

# Software as a service subscription agreement (pro-supplier): drafting note

Resource type: Drafting note

Status: **Maintained**

Guidance notes on an agreement for the supply of software applications and platforms which are hosted remotely by the supplier and made available to the customer via the internet, drafted from the point of view of the supplier.

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**Standard document:** [Software as a service subscription agreement \(pro-supplier\)](#)

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## **GENERAL DOCUMENT NOTES**

Software as a service or “SaaS” is an evolution of the Application Service Provider (“ASP”) model that emerged in the late nineties. The ASP model was an early beneficiary of the convergence of computing and communications that the first stage of the ‘internet revolution’ enabled between 1995 and 2005. Although it remains an important model for many customers and their software providers across many industries, ASP’s popularity is being displaced as increasing broadband speed, reliability and ease of use fuel a new generation of internet-based software delivery techniques.

The new generation, characterised as SaaS, is securely delivered to the user’s terminal at the customer on a pay per use basis over a network (typically the Internet) from processors hosted remotely by the SaaS provider – as distinct from ‘software as a licence’ installed on the customers’ servers. ASP and SaaS share the essential features of service, rather than licence, delivery from a ‘one-to-many’ (rather than ‘one-to-one’) computer centre. ASP and SaaS may be seen as steps along a road whose next step is ‘cloud computing’ – the harnessing of the internet cloud for the aggregation of computing tasks performed at multiple computer centres and locations – and whose destination is ‘utility computing’ – use of software resources genuinely ‘at the flick of a switch’.

The Standard document and Drafting note should be used for the non- (or less) customised, more generic, ‘built for the internet’, ‘web-ready’ services that characterise SaaS. In the case of the separate Standard document, ASP agreement [see []], ASP is synonymous with ‘hosted application management’ whose essentials are the provisions of hosting, access and support services with an element of specific installation/configuration for the customer.

It is common for SaaS providers to host their service and store all of their customers’ data in the ‘cloud’ - the internet environment which enables customers to use the software services without knowledge or expertise of, or control over, the technology infrastructure (including the actual processing capacity) that are used to host the software application. All of the data belonging to each customer is stored, or “stacked” on shared computer platforms operated by the SaaS provider in the cloud, but each customer’s data is capable of being kept separate from that belonging to others. This multi-tenant architecture allows vendors to offer customers major cost savings as a

result of economies of scale achieved by managing multiple customer solutions in a single operation . Vendors are further able to reduce costs by using open source software in their software applications.

As well as being able to offer major costs savings to customers, SaaS vendors benefit from only having to support one version of their software and delivering their service on a single platform. In addition, SaaS providers can make enhancements to the software on a regular basis, fairly simply: as the software is located at the SaaS provider's data centre and not at the customer's premises, the vendor is able to implement enhancements and upgrades at its data centre and then make those changes available to its entire customer base. Each of its customers can then, depending on their configuration settings, either accept or reject them as required.

Customers can also benefit from the SaaS model by not having to invest heavily in hardware, software and professional skills in order to obtain a wide range of functional capabilities – they have less of an investment in the supplier's software than is the case with 'software as a licence' and so are less inhibited in switching suppliers. This is likely to make the software market significantly more competitive and further reduce costs over time, a particularly important consideration in today's economic conditions.

These characteristics explain the recent surge in the number of businesses adopting SaaS in place of ASP and traditional 'software as a licence' solutions. Indeed, experts predict that by 2010 SaaS will account for 20% of the whole enterprise applications market.

The objective of a supplier-side SaaS subscription agreement is to protect the supplier as far as reasonably possible in the context of a market-acceptable agreement, first by extending the responsibilities of the customer; secondly, by limiting the liability of the supplier for failure to perform; and thirdly, through clarity in delineating the services that the supplier is providing. The Standard document has been drafted on the assumption that it will be used for B2B arrangements, as opposed to those involving consumers. It should be used for relatively standard SaaS deals, and will usually be presented as a set of non-negotiable terms and conditions for signature by the customer.

The standard document is drafted from the perspective of the supplier of the services.

Nevertheless, it adopts a reasonably balanced approach to the relevant issues on the basis that an agreement which is drafted too much in favour of either party serves only to increase the time and cost of negotiations.

