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IT GOVERNANCE TIPS

The warranty side of software license and service agreements - Part I

Huzefa Tavawalla and Vivek Kathpalia

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Rating: --- (out of 5)

With rapid growth in the technology sector, there has been a corresponding growth in more complex software contracts. Warranties form an essential part of any Indian software contract, and they vary across deal structures. The differences arise not only due to various business models, but also from the negotiating leverage of each contracting party.

Broadly, software agreements in India consist of services and licenses. In common parlance, the agreements are generally known as "service agreements" and "license agreements."

As a customer, when your organization accepts a software solution or when the vendor provides the necessary services during the term of a license or service agreement, you usually demand a warranty period. During this period, the vendor has an obligation to rectify defects that may arise in the software, or remedy any flaws that may arise during the performance of services.

Subject to applicable laws and regulations in India, the parties are free to negotiate and agree on the nature of warranties amongst themselves. However, all customers want a far more extensive warranty that goes beyond the agreement, which may extend beyond the term of the agreement rather than a plain vanilla warranty clause. On the other hand, a vendor will always want a close-ended warranty clause, thereby ensuring that there are no warranties other than those expressly agreed to in the license or service agreement.

Industry practices

Some of the typical warranties are as follows:

• Right to enter into and perform all obligations under the agreement.
• No agreement that restricts or conflicts with the performance of both parties' rights and obligation under the agreement.
• Accuracy and completeness of technical information exchanged between the parties.
• The software, deliverables or the services performed are free from any third-party intellectual property infringement claims.

The above warranties are only illustrative, and may also be one-sided at times. Software contracts may also have express clauses in order to reflect that the services or the licensed product will comply with the specifications as mutually agreed between the vendor and the customer. Depending upon the deal size, warranties are also provided against viruses when the products (or deliverables) are developed in the vendor's environment or premises.

In case there is a breach in warranty for the licensed products or the services performed, then the recourse, which is generally agreed to is as follows:

• Rectification of the product or re-performance of the services to cure such breaches.
• If rectification is not possible, then replacement of the product.
• If none of the above remedies are available, then the vendor may refund the fees only for that particular product. If the breach is for services, then the refund will be determined on a pro-rata basis, which depends on the period that led to the deficiency in service.

Incidental clauses to warranty

Limitation of liability: Most software licenses and service agreements cap the monetary liability that may potentially arise from the breach of the above warranties. Such an amount is generally:
• The total license or service fees paid for the past six to 12 months from the date of breach; or
• A particular amount that is mutually agreed by the parties; or
• The aggregate fees paid during the entire term of the agreement.

It is now increasingly common to see that certain claims are usually carved out as exclusions to the limitation of liability clause. Thus if any situation falls under such exclusions, then the parties may claim any sums beyond the agreed limitation of liability cap.

Some examples of such claims are given below:

• Claims that result from known viruses or other contaminants, which are possibly identified at the time of software delivery.
• Third party claims for the breach of intellectual property rights.
• Claims that result from breach of confidentiality obligations.
• Claims result from acts of fraud, willful default, and gross negligence.

Warranty disclaimer: As a trade practice, software agreements also include clauses that disclaim certain liabilities. The outcome of such clauses is that if any such liability arises or accrues, they are disclaimed. Thus the parties that disclaim such warranties have no liability to the other party, irrespective of any limitation of liability clause.

A few examples of such disclaimers are:

• Disclaimer for claims or defects that arise from combination of the licensed software with any third party software without the vendor's consent.
• Disclaimer for claims that result from modification of licensed software by the customer on his own accord without the vendor's consent.
• Disclaimer of any warranties regarding end results from use of the license software.
• Disclaimer of any claims that arise from the software's use in a manner not permitted by the license.

As a trade practice, software agreements also include clauses that disclaim certain liabilities. The outcome of such clauses is that if any such liability arises or accrues, they are disclaimed.

