Negotiating Limitation of Liability Provisions in Agency-Client Agreements

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Today’s Presenters

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The Issue
Two Diametrically Opposing Points of View

**Client View**
- Vendor/Agency is caretaker of services, IP, and data.
- If the Vendor/Agency is at fault, why limit its liability?
- Agency is in part being hired to take on the risk.
- Vendor/Agency is an attractive target for hackers because it works with multiple clients.

**Agency View**
- Sometimes risk is unavoidable.
- Often Vendor/Agency is a victim too.
- Just because client is paying, does not mean it should be allowed to outsource 100% the risk.
- $XX,000 revenue stream is not worth $XXMM risk.
- Client is an attractive target due to deep pockets.
Two Diametrically Opposing Points of View

<table>
<thead>
<tr>
<th>Client View</th>
<th>Agency View</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clients may treat all risks in a similar fashion</td>
<td>Vendor/Agency wants to avoid taking on more liability than dictated by the type of services it is providing</td>
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<td>Vendor/Agency should be responsible for all its own third-party vendors</td>
<td>Vendor/Agency is often working with third-party vendors that will limit their own liability</td>
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<td>Agencies need to be thoughtful on what they pitch and be accountable</td>
<td>The type of services being conducted sometimes depends on the ability to take on risks which is a cost of doing business for client</td>
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<td>Agencies can’t suggest ideas and make the client liable for researching</td>
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Scope of Indemnification
What is the Proper Allocation of Risk?

Client Wants to be Indemnified for:
- Violation of laws
- Security Breach incidents
- Failure to comply with obligations
- Third-party services/data/tools
- Patents
- Materials and claims supplied by Agency

Agency Wants to Limit Indemnification to:
- Intentional acts, gross negligence, or wilful misconduct
- Material failure to maintain the described security protocols
- Pass-through indemnification to the extent received
- Limited patent responsibility

Client Wants to Limit Indemnification to:
- Intentional acts, gross negligence, or wilful misconduct
- Client IP
- Product liability

Agency Wants to be Indemnified for:
- Violation of laws
- Improper provision of data
- Failure to comply with obligations
- Third-party services/data/tools
- Risks client has opted to take
- Client supplied Information
- Product liability
- Client modifications/scope of use
Limitation of Liability Provisions
Typical Limitation of Liability Provisions

• Limitations based on type of damage
  • Direct
  • Consequential
  • Lost Profits/Revenue
  • Punitive

• Limitations based on cause of damage
  • Breach of Confidentiality
  • Data/Privacy
  • Indemnification
  • Patent and Other IP claims

• Limitations on amounts of damages
Typical Limitation of Liability Provisions Requested

• Disclaimer of Liability for Certain Damages
  • Consequential, special, incidental, indirect damages, punitive damages, or lost profits/reputational harm; and

• Cap on Total Liability
  • Often capped to total fees paid under the contract, or
  • fees paid in the prior 12 months

Source: 2016 Willis Towers Watson Winter 2016 Cyber Claims Brief
Typical Provision

• **Limitation of Liability.** IN NO EVENT SHALL EITHER PARTY BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL OR CONSEQUENTIAL DAMAGES, OR DAMAGES FOR LOSS OF PROFITS/REPUTATIONAL HARM, REVENUE, DATA, OR USE, INCURRED BY OTHER PARTY OR ANY THIRD PARTY, WHETHER IN AN ACTION IN CONTRACT OR TORT, EVEN IF SUCH PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. TOTAL LIABILITY OF FOR A SERVICE IS LIMITED IN ALL CASES AND IN THE AGGREGATE TO THE AMOUNT OF FEES ACTUALLY PAID BY COMPANY FOR THE CORRESPONDING SERVICE DURING THE TWELVE (12) MONTHS PRECEDING THE DATE OF THE EVENT THAT IS THE BASIS FOR THE FIRST CLAIM.
Typical “Carve-Out” to Provision

