Mr. Classen's book *A Practical Guide to Software Licensing for Licensees and Licensors* (2006) may be ordered directly from The American Bar Association at (312) 988-5000 or online at: http://www.abanet.org/abastore/

CHAPTER 3

Licensing Software

A. Overview

1. The Concept of Licensing

A license can be thought of as the permission of the owner of property to use that property. A more precise understanding, however, can be gained by using the old law school example of comparing property ownership to a bundle of sticks. The owner of the property possesses all of the sticks, including a stick for the nonexclusive use of the property. If the owner grants a license, the property owner is giving some of the sticks from the owner's bundle to the licensee. Thus, to understand software licensing it is necessary to understand the sticks, or intellectual property rights, contained in the software owner's bundle.

2. Intellectual Property Rights Applicable to Software

Software is a unique technology, in that it comprises rights that are protectable under copyright law, patent law, and trade secret law. These multiple protections arise because software can be both a work of authorship as well as a business process. Set forth below is a brief overview of the three primary types of intellectual property rights provided for under United States law that are applicable to software.

(a) Patents

Patents are granted on "any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof." 35 U.S.C. § 101. A patent is an exclusive right to practice an invention granted by the government. Anyone else who practices the invention without a license from the patent holder is infringing the patent. 35 U.S.C. § 121.

In return for granting a patent, the government requires the inventor to disclose the invention to the public in full, clear, and exact terms. 35 U.S.C. § 112. While the inventor has the exclusive right to practice the invention, anyone can examine the patent and understand the invention.

For years, software was not believed to be patentable subject matter. *See, e.g. Gottchalk v. Benson*, 405 U.S. 915 (1972) (reversing judgment of the Court of

Customs and Patent Appeals on claims to "the processing of data by program and more particularly to the programmed conversion of numerical information" on the basis that the programs were not patentable subject matter). This belief changed in 1998, when the Federal Circuit issued its opinion in *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998). In *State Street*, the district court granted summary judgment invalidating a patent governing a data processing system, relying in part on the "business method" exception to patentable subject matter. *Id.* at 1375. The theory behind the "business method" exception was that merely doing business did not qualify as patentable subject matter. *Id.* The Federal Circuit reversed the district court's decision that a data processing system did not qualify as patentable subject matter and it eliminated the business method exception, opening the floodgates on software patents.

In the United States, the term of a patent depends upon when it was filed. For patents issued before June 8, 1995, and patent applications that were pending on that date, the patent term is the longer of either 17 years from the issue date or 20 years from the earliest claimed filing date, the longer term applying. 35 U.S.C. § 154. For applications filed on or after June 8, 1995, the patent term is 20 years from the earliest claimed filing date. *Id.* Generally, a patent holder may not enforce a patent license beyond the term of the patent. *Brulotte v. Thys Co.*, 379 U.S. 29 (1964). Thus, theoretically, a software licensor could have difficulty enforcing a license to its patented software after the expiration of the patent term. Pragmatically, however, a licensor can also protect its software via copyright.

For an overview of the history of patenting software, *see The History of Software Patents*, www.bitlaw.com/software-patent/history.html.

(b) Trade Secrets

Trade secrets are another form of intellectual property that can be used to protect software. Trade secrets are protected under the relevant state trade secret laws, almost all of which are derived from the Uniform Trade Secret Act ("UTSA"), which has been adopted in 42 states and the District of Columbia. See, e.g., California: CAL. CIV. CODE § 3426 et. seq.; Maryland: MD CODE ANN. COMM. LAW § 11–1201 *et. seq.;* Pennsylvania: 18 Pa. C.S. § 3930. Several commercially important states such as New York, New Jersey, and Texas, however, have not adopted the Uniform Trade Secret Act. For a list of states that have adopted the USTA as of December 2006, see, *Introduction of Trade Secrets,* 228 COMM.L. ADV. 1, 14 (Dec. 2006).

Under the UTSA, a trade secret is information, including a formula, pattern, compilation, program device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. As set forth above, the scope of trade secrets overlaps patents but is also potentially applicable to information which does not meet the standard of patentability. Thus, trade secret protection is

potentially broader than that available under patent law. However, a program that is solely functional in nature, i.e., the program's function is readily available or ascertainable, is not protectable under the USTA.

The UTSA defines "Misappropriation" to mean the (i) acquisition of a trade secret by a person who knows or has reason to know the trade secret was acquired by improper means or (ii) disclosure or use of a trade secret without express or implied consent by a person who improperly acquired knowledge of the trade secret or, who at the time of disclosure or use, knew or had reason to know that the trade secret had been improperly acquired, and there was an obligation to maintain its confidentiality. UTSA § 1(2); see, e.g., MD. CODE ANN. COM. LAW § 11–201(c).

A fundamental distinction between patent protection and trade secret protection is the requirement that the owner of a trade secret use reasonable efforts to maintain the secrecy of information. This is sharp contrast to the duty of disclosure and enablement under patent law. Thus, a licensor seeking to protect software should include confidentiality provisions in the license agreement. Special care should be taken to protect the confidentiality of source code. See Chapter 8 for a detailed discussion of the issues involved in confidentiality provisions.

Trade secret protection offers several advantages over other types of protection for intellectual property law, principally the perpetual protection offered for trade secrets (e.g., the formula for Coke®) and initially the minimal cost to obtain such protection. These benefits are often outweighed by the fluid nature of such protection and the immediate loss of trade secret status even in the event of an inadvertent disclosure. The disclosure of the protected information in a patent or copyright application will also cause a loss of protection. See *BondPro Corp. v. Siemens Power Generation, Inc.*, 463 F.3d 702 (7th Cir 2006). Further, a competitor that is able to reproduce a trade secret without use of illegal means, is free to do so. In short, trade secrets generally retain their value so long as they remain secret.

State trade secret laws offer broader protection than copyright laws because the trade secret laws apply to concepts and information, that are both, excluded from protection under federal copyright law. See 17 U.S.C. § 102(b). Information eligible for protection includes computer code, *Trandes Corp. v. Guy F. Atkinson Co.*, 996 F.2d 655, 663 (4th Cir.), *cert. denied,* 510 U.S. 965 (1993); *University Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518 (5th Cir.), *reh'g denied,* 505 F.2d 1304 (5th Cir. 1974); *Integrated Cash Management Servs., Inc. v. Digital Transactions, Inc.*, 732 F. Supp. 370 (S.D.N.Y. 1989), *aff'd* 920 F.2d 171 (2d Cir. 1990); program architecture, *Trandes,* 996 F.2d at 661; *Computer Assocs. Int'l, Inc. v. Bryan,* 784 F. Supp. 982 (E.D.N.Y. 1992), information content including order, structure and sequence, *Q-Co. Indus., Inc. v. Hoffman,* 625 F. Supp. 608, 617 (S.D.N.Y 1985) and algorithms, *Vermont Microsystems, Inc. v. Autodesk, Inc.*, 88 F.3d 142 (2d Cir. 1996); *Micro Consulting, Inc. v. Zubeldia,* 813 F. Supp. 1514, 1534 (W.D. Okla. 1990), *aff'd without opinion,* 959 F.2d 245 (10th Cir. 1992). Mathematical algorithms are also protectable under patent law. *Arrhythmia Research Technology v. Corazonix Corp.*, 958 F.2d 1053 (Fed. Cir.) *reh'g denied,* 1992 U.S. App. LEXIS 9888 (Fed. Cir. 1992); *In re Iwashi,* 888 F.2d. 1370 (Fed. Cir. 1989).

