Negotiating Technology Contracts: On-premise vs. Cloud and Hosted Software

By Stephen F. Pinson
Scott & Scott

More and more businesses are considering accessing hosted software rather than purchasing on-premise software. They are also placing data in third-party public or private clouds instead of selecting on-premise software. This article will explain the key considerations and contractual provisions when deciding to utilize a hosted software cloud solution versus On-premise software solutions.

KEY CONSIDERATIONS

1. Strategic Considerations
Using hosted software in the cloud allows for greater flexibility such as: allowing a business to access its information from any location, and not having the initial outlay of capital to purchase servers and other infrastructure when implementing the software's use. This is a significant departure from on-premise software, which often requires substantial infrastructure investment, and can only be accessed from the device the software installed.

2. Financial Considerations
Cost Savings
Most businesses switch to the cloud because of the belief in inherent cost savings. However, in the long run, switching to the cloud will not always result in savings. Cloud infrastructure costs money, and the business will be the one that bears the costs, usually in a monthly subscription,

instead of a yearly license fee.

Return on Investment – Moving from CapEx to Op Ex
On-premise software products and hardware infrastructure are generally considered capital expenditures, while subscriptions to cloud software are typically classified as operating expenses. It is important to consult with tax professionals to ensure there are no unintended consequences from making the switch from on-premise to hosed software products.

Infrastructure investments / upgrades
Generally, on-premise software requires purchase of hardware or use of infrastructure that is already in place. On the other hand, moving to the cloud may require an investment in upgraded devices or equipment to maximize the value of the hosted solutions.

Cost to implement or migrate. When moving from on-premise to the cloud, there can be significant implementation or migration costs. Companies may not adequately consider the costs related to migrating data to the hosting or storage providers. The number of man hours required to successfully migrate can be significant and costly. Accordingly, the scope and complexity of the migration is an important consideration when negotiating a contract.

3. Operational Considerations
Outsourcing activities
Using the cloud can pave the way to outsourcing non-core operations. On the other hand, on-premise software may require more sophisticated security credentials currently in place, whereas the cloud application may reduce that need.

Support
On-premise software generally requires maintenance and support along with support levels and support times. These generally are limited to business hours, and come with increased costs for after-hours support. When using the cloud, maintenance and

support are included as part of the package, and are generally included as a 24/7/365 service.

4. Technical Considerations

Infrastructure

To use on-premise software, companies must procure appropriate hardware. For cloud solutions, the cloud vendor provides the hardware, infrastructure and applications for the software to work, but that does not mean that there is no investment by the end user to the software. The end users may need to upgrade devices and security plug-ins. They also may need to expand firewalls to cope with the additional internet traffic. Internet providers may need to provide more bandwidth.

Location and Ownership of the data

There is little question as to where data will be stored and who will own the data when using on-premise software – the customer owns the data. However, when using cloud solutions, the location and ownership of the data may become unclear. A business wants to own its data and not let it be used for research or statistical purposes, particularly by its competitors. Additionally, many businesses want or need the data to be stored in the nation where they are located or where they are doing business, and not some remote or foreign locations.

5. Security, Backup, & Privacy Considerations

Security

When using cloud or on-premise software security is important. On-premise software provides a level of security that is implemented through patches and updates to the software. Cloud providers can hand off their hosting and security to a third party provider, which can compound security risks. It is critical to understand and document who bears the risks of a security incident in the event of a security incident.

Backup

For on-premise software, the backup is left to the business

user. For cloud, the cloud provider generally provides the backup for certain intervals of time, which is generally contracted for by agreement. It’s important to have a backup schedule with redundant backups when contracting with a cloud provider, as well as a general understanding of what information is purged from the system.

Privacy

For on-premise software, privacy is generally not a concern, because the software is part of the business infrastructure. However, in a cloud implementation, privacy issues become a major concern because business information is sent over the internet which can be intercepted by hackers. Understanding how the cloud provider protects your privacy is always important.Accordingly, below is a list of key contractual provisions that are critical when deciding to utilize hosted software in the cloud vs. on-premise software.