• Limitation of Liability. EXCEPT WITH RESPECT TO CLAIMS OF INDEMNITY, BREACH OF CONFIDENTIALITY, BREACH OF DATA SECURITY OBLIGATIONS, AND ARISING FROM A DATA INCIDENT (AS SET FORTH IN SECTION XX), IN NO EVENT SHALL EITHER PARTY BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL OR CONSEQUENTIAL DAMAGES, OR DAMAGES FOR LOSS OF PROFITS/REPUTATIONAL HARM, REVENUE, DATA, OR USE, INCURRED BY OTHER PARTY OR ANY THIRD PARTY, WHETHER IN AN ACTION IN CONTRACT OR TORT, EVEN IF SUCH PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. EXCEPT WITH RESPECT TO CLAIMS OF INDEMNITY, BREACH OF CONFIDENTIALITY, BREACH OF DATA SECURITY OBLIGATIONS, AND ARISING FROM A DATA INCIDENT (AS SET FORTH IN SECTION XX), TOTAL LIABILITY FOR A SERVICE IS LIMITED IN ALL CASES AND IN THE AGGREGATE TO THE AMOUNT OF FEES ACTUALLY PAID BY COMPANY FOR THE CORRESPONDING SERVICE DURING THE TWELVE (12) MONTHS PRECEDING THE DATE OF THE EVENT THAT IS THE BASIS FOR THE FIRST CLAIM.
Ultimately Two Questions

1) Will the Agency be liable for consequential damages and/or lost profits/reputational harm for claims of indemnity, confidentiality and data breach, and if so, how much?

- **Consequential**: Parties often agree to this with carve-outs, but ... do they know exactly what they are giving up?
- **Indemnity**: Parties often agree to this carve-out, if necessary, assuming it will be covered by insurance, but ... patent infringement is often not covered by insurance
- **Confidentiality**: Parties often agree to this carve-out, if necessary, assuming that the chance of a significant loss will be low but ... this should be confused with a carve-out for data breach/privacy claims
- **Data Breach**: Agencies/Vendors highly contest this liability given the perceived large potential liability

2) Will there be an overall cap on liability, and if so, will claims of indemnity, confidentiality, and data breach be excluded?

- Parties sometimes agree to a cap on direct damages (1x, 2x, or 3x amount paid), but clients press to have unlimited liability claims of indemnity, confidentiality, and data breach
Exclusion of Damages
What Are the Types of Damages?

• “Direct”
  • Damages which, in the ordinary course of human experience, can be expected to naturally and necessarily result from a breach
  • These damages are presumed to have been foreseen or contemplated by the parties as consequences of a breach

• “Consequential” or “Special” Damages
  • Damages that arise out of special circumstances, not ordinarily predictable
  • May not be obvious to one of the parties in advance without communication of the other party’s special circumstances

• “Incidental”
  • Expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or breach
How Are Damages Categorized?

**Often Seen as Direct**
- Money paid for the service
- Cost of corrections of Work Product
- *Lost profits*

**Often Seen as Indirect, Consequential, or Incidental**
- Lost value of consumer information
- *Lost profits* from business interruption
- Loss of revenue from downstream relationships
- Data breach notification and remediation-related costs
- Attorneys’ fees and other expenses
- Third-party claims (in some cases)
- Government fines or penalties
- Damage to reputation
- Increased customer attrition/reputation damage
Common Exclusions

• Exclude consequential, incidental, indirect, damages

• Exclude lost profits/revenue and/or reputational harm
  • Do not assume that these are consequential damages

• Carve-outs to Exclusions
  • Indemnification – with caution about patent liability
  • Confidentiality
  • Data Breach/Privacy

• Consider liability in the context of your insurance limits
Unenforceable Exclusions

• All damages, particularly in sales contracts
  • *Whitesell Corp. v. Whirlpool Corp.*, 2012 WL 3631491 (6th Cir. Aug. 23, 2012)
    • Agreement clause precluded recovery of damages arising from “any performance or breach,” which effectively barred all damages and deprived the plaintiff of any adequate remedy
    • Court found the clause to be contrary to contract law requiring that sales contracts must provide at least minimum adequate remedies

• Gross negligence

• Willful misconduct or intentional wrongdoing
Lost Profits

• Courts have held that “lost profits” can be either direct or consequential damages

• The important question is whether the lost profits would follow naturally and necessarily from a breach of the contract
  • direct lost profits → generated from an agreement between the contracting parties
  • consequential lost profits → generally dependent upon an agreement with a nonparty

• Thus, lost profits should be a separate category from consequential damages
Court Holds Lost Profits Subject to Limitation of Liability Provision

SOLIDFX, LLC v. Jeppesen Sanderson, Inc.

