Software License Agreements
A Practical Guide

Second Edition

By Bradley J. Freedman

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Introduction

Computer software is an essential tool for almost every organization. Businesses and other organizations use computer software to create products, perform services, manage relationships, control internal operations, and process and store sensitive and regulated data. Almost every organization procures and uses various kinds of computer software and ancillary services provided by numerous software vendors/ service providers.

There are two basic business/technology models for the procurement and use of computer software:

▪ Traditional Installed Software: The traditional installed software model involves the customer using copies of computer software installed and maintained by the customer (or its service providers) on the customer's own technology infrastructure.

▪ SaaS: The software-as-a-service (commonly known as "SaaS") model involves the customer using its technology infrastructure to remotely access and use copies of computer software installed and maintained by a service provider on the service provider's technology infrastructure.

Each model has distinctive characteristics that affect the rights and obligations of the customer and the software vendor/service provider. Consequently, the contracts used for each model are significantly different. The contract for the traditional installed software model is commonly known as a "software license agreement". The contract for the SaaS model is commonly known as a "software-as-a-service subscription agreement" or a "cloud service subscription agreement". This handbook discusses software license agreements. Software-as-a-service subscription agreements are discussed in BLG's *SaaS Agreements – A Practical Guide*.

Software license agreements can take various forms and be implemented in various ways. Inexpensive and relatively simple commercial off-the-shelf software is usually governed by a standard form agreement the customer must accept before or during the software download or installation process. Software that is costly and complicated to implement is often governed by a signed agreement that is subject to negotiation by the software vendor and the customer.

The use of software and related services can present the customer with potentially significant business risks and legal liabilities, which should be addressed in the applicable software license agreement. Consequently, a prudent customer, with the benefit of legal advice, will carefully review each software license agreement and attempt to negotiate required revisions so that the agreement is appropriate and reasonable in the circumstances.

This handbook explains some of the important provisions commonly included in software license agreements and provides some practical guidance for organizations considering the procurement of software. This handbook provides general information only, and does not constitute legal or other professional advice. Organizations procuring software are encouraged to obtain legal advice from a competent professional regarding their particular circumstances.

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Software Procurement

Software procurement can present substantial business and legal risks. Many software procurement projects, particularly those involving costly and complicated software, fail to achieve the customer's primary business objectives – the on-time, on-budget delivery of the required technology solution.

Following are recommendations to help increase the chances of a successful software procurement, including the negotiation of an appropriate and reasonable software license agreement.

- **Business Requirements:** The customer should have an accurate and complete understanding of its business requirements (both must-haves and nice-to-haves) for the software as part of an overall technology solution.

- **Preliminary Work:** The customer's selection of software should be based on a reasonable determination that the software can be implemented, for a reasonable cost and within a reasonable period, to satisfy the customer's business requirements. It might be impossible to make that determination without some preliminary work (e.g., a fit/gap analysis and preparation of an implementation plan). In those circumstances, the required work might be performed by the software vendor, and paid for by the customer, under a simple preliminary work agreement.

- **Due Diligence:** The customer's software selection and negotiation decisions should be based on reasonable due diligence investigations of the software vendor (including their financial viability and ability to perform on-time and on-budget software implementation and provide reliable technical support and maintenance services).

- **Risk Assessment:** The customer should perform an appropriate enterprise risk assessment (including a privacy impact assessment where required by law or otherwise appropriate) of the entire software lifecycle and identify reasonable controls (including specific contract provisions) the customer might implement to manage risk.

- **Business Terms:** The customer should not engage in detailed contract negotiations with the software vendor until the customer and software vendor agree in principle to the basic business terms of the software procurement. In most circumstances, those issues are best addressed at the beginning of negotiations, when the customer usually has maximum leverage.

- **Legal Terms:** If the software procurement includes consideration of proposals from competing software vendors, the customer should consider requiring the vendors to make their proposals based on the customer's preferred legal terms with specified exceptions.

- **Implementation:** Sophisticated software often must be implemented (e.g., software configuration and interfaces to other technologies/services) by the software vendor or an authorized independent service provider. All aspects of the implementation project (including project plan/timeline and cost, the services and deliverables to be performed and provided by the vendor/service provider, and the tasks to be performed by the customer) should be addressed in a contract that gives the customer appropriate project control mechanisms and reasonable remedies for deficiencies and delays.

- **Standard Form Documents:** The customer should attempt to negotiate required revisions to the software vendor's standard form documents so they are appropriate and reasonable in the circumstances and adequately address all aspects of the software procurement, including risks of implementation project failure.

- **Ancillary documents:** Important aspects of a software procurement are often addressed in ancillary documents (e.g., statements of work, maintenance and support schedules, and data protection schedules). Those documents are usually key contract documents that should be prepared or reviewed/revised with care and appropriate technical and legal advice.

- **Negotiation:** The customer should have a reasonable and realistic negotiation plan that allows sufficient time to deal with difficult issues and unanticipated delays. The customer should not impose or rush to meet arbitrary or unreasonable deadlines. The customer should not allow the vendor to start work without a signed agreement, and should not sign a bad agreement hoping to resolve problems as they arise. When negotiating difficult issues, the customer should be mindful of its best alternative to a negotiated agreement.

- **Use the Agreement:** The customer's activities and decisions regarding the implementation and use of the software should be informed by an understanding of the software license agreement and all related ancillary documents. ∎

The Software License

In most software transactions, the customer does not acquire ownership of the software. Instead, the customer acquires a limited permission – commonly called a "license" – to use the software. A software license agreement usually specifies how the customer may use the licensed software, the purposes for which the customer may use the licensed software and other restrictions and requirements.

