

ECKERT SEAMANS CHERIN & MELLOTT, LLC

Negotiation of Software Licenses

Anatomy of a Software License

Stephen M. Foxman
Philadelphia
PBI - December 2011

ECKERT SEAMANS
ATTORNEYS AT LAW

General Principles

- Goals:
 - ◆ Licensor wants to make a sale
 - ◆ Licensee wants benefit of licensed software
- Dealkillers:
 - ◆ My way or the highway – this is our form, and we don't negotiate

ECKERT SEAMANS
ATTORNEYS AT LAW

General Principles

- Always Read the Boilerplate
 - ◆ Avoid glossing over technical terms or descriptions you do not understand – ask
 - ◆ If you don't understand it, how will a judge?
- If Representing the Licensee:
 - ◆ Understand what Licensee expects from licensed software
 - ◆ How critical is this application to business processes?
 - ◆ How important is this license sale to Licensor?

ECKERT SEAMANS
ATTORNEYS AT LAW

Identity of Licensee

- Licensor concern: Wants to limit extent software may be transferred to related parties, or be subject to expanded use, without additional license fee
- Licensee concern: Wants right to use for whole enterprise

ECKERT SEAMANS
ATTORNEYS AT LAW

Scope of License Grant

- Points of Negotiation --
 - ◆ Licensee affiliates included vs. not included?
 - ◆ Exclusive vs. nonexclusive?
 - ◆ Limited term vs. perpetual?
 - ◆ Worldwide vs. limited territory?
 - ◆ Internal use vs. Licensee customers or third parties?
 - ◆ One user/one device/one location vs. multiple users/multiple devices or cores/multiple locations?
 - ◆ Copies for backup and disaster recovery?
 - ◆ Transaction volume limitations?

ECKERT SEAMANS
ATTORNEYS AT LAW

Other Scope Issues

- Licensee right to have access to source code
 - ◆ Licensee right to modify and create derivative works
 - ◆ Licensee right to maintain or use third party maintenance and support
 - ◆ Source code escrows

ECKERT SEAMANS
ATTORNEYS AT LAW

Ownership of IP

- Licensor concerns:
 - ◆ wants clear ownership of offered programs
 - ◆ new programs or work product being used or exploited far beyond original scope by Licensee
 - ◆ protection of pre-existing tools, programs, know-how
 - ◆ middleware or connector software
 - ◆ supporting or enhancement programs that make Licensor programs more marketable

ECKERT SEAMANS
ATTORNEYS AT LAW

Ownership of IP

- Licensee concerns:
 - ◆ For custom software, Licensee wants what it paid for – expects right to exploit in intended field and expansion to other fields
 - ◆ Wants to preserve competitive advantage by controlling connector software or middleware
 - ◆ Wants ownership of licensee data and possibly improvements or enhancements written by Licensee directly, or by third parties for Licensee

ECKERT SEAMANS
ATTORNEYS AT LAW

Maintenance and Support

- Licensor concerns:
 - ◆ cash flow from ongoing updates and support
 - ◆ continuous requirement to use Licensor for maintenance (no breaks)
 - ◆ right to cease maintenance; to increase fee w/o limit
 - ◆ limit exposure from failure of software to perform, from software obsolescence or failure to upgrade
 - ◆ limit exposure to “best efforts” to resolve problems, or if specific fixes are agreed to, sole remedy is termination (i.e., no damages claim from Licensee)

ECKERT SEAMANS
ATTORNEYS AT LAW

Maintenance and Support

- Licensee concerns:
 - ◆ reduced fee based on discounted price for software
 - ◆ cap on increase in fee, (e.g., set % or CPI)
 - ◆ SLA (fee credits and right to terminate where breach)
 - ◆ software to continue to perform and meet specs
 - ◆ standard upgrades and upgrades for interoperability or compatibility with new software and hardware
 - ◆ right to terminate maintenance and right to resume
 - ◆ no Licensor unilateral termination of maintenance
 - ◆ consulting and/or customization services

ECKERT SEAMANS
ATTORNEYS AT LAW

Hosted Software (or in the Cloud)