From the customer perspective, things that the customer will need to think about include:

- In current economic conditions:
  - supplier financial stability;
  - supplier dependence on particular resources and the financial stability of the providers of those resources to the supplier;
  - the supplier's own disaster recovery/business continuity arrangements;
  - dependence on the supplier and the services;
  - impact on the customer's business in each case of a small, moderate or severe service outage; and
  - how easy or difficult it is (and hence the time and resources required) to switch to an alternative source of supply.
  
- The usual IT services deals points about:
  - service levels and credits;
  - price increases during the agreement;
  - business continuity/disaster recovery;
  - exit/disengagement management and replacement contractors; and
  - return of data.
  
- Regulatory points such as:
  - data and service security;
  - compliance with any regulatory audit obligations applicable to the customer; and
  - compliance with any other (sector-specific or generally applicable) regulatory obligations on the customer.

## **CLAUSE NOTES**

### **Interpretation: clause 1**

This clause contains definitions used in the rest of the agreement, and interpretation provisions.

### **User Subscriptions: clause 2**

Under this clause, the supplier grants to the customer a right to permit the authorised users to use the services and the documentation during the subscription term and sets out a number of usage restrictions. This right is conditional on the customer having purchased the user subscriptions.

It is assumed that the supplier and the customer will agree that a certain number of authorised users will have access to the services on a "one user per user subscription" basis (clause 2.2(a)) and that user subscriptions cannot be used by more than one authorised user (clause 2.2(b)). An authorised user will typically be an employee of the contractor, but may also include the customer's consultants and other independent contractors, and conceivably customers, suppliers or other business "partners" of the customer.

Clauses 2.2(c) to 2.2(f) set out the customer's obligations in relation to its authorised users, including the use of passwords and other security matters.

Clause 2.3 sets out certain fairly standard terms that the supplier would normally wish to see in this type of arrangement in order to protect its services and related documentation, including preventing the customer from using the services to store or transmit unlawful, infringing and discriminating material; copying, duplicating and creating derivative works of the Services and/or documentation; accessing the Services and/or documentation to build a competing service; and so on.

### **Additional User Subscriptions: clause 3**

Clause 3 allows the customer to purchase additional user subscriptions during the subscription term and sets out the procedure for doing so. The customer must pay the relevant fee for the additional user subscriptions as set out in Schedule 1. If additional user subscriptions are purchased part way through the initial subscription term or any renewal period, then the fee payable by the customer for the additional user subscriptions will be pro-rated for the remainder of that term or period.

### **The Services: clause 4**

Under clause 4.1, the supplier is placed under a general obligation to provide the services and make available the documentation to the customer. More specifically, the supplier agrees to use commercially reasonable endeavours to make the services available 24 hours a day, 7 days a week, except for planned maintenance carried out during the maintenance window and unscheduled maintenance performed outside normal business hours (clause 4.2).

The supplier also agrees to provide the customer with the supplier's *standard* customer support services during normal Bbusiness hours in accordance with its current support services policy. This

clause states that the customer may purchase *enhanced* support services separately at the supplier's then current rates (clause 4.3).

## **Customer data: clause 5**

Clause 5.1 makes it clear that the customer owns and is responsible for the accuracy, quality, and so on of the customer data, and also the means by which the customer data is acquired.

The treatment of data security and back-ups is extremely important in this type of SaaS arrangement. Under clauses 5.2 and 5.3, the supplier is under an obligation to comply with its privacy and security policy and its back-up policy.

It is likely, given the nature and scope of the services provided under this standard subscription agreement, that the supplier (the data processor) will be processing personal data on behalf of the customer (the data controller) and this eventuality has been catered for at clause 5.4. In particular, the customer acknowledges and agrees that the personal data may be transferred or stored outside the EEA (or the country or other jurisdiction where the customer and the authorised users are located) (clause 5.4(a)(i)), and the relevant third parties have been informed of and have given their consent to the supplier using, processing, and transferring the personal data (clause 5.4(a)(ii)(B)).

