

# CORPORATE LAW

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## NEWSLETTER

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### Cloud Computing, Part III *by Robert E. Braun*

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In past issues of the JMBM Corporate Law Newsletter, we discussed some of the benefits and challenges of cloud computing. As discussed in those articles, while there are a number of advantages which make cloud computing attractive, there are also a number of business and strategic challenges of cloud computing which need to be considered. These benefits and concerns, while not unique to cloud computing, reflect the qualities of accessing software and data through the Internet. This article briefly reviews some of the legal considerations and resolutions that clients can use to address those challenges.

#### What is Cloud Computing?

To review, “cloud computing” commonly refers to delivering computing services – software, storage capacity or other products and services – over the Internet. We use these products and services regularly, including off-site data storage (such as Web-based automatic file backup), online banking, Gmail, online search engines and online photo albums. Most of us use the cloud every day, by accessing search

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### Back of the Agreement - Boilerplate Provisions

*by Robert E. Braun and Michael A. Gold*

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The term “boilerplate” dates back to the 1890s, when printing plates of text for advertisements or syndicated columns were cast or stamped in steel ready for the printing press and distributed to newspapers around the United States. They were called boilerplates because of their resemblance to the thick, tough steel sheets used to build steam boilers.

Eventually, the term was adopted in legal transactions to describe contract clauses that are considered “standard language.” These terms are often dismissed as unimportant to the rest of the agreement or so routine that they should be included in the contract without thought to their consequences. Boilerplate, however, should be considered with the same seriousness as any other part of the

agreement. This column begins a regular series analyzing some of those “standard” provisions.

#### Further Assurances

Most commercial agreements include a paragraph reading something like this:

**Further Assurances.** Each of the parties hereto shall execute and deliver any and all additional papers, documents and other assurances, and shall do any and all acts and things reasonably necessary in connection with the performance of their obligations hereunder to carry out the intent of the parties hereto.

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## TRICKS AND TRAPS IN BUYING AND SELLING BUILDING MATERIALS AND RELATED COMPANIES

**C**hair of JMBM's Corporate Department, Bill Capps, spoke at the 2010 CalCIMA Annual Education Conference. Below is a summary of his presentation:

There are three features of building materials companies that make them especially problematic from the standpoint of buyers and sellers. The first is volatility—susceptibility to economic fluctuations. Many companies are probably doing half the volume they have done in the past and even that with decreased pricing. The second is public disapproval towards the industry. When building materials companies are seeking entitlements from local jurisdictions, they are often in for a fight.

The third feature is the time line building materials companies are forced to adopt in planning their businesses. Owners and managers

of these businesses must be alert to problems which could surface many decades in the future, in a changed regulatory environment.

### **Special issues for buyers and sellers:**

**Permitting issues.** A number of different agencies control permits vital to the operation of the business, requiring the examination of several jurisdictions when trying to determine if a business is in compliance with its permits.

### **Environmental concerns.**

Building materials companies directly touch water quality, air quality, traffic congestion and other environmental concerns to a greater extent than many other industries.

### **Reclamation deficiencies.**

It is possible for huge liabilities to develop over a long period of time. Operators may find themselves trying to quickly fix a problem that

may have developed over a very long time period.

**Unexpected tax obligations.** Unfortunately, there are few legal limits on the ability of local jurisdictions to impose or raise non-property taxes on mining operations. This means that the buyer must take into account the possibility that taxes will be increased without any corresponding benefit. Coupled with the immovable nature of these operations, it is clear that this is a risk factor to be taken into account.

### **How companies are valued and how to affect these values:**

There are several ways to get a building materials company in shape for a sale, including: examining and verifying entitlements; analyzing burdensome (or helpful) supplier and customer contracts; getting commitment from important executives and employees; analyzing and solving environmental and other liability issues,

and rationalizing financial statements.

It is important to remember that the purpose of due diligence from the standpoint of a buyer is not merely to determine whether or not there are problems which prevent the purchase of the business. The buyer wants to find problems in the business which the seller is not aware of since these serve to legitimize the re-negotiation (downward) of the purchase price. Therefore, any significant problem unknown or unidentified by the buyer ends up being to the seller's advantage. ■

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*We welcome the opportunity to talk with you about your business and to demonstrate how satisfying it is to work with attorneys who understand the building materials industry and care about their clients' success. For more information, please contact Bill Capps at 310.201.3513 or [WCapps@jmbm.com](mailto:WCapps@jmbm.com)*

## Cloud Computing *continued from page 1*

engines, social networks and email.

Cloud computing, however, is different. While most of these functions are for convenience, businesses using cloud computing may transfer essential functions from in-house operations to Internet-based services.

