply only to the contracting parties, or should it also extend to the relevant party’s directors, officers, agents, subcontractors and affiliates as well? One may argue that an indemnity for persons or entities who are not party to the contract, in particular customers, end users, successors or assigns, is too broad in scope and exposes the indemnifying party to unforeseeable risk. It would be reasonable to expect an indemnity to apply only to the contracting parties, their employees and agents and possibly the beneficiaries of any licenses or other rights under the agreement. Different indemnities may apply to different parties, depending upon the circumstances and which party is in the best position to insure against the risk. If the financial ability or viability of an indemnifying party is of concern, it may be worthwhile to seek a guarantee from a related company or an indemnity bond.

2. The second issue that needs to be considered when negotiating an indemnity is the scope of the payment. Some of the amounts to consider include:
   • Claims, demands or suits, that have not yet been proven, settled or decided?
   • Only damages that are awarded by a court of competent jurisdiction?
   • Damages that may be awarded by an arbitrator or that are agreed upon pursuant to a mediation settlement?
   • Only final damages, where appeal has been exhausted?
   • Only damages related to third party claims?
   • Losses and damages suffered (internally) by the indemnitee or its related parties, which may or may not include indirect damages, such as loss of profits, failure to realize expected savings, etc.?
   • Expenses and costs, including legal fees, investigation costs, costs of settlement?
   • Fines or penalties imposed under statute or self-regulatory body?

3. The third issue to consider when negotiating an indemnity is the subject matter, i.e. what is the indemnity for and how far will it extend.
   a) If either party is supplying or allowing access by the other party to assets, such as software, hardware, documentation, databases, servers, telecommunications systems or other materials (for the purposes of this section 3, the ‘supplying party’), then the agreement should provide for an indemnity by the supplying party to protect the other party (for the purposes of this section, the ‘receiving party’) from any liability arising out of the

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24 This is particularly important if customer’s non-compliance with supplier requirements could render the supplier in breach of its obligations to a third party, or infringement of a third party’s IP rights. For less serious customer dependencies, the agreement would provide for these as a condition of supplier’s performance of its obligations.
receiving party’s authorized use of such assets in accordance with the agreement. The indemnities generally given are indemnities for damages resulting from intellectual property infringement or trade secret misappropriation claims. However, a supplying party will be relatively reluctant to indemnify the receiving party:

(i) if the claim is related to or caused by the receiving party having violated its obligations or licenses under the agreement or breached its representations or warranties under the agreement;
(ii) for any items which were not created by the supplying party (e.g., which were supplied to the supplying party by third parties or supplied or modified by the receiving party); or
(iii) for any items which the supplying party does not own, or over which the supplying party has no control.

However, a supplying party may be prepared to give indemnities for such items if it can obtain corresponding indemnities from the supplying party’s developers, suppliers or licensors.

b) The receiving party will generally seek an indemnity from the supplying party that the materials received or accessed do not infringe any intellectual property right of any third party, in jurisdictions where the receiving party will use or access such materials, or where the receiving party may otherwise be subject to a claim or judgment. However, it is reasonable for the parties to agree upon limitations upon the scope of the indemnity for example, by having it apply only in territories where the supplying party has conducted intellectual property ownership searches and registrations, or where it would be reasonable to expect the supplying party to do so. Furthermore, since patent and trade-mark applications are generally not publicly available until the patent or trade-mark has been issued, it might be reasonable to limit the indemnity only to valid patents or trade-marks that have been issued as of the effective date of the agreement. 25

c) To the extent that the customer is in a better position than the Supplier to maintain control over its access passwords, the Supplier may want to seek an indemnity from the customer for any damages or claims arising from statements or other content transmitted, posted, received or created through the customer’s technology access, even if transmitted, posted, received or created by someone else (especially intellectual property infringement claims). However, if the Supplier’s obligations include the requirement to maintain adequate security measures to prevent unauthorized access to the services, the customer may not want to agree to such indemnity.