(To be continued next week)

About the authors
Vivek Kathpalia is a partner and heads the Singapore office of the international law firm, Nishith Desai Associates and is a registered foreign attorney. He is a senior member of the information technology, media and telecom practice group and represents clients in litigations and arbitrations in sectors ranging from technology, intellectual property, telecom, real estate and education.

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Nishith Desai Associates is a Mumbai-based international tax and legal counseling firm.

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IT GOVERNANCE TIPS

The warranty side of software license and service agreements - Part II

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The Indian regulatory framework provides several provisions for warranty of software license and service agreements. In the second part of the column on warranty aspects of software license and service agreements, experts from legal firm Nishith Desai Associates offer options to resolve warranty disputes.

As per the interpretation of certain provisions under the Sales of Good Act, 1930 (**"Act"**) a buyer can invoke the implied condition that the product supplied is reasonably fit for a particular purpose. However, this is possible only if the following conditions are fulfilled:

• The buyer, expressly or by implication, makes known to the seller the particular purpose for which the products are required.
• This **"making known"** to the seller of the purpose shows that the buyer relies on the seller's skill or judgment.
• The products are of a description that is in the course of the seller's business to supply.

The communication's purpose for which the products are required may also be inferred from the product description given by the buyer to the seller, or from the circumstances of each case. For example, a seller in the business of selling mobile phones is approached by a buyer (end customer), whereby the buyer specifies that the phone should have Bluetooth connectivity. In such cases, subject to the buyer not examining the phone, it is an implied condition that the phone sold by the seller has Bluetooth connectivity.

In certain situations, warranty is also inferred from the product's quality. However, as per Section 62 of the Act , if the parties to a contract have come to an express agreement with respect to a particular term or clause, a different provision on the same point implied by law cannot have effect, because the mutually agreed express term or clause will override the implied term provided by law.

In light of the above, if a software vendor licenses the software on an "as is" basis, and expressly disclaims all his liabilities by way of a contractual arrangement, then as per Section 62, such a software vendor may not be liable for any implied warranty or condition arising under law, as the same will be overridden by the express terms mutually agreed in the contract.

Under Indian law, a breach of warranty gives the right to claim damages and not the right to reject or repudiate the contract.

Under Indian law, a breach of warranty gives the right to claim damages and not the right to reject or repudiate the contract. However, breach of a condition gives the right to reject or repudiate the contract along with the right to claim damages.

Therefore, notwithstanding an agreement to the contrary, if there is an express warranty for the performance of a licensed software, then failure of such performance gives a right to claim damages and not the right to reject the software. Depending upon the facts and circumstances in each case, a refund can also be claimed . The Indian courts have also held that where replacement of the defective parts is warranted under an agreement, then it is the liability of the seller (or licensor) to replace the defective parts if the defect is reported within the warranted period .

The need for customer awareness

The Indian economy has witnessed a sea change in the recent past. However, a need for much higher levels of awareness among vendors and customers is desirable.

The existing Indian statutes have adequate provisions to uphold the contractual terms agreed between the parties, unless the same are contrary to law. Hence, it is imperative that software contracts should be express, comprehensive and unambiguous. This will not only avoid interpretation issues, but also achieve a proportionate blend of rights and obligations between the parties.

Read: The warranty side of software license and service agreements - Part I

About the authors

Vivek Kathpalia is a partner and heads the Singapore office of the international law firm, Nishith Desai Associates and is a registered foreign attorney. He is a senior member of the information technology, media and telecom practice group and represents clients in litigations and arbitrations in sectors ranging from technology, intellectual property, telecom, real estate and education.

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1 Section 16 - Sales of Goods Act, 1930
2 Section 62 - Where any right, duty or liability would arise under a contract of sale by implication of law, it may be negatived or varies by express agreement or by the course of dealing between the negatives or varied by express agreement or by the course of dealing between the parties, or by usage, if the usage is such as to bind parties to the contract.
3 Super Computer Centre Vs. Respondent: Globiz Investment Pvt. Ltd [3(2006)CPJ256,NC]
4 C.H. Krishnan Associates Vs. Union of India, [68 (1997) DLT 506]