Courts are divided as to the application of trade secret protection for customer lists. See *Morlife, Inc. v. Perry,* 56 Cal.App.4th 1514 (Cal.App. 1997) (file of customer business cards maintained by sales manager are trade secrets); *Fireworks Spectacular, Inc. v. Premier Pyrotechnics, Inc.,* 147 F. Supp.2d 1057 (D Kan. 2001) (customer lists constitute trade secrets, applying Kansas law) and *In re American Preferred Prescription, Inc.,* 186 B.R. 350 (Bankr. E. D. N. Y. 1995) (client list is trade secret). See also *DeGiorgio v. Megabyte Int'l., Inc.,* 468 S.E.2d 367 (Ga. 1996) (only tangible customer lists are subject to protection as a trade secret), and *Ed Nowogroski Insurance v. Rucker,* 944 P.2d 1093 (Wash. 1997) (memorized client list constitutes trade secret), but see *Vigoro Indus. v. Cleveland Chem. of Ark.,* 866 F. Supp. 1150 (E. D. Ark. 1994) (customer lists alone not considered a trade secret), and *WMW Machinery Company, Inc. v. Koerber A.G.,* 658 N.Y.S.2d 385 (App. Div. 1997) (customer lists are not trade secrets where lists are readily ascertainable from sources outside employee's business). Further, at least one court has held that the execution of a nondisclosure agreement by an employee does not in and of itself create trade secret status for the employer's customer lists. *Equifax Servs., Inc. v. Examination Management Servs., Inc.,* 453 S.E.2d 488 (Ga. App. 1994). For a further discussion, see *Intellectual Property Issues in the Employment Setting,* 119 INTELL. PROP. COUNS. 1, 4 (Nov. 2006).

A majority of courts have held that claims based on state trade secret laws are not preempted by federal copyright law (§ 301 of Federal Copyright Act). *Dun & Bradstreet Software Services, Inc. v. Grace Consulting, Inc.,* 307 F.3d 197 (3d Cir. 2002); *Nat'l Car Rental Sys., Inc. v. Computer Assocs. Intl., Inc.,* 991 F.2d 426 (8th Cir. 1993); *Bishop v. Wick,* 1998 WL 166652, 11 U.S.P.Q.2d 1360 (N. D. Ill. 1988); *Brignoli v. Balch, Hardy and Scheinman,* 645 F. Supp. 1201 (S.D.N.Y. 1986), but see *Computer Associates International v. Atari,* 775 F. Supp. 544 (E.D.N.Y. 1991); *Enhanced Computer Solutions, Inc. v. Rose,* 927 F. Supp. 738 (S. D. N. Y. 1996); *Benjamin Capital Investors v. Cossey,* 867 P.2d 1388 (Or. Ct. App. 1994). See also *Lennon v. Seaman,* 63 F. Supp.2d 428, 437 (S.D.N.Y. 1999) which discusses in detail the dichotomy among the different courts. At the same time, two commentators have suggested that trade secret laws may be the only method of protection for the ideas incorporated in the functionality of mass distributed commercial software. Johnston & Grogan, *Trade Secret Protection for Mass Distributed Software,* 11 COMPUTER LAW. 1 (Nov. 1994).

Matters of public knowledge, general knowledge of an industry, routine or small, skill and knowledge readily ascertainable, and differences in procedures or methodology are not considered to be trade secrets. *Anaconda Co. v. Metric Tool & Die Co.,* 485 F. Supp. 410, 421–22 (E.D. Pa. 1996). Furthermore, any skill or experience learned during the course of employee's employment is not considered to be a trade secret. *Rigging Int'l Maintenance Co. v. Gwin,* 128 Cal. App.3d 594 (1981), *American Red Cross v. Palm Beach Blood Bank, Inc.,* 143 F.3d 1407 (11th Cir. 1998) (employer may not preclude former employees from utilizing contacts and expertise gained during employment) but see *Air Products and Chemicals, Inc. v. Johnson,* 442 A.2d 1114 (Pa. Super. 1982) (details of research and development, projected capital

spending, and marketing plans are trade secrets); *Den-Tal-Ez, Inc. v. Siemens Capital Corp.*, 566 A.2d 1214 (Pa. Super. 1989) (detailed units costs, profit margin date, and pricing methods are trade secrets).

An owner of trade secrets is entitled to receive injunctive relief and damages for the misappropriation of its trade secrets. USTA § 3. Such damages include the actual loss caused by the misappropriation and any unjust enrichment arising as a result of the misappropriation that is not taken into account in computing any actual loss. UTSA § 3; see, e.g., MD. CODE ANN. COM. LAW § 11–1203. A court may also award attorney's fees if willful and malicious misappropriation exists. UTSA § 4(iii); see, e.g., MD. CODE ANN. COM. LAW § 11–1204.

Section 7 of the UTSA provides that except for contractual remedies, whether or not based upon the misappropriation of a trade secret or other civil remedies that are not based upon the misappropriation of a trade secret, the USTA "displaces conflicting tort, restitutionary and other laws...providing civil remedies for misappropriation of a trade secret". See e.g., *Auto Channel, Inc. v. Speedvision Network, LLC,* 144 F. Supp.2d 784 (W.D. Ky. 2001) (Kentucky Uniform Trade Secrets Act replaces all conflicting civil state law regarding misappropriation of trade secrets, except for those relating to contractual remedies); *Boeing Co. v. Sierracin Corp.*, 738 P.2d 665 (Wash. 1987) (USTA merely displaces conflicting tort, restitutionary, and other law regarding civil liability for misappropriation and does not displace claims for breach of contractual and confidential relationship).

Given the differences in state trade secret laws, the choice of governing law is very important. For example, South Carolina has enacted legislation providing that written agreements not to disclose trade secrets will be enforced without limitation on duration or geographic scope when the employee knows or has reason to know of the trade secret's existence, S.C. CODE ANN. § 39–8-30(d) (Law Co-op. 1997), while the Wisconsin Court of Appeals in an unpublished decision declined to enforce a nondisclosure provision in an agreement because it was unlimited as to time and overly broad. *Williams v. Northern Technical Services, Inc.*, 568 N.W.2d 784 (Wis. App. 1997).

For a general overview of trade secret issues, see *Rodgers & Marrs, Trade Secrets and Corporate Espionage: Protecting Your Company's Crown Jewels,* 22 ACC Docket. 60–78 (April 2004); William L. O'Brien, *Trade Secret Reclamation: An Equitable Approach in a Relative World,* 21 J. COMPUTER & INFORMATION LAW 227 (2003); Peterson, *Trade Secrets in an Information Age,* 32 HOUS. L. REV. 385 (1995); Dodd, *Rights in Information: Conversion and Misappropriation Causes of Action in Intellectual Property Cases,* 32 HOUS. L. REV. 459 (1995) Gross, *What Is Computer "Trade Secret" Under State Law,* 53 A.L.R 4th 1046 (1987); Gulbis, *Disclosure or Use of Computer Application Software as Misappropriation of Trade Secret,* 30 A.L.R 4th 1250 (1984); POOLEY, TRADE SECRETS, Law Journal Press (1997).

