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Software Licenses: The Cure for Lazy
Patents (PowerPoint slides)

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Software Licenses

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“The Cure For Lazy Patents”

My Goals

1. Practice Pointers
2. Hot Topics
3. Land Mines

Performance/Functional Specifications

Significant Cause of Disputes

- A/K/A
 - “Functional requirements specifications”
 - “System specifications”
- These are the functions, e.g., What the software will do
 - Consider listing them
- Why Licensor wants
 - Importance to vendor:
 - What program will not do
 - Neutralize over promising by sales people
 - Want the sale (“Make your numbers”)
 - Most important: Commissions!
 - Want their bonuses
 - Fear of being the bottom 10% ... and being fired

Performance/Functional Specifications

- Avoid customer saying: “You said the program would”
- Avoid sales person saying: “I can’t lower the price, but I can give you more functions.”
- Sales people sell in general terms (prepackaged solutions)
 - Because they do not know (or care?) what the customer needs
- Goal: Avoid erroneous expectations

Performance/Functional Specifications

- Why Licensee wants
 - Specifications of the deliverables:
 - Get what the salesperson promised
 - Detailed, definitive
 - Good measure:
 - Do they match the RFP?
 - Do they match the RFP response?
 - Just technical or should attorneys review?
 - Look out for any “waffling”
 - » “As Is”
 - » “We will attempt to ..., but no guarantees.”
 - » “Vendor will try to perform within industry standards.”

Performance/Functional Specifications

- Interface
 - User friendly
 - Term of Art? Or “The Big Lie”?
 - Compare 1980’s Airline Check-in interface vs. present Burger King (Visuals)
 - Minimum training
 - Middleware
 - Get different programs to talk with each other
 - Existing
 - Future
- Operating System compatibility (Linux, Windows, etc.)

Performance/Functional Specifications

- Foundation for other documents:
 - Statements of work
 - Design specifications
 - Software architecture specifications
 - Documentation
 - Testing
- Warranties are limited to the Specifications
 - “Software will function per the Documentation” ... not per the needs of the customer
 - Documentation is operator/user manuals, user notes, new release notes

Performance/Functional Specifications

Check List

- User interfaces
- System interfaces
- Hardware interfaces
- Software interfaces
- Communications interfaces
- Memory
- Scalability
- Operations
- IEEE 830-1998 "IEEE Recommended Practice for Software Requirements Specifications"

Acceptance

Important: Often when vendor gets paid

- Testing phase
 - Proving the program functions as advertised
 - Often vendor provides testing plan
 - In vendor's interest to get paid
 - Payment(s) conditioned upon acceptance
 - Vendor knows its software best
- "Substantially conforms all material respects" to the specifications
- Time limit within which to accept or be deemed to have accepted
 - What if Vendor stalls to run the clock

Acceptance (cont.)

- How many “bugs” are acceptable
- What is a bug or an error?
- Definition
 - Challenge is to articulate
 - Measure
 - Substantially conforms to the specifications
 - Comply in all material respects
 - Actual or Potential Defect
 - How/When will potential defects be discovered
 - Run the program through its paces

Acceptance (cont.)

- Definition of Failure:
 - “Comply with the Specifications”
 - “Function substantially in accordance with the Specifications”
 - Beware: “Compatible with Licensee needs and requirements.”

Acceptance (cont.)

- Importance of explicit specifications:
 - How can a judge, jury or arbitrator determine if there has been acceptance without specifications to compare against?
 - *SHA-I CORP v. City of San Francisco*, 612 F.2d 1215 (9th Cir. 1980)
 - “After installation, each system was to be subjected to a 30-day acceptance test, and if the system performed at ‘an effectiveness level of 95%,’ as defined in the contract, the City was to accept the system and pay for it.”
 - Per the contract, “the City’s obligation to pay for the system arose automatically when a 30-day acceptance test, as contractually defined in elaborate detail, was performed at the level of 95% Effectiveness.”