Facts:
- Software licensing agreement
- Limitation of liability section excluded lost profits in one section and consequential damages in another
- Alleged breach of contract created “lost profits”

Issue:
- Did the agreement preclude recovery of direct lost profits or only consequential lost profits?

Holding:
- Agreement excluded both direct and consequential lost profits
- Separation indicated intent to exclude direct and consequential lost profits, rather than only consequential lost profits
- If lost profits were listed as an example of a type of consequential damages in an agreement, the agreement would exclude only consequential lost profits
Court Holds Lost Profits Are Direct Damage

Biotronik AG v. Conor Medsystems Ireland Ltd.

Facts:
- Distribution agreement between a manufacturer of medical products and its distributor
- Agreement contained “no consequential damages clause”
- Alleged breach of contract created “lost profits” where breach prevented the distributor from selling the manufacturer’s product

Issue:
- Were lost profits “direct” or “consequential” damages?

Holding:
- Lower court erred in drawing a bright line rule that lost resale profits can never be general damages simply because they involve a third-party transaction
Caps on Liability
What is the Right Amount?

• Should there be a cap at all?
  • Consider the cap in the context of the whole agreement

• Is the cap reasonable in relation to the contract price and, therefore, enforceable?

• Is the cap overly expansive and therefore irrelevant?

• Should the cap be mutual?

• Should the cap be tied to insurance amounts?

• Is the amount sufficient incentive to prevent breach?
Types of Caps

• Identifying a fixed monetary amount
• Relating the cap to a proportion of the fees (excluding any media and other third-party costs) paid to the Agency during a fixed period (prior to the claims)
• Relating the cap to an amount of the fees paid for the particular work or project from which the claim resulted
• Proportionally sharing liability (e.g., based on ratio of Agency fee to client marketing spend)
• Having the Agency responsible for an initial fixed amount and then a proportional sharing of responsibility with client for any amount above such initial fixed amount
• Contractual statute of limitations
Point of Contention: Intellectual Property
Patent Liability

• ANA recommends
  • Clients should not indemnify for patents
  • Consider shared approach
  • Agencies should not recommend ideas and shift responsibility to clients to clear them

• 4As recommends
  • Agencies should not indemnify for patents
  • If indemnifying:
    • Limit contribution to an equitable and proportionate share
    • Limit contribution to claims arising solely from use prior to receipt of the claim of work product produced entirely by agency, for specific time and specific uses
  • Consider excluding claims for commonly used functionality and by known patent trolls
Liability for Trademark Clearance

• **Agency Position**
  - Agencies responsible for trademarks contained in agency creative, excluding taglines or marks provided by client
  - Clients responsible for client cleared marks/taglines
  - Agencies run preliminary clearance and clients responsible for final clearance
  - Agency responsible for marks it fails to identify to client

• **Advertiser Position**
  - Varies based on internal clearance procedures
    - Agencies fully liable for all agency creative, including trademarks
    - Client will take responsibility if identified to client
    - Take responsibility if a mark will be registered
Point of Contention: Data/Privacy
Unique Areas of Negotiation

Security  Use and Sharing  Liability
Understanding the Data

• Not all data is the same
  • Not all data is “sensitive personally identifiable information”
  • Not all data needs to be subject to strict security or data incident response protocols
  • Broad language may create liability/obligation where it does not otherwise exist

• Language is broad because the parties want to leave open the possibility for expansion of services
  • It may be inefficient to negotiate data security and use protocols on a case by case basis
Take Time to Define Data

• Consider creating different data definitions so that liability/obligation attaches proportionately based on the sensitivity of the data

• Parties may consider accepting liability where it is comfortable that the probability of the liability materializing is low

• Breach of confidentiality and breach of privacy obligations should be treated differently
Allocating Responsibility for Data Use

Ownership of data dictates which party’s privacy policy applies

Client has the primary responsibility for ensuring it has adequate consent to collect, use, and share information in connection with Agency’s services.

