Enterprise Software Licensing

New Choices – New Obligations

Agenda

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Historical Licensing Models

With some exceptions, the touchstone of most software licensing in the recent past has been the software installation itself – a primarily copy-centric metric for determining licensing obligations

For each installation of a program, a corresponding license has been required, mostly without regard to the performance qualities of the computer on which the program is installed

Historical Licensing Models – Exceptions

- The most notable exception to the "pure" installation-based licensing metric has been the server + client model characteristic of Microsoft's server products (e.g., Windows Server operating system, Exchange Server messaging software, SQL Server database software)
    - For each installation of the server software, a corresponding license was required
    - For each remote client accessing the server software, a corresponding client-access license (CAL) was required
    - Other, additive CALs have been available to "unlock" certain features of the server software (e.g., Terminal Services / Remote Desktop CALs)

- Other exceptions generally have been limited to custom, sometimes negotiation-intensive licensing agreements based on unique characteristics of the software to be licensed and the network or networks where it is to be used

New Licensing Models – "Custom" is the New Normal

Businesses now have more options and flexibility for their software needs, but with that flexibility often comes complex software asset management (SAM) obligations

Licensing models that once would have required custom agreements with unique protocols (if they were technologically feasible in the first place) now are arrayed alongside the "traditional" licenses in increasingly dense menus of choices for IT teams to weigh

Businesses must equip themselves to recognize the unique challenges entailed with the various options in order to avoid unnecessary licensing exposure

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New Licensing Models – Workstations

- **Single-seat / stand-alone**
  - Software installed on the workstation
  - "Traditional" model (though something like custom thin clients really came first)
    - Pros: Relatively easy accounting, relatively easy IT support
    - Cons: Inflexible, can be more costly to scale

- **Thin clients**
  - Software installed on a server and accessed by remote workstations (with no or little local capacity) in the company's network
    - Pros: Easier to scale, central control over deployments
    - Cons: Hardware deployments can be more expensive and technically demanding, more limited vendor options

- **The Cloud**
  - Software installed on a server owned and operated by a service provider and accessed by remote workstations over the Internet
    - Pros: Easiest to scale, little and sometimes no license-management responsibility
    - Cons: Loss of control, requires special attention to vendor contracting and relationship management

New Licensing Models – Servers

Server-software functionality generally is characterized by a higher level of diversity than workstation software (much of which often is designed to interact with server software)

Licensing models for server software therefore are correspondingly diverse:

- **Server installation** (with or without clients)
- **Processor**
  Licenses are acquired based on the number of processor chips activated and available in the computer – typically allows unlimited clients
- **Processor capacity**
  Licenses are acquired based on the strength of the computer's processor(s) – most prominent example is IBM's processor value unit (PVU) licensing model
- **Function-specific capacity**
  Licenses are acquired based on some other metric that is characteristic of how software is used (e.g., licensing for a backup solution that is based on the volume of data backed up using that solution)
- **The Cloud**

New Licensing Models – Servers (cont.)

Ideally, companies opt for some combination of the various licensing models depending on the particular solution to be deployed and on the nature of the affected IT infrastructure, however, correct license-counting in a "mixed" environment can become very difficult and fraught with challenges:

- "Document soup" of different license agreements or license-agreement attachments documenting different license acquisitions can become very difficult to track over time

- IT staff unfamiliar with all licensing obligations may make incorrect licensing assumptions for one product based on past experience with different products

- Tools to assist with network inventories may not capture all of the information necessary to adequately assess all deployments, resulting in a need for more than one tool or method to conduct internal audits

New Licensing Models – Self-Hosting Alternative

Depending on the flexibility of a publisher's business-partner licensing options, it may be possible for an enterprise to form a "captive" IT services entity to provide hosted software services to the rest of the enterprise

The enterprise, in effect, creates its own cloud, and often is able to realize the pricing predictability and scalability of cloud-based solutions without ceding fundamental control over the IT environment

However, unlike true cloud offerings, the enterprise also retains responsibility for ensuring that all software deployments are properly licensed under the business-partner license, which usually includes monthly reporting obligations

Licensing Concerns – Infrastructure Assessments

It is not possible to correctly license software unless you know what hardware you own and what software you need

