SCOTT
TECHNOLOGY ATTORNEYS
IP

Negotiating and Drafting Software License Agreements

Presented by Robert J. Scott
Partner Scott & Scott, LLP

www.*ScottandScottllp*.com

Speaker

Robert Scott

Agenda

Licensing Concerns

- Infrastructure Assessments
- Virtualization
- Third Party Access

Cloud Licensing

- Key Provisions in Cloud Contracts
- Regulatory Compliance Risks
- Risk Mitigation Strategies

Audits

- Scope & Confidentiality
- Legal Issues
- Common Mistakes
- Discovery, Analysis, Audit Materials
- Negotiating Resolution, Settlement Agreements

Infrastructure Assessments

- Businesses must be able to determine what hardware it owns and what software it needs
- Internal auditing is necessary in order to gather information about the enterprise's IT infrastructure

Infrastructure Assessments

Principal challenges include:

- Diverse hardware types and configurations can complicate the inventory process
- Need to gather division-level or even employee-level input while minimizing division-level and even employee-level involvement in the licensing process
- Technical expertise to interpret raw data may reside outside the enterprise

Virtualization

Many software publishers limit – in one way or another – their customers' ability to license software in virtualized environments, for example:

- **Microsoft** often caps the number of virtual "operating system environments" in which a software product may be installed, depending on the edition of the software to be deployed (e.g., SQL Server Datacenter versus SQL Server Enterprise)

Virtualization

Many software publishers limit… (cont'd)

- **IBM** often requires that a server or cluster be licensed to its full processor capacity for a software product – even if only one virtual machine hosted on the server or cluster is running that product – unless the company agrees to the technical and procedural requirements for "sub-capacity" licensing, allowing for license acquisition at the virtual-server level

SCOTT IP
TECHNOLOGY ATTORNEYS

Third Party Access

- Most software licenses limit access to the licensee and prohibit access by third-parties
- Third-parties often include customers, vendors, joint venture partners, and divested entities
- Allowing third-parties to access exposes the licensee to copyright infringement and breach of contract claims
- Need to carefully tailor the license grant to insure that all contemplated third-party access is covered by the license

Key Provisions in Cloud Contracts

- Intellectual property ownership
- Insurance and indemnity requirements –especially for intellectual property infringement
- Regulatory compliance
- Subcontractor liability for third party services or software
- Effect of termination – return of customer data
- Service failure corrective action plan

Regulatory Compliance Risks

- Industry-specific regulation
  - FTC Red Flags Rule – Financial
  - Gramm-Leach-Bliley Act – Financial
  - HIPAA & HITECH – Healthcare
  - PCI Compliance – Payment Systems
- Broad regulation – Massachusetts Data Privacy Law

Risk Mitigation Strategies

- Require vendors to legally assume all liabilities associated with the service
- Specify insurance coverage requirements including forensics, breach response, regulatory response and consumer claims
- Use indemnity provisions to protect against liability
- Edit limitation of liability provisions that would limit access to coverage

SCOTT IP
TECHNOLOGY ATTORNEYS

Scope & Confidentiality

Most software publishers, by default, include relatively onerous audit-rights provisions in their form agreements

- Only "reasonable" restraints on audit timing and frequency
- No express limitations on scope of potential audits (either legal, geographic or product-specific)

Scope & Confidentiality

Most software publishers… (cont'd)

- Few or no meaningful protections for information disclosed by the enterprise during the course of the audit (either as to confidentiality or to admissibility in court, in the event litigation arises)

Scope & Confidentiality

Most software publishers… (cont'd)

- Burdensome resolution terms:
  - License purchases for unlicensed deployments, regardless of use
  - Back-maintenance purchases for unlicensed deployments (or, in some cases, a percentage over the MSRP licensing costs)
  - Obligation to pay the publisher's third-party auditor, in the event that any compliance gap exceeds a stated threshold

Legal Issues

- Breach of contract liability
- Copyright infringement liability
- Successor liability resulting from mergers or acquisitions
- Individual liability for officers and directors

SCOTT IP
TECHNOLOGY ATTORNEYS

Common Mistakes

- Failure to negotiate audit procedures
- Reliance on IT staff to deploy discovery tools
- Failure to understand and gather proper proof of purchase documentation
- Failure to produce audit results as of the effective date
- Scrambling to buy software products in response to an audit letter

Software Discovery

- Automated process designed to identify all software products installed on corporate computers
- Discovery tool selection is critical to success
- Discovery of all assets is challenging
- Reporting is unreliable
- Validation is difficult
- Make sure all data is protected by attorney work-product privilege
- Attorneys experienced with software licensing should analyze the data

SCOTT IP TECHNOLOGY ATTORNEYS

Proof of Purchase Analysis

- Process of gathering and documenting proof of ownership of software licenses
- License agreements, manuals, media, purchase orders, and checks are not sufficient proof
- Dated proofs of purchase are required
- Valid proof must show product name and version
- The entity listed in the invoice or other proof of purchase must match the entity being audited
- Clients should leverage vendors to help compile entitlement data

SCOTT IP TECHNOLOGY ATTORNEYS

Gap Analysis

- Process of analyzing gross installation information against gross invoices for each specific product
- License types, use characterizations, and downgrade rights must be considered
- Must include products not included in software discovery reports such as client access licenses, and remote user licenses including terminal server, VPN and Citrix users
- Calculate the potential fine exposure for the client prior to producing the audit results

Producing Audit Materials

- Schedules and supporting documentation representing all relevant software products installed on the client's network as of the effective date
- Secure a Federal Rule of Evidence 408 Agreement
- A summary with columns for product name, number of installations, number of proofs of purchase, and excess/deficiency is required
- Organize the supporting material by product with supporting proof of purchase for each product
- Obtain management approval before producing final results

SCOTT IP TECHNOLOGY ATTORNEYS

Negotiating Resolution

- Discussions occurring after production and continuing through settlement
- Carefully scrutinize the auditor’s analysis
- Explain the basis for any challenges to the proposed deficiency counts prior to engaging in a monetary negotiation
- Understand both monetary and non-monetary considerations before negotiating
- Challenge the legal basis for arguments advanced in settlement correspondence

SCOTT IP
TECHNOLOGY ATTORNEYS

Settlement Agreements

- Make sure that executive management understands that audit results are being certified as accurate as of the effective date
- Understand that the release is predicated on the accuracy of certifications and in many instances future performance
- Make sure you are getting a full release of all potential liability
- Non-monetary provisions have “costs” as well
- Confidentiality is sometimes negotiable

Questions?

Contact Information

Robert J. Scott, Esq.
Managing Partner
rjscott@scottandscottllp.com
(214) 999-2902

Scott & Scott, LLP.
1256 Main Street, Suite 200
Southlake, TX 76092
www.scottandscottllp.com