Hidden Language

- **8.5 License Restrictions.** Neither you nor any End User may use the Service Offerings in any manner or for any purpose other than as expressly permitted by this Agreement. Neither you nor any End User may, or may attempt to, (a) modify, alter, tamper with, repair, or otherwise create derivative works of any software included in the Service Offerings (except to the extent software included in the Service Offerings are provided to you under a separate license that expressly permits the creation of derivative works), (b) reverse engineer, disassemble, or decompile the Service Offerings or apply any other process or procedure to derive the source code of any software included in the Service Offerings, (c) access or use the Service Offerings in a way intended to avoid incurring fees or exceeding usage limits or quotas, or (d) resell or sublicense the Service Offerings. All licenses granted to you in this Agreement are conditional on your continued compliance with this Agreement, and will immediately and automatically terminate if you do not comply with any term or condition of this Agreement. ***During and after the Term, you will not assert, nor will you authorize, assist, or encourage any third party to assert, against us or any of our affiliates, customers, vendors, business partners, or licensors, any patent infringement or other intellectual property infringement claim regarding any Service Offerings you have used. You may only use the AWS Marks in accordance with the Trademark Use Guidelines.***

“Small Print”

Amazon Web Services

- 8.5 License Restrictions.

During and after the Term, you will not assert, nor will you authorize, assist, or encourage any third party to assert, against us or any of our affiliates, customers, vendors, business partners, or licensors, any patent infringement or other intellectual property infringement claim regarding any Service Offerings you have used.

(Source: <http://aws.amazon.com/agreement>)

Content Reps & Warranties

Agreement Language

- 11. Representations and Warranties; Disclaimers; Limitations of Liability
- 11.1. Use of the Services. You represent and warrant that you will not use the Services, [Vendor] Properties and/or your Application and Your Content:
- (iv) in a way that is otherwise illegal or promotes illegal activities, including, without limitation, in a manner that might be libelous or defamatory or otherwise malicious or harmful to any person or entity, or discriminatory based on race, sex, religion, nationality, disability, sexual orientation, or age.”

Content Reps & Warranties (cont.)

- “11.2. Applications and Content. You represent and warrant:
- (iii) that neither your Application nor Your Content
- (a) violates, misappropriates or infringes any rights of us or any third party,
- (b) constitutes defamation, invasion of privacy or publicity, or otherwise violates any rights of any third party, or
- (c) is designed for use in any illegal activity or promotes illegal activities, including, without limitation, in a manner that might be libelous or defamatory or otherwise malicious, illegal or harmful to any person or entity, or discriminatory based on race, sex, religion, nationality, disability, sexual orientation, or age.”

Content Reps & Warranties (cont.)

- What if:
 - Inappropriate employee humor
 - Inappropriate jokes in email received by employee
 - Received by you from a stranger (friend of a friend) spam, your brother-in-law, or a customer
 - Internal review of competitor product
 - “They’re product is junk.”
 - “They’re sales materials are a pack of lies.”
 - “We can’t outsource to [country]. They’re a lawless nation of counterfeiters and thieves.”
 - If your data is encrypted ... how will your cloud vendor know of your breaches?

Do you own ... or do you rent?

Vernor v. Autodesk (9th Cir. Sept. 10, 2010)

- Owner or Licensee of software?
- Distinction important:
 - Owners have rights:
 - First sale doctrine (17 USC §109(a))
 - “essential step defense” (17 USC §117(a))
 - Licensees & transferees can be precluded from re-selling
- 3 prong test:
 - “First, we consider whether the copyright owner specifies that a user is granted a license. Second, we consider whether the copyright owner significantly restricts the user’s ability to transfer the software. Finally, we consider whether the copyright owner imposes notable use restrictions.”
 - Question: What are notable use restrictions? Compare to Autodesk’s

Error Resolution “Crashes”

- Procedures for Error Resolution
 - Usually Classified by Severity
 - Level 1
 - System Down/Will not Restart
 - No Bypass or Redundancy Available
 - Level 2
 - Major Functions Unavailable
 - No Bypass or Redundancy Available
 - Level 3
 - Non-critical but Bypass or Redundancy Available