### **Benefits and Challenges of Cloud Computing**

We've identified a number of the

advantages of cloud computing, including cost savings, staffing benefits, scalability, mobility, information security and regulatory compliance. At the same time, we warn clients to consider a number of potential pitfalls, such as whether cloud computing is actually less expensive over time, whether the relationship will create the flexibility, especially as to expansion and reduction of services, that the user seeks, how cloud computing raises security concerns, the need to retain a technical edge

as a key advantage of cloud computing, and the challenges of disaster recovery programs.

### **Addressing Key Business Concerns**

In order to make the cloud computing relationship work – that is, in order to make sure that the customer actually obtains the promised benefits – clients should consider a few key guidelines.

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## Expert Assistance

Few companies have the in-house capability to evaluate effectively either their computing needs or the ability of a vendor to meet those needs. The added features of cloud computing, including Internet-based applications or services, remote maintenance and assistance and other factors, makes it even less likely that a typical firm possesses the ability to complete this evaluation. Based on our experience, companies that engage technical and legal consultants to guide them through the process of identifying needs, engaging vendors and evaluating compliance are much more likely to be satisfied with their experience. Companies that rely on vendors to perform these duties are “hiring the fox to guard the henhouse,” and their experiences are often unsatisfactory.

## Due Diligence

Before entering into an agreement for cloud computing services, a customer should take the time to investigate the history and performance of the vendor. Has the vendor been involved in litigation, particularly litigation claiming breach of contract or failure to perform? Are there independent user groups or blogs that have identified shortcomings in the vendor and can provide real-life evaluations? How does the vendor compare to its competitors? All these are valid concerns which should be considered before making a final choice of vendor.

## Operating Characteristics

Surprisingly, many cloud computing agreements fail to identify the functions that the customer believes he or she is buying. While a customer may have been provided with significant marketing materials and while the vendor’s website may extol the virtues of its products and services, the vendor’s agreement may not reference those claims and may, in fact, disclaim any warranty based on those materials. If the cloud computing vendor fails to provide the benefits the customer believed it was purchasing, the customer may not have meaningful recourse unless key functionalities are described and incorporated into the agreement. More importantly, identifying key functions in advance will help avoid expensive disputes altogether.

## Service Availability

Because cloud computing services are provided over the Internet, and because cloud computing vendors provide services remotely, the customer and vendor must identify any anticipated disruptions in service, and who will be responsible for those interruptions. This is essential when a customer enters into an agreement for a cloud computing vendor to provide critical, sensitive services, and where disruption in those services could hamstring the customer’s operations, its relationship with its own customers, vendors and employees, or hinder compliance with obligations to lenders, investors and regulators.

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## Support

Similar to service availability, any agreement between a vendor of cloud computing services and a customer should identify how and when the vendor will provide support. The agreement should identify support levels – for example, what constitutes a minor problem, and what constitutes a major failure – and also identify the response times by the vendor.

## Cessation of Services for Non-Payment

Most cloud computing agreements provide that if the customer does not pay invoices promptly, the vendor will have a number of remedies, including the ability to terminate service. Customers should consider the impact of the loss of critical

computing functions where there may be a dispute over payment or a disagreement as to whether the vendor has provided the services promised. If at all possible, the likelihood of a termination of service should be eliminated.

## Termination and Duties on Termination

As with any service agreement, the vendor’s right to terminate services should be reviewed very carefully and appropriately limited. Moreover, particular thought should be given to the duties of the vendor on termination. One key concern should be the ability of the customer to obtain the information held by the vendor in a format that the customer can use. Any agreement should identify with specificity the obligations of the vendor to deliver the customer’s information on termination, the format in which it will be delivered, and the continuing obligation of the vendor to assist the customer after termination in assuring the completeness, accuracy and availability of that information. As an adjunct, steps should be taken to assure that the vendor will not be able to use confidential or sensitive information following termination of the relationship.

## Vendor Failure; Back-Up and Recovery Options

Companies should consider the consequences of a business failure by a cloud computing vendor; as the past few years have demonstrated, even well-known and seemingly stable companies can fail. If a cloud computing vendor fails, its customers may lose access to key company information. Among the steps a company should take include requiring the vendor to demonstrate and maintain its back-up and recovery options, provide hard and electronic copies of the customer’s information to the customer on a regular basis, and give the customer access to software, typically through a source code escrow agreement, in the event of failure.

## Improvements and Enhancements

One of the anticipated benefits of a cloud computing relationship is the availability of continually improved and enhanced software and services. The agreement between the vendor and customer should

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