KEY CONTRACTUAL PROVISIONS

1. Strategic Considerations

It is critical to clearly identify the requirements for companies that will host software applications or store the business’ data. For flexibility, it is also important to evaluate whether traditional on-premise license metrics will be appropriate for any hosted software solutions. Generally, it is its best practice to negotiate the number of users rather than the number of devices when negotiating a cloud deal for maximum use. A user can use several devices at once, and being charged for each device would be costly to the business.

2. Financial Considerations

To be sure fees are controlled when deciding on utilizing an on-premise solution versus a hosted software solution, the business should calculate the cost of both on-premise licenses along with maintenance and support and compare the costs to the total amount required to subscribe to the hosted version

of the software solution. If the costs are relatively the same, then capping the monthly cloud subscription every year would be wise to keep costs in line. Additionally, it's important to negotiate infrastructure upgrades and implementation and migration costs to the cloud or to any subsequent provider.

3. Operational Considerations

It is important to negotiate who will have access to the cloud and what administrative rights will be assessed to each user. Additionally, its best practice to negotiate the support levels when using cloud, and any service credits for failure to implement the service.

4. Technical Considerations

When negotiating a cloud deal, companies should understand and document ownership of the data, allowable uses of the data (even in aggregated form) by the cloud provider, and locations where the data may be stored.

5. Security, Backup, & Privacy Considerations

For security, it is a best practice to include security protocols in the contract and to successfully negotiate a reasonable limitation of liability for security incidents, back-up failures, or privacy incidents. In these scenarios, the limitation of liability may include a carve-out, or a super-cap to handle the increased risks involved. For backups, it is always important to contract with the cloud provider the specific backup procedures, protocols, and backup intervals required by the business. Additionally, it is important to include in the contract security reports or audits for the business to ensure that the cloud provider is following those contractual obligations. Lastly, for privacy, it is always important for the business to include privacy language and protocols for incident response. Specifically, when an incident occurs, the business should require the vendor to notify the business immediately of any privacy or security

incidents. Lastly, it's always best to negotiate the appropriate levels of insurance for provisions dealing with these topics.

When switching from on-premise software to a hosted software cloud solution, there are numerous business issues to consider. Having a plan when switching to a hosted software cloud provider is crucial to a business' success. Given the risks, it is increasingly important to seek advice from experienced counsel when negotiating contracts like these to make sure the risks are adequately assessed and each party's interests are protected.

Agreed Damages or Unenforceable Penalties – Drafting to Affirm the Former and Avoid the Latter

Glenn West, writing in Weil, Gotshal & Manges LLP's **Global Private Equity Watch**, says that agreed damages provisions are a staple of many commercial contracts.

But their enforceability is frequently questioned because of the common law's requirement that the damages payable for breach of contract not exceed the amount required to compensate the non-breaching party for the foreseeable losses it actually sustained by virtue of the breach.

West discusses a case that he says presents an important practical reminder: practitioners seeking to ensure that agreed damages provisions are enforceable should avoid

limiting the items of loss for which the agreed damages are providing compensation and constitute a legitimate pre-estimation.

Read the article.

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5 Contract Management Reports That Can Help You Become a More Strategic GC

When businesses have large contract portfolios, tracking the contract lifecycle from initiation though award, compliance and renewal can become a burden without the proper reports, according to **WoltersKluwer**.

“No matter the information you need – from expiring contracts, contracts awaiting signature, to specific contract values – it should always be close at hand,” according to the article at **Lexology.com**. “With organized contract management reporting, you can pull critical information such as contract review dates and values and sort contracts by contract owner, responsible departments and counter-parties, to inform business decisions.”

The contract management reports discussed include expiring contracts, draft contracts, pending signature, active contracts and inactive contracts.

Read the article.

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Cloud Solutions: The Danger of ‘Floating’ Contracts

In most cloud engagements these days, it is not only the customer’s data that is in the cloud, but also many key parts of the vendor contract as well, explains **Mike Overly** of **Foley & Lardner**.