(c) Copyrights

Copyright law protects "works of authorship fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device." 17 U.S.C. § 102. Copyright protection, however, does not "extend to any idea, procedure, process, system, method of operation, concept, principle, or discovery, regardless of the form in which it is described, explained, illustrated, or embodied in such work." *Id.*

Thus, copyright only protects the expression, not the underlying ideas or concepts. Software is a work of authorship that is fixed in a tangible medium of expression. As such it is entitled to protection under copyright law. Copyright protection does not extend, however, to the processes that software performs or the ideas that it implements. Instead, only the expression itself is protected. This is a fundamental distinction between the protection offered by copyright law and that potentially offered by patent and trade secret law. In a nutshell, copyright law prevents anyone from copying source code without the owner's permission, but it does not prevent third parties from independently writing software that performs the same functions as the copyright software.

Confusion often arises as to the role of registration in copyright law. A work of authorship is protected when it is fixed in a tangible medium. See *In re World Auxiliary Power Company,* 303 F.3d 1120, 1125 (9th Cir 2002). Placing a copyright notice on the work eliminates any claim of innocent infringement.

While registration is permissive, not mandatory, and not a pre-condition for protection, it does confer a number of benefits. *Id.* An originator must register the copyright with the U.S. copyright office prior to bringing an infringement claim, 17 U.S.C. § 411(a). Registration within three months of the publication of the work permits a copyright holder to obtain up to $150,000 in statutory damages for intentional infringement without proof of an actual loss and the right to obtain attorney's fees. 17 U.S.C. §§ 504(c), 412. If the work is published within five years from the date of creation, the registration is prima facie evidence of the validity of the copyright, shifting the burden of proof to the other party. 17 U.S.C. § 410(c). The ability to obtain statutory damages and attorney's fees is important as the copyright owner's actual damages and the infringer's profits may be less than the cost of the litigation. Registration also allows the copyright owner to record its registration with the U.S. customs service to protect against infringing copies being imported into the United States.

For an overview of copyright protection for software, see Buckman, *Copyright Protection of Computer Programs,* 180 A.L.R. FED 1.

B. The First Sale Doctrine

1. In General

The theory of the First Sale Doctrine under the Copyright Act 17 U.S.C. § 101 *et. seq.* is that an individual who *purchases* an authorized copy may use and resell that particular copy free of any restraint by the copyright owner. 17 U.S.C. § 109(a) (emphasis supplied). See *Bobbs Merrill Co. v. Straus,* 210 U.S. 339 (1908). A copyright owner's sale of an authorized copy "exhausts" the copyright owner's exclusive distribution and display rights, such that the purchaser may use, resell, or display that copy free of any claim of infringement. 17 U.S.C. § 109(a).[1] In short, the First Sale Doctrine addresses a *copy owner's rights* as opposed to the *copyright owner's* rights.

The First Sale Doctrine does not apply, however, to the separate exclusive rights of copying, derivative work preparation, and public display or performance. See 17 U.S.C. § 106 (which sets forth five separate and distinct rights). See, e.g., *Red Baron-Franklin Park, Inc. v. Taito Corp.,* 883 F.2d 275, 280 (4th Cir. 1989) and *Columbia Pictures Industries, Inc., v. Aveco, Inc.,* 800 F.2d 59, 64 (3d Cir. 1986). See also 17 U.S.C. § 109(e) (which, to legislatively overrule *Red Baron,* permits display of copyrighted video games in coin-operated equipment). The First Sale Doctrine only applies to the *copyright owner's* exclusive rights of distribution and display in its copyrighted work which are "automatically" conveyed to the buyer or the copy owner upon sale. 17 U.S.C. § 109(a) and (c).[2]

Section 106(3) provides that the copyright owner has the exclusive right to distribute and to authorize distribution of copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership or by rental, lease, or lending. Section 106(4) and (5) give the copyright owner the exclusive right to publicly perform or display a literary, musical, dramatic, or choreographic work or a pantomime, motion picture, or other audiovisual work. Section 106(6) gives the copyright owner the exclusive right to perform a sound recording work publicly by means of a digital audio transmission. To prove infringement, the copyright holder must demonstrate only that it possesses a valid copyright, that the copyrighted material was registered for copyright and show unauthorized copying. The principal means of showing unauthorized copying is through access and substantial similarity. *Ford Motor Co. v. Summit Motor Products,* 930 F.2d 277, 290-91 (3d. Cir. 1990). (copying is shorthand for violating any of the five exclusive rights of copyright owners)

Software developers, in order to avoid application of the First Sale Doctrine and retain control over redistribution of their programs, have typically distributed even mass-market software under license, rather than through an outright sale, in order to prevent the First Sale Doctrine from severing control over redistribution. See *Microsoft Corp. v. Software Wholesale Club, Inc.,* 129 F. Supp.2d 995 (S.D. Tex. 2000) (first sale doctrine not applicable to licensed software); *Adobe Systems, Inc. v. One Stop Micro, Inc.,* 84 F. Supp. 2d 1086, 1089 (N.D. Cal. 2000) ("First sale doctrine is only triggered by an actual sale."); *Allen-Myland, Inc. v. International Business Mach. Corp.,* 746 F. Supp. 520 (E.D. Pa. 1990) (first sale doctrine does not apply to computer programs).

For computer software, Section 109(b) limits the First Sale Doctrine and the rights of copy owners in three ways. First, adaptations may not be transferred without

permission of the copyright owner. This is true even under the First Sale Doctrine as there is no right to create derivative works. Second, under Section 117 the owner of a program may make an archival copy or that any adaptation of the program is essential to use of the original by a computer, and that the creator of the copy may only transfer it as part of lease, sale, or other transfer of rights in the underlying program. Exact copies authorized to be made under Section 117 may be transferred without permission of the copyright owner only as part of a transfer of all rights in the underlying program. The distribution right conveyed to the buyer does not, for example, include the right to make further copies for resale.

Third, it provides that the owner of a copy of computer software cannot lend or rent that copy to third parties without permission from the copyright owner. See *Microsoft v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (E.D.N.Y. 1994) (unauthorized distributor of a copy of software not entitled to protection under First Sale Doctrine because owner licensed not sold software to distributor's supplier); *Triad Systems Corp. v. Southeastern Express Co.*, 64 F.3d 1330 (9th Cir. 1995), *cert. denied,* 516 U.S. 1145 (1996) (software sold to customers is subject to 17 U.S.C. § 117 protection while copies that are licensed are not); and *Stenograph LLC v. Sims,* 2000 WL 964748, 55 U.S.P.O. 2d 1436 (E.D. Pa. 2000) (first sale doctrine does not apply to gifts).

Known as the Computer Software Rental Amendments Act of 1990, Section 109(b) also addresses computer software rentals. It provides that, unless authorized by the owner of the copyright in a software program (including any tape, disk, or other medium embodying such program), no person in possession of a particular copy of software program (including any tape, disk, or other medium embodying such program) may, for the purposes of direct or indirect commercial advantage, dispose of or authorize the disposal of the possession of that computer software (including any tape, disk, or other medium embodying such program) by rental, lease, or lending, or any similar act. Section 109(b) specifically excludes nonprofit libraries and nonprofit educational institutions from its prohibitions on renting, leasing, or lending copies of copyrighted software. In short, Section 109 prohibits the rental of a copy of a computer program by the owner of a copy without the permission of the licensor. 17 U.S.C. § 107. See generally, *Central Point Software, Inc v. Global Software & Access, Inc.,* 880 F. Supp. 957 (E.D.N.Y. 1995).