## **Third Party Providers: clause 6**

Clause 6 states that the supplier excludes its liability in relation to the content of, and the customer's use of, or correspondence with, any third party websites accessible via the supplier's services, and that the supplier does not endorse or approve any such third party website. A supplier could argue that its position in relation to liability for such third party content is, under general law, analogous to that of an Internet Service Provider ("**ISP**"). Under the E-Commerce (EC Directive) Regulations 2002 an ISP is considered to be an intermediary or a "mere conduit" of information and, as such, escapes liability for damages or criminal or civil action, provided that certain conditions are met. Furthermore, it could be argued that a supplier cannot be expected to be responsible for, or be aware of, the content of third parties' websites which are accessible by the customer via the subscription services that it provides. That said, it would be wise for a supplier that does become aware of illegal content of a site accessible via its services to promptly block its customers' access to that site.

## **Supplier's obligations: clause 7**

This clause sets out fairly standard supplier warranties, exclusions and obligations. Specifically, the supplier undertakes that the services will be performed substantially in accordance with the documentation and with reasonable skill and care. In the event that the services do not conform with such warranty, the supplier will use all reasonable commercial endeavours to correct such non-performance or provide the customer with an alternative means of accomplishing the desired performance. This is the customer's sole and exclusive remedy for the supplier's non-conformance (clause 7.2). If the "sole and exclusive remedy" wording was not included in the agreement, the customer may be able to bring an action for breach of contract against the supplier, in addition to the customer's existing remedies of correcting any non-performance or providing an alternative means of accomplishing the desired performance. This may, subject to the caps and limits on liability set out in clause 13, result in the supplier being liable for any direct loss suffered by the customer. Note that any exclusion clauses included in a party's standard terms will be subject to the UCTA reasonableness test and will be construed against the party seeking to rely on them. For a further explanation of the scope of each party's liability under the agreement, please see the note on clause 13 below.

In addition, the supplier specifically states that it is not responsible for any delays, delivery failures, or other damage resulting from the transfer of data over communications networks and facilities, including the internet (clause 7.2(b)).

## **Customer's obligations: clause 8**

This clause sets out the customer's main obligations under the agreement. In a SaaS arrangement like this, the supplier will regard it as essential for the customer to give basic commitments about co-operation, access and information.

Clause 8(b) is an obligation on the customer to comply with applicable laws. This provision is especially valuable where the scope of services might change with legislation (for example, in the areas of tax and accounting).

Clause 8(c) relieves the supplier of any responsibility for delays that are caused by the customer.

Under clause 8(d), the customer (i) must ensure that the authorised users use the services and the documentation in accordance with the agreement and shall be responsible for the authorised user's breach of any of the terms of it; (ii) must ensure that its network and systems comply with the

relevant specifications provided by the supplier (clause 8(f)); and (iii) is responsible for its network connections and telecommunications links from the customer's systems to the supplier's data centres, and all problems, loss or damage arising from its network connections or telecommunications links, or caused by the internet (clause 8(g)).

## **Charges and payment: clause 9**

In essence, there are three types of fees payable under this agreement:

- Subscription fee payable in respect of the user subscriptions. This fee will be paid in advance and will be based on the number of user subscriptions purchased (Schedule 1, paragraph 1).
- Fees payable in respect of any additional user subscriptions purchased by the customer during the subscription term (Schedule 1, paragraph 2).
- Fees payable in respect of any data stored by the customer in excess of the data storage limit set out in the documentation. (Schedule 1, paragraph 3).

Clause 9.6 provides that the supplier may increase the subscription fees, the additional user subscription fees and/or the excess storage fees at the start of each renewal period upon 90 days' prior notice to the customer.

## **Proprietary rights: clause 10**

This clause confirms the supplier's ownership of all intellectual property rights in the services and the documentation.

## **Confidentiality: clause 11**

This clause sets out minimum confidentiality and intellectual property rights protection provisions. It places a general obligation on each party to respect the confidentiality of information disclosed to it by the other party.

## **Indemnity: clause 12**

In clause 12.1, the customer gives a broad indemnity for claims and losses "arising out of ... the Customer's use of the Services and/or the Documentation".