“That is, the average cloud vendor today generally places several key areas of the contract in the cloud (e.g., service level standards, security measures, support obligations, service descriptions, etc.). In some instances, the entire contract is in the cloud. What this means is that these key contract provisions or the entire contract ‘floats’ in the cloud and can be changed at any time by the vendor, frequently without notice to the customer. Even if the customer is given notice, in many cases, the customer has no right to object to the changes,” Overly writes.

Read the article.

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Imagining the Perfect Confidentiality Agreement

The perfect confidentiality agreement is, in most cases, overkill and in any event would probably never be signed, writes **Bryan K. Wheelock**, a principal in **Harness Dickey & Pierce**.

He says a vast majority of the many CDAs, NDAs and other secrecy agreements signed every day perform adequately for their purpose. Rather than chase perfection, the parties should focus on avoiding mistakes.

He discusses the topic from the perspectives of the both the disclosing party and the receiving party. His article also provides a checklist for a confidentiality agreement.

Read the article.

Republicans Introduce Bills to Scrap New Bank Arbitration

Rule

Republican lawmakers in the House and Senate have introduced bills calling for the repeal of a just-announced regulation that would make it easier for consumers to bring class-action lawsuits against banks, reports ***The Los Angeles Times***.

The new Consumer Financial Protection Bureau rule would ban banks and other financial institutions from forcing arbitration clauses on customers to prevent them from bringing or joining class-action suits.

Some Republicans have introduced resolutions calling for use of the Congressional Review Act, which allows Congress to new regulations created by federal agencies, writes **James Rufus Koren**.

Read the *LA Times* article.

Dot Your I's, Cross Your T's, and Place Your Commas

When drafting contracts, briefs, and other documents, the significance of placing a comma is often overlooked, points out Hyatt & Weber P.A. The decision to include or omit a comma, however, could be dispositive in a dispute over the meaning of legislation or a contract.

"Indeed, in *O'Connor v. Oakhurst Dairy*, 851 F.3d 69 (1st Cir.

2017), the United States Court of Appeals for the First Circuit found the absence of a comma created an ambiguity when interpreting certain legislation, and that ambiguity drove the outcome of the litigation," according to **a post** of the firm's website.

"Guiding principles regarding the use of commas and other writing conventions should be strongly considered when drafting contracts, for example, as including or excluding a comma in a particular contract provision may ultimately determine whether a company owes or is owed millions of dollars in a subsequent dispute," the post continues.

Read the article.

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Should I Have an Arbitration Clause in My Construction Contract?

Although it is typical for AIA form contracts to contain arbitration clauses, as a contractor you should consider whether you should have an arbitration clause in your construction agreement, advises **Paul W. Norris** of Stark & Stark.

In an article posted on the **New Jersey Law Blog**, Norris explains "there are numerous factors to consider in

determining whether mandatory arbitration is the preferred dispute resolution mechanism, or whether the state court system is preferred. Although arbitration may have some advantages, there are also disadvantages which must be considered rather than simply adopting the AIA form."

He discusses the cost of the arbitration proceeding, judge or jury vs. an arbitrator, discovery during an arbitration process vs. the state court process, timeliness of the proceeding, judgments, and appeals from arbitration of a state court.

Read the article.

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My Smart Contract Just Ate $14 Million – Now What?

A Canadian digital currency exchange (QuadrigaCX) reported recently that a malfunction in a smart contract is responsible for a $14 million dollar loss of the cryptocurrency ether, reports **Jared Butcher** in the **Steptoe Blockchain Blog**.

He explains that a software upgrade performed by the company had an error in the code that prevented the smart contract from properly processing incoming amounts of the cryptocurrency Ether. During the time it took to discover the

problem, Ether sent to the company's exchange was "trapped" in the smart contract.

"The potential for new risks and severe consequences arising from smart contracts (compared to traditional contracts) suggests that a re-consideration of indemnification strategies is warranted," Butcher writes. "Risks arising from coding errors or other human errors are not the product of intentional wrongdoing or a catastrophic event and may not involve any injury to a third party."

Read the article.

How Weak Are Employee Nondisclosure Agreements?

In a **blog post** on nondisclosure agreements, **Gregory W. McClune** of Foley & Lardner addresses the questions: Does an employer have the legal means to prevent disclosure of information acquired during employment? Likewise, can an employer seek legal redress for such disclosures?

