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

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

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

Chair 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.■

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

Cloud Computing

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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.

> 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.

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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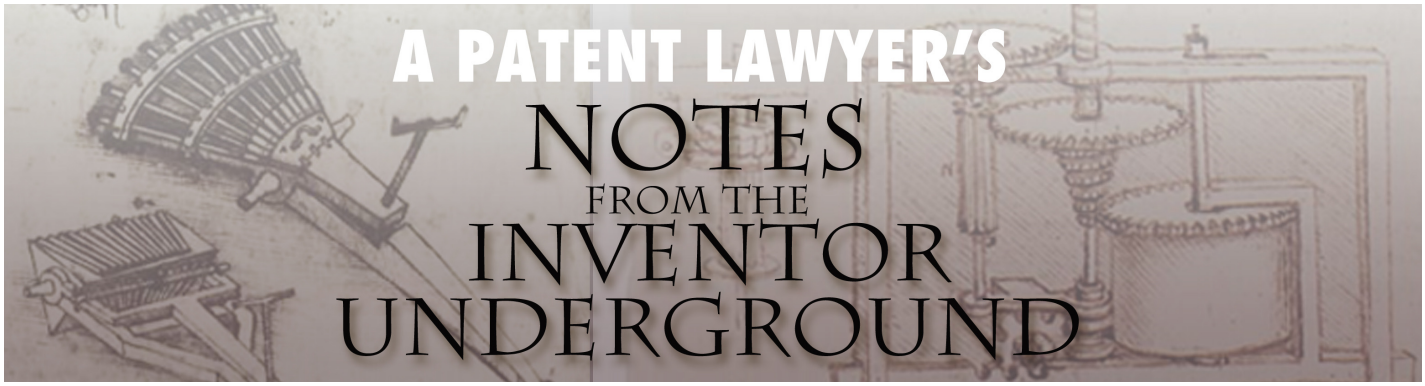
Patent Owners: Do Not Forget Taxes

by Stanley M. Gibson



What patent holders and inventors need to know before licensing, acquiring, or settling a lawsuit involving intellectual property

There are complex tax issues surrounding the licensing of intellectual property and the settlement of lawsuits regarding intellectual property. Therefore, the tax issues impacting a particular situation should be thoroughly analyzed before a patent owner goes too far down the road in licensing or settling a dispute over intellectual property. There are even more specialized rules for inventors of patents who may be able to achieve capital gains treatment for the sale of their patents, provided that the proper guidelines are followed.

The main purpose of this note is to advise that inventors and patent holders should consult their tax professionals early in the process and certainly before a license or a settlement agreement is consummated. In particular, for inventors, section 1235 of the internal revenue code should be analyzed to determine if a patent sale can be structured in a way that provides capital gains tax treatment. Section 1235, pertaining to the sale or exchange of patents, provides:

General. A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 1 year, regardless of whether or not payments in consideration of such transfer are—

1. payable periodically over a period generally coterminous with the transferee's use of the patent, or

2. contingent on the productivity, use, or disposition of the property transferred.

"Holder" defined. For purposes of this section, the term "holder" means—

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The purpose of this clause is to ensure that the parties will cooperate to accomplish whatever routine matters are necessary to fulfill the goals of the agreement. While one would hope and expect that the parties will cooperate (for example, by providing additional signed copies of documents or certifying to government authorities that agreements are authentic), including a further assurance clause that is broad and vague could lead to unreasonable requests for further assurances, disputes over whether the language covers such a request and debates about who pays for actions taken to provide "further assurances."

The parties to an agreement should consider including a further assurances clause, but also consider whether it should be qualified in some way. For example, the parties should try to foresee the additional agreements that are likely to be necessary and specifically provide for them. The general further assurances clause also might be qualified to provide that a party should not be required to incur expense or incur expenses in excess of a particular dollar amount or assume any liability as a result of the clause. The clause can expressly exclude certain actions as outside the scope of a further assurances request.

The bottom line with the further assurances clause is that, like all boilerplate, has important legal consequences and can spring some nasty surprises on contracting parties when they haven't given thought to what the clause can require parties to do as part of their contract obligations. ■

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1. any individual whose efforts created such property, or

2. any other individual who has acquired his interest in such property in exchange for consideration in money or money's worth paid to such creator prior to actual reduction to practice of the invention covered by the patent, if such individual is neither—

- the employer of such creator, nor
- related to such creator (within the meaning of subsection (d) of Section 1235).

Thus, for inventors it is particularly important to analyze their tax options before they make any transfer or assignment of patents.

For a company, there may be many different ways to treat a license, acquisition or settlement of an intellectual property dispute, each of which may have different tax consequences. For example, even though a company may receive a settlement that provides for an upfront payment for a perpetual license to compensate for both past and future use, the taxes may be due for the year in which the payment is made depending on the terms of the settlement agreement. A company expecting to defer its tax payments over a number of years may face an unpleasant surprise if it fails to structure its settlement agreement to make the deferment possible.

> If you wait until the ink is already dry on the agreement, it will be too late and the tax consequence may be severe and detrimental.

The point here is to emphasize that patent owners in any intellectual property license, acquisition or settlement involving intellectual property, should consult their accounting and tax professionals early and often. If you wait until the ink is already dry on the agreement, it will be too late and the tax consequence may be severe and detrimental.

About Notes from the Inventor Underground

Notes from the Inventor Underground is a periodic publication designed to inform inventors of legal and business issues that affect their businesses and intellectual property rights. I spend a good deal of my time enforcing and defending the technology, patent and intellectual property rights of inventors. I am continually impressed with the focus and dedication that distinguish successful inventors and I am committed to bringing the same level of rigor and intelligence to their legal and business matters. I work closely with a CPAs, management companies, financial advisors and other professionals who serve inventors and would be pleased to hear from inventors and their advisors regarding issues they would like to see covered in these Notes.■

Stan Gibson, an experienced technology and IP trial lawyer, represents inventors, manufacturers, owners and others in litigation centering on complicated technology. Stan's practice is national in scope and he represents both plaintiffs and defendants and has litigated dozens of cases on behalf of his clients, taking many of them to trial. Although most cases settle, Stan's ability to take cases to trial enhances their value and drives favorable verdicts and settlements. For more information, contact Stan at 310.201.3548 or SGibson@jmbm.com

If you would like to receive future editions of the "Notes from the Inventor Underground," please email jh7@jmbm.com.

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identify how these improvements and enhancements are implemented, the cost, if any, for the improvements, how customer requests for enhancements are treated, and related matters.

Security

As we discussed in earlier articles, identity and information thieves may find cloud computing services attractive targets. A cloud computing vendor should make clear representations as to its privacy and security policies and procedures, including compliance with applicable state and federal laws and regulations, as well as various industry standards. For example, a cloud computing provider that processes credit card transactions should be in full compliance with the Payment Card Industry's Data Security Standards. The agreement between the vendor and customer should also allocate responsibility for addressing any breach involving the customer's security. In most cases, the customer will want to control any communication with its customers, employees and other affected constituents, but will want the cloud computing vendor to be responsible for costs incurred because of a breach.

Conclusion

Accessing software, storage capacity and other products and services over the Internet bears the promise of achieving benefits key to many companies. At the same time, cloud computing customers need to understand what can stand in the way of those benefits. Jeffer Mangels Butler & Mitchell LLP regularly counsels clients on negotiating and implementing cloud computing and other technology agreements.■

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This newsletter is also available in electronic format. For more information or to provide feedback, contact Bob Braun at RBraun@jmbm.com.

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