Hardware, Software and Service Contracts

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Hypothetical

- Purchase/sale of a baggage scanner
  - Hardware
  - Software to run the hardware
  - Initial services
    - Installation
    - Customization for buyer’s specific needs (software; maybe hardware)
    - Training
  - Ongoing services
    - Hardware fixes/replacements
    - Software bug fixes
    - Software upgrades

- UCC Article 2 applies to this transaction
Hypothetical
Overview

- Acceptance
- Warranties/Representations
- Support
- Licenses
Overview

Today’s key lesson:

“It’s all about the remedies”

- Remedies first, drafting (or reviewing) second
- Remedy-less provisions are usually worthless
- If you focus on remedies, you’ll draft efficient contracts
Acceptance

Life cycle of a sale

- Delivery
- Acceptance
- Warranty
- Support

Seller’s goal: move buyer to “support” stage ASAP
- Narrow buyer’s remedies
- Accelerate revenue recognition
Acceptance

- UCC 2-601: Perfect Tender Rule
  - Delivered goods must conform exactly to contract terms
- Buyer’s remedies for imperfect tender
  - Termination of contract (“rejection”)
  - Damages
    - Either cost to cover or actual damages
Acceptance

Seller’s solutions

- Describe acceptance criteria/process
  - Criteria should be less than perfect tender!
  - Provide objective standards for acceptance
  - Failure to respond = acceptance

- State “sole and exclusive” remedies for rejection
  - Otherwise, you just create bonus remedies

Seller’s ideal: eliminate acceptance altogether

- Limit buyer’s remedies to warranty claim or support
- Ex: “Buyer irrevocably accepts the goods on delivery.”
Warranties

- Warranties create additional/special remedies
- Seller’s solutions
  - Avoid warranties as much as possible
  - Specify “sole and exclusive” remedies for breach of any warranties given
    - Narrow remedies may “fail of their essential purpose”
    - Ultimately, you probably need a refund remedy
- Seller’s ideal: no warranties
  - Instead, provide “free” standard support during “warranty period”
Representations

- Representations create all standard contract remedies plus...
  - Contract rescission
  - Tortious action for fraud
- Misrepresentation remedies are pernicious
  - Warranty disclaimers are ineffective
  - Liability limits (dollar caps, damages waivers) may not work
- Seller’s solution: do not make representations in the contract
  - Hard to avoid pre-contract sales representations
Seller Risk Management

- Standard ways to manage risk
  - Warranty disclaimers
  - Consequential damages waiver
  - Dollar caps

- More esoteric ways to manage risk
  - “Sole and exclusive” remedies
    - Or convert covenants/warranties into termination triggers
  - Shortened statute of limitations
  - Arbitration (no jury trials)
Buyer’s Perspective

◆ Buyers just want a working solution
  ▪ On time
  ▪ On budget
  ▪ Flawless performance
◆ But a complex purchase has multiple moving parts
  ▪ Sellers often compartmentalize components/remedies
    ◆ Segregated documentation facilitates this thinking
  ▪ But buyers want remedies based on the overall solution working
Buyer’s Perspective

Buyer’s solutions

- Avoid sole-sourcing where possible
  - Competition is best attitude-adjuster!
- Limit seller’s discretion to end its obligations
- Delay acceptance as long as possible
  - Desire to recognize revenues is powerful incentive
- Liquidated damages for painful breaches
  - But remember—liquidated damages cap recovery
- Be explicit about what breaches lead to termination
  - Standard approach (“30 day cure period for material breach”) leaves open too many holes
- Source code/technology access
Support

“Service level agreements” (SLA)

- Triggers for seller’s duties
- Response times
  - No further cure periods
  - No force majeure exclusion
- Remedies for failure
  - Credits v. liquidated damages
- Updates/upgrades/new versions
  - When does a new release cost more money?
  - How will buyer integrate customizations made to previous versions?
Support

Technology escrows are usually wasted money

- Buyer may have to end maintenance plan
- Escrowed materials often not updated
  - Or essential third party components may be excluded
- Buyer can’t figure out technology on time-effective basis
- Poorly-drafted release conditions can inhibit timely release
- Seller can delay release

Buyer’s solution: get all technology upfront
Licenses

- Software components often need separate licensing rules
  - Server components
  - Client components
  - Software Development Kit (SDK)/Application Programming Interface (API)
  - Documentation

- Derivative work license requires separate licenses to create and exploit

- Confidentiality clause is trade secret license
  - Needs integration/harmonization with license grant
Licenses

- Typical license restrictions that many buyers breach on day 1
  - Contractors can’t operate/repair
  - Limits on backup/archival copies
  - “Internal use” restrictions

- Clauses buyers want for future flexibility
  - Right to outsource
  - Transfers on M&A