

Understanding Key Terms for 3PLs in Information Technology Agreements

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TECHNOLOGY increasingly forms an essential component of every sophisticated warehousing and logistics operation. The prudent development and use of such technology (including, but not limited to, warehouse management software, warehouse control systems, warehouse execution systems, transportation management software, and the like) can frequently distinguish one operator from another in the eyes of a prospective customer. Indeed, efficiency – one of the most critical qualities that any warehouse offers – can usually be linked directly to an organization’s technological savvy.

In light of the benefits and the importance of information technology (IT), warehouse operators and other third-party-logistics providers must have strong agreements in place relating to critical IT systems, particularly in light of the recent move to cloud-based services. This article provides an overview of the critical areas that are general to all IT agreements and those specific to outsourced or hosted (cloud) services. While many warehousing and logistics operators may be intimidated by such agreements, this overview will give you a starting place for your next negotiation with an IT services provider.

■ Areas Generally Applicable in All IT Agreements

Scope of the License or Services

Whether licensing software for use in-house or outsourcing a particular function, the initial focus of any negotiation with a potential IT vendor should be defining the products or services being licensed or provided by the vendor to your company. This

fundamental concept is important as it sets the expectations of the relationship for both parties. In general, IT vendors do not sell or transfer ownership of their technology, but license the ability to use the technology subject to restrictions on its use (for example, how long you can use it, how many users may access the technology and the locations where it may be used). The restrictions re-

quired by an IT vendor may limit (or impose additional costs on) the ability to expand use of the technology if your organization grows or requires additional license purchases. As you will likely have more leverage at the time of the initial transaction than at any other point, you will want to consider negotiating future needs in light of the scope of the license or services, such as the cost of additional user licenses, caps on increases in pricing, pricing for additional data volume and so on.

Confidentiality and Data Security

Each party to an IT agreement must consider the nature, as well as the sensitivity and value, of the information being exchanged between them over the course of their relationship. The need to protect confidentiality is readily apparent where the software or services will process sensitive or non-public data. Well-phrased confidentiality clauses will specifically identify categories of confidential information, impose an affirmative obligation to protect that confidential information, and include a specific standard of care to which the parties’ respective treatment of the other’s confidential information will be held. For outsourced services, you may want to apply specific data security controls and even specific audit standards

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related to the handling of confidential information. (Sarbanes-Oxley compliance for publicly traded entities is necessary where data affecting financial controls is processed by third-parties.) For instance, you will want to be sure to protect the confidentiality of your customer lists, pricing, performance metrics or key performance indicators, and the like.

Warranties

The warranties tend to be one of the most important (and divisive) issues in an IT agreement. This notion should not be all that surprising considering the conflicting interests of the parties. Vendors will inevitably seek to limit the form and nature of any warranties in order to limit their liability and obligations to the greatest extent possible, while you will almost always favor more expansive guarantees to protect your investment. With this in mind, the following guidelines can significantly ease your company's warranty concerns where almost any form of technology is involved and irrespective of whether the warranties are made in the agreement itself or in an accompanying service-level rider.

- First, the warranties should focus on what the vendor can actually control. Vendors will understandably resist guaranteeing the products and services of others (e.g., third-party products used in connection with the vendor's product). Your company may, therefore, find its vendors far more willing to make warranties concerning the functionality and interoperability specific to the vendor's product or services, to agree to repair or replace third-party components that are non-compliant, to agree to make efforts to avoid less-foreseeable third-party problems, and to agree to implement specific security standards.

- Second, warranties should focus on the risks unique to the particular product or services being licensed and your company's intended use

of the product or service, so careful consideration should be made on a case-by-case basis of any requirements necessary to protect your investment.

- Third, the agreement should specify the consequences of a breach of warranty. With respect to remedies, vendors will commonly seek exclusive remedies that only require repairs to (or commercially reasonable measures to repair) a non-functioning product or product component. While promising to

A strong (but fair) pro-user IT services agreement will enhance your ability to provide value-added services.

make repairs is certainly a great starting point, repairs alone may not achieve the primary purpose for which your company entered into the agreement in the first place – obtaining the advantages of functioning technology. A good approach, then, is to press for three generalized remedies: the shortest obtainable repair timelines, pro-rata refunds during downtime and, assuming a failure persists, the right to terminate the agreement and to receive a refund (partial or full). These combined remedies are arguably the most effective means of guaranteeing performance because they condition payment and the future of the relationship upon the technology's operability.

Remedies

Depending on the role the particular technology plays in your operation, seeking a product damage and loss provision may also be advisable. These types of provisions generally hold vendors liable for damages (including product loss or delay) they cause to the products deposited in your warehouse. For instance, what if the vendor's IT services result in a misshipment of goods that results in damage or loss of the goods, or what if the vendor's IT services break down, resulting in goods not delivered with reasonable dispatch?

