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
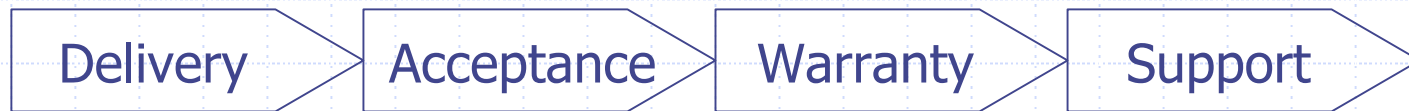- ◆ Licenses

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