- Licensor Concerns:
 - ◆ Subscription model – terminate if not renewed or failure to pay fee
 - ◆ No liability for loss of access, loss of data, or security breach
 - ◆ Prohibit Licensee's wrongful, illegal or abusive use (e.g., Acceptable Use Policy)
 - ◆ Licensor, by hosting, has less problem with compatibility, upgrades, installation, control of copying

ECKERT SEAMANS
ATTORNEYS AT LAW

Hosted Software (or in the Cloud)

- Licensee Concerns:
 - ◆ Availability (uptime) and responsiveness
 - ◆ What happens at end of subscription or renewal term – how does data get transferred or returned?
 - ◆ Loss of access, loss of data, security breach – limited insurance coverage for losses of service function
 - ◆ No ability in most circumstances to modify, improve, enhance or adapt software to Licensee's needs
 - ◆ Redundancy – if access unavailable, can Licensee continue to conduct business?

ECKERT SEAMANS
ATTORNEYS AT LAW

Representations and Warranties

- Licensor concerns:
 - ◆ Disclaimer of any warranty vs. limited to conformance to published specs (assuming proper environment, compatible software and hardware, used in accordance with documentation)
 - ◆ Limit duration of warranty in time (typically 90 days from delivery to Licensee)
 - concern about changes in Licensee's software operating systems, hardware, and telecommunications standards

ECKERT SEAMANS
ATTORNEYS AT LAW

Representations and Warranties

- Licensee concerns:
 - ◆ Ownership and right to license or sublicense; authority to enter into license agreement
 - ◆ Software will perform in accordance with published specs, Licensor's proposal, and documentation
 - ◆ Software will work with licensee's existing system
 - ◆ No infringement of third party IP rights
 - ◆ No viruses or other malware or harmful code
 - ◆ Warranty term, commencement of term, and continued warranty if maintenance contract

ECKERT SEAMANS
ATTORNEYS AT LAW

Indemnification

- Licensor concerns:
 - ◆ May want to seek general indemnity for any breach of agreement by Licensee
 - ◆ Licensor may want to limit its indemnity to IP reps and to third party claims only
 - ◆ Avoidance of defense obligation or costs
 - ◆ Limit exposure on breach of indemnity to direct damages and liability limit in dollars, usually to what was paid by Licensee for license, or over limited time

ECKERT SEAMANS
ATTORNEYS AT LAW

Indemnification

- Licensee concerns:
 - ◆ Indemnity for breach (rarely given), violation of reps and warranties (not uncommon), and infringement claims (quite common)
 - ◆ Indemnity to include obligation to defend, and to pay legal costs of defense
 - ◆ Wants broad indemnity, not necessarily limited to third party claims, and then wants indemnification obligation NOT to be limited by any disclaimer as to liability for consequential damages or limitation of liability to specific dollar amount

ECKERT SEAMANS
ATTORNEYS AT LAW

Disclaimers

- ◆ Licensors want broad disclaimer without any exceptions; typical disclaimers for UCC implied warranties, no consequential damages
- ◆ Licensors may want contract statute of limitation on all claims under contract by Licensee (usually tries to limit claims to one or two year period)
- ◆ Licensee wants exception for specified warranties contained in the license agreement, exception (as to consequential damages disclaimer) for claims based on willful misconduct, breach of confidentiality or indemnification provisions

ECKERT SEAMANS
ATTORNEYS AT LAW

Limitations of Liability

- ◆ Licensors usually will try to limit any liability arising under the license agreement to low dollar amount, or tie to amount received by Licensors over prior specified period (e.g., 12 months)
- ◆ Licensee prefers no limit, but if limitation, then should be mutual and dollar limit should be realistic in relation to risk of damage involved. If tied to amount paid by Licensee, should cover amount "paid or to be paid" over term (or specified floor amount)
- ◆ Licensee wants to exclude from limit any indemnification obligations (e.g., defense cost in an IP case would likely swamp most dollar limits), liabilities for breach of confidentiality provisions, willful misconduct and sometimes breach of reps and warranties

ECKERT SEAMANS
ATTORNEYS AT LAW

Effect of License Termination

- Licensor concerns:
 - ◆ Ends on expiration or earlier termination (Licensor has leverage to force renewal or extract more fees)
 - ◆ Wants to prevent Licensee from using software after termination and does not want to be bound to provide transition or migration services (leverage issue), particularly if Licensee breach