"Drafting and enforcing NDAs requires considerable thought, care, continual maintenance and a skilled legal advisor," writes McClune. "It is an area rife with risks and traps; and employers who believe they can "gag" their employees, by simply requiring them to sign a broadly worded agreement with heavy penalties, may be in for a rude shock."

His article discusses difficulties as dealing with the lack of

uniformity among states in enforcing NDAs, and the lack of sympathy for employers in the courts.

Read the article.

Contract Tools: Live Demo on July 24

Paper Software will demonstrate its **Contract Tools** product, a powerful Word add-in for working with contracts, in a complimentary live webinar. The event will be Monday, July 24, at 12 p.m. EDT.

Contract Tools, a TechnoLawyer **Top 5 product** of 2016, is designed to make creating and reviewing contracts easier.

The live **demonstration** will provide a tour of Contract Tools' new features, including real-time updating.

Paper Software also offers a free **seven-day trial** of Contract Tools.

Register for the live demonstration.

Post M&A Disputes: Breach of Indemnification Clauses in M&A Contract

Baker McKenzie's **Global Arbitration News** has posted an article discussing the difficult questions raised in both substantive and procedural law by indemnification clauses in share purchase agreements.

The author, **Dr. Philipp Schuett**, explains that the reason is that an indemnification dispute involves at least four parties: "The target company, the third party who raises claims against the target company, the seller (= the indemnitor) and the buyer (= the indemnitee)."

He then discusses the reasons to include indemnification clauses in SPAs, the scope and wording of indemnification clauses, the potential for disputes, and avoidance of post-M&A disputes.

Read the article.

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Legal Developments Encourage the Use of Smart Contracts in the United States

An alert from **Pillsbury Winthrop Shaw Pittman** takes a look at some new laws in the United States that provide a clear indication that smart contracts will be impactful.

Authors of the article are **Craig A. de Ridder**, **Mercedes K. Tunstall** and **Nathalie Prescott**.

The article covers the Current legal state of smart contracts and blockchain technology, provides a refresher on smart contracts, discusses upcoming smart contract and blockchain technology projects, and looks at the future of smart contracts.

Read the article.

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What Would the Perfect Employee Agreement Look Like?

Image by [NY Photographic]

Bryan K. Wheelock of Harness Dickey has posted **an item** on the firm's website contemplating what perfection might look like in regard to an employee agreement.

"Lawyers strive for perfection in their work, but time constraints, budgets, and other factors work against us. Also, perfection is not always the same thing in every circumstance," he writes.

He discusses such topics as confidentiality, non-compete clauses, non-solicitation, assignment of inventions, access to computers, the return of employer property and confidential information, and publicity and social media restrictions.

Read the article.

Fiduciary Rule Creates Breach of Contract Claim, No Private

Right of Action

The first part of the Department of Labor's Conflict of Interest Rule went into effect in June, and a large group of newly-defined "fiduciaries" are now subject to certain requirements of the Best Interest Contract (BIC) exemption, a portion of the Fiduciary Rule that according to some commentators creates a private right of action for investors, reports **Kilpatrick Townsend**.

"The creation of a private right of action is one of the investment industry's chief concerns with the Fiduciary Rule," write **Paul Foley** and **John I. Sanders**. "Industry leaders claim that the BIC exemption creates a private right of action because it enables investors to bring breach of contract claims and class actions against the fiduciaries with whom they contract. However, a federal judge from the Northern District of Texas flatly rejected this claim in *Chamber of Commerce of the United States of America v. Hugler*."

Read the article.

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Unsigned Contract = No Proper Insurance Coverage

Commonsense Construction Law reports on a case in which an unsigned contract meant that the contractual liability

exclusion in the subcontractor's insurance policy would control, since there was no obligation "assumed in a contract or agreement . . . [where the claim] occurs subsequent to the execution of the contract or agreement."

Stan Martin wrote the article.

"And this was not just a matter of having an agreed contract form which the parties never got around to signing," he explains. "The subcontract at issue stated that it 'is not valid without the Subcontractor General Conditions Version 2012-003 signed and agreed to by all parties.' There was no dispute that the parties had not signed the general conditions."