Section 109(d) further limits the scope of application of the First Sale Doctrine by providing that, unless authorized by the copyright owner, the provisions of 17 U.S.C. § 109 (a) and (c) do not extend to any person who has acquired possession of the copy or phonorecord from the copyright owner, by rental, lease, loan, or otherwise, without also acquiring ownership of it.

2. Applicability to Software

A software owner needs to consider how it will protect its software. It may be able to protect methods and processes by either trade secret or patent. Patents, however, require revealing the protected process to the public, while trade secret protection requires keeping it confidential. Thus, the same process cannot be protected by both methods.

By writing the software, the owner receives copyright protection on the actual expression. This protection does not, however, prevent third parties from independently developing software which performs the same function.

When granting a license to a licensee, a vendor needs to consider what protections it has in the software, and what rights (or sticks in the bundle) it wishes to convey to the licensee. The scope of the license granted will govern the licensee's use. Only if the licensee exceeds the scope may the licensor seek damages or other remedies from a licensee under any intellectual property regimen. Thus, the license grant should be drafted broadly enough to permit use by the licensee, but narrowly enough to enable the intellectual property holder to use copyright, patent or trade secret law to stop or prevent infringement by the licensee.

For a discussion of several different types of intellectual property protections available for software, see, Neelakantan & Armstrong, *Source Code, Object Code, and the Da Vinci Code: The Debate on Intellectual Property Protection for Software Programs,* 23 COMPUTER & INTERNET LAW. 1 (Oct. 2006).

C. The Transfer of Intellectual Property Rights

In general, there are two means of conveying intellectual property rights: assignments and licenses. In an assignment, the property owner conveys all of the sticks in the owner's bundle, while in a license the property owner only transfers certain sticks, and retains the rest. Under copyright law, a license applies to *intangible* property rights while a "sale" applies to the transfer of *tangible* property. 17 U.S.C. § 202; see also *Chamberlain v. Cocola Assoc.*, 958 F.2d 282 (9th Cir. 1992).

The First Sale Doctrine, which applies to the sale of a tangible *copy* of software, provides that such sale conveys certain rights to the buyer in the purchased tangible copy of the software, namely the buyer's right to resell the software copy. 17 U.S.C. § 109(a). This right is in derogation of the overall copyright and it is also "automatically" transferred to a new buyer if the copy is resold. 17 U.S.C. § 117. Any transfer of ownership in a copyright must be through an unambiguous written agreement. *Davis v. Meridian Films, Inc.*, 2001 WL 758765 (4th Cir. 2001).

Typically, the sale of software is not a "sale" of a copy (or anything else) within the meaning of Section 109. The only thing that is sold when software is "sold" at retail is the media on which the copyrighted work is fixed. Certain rights inherent in the work are licensed in conjunction with the sale. A copyright owner who grants a nonexclusive license to use copyrighted material generally waives the right to sue the licensee for a

copyright infringement to the extent of the license granted. *Sun Microsystems, Inc. v. Microsoft Corp.*, 188 F.3d 1115 (9th Cir. 1999).

An assignment is an absolute conveyance of the intangible rights and equates to a "sale," with the caveat that a sale typically only conveys the absolute right of distribution and, subject to certain exceptions, the right to display and use. *MacLean Assoc., Inc. v. William M. Mercer-Meidinger-Hanson, Inc.*, 952 F.2d 769 (3d Cir. 1991). A "sale" does not include, for example, the rights of performance or preparation of derivative works rights.

Similar to an assignment, an exclusive license, even if limited in time or place of effect, can amount to a "transfer of copyright ownership." 17 U.S.C. § 201(d)(2). Under the Copyright Act, transfer of an exclusive license is considered to be a conveyance of copyright ownership to the extent granted in the license. 17 U.S.C. § 201(d)(2).

In short, entering into a license agreement in which the licensor reserves title is not a "sale" for purposes of the Copyright Act. For example, a licensee cannot distribute the licensor's software without the licensor's authorization, because the licensor is still the owner of the intellectual property. *Relational Design & Technology, Inc. v. Brock*, 1993 WL 191323 (D. Kan. 1993).

See Chapters 4.A.7 and 4.B for a more detailed discussion.

1. Section 109(a) codifies the First Sale Doctrine, which provides "Notwithstanding the provisions of Section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of that copy or phonorecord."

2. The owner of a copyright embodying the copyright work receives only the right to display that physical copy where it is located. 17 U.S.C. § 109(a).

SOFTWARE LICENSE AND SERVICES AGREEMENT

THIS SOFTWARE LICENSE AND SERVICES AGREEMENT is made this _____ day of _____, 20__ by and between _____, a _____ corporation with its principal address at_____ (hereinafter "Licensor") and _____, a _____ corporation with offices located at _____ (hereinafter "Customer").

- ***Who are the appropriate contracting entities?***
- ***Who is the Customer? Is the Customer financially stable and able to pay Licensor or is a parent guarantee needed? (See Sections 8.H and 42)***
- ***Is a parent guarantee or performance bond needed to ensure the Licensor's performance? (See Section 8.H)***
- ***Consider the Licensor's and Customer's addresses as they may have income tax implications for the Licensor, sales tax implications for the Customer, and impact any dispute over venue and governing law.***

Background

Licensor has developed and owns certain proprietary software for use in the _____ industry. Customer desires to obtain a license to use such software and have Licensor develop certain modifications and enhancements for such software. Licensor desires to license such software to Customer and perform the services on the terms and conditions set forth herein.

- ***Think carefully about the wording contained in any recital, as the laws of some states such as Michigan treat recitals involving a statement of fact as conclusive evidence of the facts stated. See,* Detroit Grand Park Corp. v. Turner, 25 N.W.2d 184 (Mich. 1946).**
- ***Avoid incorporating by reference the Customer's RFP or the Licensor's RFP response as this may create an internal conflict with the terms of the Agreement and the functional specifications contained in the Agreement.***

IN CONSIDERATION of the foregoing and the mutual covenants set forth herein, and intending to be legally bound, the parties agree as follows:

1. Definitions

Whenever used in this Agreement, any Schedules, Exhibits or Addenda to this Agreement, or the Source Code Escrow Agreement, the following terms shall have the meaning ascribed to them below. Other capitalized terms used in this Agreement are defined in the context in which they are used and shall have the meanings ascribed therein. The terms defined in this Schedule include the plural as well as the singular.

See Exhibit X for additional and/or alternative definitions which may be more applicable for your transaction.

1.1 **Acceptance** for the System shall occur only when: (a) Licensor has provided to Customer all Deliverables required to be provided to Customer; and (b) (i) Customer notifies Licensor in writing that all testing for the System has been completed successfully in accordance with the terms of this Article; or (ii) Licensor provides to the applicable Customer Project Manager a written notice of completion stating that all Critical Defects and Medium Defects have been corrected. Nothing else, including Customer's use of the System, or any portion thereof, in a live, operational environment, shall constitute Acceptance (under contract law or the Uniform Commercial Code of [STATE]) of any portion of the applicable system.

1.2 **Affiliate(s)** or **Affiliate Company** shall mean those companies that are initially listed on Appendix 1.2 attached hereto, which may be amended from time to time with the prior written consent of an authorized executive officer of Licensor.

