

Negotiating Software Contracts – Successfully Negotiating a Limitation of Liability

By Stephen Pinson

Limitation of Liability ranks as one of the most important contract provisions in a software contract. The limitation of liability limits each party's liability for all sorts of harm. A software provider's liability is usually limited to the amount of fees paid to the vendor or a fraction thereof. The risk in not negotiating these terms is that the licensee is capped at the amount of damages. A "cap" is the aggregate upper limit for direct damages associated with a party's liability. The cap on liability can be a specific dollar amount, but in many contracts the "cap" is tied to the amounts paid for the products or services purchased. This cap may not equate to the actual amount of harm of the licensee. Therefore, successfully negotiating a limitation of liability becomes the key point in finalizing the contract. But, what exactly are the pitfalls when negotiating a limitation of liability, and how do you successfully navigate them?

One of the major pitfalls in negotiating a limitation of liability is contained in the structure of the contract provision. Many contracts include boilerplate limitation of liability language. Thus, contract negotiators must develop a systematic way to review the language and then develop a strategy to address the liability concerns for their side of the deal. To do this, the parties must first understand the risks involved with a particular deal and negotiate for the specific risk type.

The best way to put this into action is to review the boilerplate language and put the language into more concrete roadmap to negotiate the contract by asking the following questions: (1) what damage provisions are typically included in the limitation of liability, (2) what damages will be capped, (3) what claims will be carved-out of the contract (or excluded from the limitation of liability) that will not have a cap, and (4) what type of insurance should be negotiated.

Included and Excluded Provisions:

The following is a list of commonly included "boilerplate" exclusion of damages language in a limitation of liability section of a contract:

- Incidental damages
- Special damages
- Consequential damages
- Exemplary Damages
- Punitive Damages
- Loss of use, data, profits, business, goodwill, or opportunity costs
- Computer failure or malfunction
- Costs, expenses or other losses

Capped & Uncapped Damages:

The following is a brief list of common limitation of liability damages, and whether they are capped, uncapped, or subject to insurance from the perspective of the software publisher.

- Negligence – Capped
- Personal injury – Not Capped

- Physical property damage – Insurance coverage
- Lost Data subject to failure of adequately having an onsite backup solution – Capped
- Lost profits - Capped
- Lost revenue – Capped
- Consequential damages - Capped
- Infringement of intellectual property – Not capped because they are considered direct damages
- Gross Negligence, willful misconduct, and fraud – Not Capped

Carve-outs:

For those damages that are considered capped to the amount of products of services offered, a successful negotiator will seek to carve these provisions out of the contract by making exceptions to the limitation of liability, making them subject to insurance for different claims scenarios:

1. Breach of obligations to comply with laws
2. Breach of the parties confidentiality or confidential information / materials
3. Breach of data security or privacy obligations
4. Indemnification obligations
5. Intellectual property infringement
6. Gross negligence, willful misconduct, and fraud
7. Violations of certain terms to the agreement or payment schedules
8. Claims subject to insurance
9. Claims for death or personal injury
10. Any other forms of liability which by law cannot be limited or excluded

Insurance:

The following is a brief list of insurance provisions that could be negotiated in a software or services contract in excess of the cap for the different types of claims scenarios. Individual and aggregate limits must be negotiated for the types of risks involved:

- Automobile Liability
- General Commercial Liability
- Umbrella Liability Insurance
- Workers' Compensation
- Employer's Liability Limits
- Network Security and Privacy Liability
- Professional Liability Insurance, Errors and Omissions, including Cyber Liability
- Data Breach, Data Loss, Regulatory Response
- Evidence of Insurance Policies

Remember, it is always important to seek advice from experienced counsel when negotiating a limitation of liability provision in software and service contracts to make sure the risks are adequately assessed and your interests are protected.



About the author Stephen Pinson:

Stephen represents clients involved with intellectual property and technology disputes. Specifically, he defends clients in software licensing and copyright infringement matters. Prior to joining the firm, Stephen practiced in high-stakes securities litigation, regulation, and enforcement actions. He spent the majority of his time prosecuting and defending large corporate clients, institutional investors, and Wall Street firms.

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