4. The fourth issue to consider when negotiating an indemnity is how the indemnity is triggered and what other options each party has.

a) For example, an indemnifying party would generally want:

(i) to receive adequate notice of a claim for which it is obliged to indemnify;
(ii) the ability to conduct and control any settlement or defence of any related lawsuit; and
(iii) assistance from the indemnified party in investigating the allegations and conducting the defence.

b) An indemnity for a claim of infringement of a third party’s rights could also include the ability on the indemnifying party to:

(i) modify the infringing material so that it becomes non-infringing;
(ii) replace the infringing material (with consideration given to the criteria for such replacement, e.g., such that it materially has the same functionality); or
(iii) obtain from the third party claiming infringement the right to use the infringing material (provided that such rights can be obtained on terms satisfactory to the indemnifying party).

c) The indemnifying party would argue that the foregoing remedies should be at its option, since it would be in the best position to determine the feasibility of the same. However, an indemnified party may want the option

25 See additional discussion on ‘Limitations on Liability and Disclaimers’, L. Abe, supra, note 1.
to decide which remedy should be sought, particularly where none of them are impossible and a choice could have different commercial implications on the indemnified party’s business.

d) As well, the indemnifying party would generally ask that in the event of an alleged infringement, it should have the ability to:

- request that the indemnified party and all users cease using, remove, return or destroy the infringing material, at least until the infringement allegation is dismissed; or
- terminate the license for the infringing material and possibly the entire agreement.

This is very important to the indemnifying party since the indemnified party’s or other users’ continued use of the infringing material would continue to expose the indemnifying party to liability.

e) From the indemnified party’s perspective, it would likely want to negotiate some kind of payment as liquidated damages in exchange for:

- losing the future benefit of the material that it was using;
- any pre-paid fees; and
- any early termination.

f) One should also consider whether the options, referred to above, are intended to be the sole and exclusive remedies of the indemnified party or whether the indemnified party can also:

- obtain the benefit of the additional indemnities afforded to it under the agreement;
- exercise other rights or remedies under the agreement, at law or in equity; or
- sue the indemnifying party for damages, subject to any limitations agreed to between the parties.

**Remedies for Breach**

**Legal Remedies Not Specified in the Agreement**

Not all terms of a contract are of equal weight and importance. They have different characteristics and different effects in law, depending upon their particular nature and the way in which the law has developed with respect to each. Classical legal analysis distinguished between two types of terms: conditions and warranties. Historically, “warranty” referred to any sort of promise or “guarantee”\(^\text{26}\), while “condition” referred to requirements that had to be satisfied in order to produce a binding contract. However, as a result of the development of the law relating to sale of goods, and the codification of that law in the common-law provinces of Canada, the expressions “warranty” and “condition” acquired somewhat special meanings in the law of contract. Eventhough originally those meanings applied only in relation to the contract of sale of goods, eventually those meanings spilled over into other contractual contexts. The distinction became one of the effects of a breach. It did not matter what the parties called the term in question; what mattered were its real consequences.\(^\text{27}\)

The remedies available for breach of a warranty will depend upon whether the breach is really of a true warranty, or a condition, or something else. In many cases, contracts are drafted with terms referred to as “warranties”, but this label is not determinative of the way in which the courts interpret their true legal effect. The actual determination of the correct character of the contractual term under consideration by a court in any given instance may not always be simple and straightforward. It will be the quality of the term in issue, that is, its potential legal effects, that will be examined.


Remedies for breach of Condition
A “condition” is a term of a contract that is of fundamental importance or which goes to the root of the contract. Breach of a condition entitles the innocent party to treat the contract at an end and to pursue whatever remedies thereupon become available. It is possible that something that is warranted in a contract may, in fact, be sufficiently important for it to be treated as a condition thereby giving rise to a right of repudiation or termination. In contrast, the intentions of the parties as determined by examining the contract as a whole, as well as the recourse available in the event of a breach as drafted into the contract, may prevent the party from being released from their obligations under the agreement and entitle them only to a potential damage award.

