

CONTRACTS and Risk Management

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You have locked down the entry points, firewalled and proxied devices, and educated staff on appropriate network use and good Web habits. You have network security and risk management covered, right? Not quite.

What do your network and IT service contracts (those obtuse documents that you hated haggling over and swore you would never look at) have to say?

A service contract can and should play a critical role in a business's risk mitigation thinking and efforts. Each service provider ("SP") relationship creates a new actor in your network. A key point of defense against the risks associated with that relationship is (or should be) the SP contract. This article is a brief discussion of negotiating service contracts to serve an enterprise's overall risk mitigation strategy.

The Contract: Obligations and Consequences

Broadly speaking, service contracts consist of two interrelated parts. The first part consists of the parties' obligations to one another. SP-related clauses describe what services it will provide and how, when, and where it will provide them. Customer-related clauses usually focus on when and how much it will pay for the services. The second part consists of terms -- warranties, liability limits, indemnities, and termination rights -- that address the allocation of risk between the parties and what happens when a party fails to hold up its end of the bargain. Both parts play an important role in risk management.

The Obligations – What to Do and When, Where, and How to Do It

Obligations can limit risk by aligning the parties' practices and expectations and prohibiting (or at least discouraging) risky behavior. For example, a business can limit disputes on scope -- what it is getting from the vendor -- by negotiating a detailed

service description. It can set expectations around resilience and trouble response by including appropriate service levels and associated governance mechanisms. It can limit its exposure to service disruptions and repair delays by negotiating terms governing who may access its sites and requiring compliance with its change control procedures. And it can limit its exposure to security breaches by negotiating SP obligations to comply with site and remote access security policies. The greater the SP's role in (and access to) the customer's environment, the greater the need to negotiate terms that ensure it complies with the customer's security policies.

Consequences – What Happens (and Who Pays) When Things Go Wrong

Risk allocation provisions are also part of the risk mitigation calculus. They specify what happens when a party fails to act as promised or causes the other party grief (e.g., by getting sued). These are the terms that make IT managers' eyes glaze over, but these are also the provisions that give meaning to (or undermine) performance commitments. For example, the broad exceptions in most boilerplate SP indemnification clauses will likely leave the customer without a remedy if a third party sues it because its use of the SP's products infringes a patent or copyright. In fact, such clauses may well provide that the customer is obligated to defend (and pay the damages of) the SP. Another example -- many

liability limitations effectively limit the SP's liability to pretty close to 0 if it does not perform, but put no limits on the customer's responsibility to pay invoiced or other charges.

Some Thoughts on Form Contracts

We will close with a comment on the special concerns presented by form contracts. Almost without exception, such forms do an excellent job of protecting the party that drafted them but offer few protections for the other side. That does not make the party who wrote the form bad; it just means that its lawyers are doing their jobs by seeking to minimize the party's business risks to the fullest extent possible. This is more of a problem for customers than providers, because most sourcing transactions start with the provider's form. The good news is that reputable vendors will cooperate to negotiate changes to their standard

forms to reasonably divide risks between the parties. The cautionary point is that it is a really bad idea from a risk point of view to accept an off-the-shelf standard form just because the account rep is a great guy and you are in a hurry to get the deal done. Instead, make sure the contract language reflects the good will and fairness pledged by the SP when it was trying to retain or win your business.

Hank Levine (WSTA's General Counsel) and Mark Johnston are partners in the law firm of Levine, Blaszak, Block & Boothby, LLP, which specializes in the representation of enterprise customers negotiating network and IT agreements with major suppliers. This article is a general and hypothetical discussion, and is not the provision of legal advice on which a reader can rely in a specific fact situation. For further information please go to www.lb3law.com.