Like warranties, these remedies should essentially focus on three points. First, they should establish a standard of care to which the vendor

will be held. A general negligence standard is most common, though a low product value coupled with minimal vendor interrelation with the product may justify a higher standard such as gross negligence. Second, well-crafted damage and loss clauses should identify those circumstances under which the vendor will not be liable at all. Damages resulting from other parties (third-party transportation providers, for example) or damages to a product resulting from manufacturing defects or the acts and omissions of the manufacturing company's personnel are, understandably, circumstances where it may be appropriate to exclude liability for the IT vendor. Third, the product damage and loss clause should also identify the remedies available to your company in the event that the vendor fails to adhere to the agreed standard of care, and the vendor's liability for damages or losses resulting from events other than those explicitly excused by the contract's terms. Because your company will likely want to control its own services (and your own customer's goods), repair or replacement may not be preferred remedy options for these types of clauses. Instead, a more appropriate remedy might focus on replacement costs for your customer's goods or the cost of substitute services. The goal in drafting these types of clauses should not be to punish the vendor, but rather to reasonably approximate the actual reduction in value to the products or services caused by the vendor's conduct.

■ **Areas Specific to Cloud-Based Services**

Availability/Service Levels

For any cloud-based service, the availability of the service is obviously important as the service cannot be used if it is not accessible. The industry standard for availability for cloud-based solutions exceeds 99 percent. IT vendors will generally seek carve-outs for necessary maintenance and for issues created by third parties, but will usually commit to a specific uptime mini-

mum. Other necessary service levels should also be considered on a case-by-case basis. While IT vendors will usually try to limit remedies for failures to meet service levels, you should ensure that the remedies for the vendor's failures to meet service levels address both chronic failures and catastrophic failures, while ultimately allowing for termination of the services in the event of ongoing or major problems.

Accessibility and Data Integrity

A company's ability to access its data is extremely important. In addition to the confidentiality and data-security issues addressed above, any cloud-services agreement should contemplate how and when you can access and retrieve your data. Will remote access be permitted? Will periodic data exports be provided? Also, under what circumstances can the vendor suspend the services? While many vendors will push for a suspension provision, it is very common to have no suspension right where the services are mission-critical. Likewise, the responsibility for ongoing data integrity should be addressed. The agreement should properly document which party will be responsible for backup of the data and what, if any, disaster-recovery requirements will apply (including committed recovery-time and recovery-point objectives).

Functionality of the Services

Cloud services are usually subject to change as the vendor's product matures and is enhanced over time. If, however, specific functionality is an essential reason for your use of the services, it is important to ensure that the vendor commits to maintain the specific functionality during the term of the agreement and that specific features or functionality will not be removed.

Transition Upon Termination

An agreement for cloud services should address what happens to the parties' information after the agreement ends. Requesting the return or destruction of confidential or proprietary information following termination of the agreement

or, at minimum, imposing ongoing confidentiality obligations, can help to ensure that your company's sensitive data is protected long after your services term has expired.

Incorporation of Additional Terms

A common concern with agreements provided by IT vendors is the incorporation of terms outside of the actual document that is signed by the parties. Vendors will incorporate various terms and conditions that are posted to their websites or require the acceptance of additional click-through agreements upon a user's log-in to a service. Any agreement with a cloud-services vendor should ensure that the agreement of the parties is not subject to being altered or superseded by these extraneous terms.

In short, understanding the foregoing fundamentals will give you the appropriate footing for commencing negotiations with your IT services vendor. Having a strong (but fair) pro-user IT services agreement in place will not only protect your business but also enhance your ability to provide value-added services to your customers. Remember: Each of your customers' supply chains is only as strong as its weakest link. Don't let the technology agreements that you negotiate become that weakest link.

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IWLA Events Calendar

- ★ **IWLA Legal Documents Webinar**
August 28
- ★ **2014 IWLA Safety & Risk Conference**
September 10 and 11 – Fort Worth, Texas
- ★ **2014 IWLA Legislative Fly-in & 2014 IWLA Chemical Council Meeting**
September 17 to 19 – Washington, D.C.
- ★ **2014 IWLA Government Affairs Update Webinar**
October 2
- ★ **2014 IWLA Essentials of Warehousing Course**
October 7 to 10 – Adelphi, Md.
- 🍁 **IWLA-Canada Fall Conference**
October 30 – Vaughan, Ont.
- ★ **IWLA Board of Directors Meeting**
November 12 – Chicago, Ill.
- ★ **IWLA Technology & Operations Solutions Conference**
November 12 to 14 – Chicago, Ill.