

Checklist for Information Technology Outsourcing Agreements

This is a non-exhaustive checklist of some of the major legal topics to think about when negotiating and drafting an outsourcing agreement. For further information and discussion contact Todd B. Ruback, Esq, CIPP, CIPP/IT at truback@newjerseylaw.net or at 908-757-7800.

1. **Services-** What the vendor does for the client. Normally a software developer will write software. To develop software a vendor must first understand what the client wants the software to do. This understanding comes from client supplied requirements and software developers write software based upon these requirements. The services that are provided are usually reflected in an attachment called a Statement of Work (SOW). The agreement normally serves as a master document that lays over the relationship and stays dormant until there are specific projects to do. The business terms of any project are reflected in the SOW and the legal terms of the relationship are reflected in the agreement.
2. **Deliverables and Acceptance-** When a software developer writes software or code it is called a Deliverable. It sends the Deliverable to the client who should then test the Deliverable by a process called Acceptance Testing. This is when the code is measured against the requirements to see if it works, or if there are defects in the code. If the Deliverable meets the requirements in all material respects, then the code is accepted. This can be acknowledged by an email, or deemed accepted by silence. If there is a defect in the code, then the defect is identified in writing and sent back to the Developer to fix. The Developer attempts to correct the defect and the acceptance testing process occurs again. Normally, a developer and client do this process twice. If the defect is not cured after the second round, the client can call a material breach and terminate the agreement. It is important to keep the client to a short acceptance testing period, normally 5 business days.
3. **Payment-** If representing the Developer, net 15-30 days from date of invoice, which can be sent by email. If representing the client, net 30 days from date of receipt of invoice. The client always wants the right to not pay disputed amounts.

Disputes must be in writing and state with specificity the reason for the dispute. Make sure taxes are mentioned and that they will be passed through to the client. Expenses should also be addressed in this section. Examples of expenses include work visas to come onsite, travel, hotel, car and a per diem food allowance.

4. **Obligations of the Parties-** If the Developer is coming on site, then the client must provide an adequate work environment so the Developer can perform its services. This may include office space and equipment, access to and use of the client networks, Internet, software and hardware and any associated licenses. It is important to reference Export Control. This concept focuses upon services that are not allowed to be shipped outside of US borders. It is illegal to violate export control laws such as the USA Patriot Act.
5. **Ownership-** Title to Deliverables should pass upon payment in full to the Developer. Until such time and so long as there is not a material breach, the client should have a license to use the Deliverable. This license is revocable if the client fails to pay. Residual rights- should be protected if you represent the Developer. This concept states that a Developer can learn and improve its coding processes from a project and use that new knowledge on future projects for other clients. The client should not own any residual rights in improved processes. That is intellectual property and part of a Developer's secret sauce that allows it to increase margin on future projects and expand profit.
6. **Confidential Information-** Define what is confidential. Usually there will be a Non-Disclose Agreement (NDA) that has already been signed by both parties. You can reference the NDA or capture the concept in this section of the agreement. The definition of Confidential Information should always include trade secrets, as well as source code, etc, however provided and whether marked confidential or not. There must be a section stating the obligations of both parties concerning confidential information. There is also an exceptions section to this provision, stating when you can release confidential information. Examples include when you are compelled by court, when the information was publically available at the time it was disclosed, when it was received by a third party without restrictions, and when it was independently developed.
7. **Indemnification-** Parties indemnify each other for third party claims that there was a violation of intellectual property rights. It can be mutual or one way, depending on the circumstances. Often there are also indemnification obligations for injuries to third parties or property. There should be a process set up around indemnification and there should be limits and remedies.
8. **Warranty-** It is industry practice to warranty a Deliverable for 20-30 days. This means that if, after Acceptance, the Deliverable doesn't work within the warranty period, the Developer will fix it for free. Make sure there is a remedies section attached to Warranties and also a disclaimer section. If the client modifies or customizes the Deliverable, or uses it with hardware for which it was not designed, then the warranty does not attach.
9. **Limitation of Liability-** Developers never agree to indirect damages. The risk of liability is simply too high and there are too many variables that are unknown and out of the Developer's control. Examples of indirect damages include loss of revenue, goodwill, profits, special damages, consequential, punitive, or the like. It is best to specifically exclude indirect damages from liability. For total liability, Developers like to cap liability to a factor of fees paid or payable, such as 12X.

Developers do agree to carve outs from the liability cap for actions such as the Developer's gross negligence, willful misconduct or fraud.

- 10. Term and Termination-IT** Agreements are usually umbrella documents and not stand alone documents. Because of this the term can be for one year, three years, whatever the parties may agree to, and can also automatically renew unless terminated by either party. There is no obligation to do business. That obligation comes with a signed SOW. Termination can be for convenience or for cause. If for cause, then list the items that constitute material breach, such as bankruptcy, the inability to cure a defect in a Deliverable, etc. Normally for termination for cause, there is a cure period of up to 30 days before a material breach is declared.
- 11. Survival-** Make sure that the critical sections of an agreement survive the termination of the agreement.
- 12. Miscellaneous-** Governing law, venue and jurisdiction should be addressed. Make sure you state that the provisions of the UCC do not apply. Address assignment, and that except for a merger or acquisition the agreement can't be assigned without the consent of the other party, not to be unreasonably withheld. Any assignment must be binding on the successors.