- ***Think about who is going to be able to use the Software and how the usage by those - entities may affect Licensor's revenues and pricing. The Customer may want to provide software to all of its "Affiliates" including those overseas. The licensor will often want to restrict the license to the Customer alone or to the Customer's then existing "Affiliates" who are listed on an attached Appendix. By listing the Affiliates the Licensor is able to limit the license to a finite number of entities avoiding any potential misunderstanding as to who is included. The Customer may not add an entity to the list of Affiliates without Licensor's permission. The breadth of this definition is often an element of price. In addition to pricing concerns, the Licensor may want to limit use of the software to ensure compliance with U.S. export laws.***

1.2.A **Affiliate** shall mean, as to a Party, any other Person that directly or indirectly controls or is controlled by such Party. The term "control" (including, with correlative meanings, the terms "controlled by" and "under common control with") as applied to any Person means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of such Person, whether through the ownership of voting securities or other ownership interest. For the -purposes of this definition, "Person" means any individual, partnership, corporation, limited liability company, unincorporated organization or association, any trust, or any other business entity.

- ***The definition of "Affiliate" set forth in Section 1.2.A offers greater flexibity to reflect the ever changing nature of a large corporation's relationship with its affiliates. The definition of "Affiliate" is not fixed as of a particular time allowing additional users without modifying the license agreement. This definition more closely tracks the definition of affiliates used under the securities laws and from a Securities and Exchange Commission perspective.***

1.3 **"Consolidated Net Worth"** means, at any time, (a) the total assets of the Customer [and its Affiliates] which would be shown as assets on a consolidated balance sheet of the Customer [and its Affiliates] as of such time prepared in accordance with GAAP, after eliminating all amounts properly attributable to minority interests, if any, in the stock and surplus of Affiliates, *minus* (b) the total liabilities of the Customer and its Affiliates which would be shown as liabilities on a consolidated balance sheet of the Customer and its Affiliates as of such time prepared in accordance with GAAP.

1.4 **Critical Error(s)** shall mean a failure of the Software that severely impacts Customer's ability to provide service or has a significant financial impact on Customer for which an alternative temporary solution or work around [acceptable to Customer] may not be accomplished.

- ***This definition favors the Customer as it includes not only those errors that impact Customer's ability to provide services but also any that have a "financial impact" on the Customer.***

1.5 **Custom Software** means those Deliverables that are classified in Appendix 1.5 hereto as Custom Software, as well as the documentation related thereto; an exhaustive list of Custom Software is set forth in Appendix 1.5 hereto.

1.6 **Deliverable** means the Hardware, Software, and Documentation to be delivered hereunder; an exhaustive list of all Deliverables is set forth in Appendix 1.6 hereto.

1.7 **Direct Damages** means the damages incurred by the claiming Party to this Agreement directly resulting from a breach of this Agreement by another party to this Agreement and - specifically excludes: (a) loss of interest, profit, or revenue; failure to achieve cost savings or business interruption and (b) any incidental, consequential, punitive, multiple, or indirect damages of any kind or nature. Direct Damages include by way of example but without limitation, (i) the costs incurred by Customer to obtain software or services that are the same as or substantially similar to (but not broader in scope than) the Software or Services being replaced, that is, the charges to be paid to another services provider(s) to the extent such costs are commercially -reasonable and exceed the Fixed Charges hereunder for such Software or Services; (ii) the costs to correct any deficiencies in the Software or Services rendered that result in a failure of the Deliverables to meet Service Levels or the specifications set forth in the applicable Statement of Work, after Licensor has failed or refused to correct such deficiencies; (iii) the costs incurred to -transition the Software or Services to another provider(s) of services; (iv) any payments, fines, -penalties, or interest imposed by a governmental body or regulatory agency for failure to comply with requirements or deadlines; and (v) the reasonable out-of-pocket costs and fees incurred by -Licensor to collect from Customer any fees payable to Licensor under the Agreement.

- ***Alternatively the parties may want to include a section similar to Sections 17.3 and 17.4***

1.8 **Divested Business** means any business unit, as determined by Licensee, that Licensee sells or of which it otherwise transfers the assets or ownership. The term "Divested Business" shall mean such business unit or the acquirer thereof, as applicable.

1.9 **Documentation** means collectively: (a) all of the written, printed, electronic, or other format materials published or otherwise made available by Licensor that relate to the functional, operational, and/or performance capabilities of the ABC System and/or any Software; (b) all user, operator, system administration, technical, support, and other manuals and all other written, printed, electronic, or other format materials published or otherwise made available by Licensor that describe the functional, operational, and/or performance capabilities of the ABC System and/or any Software including but not limited to the Functional Specifications and Software Acceptance Plan; and (c) any other Deliverable that is not Hardware or Software. Documentation shall not include Source Code.

1.10 **Error(s)** shall mean a failure of the Software to substantially conform to the Documentation or the Functional Specifications, which materially impacts the Software's operational performance or functional performance.

- ***The definition of "Error" is written to recognize that software by its nature is imperfect. The Customer, however, may want a tighter definition to ensure the software's performance meets the Customer's needs.***

1.11 **Functional Specifications** shall mean those specifications to which the Software shall conform as set forth Appendix 1.11.

- ***The Functional Specifications should be set out in detail prior to execution of the Agreement to avoid later disagreements. Agreement in advance may not be feasible depending on the nature of the development undertaken by Licensor. Without agreeing upon the Functional Specifications, the Licensor cannot give the Customer a fixed price for any software development. At the same time, it is unwise for either party to agree to a fixed price with the intent on negotiating the Functional Specifications later.***

1.12 **Hardware** means those Deliverables that are classified in Appendix 1.5 hereto as Hardware, as well as the documentation furnished therewith in the normal course of business; an exhaustive list of Hardware is set forth in Appendix 1.12 hereto.

1.13 **License(s)** shall mean any personal, nonexclusive, nontransferable, non-assignable license or licenses for Customer's internal use only granted by Licensor to Customer to use the Software under this Agreement.

1.14 **Object Code** shall mean the binary machine-readable version of the Software.

1.15 "**Open Source Materials**" shall mean any software, library, utility, tool or other computer or program code (collectively, "**Code**") that is licensed or distributed as "free software," "freeware," "open source software" or under any terms or conditions that impose any requirement that the Code or any software using, linked with, incorporating, distributed with, based on, derived from or accessing the Code: (i) be made available or distributed in source code form; (ii) be licensed for the purpose of making derivative works; (iii) be licensed under terms that allow reverse engineering, reverse assembly or disassembly of any kind; or (iv) be redistributable at no charge. Open Source Materials include without limitation any Code licensed or distributed under any of the following licenses or distribution models or similar licenses or distribution models: the GNU General Public License (GPL), GNU Lesser General Public License or GNU Library General Public License (LGPL), Mozilla Public License

(MPL), BSD licenses, the Artistic License, the Netscape Public License, the Sun Community Source License (SCSL) the Sun Industry Standards License (SISL) and the Apache License).

> **** Licensees and Licensors need to ensure the definition of "open source" reflects the contemplated use of the software and any changes in technology. The parties should not ignore the risk of utilizing language such as "includes without limitation" or "including but not limited to".***

1.16 **Performance Standards** means, collectively the warranties and performance standards set forth in Section 16 and all associated Exhibits, Appendixes, Attachments, and Addenda referenced therein.

1.17 **Regulatory Requirements** is defined in Appendix 3.B "Service Level Standards and Credits", Attachment 8 "Information Technology Support".

1.18 **Services** shall mean the work done by Licensor in support of the Software, including but not limited to development services, installation services, training, consulting, support, telephone support, and such other -services.

1.19 **Site** shall mean a Customer's computer facility located in one specific geographic location.