Clause 12.2 is a more limited indemnity in the customer's favour in respect of intellectual property infringement claims. For further discussion of intellectual property indemnity provisions, see

[*Practice note, Main issues in software licensing and maintenance contracts: Intellectual property and indemnities.*]

## Limitation of liability: clause 13

The IT industry has since the mid-1990s been the crucible in which the UK courts have hammered out the judicial response under the Unfair Contract Terms Act 1977 (UCTA) and related UK contract and statute law on the effectiveness of contractual clauses seeking to limit contract terms and restrict liability.

Clause 13 seeks first to confirm that the customer is responsible for results obtained from the service and that the supplier has no liability in relation to what the customer chooses to do with the services (*clause 13.2(a)*); and then, to negate all implied terms (*clause 13.2(b)*), so seeking to cut down the extent and scope of the supplier's obligations at the outset.

Secondly, clause 13.3 makes a virtue of necessity by stating that death or personal injury arising from negligence cannot be excluded (*section 2(1) UCTA*), and nor can liability for fraud or fraudulent misrepresentation (*Thomas Witter v TBP. Industries [1994] Tr L R 145*).

Thirdly, clause 13.4(b) seeks to limit the supplier's aggregate liability under the contract to a pre-set sum, either by reference to the contract price or a fixed amount. As a rule of thumb, if this is a contract to which UCTA potentially applies (that is, if it is, or could be considered to be, effectively on the supplier's standard terms) then there is a risk that if the liability cap is significantly below the contract price, it could be struck down by the courts as unreasonable. In this situation, damages would be recoverable without limitation, on the basis of the ordinary contract law rules of remoteness. Depending on which formulation is chosen, these rules say that recoverable loss is either:

- Loss which arises naturally from the breach or which may reasonably be supposed to have been in the contemplation of the parties when they made the contract as the probable result of the breach (the classic formulation in *Hadley v Baxendale (1854) 9 Exch 341*); or
- All loss which at the time the contract was made was reasonably foreseeable as liable to result from the breach (*Victoria Laundry (Windsor) v Newman Industries [1949] 2 KB 528*).

Finally, clause 13.4(a) in any event seeks to exclude all loss that is special, indirect or consequential. The distinction between "direct" and "indirect" loss is not clear-cut, and there is no easy formulation to determine on which side of the line a particular category or type of loss falls in any specific case. A particular difficulty arises when deciding whether loss of profits is direct or

indirect. Recent case law has tended to hold that loss of profits can be a direct loss. In a limitation of liability clause such as this, loss of profits should therefore always be specifically excluded, and described in a way that does not link it with indirect loss. Otherwise, direct loss of profit is unlikely to be excluded, since exclusion clauses are interpreted by the courts *contra proferentem*: that is, against the person seeking to rely on them - in this case, the supplier.

## **Term and termination: clause 14**

Clause 14.1 provides for the agreement to last for an initial subscription term (as set out in Schedule 2), and after that for successive periods of 12 months (renewal periods), unless either party notifies the other of its intention to terminate the agreement at least 60 days before the end of the initial subscription term or any renewal period. The supplier and customer alike should consider whether 60 days is a sufficient period of time. Each party has the right to terminate the contract in the event of the other's insolvency or default (*clause 14.2*). For an alternative termination clause, see [PLC Corporate, Standard clause: Boilerplate: Termination](#) and its accompanying [drafting note](#). Clause 14.3 sets out fairly standard provisions for the consequences of termination.

## **Force majeure: clause 15**

A force majeure clause usually excludes liability for breach of contract where delay or failure to perform is as a result of an event outside the control of the party who is in default. The phrase derives from the codified systems of law on the continent. Those events which are to be considered as being "beyond reasonable control" must be drafted so that they are beyond dispute. This may often involve the listing of various examples - such as acts of God, strikes and defaults of suppliers - with a sweep-up clause which is drafted so as to be construed widely and not be limited by other items which have been listed.

In a business-to-business contract, a force majeure provision is likely to be subject to the reasonableness test under section 3 of UCTA, but may well be held reasonable if it is limited to events which are genuinely outside the control of the party relying on them.

See [Standard clause: Force majeure](#) and its accompanying [drafting note](#) for further consideration of force majeure provisions and an alternative form of clause.