ECKERT SEAMANS
ATTORNEYS AT LAW

Effect of License Termination

- Licensee concerns:
 - ◆ Wants perpetual license (no expiration date), or sufficient time (no sudden termination) to acquire replacement software and migrate data
 - ◆ Wants assistance from Licensor to get migration of data to new software or service provider, regardless of reason for termination – cooperation obligation and cost can be covered in license agreement

ECKERT SEAMANS
ATTORNEYS AT LAW

Remedies – Licensor Concerns

- ◆ Wants all remedies at law or in equity
- ◆ Wants to terminate all use of software, return of all copies; injunctive relief; collect unpaid amounts
- ◆ If Licensor breach, “commercially reasonable efforts” to fix; if not fixable, no liability beyond refund of prepaid maintenance fees
- ◆ No consequential damages; limit damages to specific dollar amount or price “paid” by Licensee over the preceding 12 or 6 months
- ◆ Usually wants waiver of right to jury trial

ECKERT SEAMANS
ATTORNEYS AT LAW

Remedies – Licensee Concerns

- ◆ Limit damages to fees through date of termination
- ◆ Avoid disruption from termination of license; no sudden turn off and assistance with migration
- ◆ SLA with objective metrics, rapid response and teeth - termination if problem cannot be fixed within a specific time, or occurs repeatedly
- ◆ Exclusion of consequential damages to be mutual
- ◆ No dollar limit on liability, or reasonable dollar limit
 - Damage limit that is equal to licensor insurance coverage?
- ◆ Exceptions to dollar limit:
 - Indemnification; confidentiality breach; willful misconduct or gross negligence

ECKERT SEAMANS
ATTORNEYS AT LAW

Insurance

- Licensor concerns:
 - ◆ Usually does not want insurance provision
 - ◆ May try to limit required coverage to general liability
- Licensee concerns:
 - ◆ Wants Licensor to have and maintain coverage
 - ◆ Wants evidence of coverage; info on deductibles; errors and omissions coverage
 - ◆ Wants coverage on acts of Licensor employees
 - ◆ Liability not limited to insurance proceeds

ECKERT SEAMANS
ATTORNEYS AT LAW

Insurance – Cloud/Hosted Issues

- Licensor concerns:
 - ◆ May offer insurance, but problem of being overwhelmed by multiple service user claims
 - ◆ May try to contractually limit liability beyond reconstruction or recovery of lost data; liability for business interruption too great to assume
- Licensee concerns:
 - ◆ Licensee may need special insurance coverage
 - ◆ Licensee's insurance usually does not cover damages or business interruption where the failure or casualty affects software operated or services provided from location and equipment not owned by Licensee

ECKERT SEAMANS
ATTORNEYS AT LAW

Governing Law and Jurisdiction

- ◆ Licensors want its own state's law to apply, and exclusive jurisdiction and venue in its own state
 - Licensors have argument that it otherwise would be forced to defend or enforce its license agreement in many different jurisdictions under many different laws
- ◆ Licensees want home jurisdiction, because it will be more expensive to litigate or arbitrate elsewhere
 - In most cases, Licensee will lose, unless Licensee has particular economic clout, or Licensor is hungry for business and is willing to concede to get order
- ◆ Consider neutral jurisdiction – DE or NY

ECKERT SEAMANS
ATTORNEYS AT LAW

SLA Provisions

- ◆ Licensors want to limit SLA to commercially reasonable efforts to fix problem or provide work around, and to provide non-binding time periods for correction
- ◆ Licensees want specific metrics met, or some specific remedy, such as monetary credits against maintenance or service costs, and/or ultimate right to terminate the license or service agreement
- ◆ Typical standards – uptime; latency; classification of severity of problem and target response and remedy times
 - other metrics may be relevant to specific software functions

ECKERT SEAMANS
ATTORNEYS AT LAW

Boilerplate Clauses

- Mistake to ignore these clauses
- Negotiated provisions:
 - ◆ Assignment clause – consider effect on sale by party; effect on scope of licensed users
 - ◆ Integration clause – may create problem if multiple agreements used to document deal (prioritization problem)
 - ◆ Export clause – relevant?; foreign access problem
 - ◆ No-hire clause – non-targeted solicitation issue; failure of maintenance problem

ECKERT SEAMANS
ATTORNEYS AT LAW