Client will rely on Agency to understand what data is being collected, how data is being used, stored, and shared.
Other Ways to Limit Liability

Narrow the circumstance in which you are responsible for a Security Breach

**Client Preferred**
Agency liable if the breach occurred in its system

**Agency Preferred**
Agency liable if it is intentional

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Other Ways to Address Liability

Negotiation Points

• Scope of what constitutes a breach and what constitutes PII
• Vendor liable if it fails to undertake specified actions
  • Breach of security duties spelled out in the contract (e.g., failure to maintain virus protection or firewall)
• Vendor only liable for notification-related costs (not all losses)
• Exclude profits (even if agree upon liability for consequential damages)
• Limit liability for third-party vendors
  • Limit obligations to pass-through indemnification and limitations of liability
• Client can negotiate directly with third-party vendors that handle client data
Remember, Data Breach Costs Can Be Consequential or Direct Damages

• What services are provided?
  • If data security and privacy isn’t at the core of the services, may be consequential damages

• Reputational loss vs. investigation and notification costs
  • What is the risk of each?
Court Holds Data Breach Losses “Consequential”


Facts:
- LMT hired Silverpop to send emails on its behalf
- LMT provided Silverpop its confidential email list
- Silverpop had a data breach and list was misappropriated
- Contract excluded consequential damages

Issue:
- Was the decrease in value of the email list a “direct” or “consequential” damage?

Holding:
- Damages were “consequential” b/c contract’s purpose was email marketing & confidentiality obligations were incidental to the purpose
- Conclusion despite a provision in the agreement requiring Silverpop to protect “confidential information,” suggesting that security was an aspect of the deal
Court Holds Data Breach Damages Are “Consequential”

_In re Heartland Payment Sys., Inc. Customer Data Sec. Breach Litig._

**Facts:**
- Heartland Payment Systems processes credit card info
- Hackers stole credit card and banks sought the costs they incurred in paying for the fraudulent transactions and replacing consumers’ cards
- Contract between banks and Heartland excluded consequential damages

**Issue:**
- Are data breach damages “direct” or “consequential”? 

**Holding:**
- Data breach damages were “consequential” damages
- Direct damages are only the difference between the amount paid and the value received
- Note: this rule was rejected by the New York Court of Appeals and California Supreme Court in other cases
8th Cir. Case on Limitation of Liability in Security Breach Case

Schnuck Markets Inc. v. First Data Merchant Data Services Corp.

**Facts:**
- First Data provided credit and debit card processing services to Schnucks
- First Data claimed damages in order to reimburse banks that issued payment cards affected by a Schnucks data breach
- Schnucks must indemnify for “all losses, liabilities, damages and expenses” but limits Schnucks’ liability to $500,000
  - Exception for “chargebacks, servicers’ fees, third-party fees and fees, fines, or penalties” assessed by payment card networks

**Issue:**
- Are damages owed to banks exempted from the limitation of liability as “third-party fees” and “fees, fines, and penalties”?  

**Holding:**
- Schnucks’ liability is limited to $500,000
- Exception for “third-party fees” and “fees, fines, and penalties” was not intended to apply to liability for issuer losses assessed
FTC Privacy Settlements

<table>
<thead>
<tr>
<th>Company</th>
<th>Details</th>
<th>FTC Settlement</th>
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<tbody>
<tr>
<td>Ashley Madison</td>
<td>• 36 million user profiles hacked&lt;br&gt;• Only the last 4 digits of a credit card number&lt;br&gt;• FTC and State Settlement $1.6 million</td>
<td></td>
</tr>
<tr>
<td>Snapchat</td>
<td>• 4.6 million profiles hacked&lt;br&gt;• Only usernames/phone numbers&lt;br&gt;• FTC settlement with no monetary penalties</td>
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</tr>
<tr>
<td>Accretive Health</td>
<td>• 23,000 health records&lt;br&gt;• No payment data&lt;br&gt;• FTC settlement with no monetary penalties</td>
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<tr>
<td>ASUSTeK</td>
<td>• 12,900 consumers&lt;br&gt;• Hackers gained unauthorized access to connected storage devices&lt;br&gt;• FTC settlement with no monetary penalties</td>
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</tbody>
</table>
Class Action Standing Post-Spokeo

Breaches involving credit card numbers have been surviving standing challenges

• 7th and 6th Circuits have upheld standing where plaintiff alleges personal information was stolen, an increased risk of future harm, and that mitigation costs were incurred in response to that risk.