## **Waiver: clause 16**

The supplier may fail to enforce its rights under the agreement, particularly if they are being used as standard terms (whether as a result of oversight or because of the commercial realities of the situation). Clause 16 provides that a waiver of a breach of the terms on one occasion will not affect the rights of that party if there is a further such breach or if the customer subsequently requires compliance with the relevant terms.

See [Standard document, Waiver and remedies](#) and its accompanying [drafting note](#) for a consideration of waiver provisions and an alternative clause.

## **Entire agreement: clause 18**

It is important for the supplier to exclude all pre-contractual statements from the agreement unless expressly agreed otherwise. This is because, as a practical matter, it is highly likely that during the sales process the supplier's personnel (particularly its salespeople, who are likely to be remunerated in part on the basis of sales targets) will have attended meetings and passed over sales documentation that will contain upbeat and positive statements about what the supplier can do.

The supplier should, as a business matter, ensure that it has internal policies and procedures in place to avoid "over-selling", but this clause is still particularly important. In a number of the liability cases in the IT sector (see for example *South West Water v International Computers Limited QBD, Technology and Construction Court, 1997 ORB 232*) a degree of over-selling by overly zealous sales people influenced the court to favour the customer's case over that of the supplier.

## **Assignment: clause 19**

The customer is not entitled to assign the contract without the supplier's consent, but the supplier may do so without the customer's consent. See [Assignment: drafting note](#) for a consideration of assignment provisions.

## **Third party rights: clause 21**

Standard terms should include a provision to deal with the Contracts (Rights of Third Parties) Act 1999 (1999 Act), either:

- Excluding the contract from the application of the 1999 Act; or
- Granting limited rights to identifiable third parties to enforce certain specified terms.

Any rights that are granted should be made subject to appropriate conditions that modify the statutory provisions of the 1999 Act: for example, dispensing with the need to obtain the third party's consent to any variation, or restricting the defences available to the third party.

Although it is unlikely that this agreement could be found to purport to confer a benefit on a third party, it is still advisable to include this clause to avoid any uncertainty.

See [Standard document, Boilerplate agreement, clause 23](#) for alternative forms of wording where limited rights are to be granted to third parties. See also [Third party rights: drafting note](#) for a consideration of third party rights provisions.

## **Governing law and jurisdiction: clause 23**

See [Practice note, Supply contracts: overview, Export contracts, Choice of law and jurisdiction](#) for a consideration of choice of law and jurisdiction provisions. See also [Governing law and jurisdiction: drafting note](#) for further consideration of such provisions and links to alternative clauses.

## **Non-contractual obligations and governing law**

The Rome II Regulation (which applies from 11 January 2009) allows parties to agree a governing law for non-contractual obligations. In many cases, parties will choose to conclude a governing law agreement which covers both contractual and non-contractual obligations and disputes. Even without the words in parentheses, the wording of clause 23.1 of the governing law and jurisdiction clause is probably sufficiently broad to encompass non-contractual claims which relate to the contract. The words in parentheses are intended to put the matter beyond doubt, thereby securing the Rome II protection for freedom of choice.

Note, however:

- Parties may wish to agree a more extensive choice of law for non-contractual obligations or disputes - for example, in respect of claims which relate to other, connected agreements. If so, a wider formula must be adopted.
- Conversely, some parties may wish to restrict the contractual choice of law to contractual disputes. In that case, a narrower wording (such as, for example, "claims arising under the contract") should be substituted.

If the Standard document is used (as intended) as a set of non-negotiable terms and conditions, the choice of governing law for non-contractual obligations may be ineffective. This is because this

right of choice (provided by Article 14(1)(b) of Rome II) applies to agreements that are “freely negotiated”. Although the meaning of “freely negotiated” has not been defined in Rome II, its requirement creates uncertainty over whether a non-contractual obligation governing law clause in standard form agreements will be effective.

For a detailed discussion of the possibility of the parties agreeing contractually on the law that will govern their non-contractual obligations in the light of the Rome II Regulation, and more detailed discussion of the drafting issues which may arise, see [Practice note, Rome II: an outline of the key provisions](#).

## **Schedules**

### **Subscription Fees: Schedule 1**

See note on clause 9 above.

### **Initial Subscription Term: Schedule 2**

See notes on clause 14 above.