

HOW TO

Improve Your Company's Form Software License Agreement

PART 1: LIMITATION OF LIABILITY



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ATTORNEYS

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KEY TAKEAWAYS

- 1 A form software license agreement should contain a waiver of consequential damages provision and an aggregate liability cap provision in favor of the licensor.**
These two provisions are often referred to collectively as “limitation of liability”.
- 2 Licensors should be very careful when agreeing that certain damages and liabilities are exceptions to the limitation of liability provisions and subject to unlimited liability.**
- 3 If a licensor agrees to allow the limitation of liability provisions to limit the customer’s liability (“make them mutual”), the licensor should add certain additional exceptions to the limitation of liability provisions that are subject to unlimited liability.**

Contracts are, in essence, a set of legally enforceable promises. If a party breaks one of its contractual promises, the other party may be able to obtain remedies (often in the form of money damages) from the party that broke its promise. Notwithstanding the foregoing, even if a licensor breaks one of its contractual promises, it is customary and “market” for a licensor to disclaim certain types of damages and to limit its aggregate liability under the software license agreement. The primary rationale behind these provisions is that no one commercial contract is worth “betting the company” by exposing the licensor to unlimited liability.

As a starting point, a licensor’s form software license agreement should contain a waiver of “consequential damages” provision in favor of the licensor. This provision says that the licensor will not be liable for any consequential, incidental, and other indirect or punitive damages—often referred

to collectively as “consequential damages”—resulting from the licensor’s breach of the software license agreement. Broadly put, consequential damages are damages suffered by a party that flow indirectly from the other party’s breach of contract. A waiver of consequential damages provision can provide a lot of protection to the licensor because it expressly says that many potential damages are not recoverable by the customer if the licensor breaches the software license agreement.

The form software license agreement should also contain an aggregate liability cap provision in favor of the licensor. This provision says that the licensor’s total aggregate liability for all claims relating to the software license agreement will not exceed a certain amount (the “liability cap”). The liability cap figure is typically a function of fees received by the licensor under the software license agreement, i.e., 12 months’ fees. Although the liability cap concept seems simple,

the language can have a significant amount of nuance. For example, a licensor should ensure that its liability cap is an aggregate cap that limits the licensor's aggregate liability in connection with any and all claims relating to the software license agreement, rather than a "claim by claim" liability cap or some other variation that only caps a subset of the licensor's liability. The licensor should also consider its insurance coverage when determining acceptable liability caps under software license agreements.

We can use an example to demonstrate the criticality of these provisions for licensors: let's assume a licensor licenses a logistics software tool to airlines that is mission critical for airlines to schedule their flights across the globe. In this example, such licensor licenses the software to an airline for \$500,000 per year. Let's further assume that the software delivered to the airline contains a bug in breach of the software license agreement, and the airline is forced to halt operations for one day. Finally, we will assume the airline incurs \$10 million in damages due to the software bug – costs to fix the bug as quickly as possible, costs to perform the same business function via an alternate method, lost profits due to flight cancellations, costs to perform a press campaign to fight bad publicity, costs to respond to regulatory investigations, etc.

Without the standard limitation of liability provisions, it is possible that the licensor could be liable for all \$10 million. With properly worded aggregate liability cap provision, it is possible that the licensor would only be liable in amounts that would in no event exceed \$500,000. Moreover, with a properly worded waiver of consequential damages provision, the licensor's liability could be even lower because many of the damages, costs, and expenses suffered by the airline would be deemed consequential damages.

Customers will oftentimes edit limitation of liability provisions so that certain damages and liabilities are exceptions to the limitation of liability provisions, meaning that the licensor will not get the benefit of the

liability cap and the waiver of consequential damages provision if it breaches the software license agreement. Although the current trend for technology providers is to avoid unlimited liability more aggressively than in the past, it is still common for licensors to accept unlimited liability for the following:

- (1) fraud and willful misconduct;
- (2) breach of confidentiality obligations; and
- (3) indemnification obligations for third-party claims that allege the software infringes third-party intellectual property rights.

Any additional exceptions to the limitation of liability provisions may be outside of "market" terms. In our example above, if the licensor agreed to broad exceptions to the limitation of liability provisions, it could be "on the hook" for most or all of the \$10 million in damages suffered by the airline. Also, when the licensor agrees to unlimited liability for breach of confidentiality obligations, it should ensure that it does not agree to unlimited liability for breach of any data privacy or security terms.

Sometimes, customers will edit limitation of liability provisions to benefit the customer as well. The limitation of liability provisions will say that the customer will not be liable for any consequential, incidental, or other indirect damages resulting from the customer's breach of the software license agreement and that customer's total aggregate liability for all claims relating to the software license agreement will not exceed the liability cap. Generally speaking, licensors are willing to make the limitation of liability provisions mutual if the following additional exceptions are added:

- (1) customer's obligations to pay license fees;
- (2) customer's use or disclosure of the software outside the scope of the license grant; and
- (3) customer's indemnification obligations (if any).

This article is one part of a ten-part article published by Koley Jessen to help software licensors improve their form software license agreements.

Please contact Koley Jessen's Commercial and Technology Contracts Practice Group for further assistance.