1.20 **Software** means the aggregate of the Standard Software and the Custom Software including all physical components that are provided by Licensor, including but not limited to, magnetic media, job aids, templates, and other similar devices; an exhaustive list of all Software is set forth in Appendix 1.20.

1.21 **Software Acceptance Plan** shall mean that plan set forth in Appendix 1.21.

- ***The Software Acceptance Plan should be set out in detail prior to execution of the Agreement to avoid later disagreements. Agreement in advance may not be feasible, however, depending on the nature of the development undertaken by Licensor. Any plan should be objective in nature to protect both parties.***

1.22 "***Source Code***" means computer software in the form of source statements for the Software (excluding all Third Party Software) including, without limitation, all software in the form of electronic and printed human-readable, mnemonic or English-like program listings, including printed and on-line descriptions of the design of such software including, without limitation, data definition models, indices, structure tables, system flow charts, program flow charts, defined terms, file layouts, program narratives, global documentation (including global variables) and program listings.

.1.23 **Standard Software** means those Deliverables that are classified, in Appendix 1.23 hereto as Standard Software, as well as the documentation furnished therewith by Licensor or its subcontractors in the normal course of business; an exhaustive list of the Standard Software is set forth in Appendix 1.23 hereto.

- ***The "Definitions" section of any agreement is very important, as this is where the Customer or Licensor may try to insert a definition, which has a favorable implication later in the Agreement, based upon its use. For example, many Customers try to define the "Agreement" to include the RFP. This is dangerous as***

the deliverables may have changed from the RFP or Licensor may never have intended to meet certain requirements of the RFP by listing such requirements in the "Exceptions" portions of Licensor's RFP response. Further, if the RFP and RFP response are incorporated in the Agreement the two documents may be inconsistent, leading to internal inconsistencies and potential problems of interpretation.

2. Scope of This Agreement

2.1 **Scope.** This Agreement defines the terms and conditions under which Licensor will design, develop, integrate, deliver, install, and support the Software and the Deliverables.

2.2 **Turn-key Basis.** The Parties hereto acknowledge that the performance by Licensor of its obligations hereunder is to be done on a "turn-key" basis." This expression is understood to mean that Licensor is fully responsible, pursuant to the terms and conditions hereof, for the delivery of the Deliverables in full conformity with the terms and conditions hereof, and that the said Deliverables shall function in conformity with the performance criteria stipulated herein upon delivery and up to and including the date on which the acceptance certificate is issued.

- ***From the Customer's prospective, it is important that the Licensor be responsible for providing the entire software system. Otherwise, if there is a defect each individual vendor will affix blame for the -problem on the other vendors. The Customer wants to place the responsibility on the Licensor to deliver a complete, integrated working system and if required fix any problem that arises regardless of whether it arises from the hardware, operating system, proprietary software, data base software, etc. For assuming this additional risk, the Licensor should be entitled to receive a higher fee.***

2.3 **Modification of Delivery Date.** Either Party hereto may submit a request to the other to modify the delivery date for one or more Deliverable(s) if it believes that such a modification of a delivery date is necessary or appropriate given circumstances external to this Agreement or the failure of the other Party to perform in strict conformity with the terms hereof. It is nonetheless acknowledged that the other party shall have full power and authority to accept or reject such a request.

3. Software and Services

3.1 **License Grant.** Subject to the provisions of this Agreement as well as the payment of all applicable license fees for the term of such license, Licensor grants Customer and Customer accepts a limited, personal, nonexclusive, nontransferable, non-assignable Object Code [Source Code] license to use the [Standard] Software for Customer's internal use only in the United States [on the Central Processing Units ("CPUs") listed on Appendix 3.1.]

- ***Customer—Who is the Customer?***

- ***License—Licensor "licenses" its software, Licensor does not "sell" it. "Selling" indicates a transfer of ownership meaning the Customer could potentially "resell" the Software to a third party.***
- ***Limited—Customer has only limited rights in the software.***
- ***Personal—Use of the software is "personal" to the Customer only.***
- ***Nonexclusive—Other customers may receive a license to use the same software.***
- ***Nontransferable— The Software cannot be transferred to other -entities.***
- ***Non-assignable—The Software cannot be assigned to other entities.***
- ***Object code—Unless source code is being licensed, the Customer will receive object code only.***
- ***Internal use—The Software cannot be used for outsourcing, timesharing, service bureaus, etc.***
- ***United States—To avoid export issues and the potential diversion of the Software, the - Customer may use the Software only in the United States.***
- ***This Section assumes that the Licensor shall own all Software including the Custom - Software in contradiction of Sections 6.4 and 12.1, which assume that the Customer will own the Custom Software. Section 3.1.A below provides additional language, which allows the Licensor to retain ownership, but grants the Customer an exclusive license to use the Custom Software.***
- ***The entire license grant is preceded by the clause "Subject to the provisions of this - Agreement," which allows Licensor to terminate the license grant if the Customer breaches any other terms of the Agreement.***
- ***The scope of the license grant is directly related to pricing. For example, while Licensor may not initially grant a source code license that could potentially limit Licensor's -ability to earn revenue from maintaining the software or developing enhancements, licensors will often license source code for an appropriately larger license fee.***

Additional Language Granting the Customer an Exclusive License in Return for Funding Development

3.1.A **Exclusive License Grant.** In consideration of the Customer funding the development of the Custom Software, the Customer is hereby granted the exclusive license and right to utilize the Custom Software for five years from the date Customer accepts the Software (the "Exclusivity Period"). During the Exclusivity Period, Licensor shall not license or sell the Custom Software or allow any other individual or entity to utilize the Custom Software. Further, the Licensor shall not develop, create, or license any other software functionally equivalent to the Custom Software.

- ***This language provides a compromise to the Customer claiming ownership of the Custom Software. It allows the Licensor to retain ownership of the Custom Software while providing the Customer with the benefit of any competitive advantage that the Custom Software may provide. This language is too broad from the Licensor's perspective. Not only does it provide the Customer with an exclusive license, but it also prohibits the Licensor from developing any functionality equivalent software. This prohibition may severely impact the Licensor's ability to sell future work.***

Section 8.H provides alternative language allowing the Customer to recoup its - investment in funding the development of the Custom Software from -royalty payments for future licenses of the Custom Software granted by the Licensor.

3.2 **Software Related Materials.** All Software used in, for or in connection with the software, parts, subsystems, or derivatives thereof (the "ABC System"), in whatever form, including, without limitation, source code, object code, microcode, and mask works, including any computer programs and any documentation relating to or describing such Software such as, but not limited to logic manuals and flow charts provided by Licensor, including instructions for use of the Software and formulation of theory upon which the Software is based, are furnished to Customer only under a personal, nonexclusive, nontransferable, non-assignable Object Code license solely for Customer's own internal use.

3.3 **No Licenses.** Except as explicitly provided in Section 3.1 of this Agreement, no license under any patents, copyrights, trademarks, trade secrets, or any other intellectual property rights, express or implied, are granted by Licensor to Customer under this Agreement.

3.4 **Reverse Engineering.** Customer shall not and shall not permit its Affiliates or any third party to translate, reverse engineer, decompile, recompile, update, or modify all or any part of the Software or merge the Software into any other software.