Further Specifications

- Scalability and Capacity to expand:
 - Operating system capability
 - Database storage size
 - Transmission (use surges)
- Backup (offsite in light of Sept. 11 events)
- Disaster plans (in light of Sept. 11)
 - Redundancy
- Sarbanes-Oxley Considerations
- Force Majeure (with time limitations on restoration and full service)
- Security (firewall, hackers, virus protection: State of the art, best in class)
- Data Encryption

Further Specifications

- Fees:
 1. ID's/Password
 - Vendors want to police usage; exceed # users?
 - Freely changeable passwords by licensee
 2. Number of Employees or Users (ranges)
 3. CPU sizing
- Sales Taxes
 - Services characterization (in some jurisdictions = no sales tax)
 - Software characterization (in some jurisdictions = sales tax)
 - Manipulation of characterizations
 - Off the shelf software taxed (*Lucent v. State Board of Equalization* (Cal. Superior Court, Los Angeles, Sep. 27, 2013))

Further Specifications

- Termination:
 - Notice before shutdown (RedGorilla.com)
 - Want your data within set time, i.e., 72 hours
 - Ability to maintain your own backups
 - Escrow (covered below)

Regulatory Compliance

- Requirement for Licensor to modify software when “recommended or required” to meet governmental and quasi-governmental statutes and regulations
- Additionally: Industry standards
 - Standards may continually change
- “Related to” Licensee’s services or use of the software

Regulatory Compliance

- Includes?
 - Privacy
 - PCI (Payment Card Industry)
 - Sarbanes-Oxley
 - HIPAA
 - State and local counterparts

Object vs. Source Code

- Confidentiality provisions
 - Limited access by employees & contractors
 - Must remain at one location
 - No copies
- No derivative works
- Traditionally more expensive than binary only
- Escrow for breach or bankruptcy
- Escrow: Restrictions on when source code may be accessed
- Escrow: Duty to update source code (Escrow Agreements)

Bankruptcy

- **By Licensor**
 - Licensee cannot be unilaterally terminated
 - Trustee may reject. If so:
 - Licensee may still use software
 - Licensee fees must still be paid
 - No further maintenance
 - No unfinished development work
 - No further upgrades

Bankruptcy (cont.)

- **By Licensee**
 - To continue use of the software, Licensee must:
 - Perform its obligations
 - Cure breaches
 - Provide adequate assurances of future performance
 - If Licensee does not, it must reject and lose rights under the license

Who is the licensee?

- Affiliates and subsidiaries included in definition of Licensee
- Greater than 50% ownership
- “Control” to avoid playing games with “ownership”
 - Voting control
- Extensive affiliates reduces potential license fees
- Beware: For as long as entity remains an affiliate

- **Term**
 - Perpetual or defined period?
 - Does it matter? Obsolescence with new versions?
 - **When maintenance ends**
- **Obligations upon termination**
 - Stop using software
 - Return CD's and documentation
 - Certification by officer as to cessation of use and return of all documentation
- **No copies**
 - Only one backup for archival purposes (Section 117)

- “Irrevocable”
 - Meaningless or throw away term?
 - Terminable for breaches
 - Most grant clauses: “Subject to the terms of this Agreement, Licensor grants to Licensee a nonexclusive right to use the Software”
 - BUT *Nano-Proprietary v. Canon* (5th Cir. July 25, 2008) (patent license agreement)

Nano-Proprietary v. Canon

- “Canon argues that, based upon the plain language of the PLA, Nano’s termination was improper because the PLA granted an ‘irrevocable,’ ‘fully paid-up,’ and ‘perpetual’ license. We agree. Under New York law, ‘words and phrases used by the parties must . . . be given their plain meaning.’ The term ‘irrevocable’ is defined as ‘[u]nalterable; committed beyond recall,’ or ‘[i]mpossible to retract or revoke.’”