Read the article.

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What Does Your Reservation Clause Mean?

Locke Lord partner **Martin Gibson** (Austin) and associate **Kerstie Moran** (Houston) co-authored an article examining a decision by the San Antonio Fourth Court of Appeals in *Webb et al. v. Martinez* in a property dispute including reservations of a mineral estate.

The article was originally published by the **National Association Of Division Order Analysts**.

“This decision further emphasizes the importance of properly phrasing a reservation clause, as to avoid inadvertently granting an interest in a mineral estate. The *Webb* Court demonstrates the way in which courts consistently interpret grantor’s intent based on the plain language of the deed,” according to the authors.

The appellate court affirmed the trial court’s take-nothing summary judgment regarding a property dispute in favor of Martinez. Webb had owned the entire surface and 75% of the mineral estate. The remaining 25% of the mineral estate was owned by a third party. Webb agreed to sell the entire property to Martinez through a contract of sale. The 1998 deed included a reservation clause that was at the heart of the litigation.

Read the article.

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Drafting and Negotiating IP & IT Provisions in M&A Transactions

Practical Law will present a free **75-minute webinar** with Rita Berardino, Senior Legal Editor, Practical Law Intellectual Property & Technology, and presenters from Wilson Sonsini Goodrich & Rosati, who will discuss IP and information technology (IT) considerations in drafting and negotiating M&A agreements.

The event will be Wednesday, June 28, 1-2:15 p.m. EDT.

Intellectual property and technology assets have become increasingly significant components of a company's business strategy and the focus of many M&A transactions, the company says on its website.

Topics will include:

- Common structures for M&A transactions.
- Key IP and IT provisions of M&A transaction documents, including:
    - Drafting and negotiation of IP and IT provisions.
    - How courts have interpreted these provisions.
- Key ancillary IP and IT agreements, including licenses and assignments.

A short Q&A session will follow.

Presenters:

- Manja Sachet, Partner, Wilson Sonsini Goodrich & Rosati
- Jason Greenberg, Associate, Wilson Sonsini Goodrich & Rosati
- Jennifer McGrew, Associate, Wilson Sonsini Goodrich & Rosati
- Rita Berardino, Senior Legal Editor, Practical Law Practical Law IP&T (Moderator)

Register for the webinar.

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Are Employment Contracts the Real Stars of the NBA Draft?

The NBA Draft was June 22, and while fans focused on their favorite team's selections, the newest professional players and their lawyers had more weighty concerns to address: employment contracts.

Dallas-based attorney **Rogge Dunn**, partner at **Clouse Dunn**, works with professional athletes and coaches including Basketball Hall of Fame Coach Larry Brown.

In a blog post on the website of **Androvett Legal Media & Marketing**, Dunn said:

> *Athlete employment contracts are singularly unique in many ways. For example, compensation may be tied to a player's performance metrics, such as shooting averages, games played or post-season awards, and are likely to be quite invasive on issues including the player's weight, health issues and off-season activities. Also, unlike most employment contracts, they will likely contain morals clauses.*
>
> *However, so-called 'guaranteed contracts' protect most athletes in a way that most of us with employment contracts do not have, by guaranteeing their compensation even if an injury prevents them from playing. We should all be so lucky*

to have guarantees such as these. Most executive contracts terminate payments or force a leave of absence if you are disabled or can no longer do the job.

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Webinar: Avoiding Construction Claims and Disputes

A Baker Tilly **on-demand webinar** provides an overview of strategies to identify potential claims scenarios and potential resolutions available to mitigate claims.

"Conflict and disagreements are normal on construction projects; however, when everyday disagreements escalate into unresolvable issues, claims and disputes may result," the firm says on its site. "These can lead to costly and time consuming distractions for your organization and your project."

Learning objectives:

- Understand red flags associated with high-risk projects
- Learn characteristics of a culture of claims avoidance
- Learn contractual methods/provisions that can help to proactively avoid disputes
- Understand remedies not requiring legal action

Watch the on-demand video.

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