- ***Section 3.4 restricts the Customer from modifying or enhancing the Software. It is essential this paragraph remain in the Agreement, otherwise the Customer (and potentially the Customer's other vendors) would under the* Sega, Atari, *and* Bateman *decisions have the right to reverse engineer the Software to create its own interfaces, etc. It is also important that the Customer is forbidden from merging the Software with other -software, which in turn may create a new work, which could be copyrighted in the -Customer's name.***

3.5. **Ownership of Materials.** All patents, copyrights, circuit layouts, mask works, trade secrets, and other proprietary rights in or related to the Software are and will remain the exclusive property of Licensor, whether or not specifically recognized or perfected under the laws of the jurisdiction in which the Software is used or licensed. Customer will not take any action that jeopardizes Licensor's proprietary rights or acquire any right in the Software or the Confidential Information, as defined in Section 12 herein below. Unless otherwise agreed on a case-by-case basis, Licensor will own all rights in any copy, -translation, modification, adaptation, or derivation of the Software or other items of Confidential Information, including any improvement or development thereof. Customer will obtain, at Licensor's request, the execution of any instrument that may be appropriate to assign these rights to Licensor or perfect these rights in Licensor's name.

- ***Section 3.5 provides that even if the Customer creates a derivative work or a modification or enhancement, in contradiction to Section 3.4, Licensor will have sole and exclusive ownership of such work. The Licensor needs to be careful that any restrictions placed on the Customer do not amount to copyright misuse.***

3.6 **Third Party Access.** Customer shall not allow any third party to have access to the

Software without Licensor's prior written consent. Further, Customer shall neither engage in nor permit any use of the Software such that a copy would be made of such Software solely by virtue of the activation of a machine containing a copy of the Software.

- ***Section 3.6 prevents the Customer from utilizing outside contractors and consultants from utilizing, maintaining, or supporting on the Software. This protects Licensor from the Customer hiring Licensor's competitors or outsourcing the software and its maintenance. The second sentence seeks to negate the effect of The Computer Maintenance Competition Assurance Act, 17 U.S.C. 117.***

Alternative/Additional Language

3.A **Commitment to Research and Development.** Licensor acknowledges that research and development is an integral part of being able to continue to improve functionality and meet the increasing business needs of the [name of] industry in the future. Having acknowledged the foregoing, Licensor shall invest on a yearly basis a minimum of [XX] percent (XX%) of the gross revenues it collects from all customers using and receiving services related to the Software into research and development efforts related to the Software. In the event that Licensor fails to invest the required amount into the research and development of the Software, Customer shall: (a) have the right to migrate to the new services or system that Licensor offers to its customers, which migration shall be at no additional cost to Customer and shall include the retro--fitting of all custom programming; or (b) have the right, at any time, to terminate this Agreement and: (i) obtain all Source Code and other deposit material to all Software and/or to provide Services to Customer; and/or (ii) transition to a new software vendor, pursuant to Customer's rights under Section 5.3.3. [Transition Rights in the event of Licensor breach.] All Services provided by Licensor during any such transition period shall be provided at no cost to Customer.

- ***When purchasing a mission critical software system, a customer should obtain a -commitment from the Licensor that the Licensor will continue to invest in the product to keep the product competitive during the customer's use of the product. This protects the customer from the Licensor "sun setting" the product by failing to invest in the -product and keep the product competitive with market requirements. The language set forth above provides the customer the right to migrate to any new product the Licensor offers to replace the licensed software at no additional cost or terminate the Agreement and obtain the source code and/or transition to a new vendor. This clause provides complete protection in the event the Licensor creates a new product shortly after the -customer enters into the license agreement. At the same time, the clause creates significant risks for the Licensor and will likely be hotly debated in most licensing negotiations.***

3.B **Service Level Standards**

3.B.1 **General.** Licensor shall provide the Software, and any other Services, as applicable, according to the performance criteria and at the service level standards ("Service Level Standards") set forth in Appendix 3.B.1. Licensor and Customer shall meet on a semi-annual

basis to discuss whether changes to the Service Level Standards are necessary due to any changes business needs of Customer. Any changes to the Service Level Standards agreed upon in writing by both parties shall replace the then existing Appendix 3.B.1.

- ***Almost all license agreements from the Customer's prospective should include service level standards. Service level standards establish the minimum level of acceptable performance such as response times and refresh rates. While a general warranty may include broad generalizations as to the software's performance, service level standards provide specific standards that the Licensor's software must meet. This creates greater risks for the Licensor but the Customer is only asking the Licensor to commit in writing to the standards the Licensor has most likely already agreed to or stated in its marketing materials.***

3.B.2 **Service Level Credits.** In the event Licensor fails to meet the Service Level Standards, Customer shall be entitled to receive from Licensor service level credits ("Service Level Credits"), which shall be: (a) in the amounts and according to the terms set forth in Appendix 3.B.1, all of which shall be based on Licensor's monthly performance as set forth in the monthly performance reports prepared by Licensor pursuant to Section X.6.3 (attached as an alternative section); and/or (b) in the amount imposed upon Customer by [Regulatory Agency] for failing to comply with a State standard where such failure is caused by a Licensor failure to meet the Service Level Standards or any other performance standard or requirement set forth in this Agreement. Customer shall have the right to set off any undisputed amounts owed to Licensor against any Service Level -Credits assessed by Customer against Licensor.

- ***Service Level Credits flow directly from the failure of the software to meet the Service Level Standards. The Customer has a significant amount of money and effort invested in the implementation of the software. Termination of the license agreement for the failure of the software to meet the Service Level Standards is not always a practical solution. Further, a regulatory agency or end-user may have imposed penalties on the Customer causing the Customer to incur out-of-pocket costs. Consequently, Service Level Credits provide the Customer with a way to incent the Licensor short of terminating the Agreement. The Customer should provide, however, that if the Service Level Credits exceed a certain threshold that the Customer shall the right to terminate the Agreement (See § 5.1(d)). The Licensor should ensure that the level of credits is acceptable and that the Service Level Standards are realistic. Further, the Licensor should insist that each set of credits be capped in the aggregate and on a monthly basis.***

3.C Liquidated Damages

3.C.1 **Liquidated Damages Payable by Licensor.**

(a) In the event that Customer refuses, as per the provisions of Appendix 3.C hereto, to issue the On-Site Acceptance Certificate on or before a day which is twenty (20) calendar days after the Delivery Date for Milestone Nos. ___ or ___ (On-Site Acceptance Certificates), respectively (hereinafter referred to as the "LD Date"), liquidated damages shall be payable by Licensor pursuant to the conditions set forth in Section 3.C hereof. Such liquidated damages shall be imposed on a daily basis, as from and including the day

immediately following the LD Date up to and including the date on which the aforesaid On-Site Acceptance Certificate is issued. The amount of such liquidated damages shall be _____ (____) per calendar day, subject to a maximum amount of _____ (____).

(b) In the event that Customer refuses, as per the provisions of Appendix 3.C hereto, to issue the Provisional Acceptance Certificate on or before a day which is twenty (20) calendar days after Milestone Nos. ____ or __ (Provisional Acceptance Certificates), respectively (hereinafter referred to as the "LD Date"), liquidated damages shall be payable by Licensor pursuant to the conditions set forth in Section 3.C hereof. Such liquidated damages shall be imposed on a daily basis, as from and including the day immediately following the LD Date up to and including the date on which the aforesaid Provisional Acceptance Certificate is issued. The amount of such liquidated damages shall _____ (___) per calendar day, subject to a maximum amount ____ (____).