Nano-Proprietary v. Canon

- “Based upon the unambiguous meaning of ‘irrevocable,’ we find that the PLA could not be terminated, notwithstanding a material breach of the agreement. Otherwise, the terms ‘irrevocable’ and ‘perpetual’ would be rendered superfluous, in contravention of established rules of contract interpretation.”

Nano-Proprietary v. Canon

- “Simply put, Nano was not entitled to terminate the license because it contracted for an irrevocable and perpetual license. At the time of material breach, Nano was entitled to sue Canon under any available form of relief, but termination of the PLA was not permissible.”
- “Subject to the terms of this Agreement, Licensor grants” language not in 5th Cir. Opinion
- Fully paid up a distinction?
- Must both words be present?

“Perpetual”

- Industry usage
 - “If you buy a perpetual license, you own that copy of Office,” Gartner analyst Neil MacDonald said. “You pay for it once, and that’s it. Non-perpetual means that after three years, you’re going to have to pay Microsoft again for that same functionality.”

“Perpetual” (cont.)

Strategy:

If forced to include either or both terms, consider:

- “Except as provided herein including without limitation Section [Termination].”
- “Subject to timely payment of all Fees due Licensor herein,”

Use Restrictions

Goal: No outsourcing

- Internal use only
- Prohibit:
 - data processing
 - service bureau (i.e., per transaction fee)
- Restricted to a particular computer or type of computer
- Limited to particular application only

Users

- Per seat, CPU or PC
- "Seats" means the number of end-users permitted to concurrently access and use, at the same time, the Program
- "Seats" means the maximum number of concurrent users authorized to access the Software at a given time.
- Installed on multiple units but no concurrent use

Users (cont.)

Example of Provision

- “Licensee’s use of the Software shall also be to a maximum number of (a) seats (i.e. users with access to the installed Software), (b) concurrent users, sessions, ports, or issued and outstanding IP addresses, or (c) central processing unit cycles or instructions per second.”

Derivatives, modifications, and combining with other software

Options:

- Prohibit outright
- Allow: but who owns derivative works?
- Cross license by application
- Licensor seeks protection of its core applications
- Licensee still pays royalty for use of underlying code

Assignability

Cincom Systems v. Novelis (6th Cir., Sept. 25, 2009)

Software License Agreement

- Non-exclusive
- Non-transferable: Alcan Ohio could “not transfer its rights or obligations under this Agreement without the prior written approval of Cincom.”
- Series of internal mergers among various subsidiaries with surviving corporation named “Novelis”
- Held: Patent licenses presumed nonassignable and nontransferable

Cincom Systems v. Novelis (6th Cir., Sept. 25, 2009)

- “Federal common law governs ‘questions with respect to the assignability of a patent [or copyright] license.’”
- “There is no federal general common law.” *Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 78 (1938)
- “In copyright cases such as this, we refer to the case law interpreting patent law ‘because of the historic kinship between patent law and copyright law.” *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 439 (1984).

Cincom Systems v. Novelis (cont.)

- “Federal common law, and the actual language of the license in this case, is clear: the only legal entity that can hold a license from Cincom is Alcan Ohio. If any other legal entity holds the license without Cincom’s prior approval, that entity has infringed Cincom’s copyright because a transfer has occurred. Simply put, *in the context of a patent or copyright license, a transfer occurs any time an entity other than the one to which the license was expressly granted gains possession of the license.” (Italics in original)*

Cincom Systems v. Novelis (cont.)

- “Allowing state law to permit the free assignability of patent or copyright licenses would ‘undermine the reward that encourages invention’ ... because any entity desiring to acquire a license could approach either the original inventor or one of the inventor’s licensees.”