Remedies for breach of Warranty
A “warranty” is a term of a contract that is more basic and which entitles the injured party to sue for damages representing what he lost by such breach, although still bound to perform obligations under the contract. If a breach of a term is to be dealt with by the payment of damages, then it is likely that the parties intended the term to be a warranty, not a condition. Also, if the most flagrant breach of the term does not give rise to an event that would deprive the innocent party of substantially the whole benefit of the contract, then it would amount to a warranty, not a condition. With a warranty, non-fulfillment of the term would not affect the substance and foundation of the transaction and the obligation arising from the term would not go so directly to the substance of the contract, that its non-performance could be considered non-performance of the contract itself.

Limitation of Liability
Whether or not a term is truly a warranty or a condition may also affect the application of disclaimer and limitations clauses. There is a tendency by the courts to interpret disclaimer clauses narrowly and against the interests of the person seeking to rely on it. While liability for breach of condition or breach of warranty can be excluded or limited through the use of exemption, exclusion, or limitation clauses in a contract, the doctrine of strict construction of contracts and the contra proferentem rule, will apply to restrict the operation of limitation clauses as much as possible.

Remedies for breach of Fundamental Terms
Over time, the courts recognized problems arising in contracts other than those of sale of goods, and also with the introduction of exemption, exclusion or limitation clauses. Hence the modern courts developed two new categories of terms, for which more flexibility around remedies are available. These are “fundamental terms” and “innominate terms”.

A “fundamental term”, is meant to be so basic and fundamental to the contract that: (a) its breach involved liability for non-performance of the contract; (b) it could not be excluded by an exclusion or exemption clause (at least until the Suisse Atlantique case suggested that it might); and (c) it is

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28 This is not to be confused with “condition precedent”, which depends upon a future uncertain event, the happening of which depends entirely on the will of a third party, and if not satisfied, there is no contract.
29 A “vital” term: Oscar Chess Ltd. v. Williams, above, at 328 per Denning L.J.
32 A “subsidiary term in a contract”: Oscar Chess Ltd. v. Williams, above, at 328 per Denning L.J.
37 Supra, note 35.
neither a condition nor a warranty but a term that was more important than either, a term that went to the “core” of the contract.\textsuperscript{38}

Where the innocent party is deprived of substantially the whole benefit of the contract, or if the breach goes to the root of the contract, the innocent party will have the right to terminate. Also, an exclusion of liability is said not to apply if there is a “fundamental breach”.\textsuperscript{39}

**Remedies for Innominate or Intermediate Terms**

An “innominate term” or intermediate term, is a term which fails to be shown to be a condition or a warranty. If the contract does not expressly or by implication make it clear that a term is a condition or a warranty, (the necessary implication arising from the nature, purpose and circumstances of the contract, i.e. the “factual matrix”), the term in question is an innominate term. Only then will the remedy for its breach depend on the nature, consequences and effect of the breach.\textsuperscript{40}

**Remedies for Representations**

“Representations” are statements as to an existing or past fact, not promises as to future events or states of affairs. Although representations can have legal consequences, if made falsely, or negligently, or, on occasion, innocently without either fraud or negligence on the part of the representor, such consequences are non-contractual in their nature. They stem from the misleading nature of a statement, not from any promissory character.\textsuperscript{41}

The remedies for breach of a representation will depend upon whether the breach was an innocent, negligent or fraudulent misrepresentation. An innocent misrepresentation may give the injured party a right of rescission but not damages. A negligent representation may give both a right of rescission in common law and damages in tort. A fraudulent representation \textit{prima facie} may give rise to damages for fraud and rescission.\textsuperscript{42}

Therefore, whether or not a term is a representation, warranty, condition, fundamental term, innominate term, promise or covenant will affect the remedies available to the innocent party. It is important when negotiating and drafting technology contracts to carefully consider whether or not breach of a particular term, regardless of how it is labelled, is significant enough that it should entitle the innocent party to a right of termination. If specific remedies are required or if the intent is not to terminate the contract, then those provisions should be clearly set forth in the contract.