Therefore, some level of internal auditing is necessary in order to gather information about the enterprise's IT infrastructure

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

Licensing Concerns – Virtualization

Many enterprises are moving to IT environments that utilize virtualization (creating one or more "virtual" servers with their own software configurations on one physical server host), and many of those virtualized environments also may utilize server clustering (using two or more physical servers with shared and managed resources to host the virtual servers)

However, most 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)

- 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

Licensing Concerns – License Agreement Types

Retail EULA

The retail "shrink-wrap" or "click-wrap" end-user license agreement remains the most familiar kind of license agreement for the software industry, but it is not the norm for software licensing by enterprises

Retail EULAs do not offer any opportunity for custom terms, and pricing typically is not competitive for large license purchases

In addition, retail EULAs make license tracking for large organizations very difficult (especially if software purchasing is not centralized by company mandate), which can increase exposure in the event of a software audit

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Volume Licensing

Most large software publishers offer standardized license agreements – with more competitive price points and more scalable license-management options – for companies able to commit to purchase requirements over a set term

Many of these agreements also include ancillary benefits (like downgrade rights) and online, license-management portals, both of which facilitate license tracking and thereby help to reduce audit exposure

However, most volume licensing agreements remain "off-the-shelf" forms that offer little, if any, room for customization and that also typically include onerous audit-rights terms in favor of the publisher

Enterprise-Level Agreements

Past a certain size or level of IT-environment complexity, most enterprises start exploring the availability of license agreements covering multiple (or all) divisions within the enterprise

Typically, only enterprise-level agreements offer even the possibility for more favorable terms for scalability and auditing (e.g., Microsoft's standard EA calls for annual, retrospective license true-ups in lieu of predictive license purchases based on current or future need)

Depending on the company's licensing commitments, enterprise-level agreements also offer the possibility of terms customization

Licensing Concerns – License Agreement Types (cont.)

Enterprise-Level Agreements (cont.)

However, with flexibility also usually comes higher front-end costs:

- Higher up-front license-purchase requirements
- Necessity of legal review and (in many cases) negotiation with counsel for the software publisher
- Need for IT teams to implement new solutions or procedures to correctly track deployments and licenses under the applicable agreement or agreements

Software Audits – 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)
- 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)
- 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

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Software Audits – Scope & Confidentiality (cont.)

At the very earliest stage of any audit, it is vital to try to obtain the publisher's agreement (<u>in writing</u>) as to:

- Computers and products to be included in the inventory

- Requirement that all audit materials and audit-related communications be maintained confidential

- Prohibition on using any audit materials or audit-related communications for any purpose (including litigation) other than conducting and resolving the audit

Software Audits – Data Collection

Data-collection challenges within the context of a software audit generally are the same as those within the context of regular inventory processes:

- "Document soup" complicates license tracking
- Tools to assist with network inventories may not capture all necessary information
- Much heightened need to gather employee-level input while minimizing employee involvement in the audit process
- Technical expertise to interpret raw data may reside outside the enterprise

However, the failure to meet those challenges during an audit entails a greater level of exposure, since even the most amicably-presented audit engagements still imply the threat of breach-of-contract or copyright-infringement claims and damages

Whenever possible, companies should try to internally assess their level of exposure <u>before any information is disclosed to the auditing entity</u>

Internal assessments help not only to make any financial preparations necessary for the company to absorb compliance costs resulting from the audit, but also, in many cases, to identify inventory data that may be erroneous or infrastructure details that may effect licensing obligations

Software Audits – Resolution

Ideally, enterprises should work to negotiate away any defined audit-resolution terms at the licensing stage – at the audit stage, even though publishers sometimes are willing deviate from the default requirements, those terms also give the publishers an unacceptable amount of leverage when it comes to driving the audit process

If a company is stuck with burdensome resolution provisions during an audit, it may still be possible to negotiate a better outcome:

- Instead of purchasing licenses to cover the compliance gap, instead offer to purchase licenses of equal value to cover prospective needs
- Instead of retroactive support or maintenance, offer to commit to a longer or higher-level support term going forward

Regardless of the licensing outcome, it also is vital to obtain a release from the publisher at the end of the audit in order to confirm the legal resolution of any compliance discrepancies

Questions?

Thank You!!

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