• But, 2nd Circuit finds no standing in recent Michaels breach because credit card was promptly cancelled, no other information stolen, no specifics on time and costs

Those that don’t involve payment cards have been mixed

• Suits have held (8th Cir.) that plaintiffs lacked standing because they argued on the basis of a “threat of future harm” — that the breach would make them more vulnerable to identity theft in the future

• However, some courts have held that a data breach creates a sufficient “risk of real harm” to allow standing under Spokeo

• Mere threat of identity threat sufficient “harm” to confer standing
Insurance Coverage
Key Question: What Does Insurance Cover?

• Most CGL policies contain explicit cyber-exclusions and will not provide data breach coverage unless cyber endorsements are selected
  • Many courts have ruled CGL doesn’t cover security breaches
  • Does the cyber policy include liability for consequential damages?
• Most E&O policies don’t cover patent infringement
• Trademark and advertising claims are covered by E&O rather than CGL
• Insurance limits vary from $1-10 million, varied based on scope of work
  • How does the deductible affect the liability cap?
Insurance Coverage – Specialized Cyber Risk Policies

First-Party Coverage + Third-Party Coverage = Covering All the Bases
First-Party Coverage

Security Breach coverage may include:

- Determining whether a breach has occurred
- Investigating the cause/scope of breach
- Notifying impacted parties
- Credit monitoring
- Overtime salaries for staff dealing with breach
- Public relations expenses

Other coverage available:

- Costs to restore/recreate data
- Your own direct losses due to computer fraud/fund transfers
- Your own business income/extra expenses
- Extortion threats
- Legal consultation fees
- Policies may not cover your lost profits/reputational harm
- May need separate endorsement
Third-Party Coverage

May cover:
- Defense costs, damages/settlements in connection with:
  - Civil liability arising from disclosing PII or virus transmission
  - Regulatory investigations and proceedings
  - Don’t cover penalties but could cover settlement with regulators if guised as compensatory
  - Lost profits/reputational harm
  - So if not excluded is included

Other coverage available:
- Programming errors and omissions liability
- Media liability
  - Can be broad or more limited
  - Often used in IP space
- Can cover privacy invasion
- May also cover right of publicity violation
Ways to Limit Liability Outside the Limitation of Liability Provision
Sequential Liability

• Agency will be responsible for paying media/vendors if paid by client first
  • If the client doesn’t pay, client will be directly liable

• Agencies will often ask for “sequential liability” in contracts
  • With Client and Media/Vendors
    • To avoid acting as credit for clients, particularly in large $$$ contracts (e.g., media)

• Client pushback
  • Willing to deal with Agency if there is non-payment, unwilling to deal with unknown third parties
Third-Party Liability

• Points at issue
  • Agencies may be more willing to take responsibility if marking up vendor cost
  • Responsibility for sub-contractors vs. vendors
  • Liability for vendors that the client directed the agency to use
  • Pass through indemnification/liability coverage
  • Whether the agency signs as agent
Contract as a Whole

• Cumulative Remedies
  • Ensure the provision is subject to any limitation of liability provision

• Equitable Relief
  • Limitation of liability does not limit the ability to seek equitable relief

• Exclusive Remedy
  • Specify that the limitation of liability section sets forth the sole and exclusive remedies for any claims of liability

• Retain drafts of revisions
Ways to Improve Chance of Success in Negotiation

- Create firm liability policy and do not deviate
- Be upfront on policy
- Socialize the policy internally
- Everyone must be part of the team when defending the issue
- Be prepared to walk away
- See draft agreement and negotiate as soon as possible
Thank You.