Complex Systems Inc. v. ABN Amro Bank NV, 08-cv-07497 (S.D. N.Y. May 9, 2014)

“[ABN AMRO Information Technology Services Company, Inc. (“IT”)] was the licensee of a software application ... called BankTrade. By virtue of its corporate affiliation with ABN, ABN was entitled to use BankTrade Following the LaSalle Transaction, IT remained the licensee. ABN did not have a separate license and was not itself a licensee. This did not stop ABN from using BankTrade, however. ABN has continued to use BankTrade uninterrupted up until today. Perhaps ABN assumed that following its sale of IT it could easily obtain its own license from CSI; perhaps it assumed that somehow once IT no longer needed the license, IT could transfer it back; perhaps ABN just overlooked certain details in the throes of closing a quickly- negotiated \$21 billion deal. Regardless, the evidence is clear that the moment the LaSalle Transaction closed, ABN no longer had a license to use BankTrade.”

Custom Software

- Who owns copyright in program
- Licensor will not want to convey an interest in underlying pre-existing modules or codes, particularly if an exclusive license.
- Works made for hire: Get assignment transferring all right, title and interest in the work

Custom Software (cont.)

California Labor Code Section 3351.5

"Employee" includes:

(c) Any person while engaged by contract for the creation of a specially ordered or commissioned work of authorship in which the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire, as defined in Section 101 of Title 17 of the United States Code, and the ordering or commissioning party obtains ownership of all the rights comprised in the copyright in the work.

Custom Software

- Moral Rights: Beware of moral rights if outsourcing to overseas for code writing
- Detailed functional specifications should be agreed before signing license
- Both parties need to know beforehand the cost to write and implement

Training

- Who pays
- How many sessions
- Length of each session
- Location
- Who pays for travel costs, hotels, meals
- How many attendees
- English language

Warranties

- Standard:
 - Title to the software
 - Right to grant the license
 - Free from physical defects in material and workmanship
 - Includes “bugs”?
 - Operate in substantial conformance with the Specifications
 - If a “system” license, make sure system is warranted, not just individual programs running independently of each other

Warranties (cont.)

- Will program be “sunsetting”? How soon?
- Term: e.g., 60 - 90 days
- Cure:
 - Notice to Licensor
 - Response time (Mission critical concerns)
 - Time in which to cure (Mission critical concerns)

Warranties (cont.)

- Modification voids warranty
 - We won't pay to clean up your mess from tampering
- Disclaimers:
 - Merchantability
 - Fitness for particular purpose
 - Error-free operation
 - “As Is”
 - Consistent with the Specifications?

Indemnification

For Infringement

- Patent Infringement
 - U.S. only?
 - Able to know what inventions are claimed in unpublished patent applications?
 - Patent infringement litigation can be expensive
- Copyright infringement
 - U.S. only?
 - Overseas use: Corruption? Anti-American sentiments? What is your exposure?
- Trade secrets
 - Difficult to know of as by their nature they are undisclosed and not recorded
- Export control breach by Licensee

Indemnification (cont.)

- **Licensor's limitation:**
 - Indemnification does not have to be unconditional
 - Obligation satisfied by any one of the following options:
 - defend licensee against the claim
 - acquire for the licensee the right to use the software which is the subject of the claim
 - replace the software with non-infringing software, or
 - modify the software to make it non-infringing (same functionality)
 - terminate the agreement.

Indemnification (cont.)

- **Licensor would have no obligation to indemnify if infringement claim arises out of:**
 - Modification by licensee of the software not authorized by Licensor
 - Use of software in violation of the license
 - A patent, copyright or other intellectual property right claim in which the licensee or any affiliate of licensee has an interest; or
 - Use of old software after receipt of modified software from Licensor

Indemnification (cont.)

- Licensor has right to control the defense and settlement
- Licensee obligated to cooperate
- Licensor's satisfaction of any of the above options would satisfy Licensor's liability and be Licensee's exclusive remedy for infringement

Limitations of Liability

- Dollar cap:
 - Total license fees paid
 - License fees paid in past [i.e., 12] months
 - Specified dollar amount
 - Cannot be so low as to be unconscionable (assumed conscionable in commercial contracts)

Limitations of Liability (cont.)

- Standard Limitations
 - Direct, indirect, consequential, exemplary, punitive, special, incidental damages
 - Lost profits, revenue or data or costs for substitute software
 - Tort, contract, product liability or otherwise
 - Should be distinct from the warranty provisions

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