**Contractual Remedies**

In addition to the Indemnities, discussed in Section C above, the parties to the contract may agree upon specific remedies for breach of any representation, warranty, or other term. As well, any remedies that are not available should be specifically disclaimed or limited. The following are some types of remedies commonly found in technology agreements:

a) Repair of defects by the supplier at no additional charge.

b) Termination provisions. If the parties intend a right of termination to arise as a remedy and consequence of a breach, they should expressly specify a right of termination (with all its accompanying process details, including notification, opportunities to cure the breach if curable, and transitioning out) or at minimum refer to the term as a condition.

For example:

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\textsuperscript{38} See Fridman, supra, note 27 at 491-492.


\textsuperscript{40} \textit{Bunge Corp. v. Tradax Export S.A.} [1981] 2 All E.R. 513.

\textsuperscript{41} \textit{Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of)} (1998), 40 B.L.R. (2d) 1 at 113 (Ont. Gen. Div. [Commercial List]).

\textsuperscript{42} S.M. Waddams, \textit{The Law of Contracts 6th ed.} (Toronto: Canada Law Book) at 419.
(i) A party may terminate this agreement in the event that the other party shall breach a material provision of this agreement and shall fail to remedy such breach within thirty (30) days after receipt of written notice of such breach.

Note that unless the contract is clear that a warranty is a “material term”, one could argue that, by definition, a warranty is a minor term not giving rise to a termination right.

c) Obligation on supplier to assign to customer all subcontractor warranties as requested.
d) Customer named as third party beneficiary under any agreed-upon subcontracts, thereby allowing customer to enforce the warranty rights of the supplier against its subcontractors, without the approval of the supplier and in the name of the supplier. If the customer elects to include this remedy into the agreement, the supplier will likely require that the customer provide the supplier with all pertinent information requested by the supplier that relates to the claim and permit the supplier to participate in the claim.43

e) Breaches of service levels or key performance indicators against which performance is measured and for which the supplier is held accountable, are usually accompanied by specific remedies for breach such as credits against monthly fees. The actual amount of the credit may vary according to the severity of the failure or the impact on the customer. Credits are usually intended as a deterrent to prevent poor performance by the supplier, but few suppliers will agree to credits that are even close to the amounts that would compensate the customer for its actual losses resulting from service level failure.

The remedy also includes obligations on the supplier to: (i) measure and report (at least on a monthly basis) the service levels achieved; and (ii) take diligent steps to identify the underlying cause of the failure and to prevent further occurrences.

Suppliers also often specify that service credits are the customer’s sole remedy, although some suppliers will allow the customer to choose between damages (subject to the limits and exclusions in the agreement) or the applicable service level credit in the event of a service level failure. The sole remedy provision should not preclude a right by the customer to terminate the service agreement for cause if the service level failures become chronic. Service level failures occurring several months in a row or several times in a 12-month period could be a threshold for termination of either the service or the whole agreement.

f) Off-the-shelf, or single user/copy software licenses, typically do not contain any warranties as to software quality. However, the agreements often do provide the customer with the remedy of return or repair in the event of a defect in the physical media on which the software is recorded.

g) Acceptance testing procedures can also be viewed as remedial, giving the customer the opportunity to conduct its own due diligence to determine whether the supplier has in fact delivered on its representations and warranties.

h) Right to audit a party, its systems and technology, to mitigate potential breaches and damages.
i) Holdbacks of fees payable by the customer are sometimes allowed in the event the supplier is in breach or the technology or service does not meet the specified warranties.
j) Release from escrow (in accordance with terms of a technology escrow agreement) of technology, passwords, keys and other materials, and supply of corresponding licenses from supplier.
k) Return and destruction of technology, data, or other proprietary materials.
l) Liquidated damages clauses. Note that these need to be carefully drafted to ensure the amounts are a reasonable estimate of damages and not a penalty, which could render the clause unenforceable.

This paper contains statements of general principles and not legal opinions and should not be acted upon without first consulting a lawyer who will provide analysis and advice on a specific matter.

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