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Key considerations when negotiating MSAs

By David R. Brown and
Christopher J. Schafer

Service contracts form an integral part of the operations of any service business. In the technology consulting area, these agreements, generally called Master Service Agreements (MSAs), can be the subject of intense bargaining for several reasons, including the comparatively large amounts changing hands and the inherent intellectual property issues.

An MSA governs the overarching relationship between client and service provider, generally involving multiple assignments over a number of years. The specifics of each assignment are set forth in a statement of work (SOW) entered into from time to time as the client's needs dictate. Each SOW is subject to the terms of the MSA. The parties generally see the MSA as providing the "legal terms" (translation: involving lawyers and onerous to negotiate) and the SOW as providing the "business terms" (translation: getting the deal done without interference from the lawyers). Consequently, the parties may consult with counsel to negotiate the MSA only, and not the SOWs that follow. This makes it doubly important for counsel to get the legal terms of the MSA right.

Five Key Provisions. A comprehensive discussion of MSA terms is beyond the scope of this article, but by focusing on five key provisions of the MSA, counsel can set the groundwork for a successful relationship between client and service provider. These areas are: (1) payment, (2) intellectual property ownership, (3) indemnification, (4) limitation of liability and (5) order of precedence. This article provides practical tips on each drawn from our experience negotiating numerous MSAs on behalf of service providers and clients ranging from large public companies to start-ups.

David R. Brown and Christopher J. Schafer are associates in the corporate, securities and finance department of Ungaretti & Harris LLP. Brown can be reached at drbrown@uhl.com. Schafer can be reached at cjschafer@uhl.com.

Counsel negotiating an MSA must observe all of the usual best practices of contract drafting, taking care to create an agreement that is clear, concise, easy to follow and adequately flexible to serve the foreseeable needs of the parties.

Payment. The MSA should contain payment provisions for consistency across all SOWs (actual pricing for particular services will, however, be contained in individual SOWs). From the perspective of the service provider, payment terms (e.g., net 30) should be set, perhaps with the right to assess late charges for nonpayment. The service provider may also want the right to suspend services for nonpayment and to recover its costs of collection (including reasonable attorneys' fees). The client, on the other hand, may wish to condition its payment obligation upon receipt of services and deliverables conforming to the detailed requirements of the SOW. It may also want the right to have the service provider correct nonconforming deliverables without charge.

Intellectual Property Ownership. The MSA should specify which party (service provider or client) will own the service provider's work product (often called "deliverables"). From the client's perspective, outright ownership of deliverables may be expected, especially where the deliverables are heavily customized. This may also be so where the service provider is merely implementing and customizing third-party software. The service provider, however should be concerned with granting outright ownership to all aspects of a deliverable, because this could result in the service provider unwittingly assigning away valuable intellectual property it may need

to service other clients. Very simply, the client should expect to receive what it paid for, but not to prevent the service provider from using what it learned in creating the deliverables for future engagements. A well-drafted MSA can strike the right balance by providing: (1) an assignment of the deliverables to the client, except for certain specified "Provider Materials" ("know-how," templates, methods, etc.), and (2) a non-exclusive, royalty-free license allowing the client to use the Provider Materials in connection with the deliverables. The parties may wish to add additional, deal-specific intellectual property terms. At a minimum, (1) the service provider should have the right to future use of improvements in the Provider Materials developed while servicing the client, and (2) the client should be protected against disclosure of its confidential information.

Indemnification. The client generally relies upon the service provider to provide important services and deliverables under the MSA, and consequently usually demands indemnification from the service provider. Most significantly, the client may require that the service provider indemnify it for third-party claims alleging infringement of intellectual property rights, so that the client is protected if deliverables contain misappropriated materials. The MSA can help the service provider mitigate the risk associated with intellectual property indemnification while providing a reasonable level of protection to the client. Specifically, service providers commonly exclude indemnification for certain client actions, including misuse or alteration of deliverables, the client's failure to use or implement corrections to deliverables, and the combination of deliverables with materials not provided or approved by the service provider. The client may also seek other forms of indemnification, including protection against the negligent performance of services, personal injury, property damage and various other items. The appropriate allocation of risk on these issues is

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situation-specific, but each party should use common sense and consider available insurance coverage. The operation of the MSA's indemnification provisions is also inextricably linked with its limitation of liability provisions, which are considered next.

Limitation of Liability. The service provider, and sometimes the client as well, almost always seek to limit liability under the MSA. Absent limitation of liability provisions, each party is fair game for the other's claims for direct and indirect (consequential, punitive, etc.) damages, with the prospect of costly and time-consuming litigation. Liability limitation provisions in MSAs generally take one or more of the following forms. First, a party's liability may be limited by type of claim, most often by excluding indirect damages entirely, giving some comfort that more speculative claims (e.g., lost profits)

will not be available. Second, liability may be capped at a dollar amount or by formula (e.g., the fees charged by the service provider for its services — under either the MSA or the relevant SOW only — during the three months preceding a claim). Finally, the parties may specify a period after which no claims may be asserted, effectively shortening the statute of limitations on claims relating to their written agreement.

Order of Precedence. As noted above, the parties to an MSA may consult counsel only in connection with the negotiation of the MSA and not for SOWs signed in the future. For this reason, the MSA should clearly state the order of precedence between the MSA and the SOWs issued pursuant to it. In general, to ensure that the legal terms embodied in the MSA remain effective, the MSA should state that it trumps contradictory terms in the

SOW. That said, the parties may choose at some point to override the terms of the MSA for a particular SOW (e.g., setting nonstandard payment terms). This should be accommodated by providing that, notwithstanding the general rule granting the MSA precedence, the SOW will control if the parties include language explicitly overriding the MSA.

Final Thoughts. Counsel negotiating an MSA must observe all of the usual best practices of contract drafting, taking care to create an agreement that is clear, concise, easy to follow and adequately flexible to serve the foreseeable needs of the parties. An MSA that addresses the five key issues outlined above will go a long way towards protecting the interests of both service provider and client. Conversely, a failure to do so can have serious consequences that may not manifest themselves for years to come.