(c) Notwithstanding the provisions of Sections 3.C.1 (a) hereof, in the event that the On-Site Acceptance Certificate is issued on a date that is more than twenty (20) calendar days after Milestone No. ___ (On-Site Acceptance Certificate), Milestone No. ___ (Provisional Acceptance Certificate) shall be deemed to be moved forward in time by the number of calendar days equal to a number of calendar days between Milestone No. _____, plus twenty (20) days, and the date on which the On-Site Acceptance Certificate is issued, provided, however, that in no event shall the number of days by which the aforesaid Milestone No. ___ shall be moved forward in time exceed one hundred (100).

3.C.2 **Liquidated Damages Payable by Customer**

(a) In the event that Licensor refuses, as per the provisions of Appendix 3.C hereto, to issue the Acceptance Test Cases Acceptance -Certificate on or before a day which is twenty (20) calendar days after Milestones Nos. __ or __ (Acceptance Tests Cases Certificates), respectively (hereinafter referred to as the "LD Date"), liquidated damages shall be payable by Customer pursuant to the conditions set forth in Section 3.C.3 hereof. Such liquidated damages shall be imposed on a daily basis, as from and including the day immediately following the LD Date up to and including the date on which the aforesaid Acceptance Test Cases Acceptance -Certificate is issued. The amount of such liquidated damages shall be _____ (_____) per calendar day, subject to a maximum amount of ____ (___).

(b) In the event that Licensor refuses, as per the provisions of Appendix 3.C hereto, to issue the Site Ready Acceptance Certificate on or before a day which is twenty (20) calendar days after Milestone No. ___ (Site Ready Acceptance Certificate) (hereinafter referred to as the "LD Date"), liquidated damages shall be payable by Customer pursuant to the conditions set forth in Section 3.C.3 hereof. Such liquidated damages shall be imposed on a daily basis, as from and including the day immediately following the LD Date up to and including the date on which the aforesaid Site Ready Acceptance Certificate is issued. The amount of such liquidated damages shall be ___ (___) per calendar day, subject to a maximum amount of ____ (____).

(c) Notwithstanding the provisions of Section 3.C.2 (a) hereof, in the event that the Acceptance Tests Cases Acceptance Certificate is issued on a date that is after Milestone

No. ___ (Acceptance Tests Cases Acceptance Certificate), Milestones Nos. ___, ___ and ___ (On-Site Delivery, On-Site and Provisional Acceptance Certificates) shall be deemed to be moved forward in time by a number of calendar days equal to the number of - calendar days between Milestone No. ___ and the date on which the Acceptance Tests Cases Acceptance Certificate is issued, provided, however, that in no event shall the number of days by which the aforesaid Milestones Nos. ___, ___ and ___ shall be moved forward in time exceed one hundred (100). Notwithstanding the provisions of Section 3.C.2 hereof, in the event that the Site Ready Acceptance Certificate is issued on a date that is after Milestone No. ___, subsequent impacted Milestones shall be deemed to be moved forward in time by a number of calendar days equal to the number of calendar days between Milestone No ___ and the date on which the Site Ready Acceptance Certificate is issued, provided, however, that in no event shall the number of days by which the aforesaid subsequent impacted Milestones shall be moved forward in time exceed one hundred (100).

3.C.3 **Payment of Liquidated Damages.** If Customer is entitled to receive liquidated damages pursuant to Section 3.C.1 hereof, it shall notify Licensor thereof in writing and Licensor shall cause a credit to appear on the next invoice it issues hereunder. If Licensor is entitled to receive liquidated damages pursuant to Section 3.C.2 hereof, it shall notify Customer thereof in writing and shall cause a debit to appear on the next invoice it issues to - Customer hereunder.

3.C.4 **Termination in Lieu of Liquidated Damages.** In the event that the maximum amount of liquidated damages prescribed by Sections 3.C.1 or 3.C.2 is reached, the Party that would otherwise be entitled to receive liquidated damages shall have the right, but not the obligation, to terminate this Agreement pursuant to the provisions of Section 5 hereof by sending a notice to that effect to the other Party.

- ***Liquidated damages are a predetermined good-faith estimate of damages the Customer will incur as a result of Licensor's breach or that the Licensor will incur as a result of the Customer's breach, which eliminates the necessity that the injured party prove its -damages. For example, once the Customer demonstrates that the Licensor breached its obligations, it is entitled to collect the pre-agreed damages. If there are concerns about the ability to collect payment, each party can require the other to establish an -irrevocable bond or letter of credit.***
- ***Any provision for liquidated damages should be mutual as the Licensor may also suffer damages, for example if the Customer's performance is delayed.***
- ***To the extent one party's performance is delayed by the action or inaction of the other party and as a result is liable for liquidated damages, the party whose performance has been delayed shall be entitled to one extra day for each day its performance has been delayed by the other party.***

4. Term of Agreement and License

4.1 **Term of Agreement.** The term of this Agreement shall commence upon the execution of this Agreement, and shall continue for ____ years unless terminated upon the breach of this Agreement by either party [or as otherwise provided herein].

- ***This "term" relates to the term of the Agreement although the term of individual licenses granted under the Agreement may be different.***

Additional Language Allowing Customer to Terminate for Convenience

4.1.A **Termination without Cause.** Upon written notice to Licensor, -Customer shall have the right to terminate this Agreement without cause. In such event: (a) Licensor shall discontinue its Services with respect to this Agreement; and (b) Customer shall be obligated to pay to Licensor a termination fee in an amount equal to the Services Fees paid or payable for the two (2) month period immediately preceding the effective date of such termination.

- ***This clause usually benefits the Customer as it allows the Customer the terminate the agreement at the Customer's convenience and depending on the wording it may not allow the Licensor to recover its termination costs, investment etc. The Licensor should make sure that if the Licensor accepts such a clause that the negotiated termination fee allows the Licensor to recover its investment, expenses, and the cost of money. The Licensor may have significant termination costs including employee termination costs, subcontract termination costs, leases, travel, etc. The language set forth above does not favor the Licensor as the termination fee is not specifically stated and is tied to revenues. This creates the risk of an unanticipated event that reduces the agreement's revenues and in turn lowers the termination fee the Licensor is entitled to receive.***
- ***This clause must be carefully worded to clearly state how any termination fee will be determined. Usually the Customer must pay for work completed Licensor's termination costs* and *Licensor's lost profit. The Licensor must determine whether the Customer should compensate Licensor for work performed based on Licensor's costs (a cost plus model) or on a percent complete (of the project) basis. In either case, the agreement should provide that Licensor is entitled to recover Licensor's lost profit or at least a pro rata portion of its lost profits.***

4.1.B **Termination upon Acquisition by XYZ Software Company.** Upon written notice to Licensor, Customer shall have the right to immediately terminate this Agreement if Licensor is acquired by XYZ Software Company of one of its Affiliates. In such event: (a) Licensor shall -discontinue its Services with respect to this Agreement; and (b) Customer shall be obligated to pay to Licensor a termination fee in an amount equal to the Services Fees paid or payable for the two (2) month period immediately preceding the effective date of such termination.

4.2 **Term of Licenses.** Subject to the limitations contained in this Agreement, the term of each individual License granted under this Agreement begins on the date of delivery of the Software, and shall terminate on the date set forth herein, unless earlier terminated as provided in this Agreement.

- ***The term of the "License" should begin on "delivery" and not on "acceptance" otherwise the Customer would have no legal obligations as to the use of the Software prior to "acceptance." Binding the Customer to the terms of the license upon delivery does not indicate the Customer's acceptance or create an obligation for the Customer to pay the applicable license fee.***