The software license is of fundamental importance to the customer because use of licensed software beyond the scope of the license is a breach of the software license agreement and might constitute an infringement of the software vendor's rights in the licensed software. If the customer violates the limits and restrictions specified in a software license agreement, then the customer risks serious adverse consequences, including financial liability to the software vendor and early termination of the software license.

Permissible Users and Beneficiaries

Software license agreements usually grant software licenses to the customer only and prohibit the customer from allowing other persons (including the customer's corporate affiliates and subsidiaries) to use the licensed software. In addition, software license agreements usually prohibit the customer from using the licensed software to provide services to or for the benefit of any other person (including the customer's corporate affiliates and subsidiaries).

Kinds of Licenses

There are various kinds of software licenses. Most licenses are "non-exclusive" (the software vendor and other licensees can also use the licensed software), but licenses can be "sole" (the customer is the only licensee, but the software vendor can use the licensed software as well) or "exclusive" (the customer can use the licensed software to the exclusion of all other persons, including the software vendor).

Scope of Use

A software license defines the scope of the customer's permissible use of the licensed software. The scope of a software license can be adjusted by limiting or restricting various aspects of permissible software use. For example:

- **The Software:** The particular software versions, modules, features or functionalities that may be used under the license.

- **End-Users:** The individuals who may use the licensed software. For example, a software license might limit the total number of concurrent individual users of the software, limit use of the software to specific individuals (e.g., identified by name, business role or location), or impose other requirements (e.g., a user must be employed by the customer) or prohibitions (e.g., a user must not be an IT service provider engaged by the customer).

- **Purposes:** The purposes for which the licensed software may be used. For example, software licenses commonly provide that the software may be used for the customer's "internal business purposes only" and prohibit use of the software to provide services to or for the benefit of other persons (e.g., the customer's corporate affiliates or subsidiaries).

- **Manner of Use:** The way in which the licensed software may be used. For example, a software license might limit the number of installed copies of software (known as "instances"), restrict the kinds of computers on which the software may be installed (e.g., desktop computers only), limit the computing power that may be used by the software (e.g., maximum number of processor cores), limit the number or kinds of systems, software or interfaces that may be used to access, invoke or exchange data with the software, or limit the kinds and amounts of data that may be processed or stored using the software.

- **Location of Use:** The locations or geographic territories where the licensed software may be installed or used.

- **Duration of Use:** The duration of the license. For example, software licenses are either time-limited or perpetual, and are usually subject to suspension or termination in specified circumstances.

Documentation

Software license agreements usually give the customer a license to reproduce and use technical documentation (e.g., user manuals) regarding the licensed software. Licenses for technical documentation are often subject to the same limits and restrictions that apply to the use of the licensed software.

Technological Enforcement Mechanisms

Software vendors often use technological mechanisms (commonly known as "license management technologies") to help enforce certain kinds of software license restrictions and requirements. For example, license management technologies often require the customer to use vendor-provided license keys or codes to initially activate and periodically reactivate each installed instance of the licensed software.

Some license management technologies record detailed information about the customer's use of the software and make the information available to the software vendor through remote access (if permitted by the customer) or in reports the customer must send to the software vendor.

Contractual Enforcement Mechanisms

Some kinds of software license restrictions and requirements cannot be enforced by technological mechanisms. The software vendor must rely on contractual enforcement mechanisms – monitoring, periodic reports and audits – to detect breaches of the restrictions and requirements.

Software license agreements usually give the software vendor the right to conduct audits of the customer's facilities and records to verify the customer's compliance with the software license agreement. In addition, some software license agreements require the customer to provide the software vendor with specific information about the customer's use of the licensed software.

Some software license agreements require the customer to pay punitive fees for all unauthorized use of the licensed software that is discovered by the software vendor using contractual enforcement mechanisms. Consequently, the customer should take steps (including educating the customer's employees and conducting internal audits) to prevent unauthorized use of the licensed software.

Changes

Some software license agreements permit the customer to change the scope of the software license, subject to specified minimums. For example, the customer might be permitted to increase the maximum number of installed software instances or end-users. Those kinds of provisions enable the customer to adjust the software license, at a predetermined cost, to accommodate changes to the customer's business requirements.

Recommendations

When negotiating a software license agreement, the customer should ensure that the agreement allows the customer and its corporate affiliates and subsidiaries (if applicable) and service providers (if appropriate) to use and benefit from the licensed software as required for current and reasonably anticipated future needs. The customer should also take reasonable precautions to minimize the risk of unintentional use of the licensed software and documentation in breach of the software license agreement. ■

Software Quality Promises – Warranties and Disclaimers

Software license agreements often contain limited promises by the software vendor regarding the quality of the licensed software, and provide limited remedies for the customer if the software is defective. The customer should understand those provisions and manage and mitigate risk through other contractual rights and prudent business practices.

Software Quality Warranties

Software license agreements often contain limited promises (known as "warranties") by the software vendor regarding the quality (i.e., functionality, operation, performance and results) of the licensed software. For example, the software vendor might promise that for a specified period (known as a "warranty period") the licensed software will conform to the description in the applicable documentation. Software quality warranties are usually subject to exceptions for problems that are not caused by software defects (e.g., problems caused by the customer's improper installation, configuration or use of the licensed software) or by circumstances beyond the software vendor's control.

Limited Remedies

Software license agreements usually provide the customer with limited remedies if the licensed software fails to comply with the quality warranties during the warranty period and the customer submits a timely claim using a prescribed procedure. For example, the software vendor might be required to either remedy or replace the defective software (so that the software conforms to the applicable documentation) or terminate the customer's license to use the software and refund the license fee paid by the customer for the terminated license. The specified remedies for breach of quality warranties are usually exhaustive and expressly exclude all other remedies, including financial compensation for loss and damage suffered by the customer as a result of the defective software.

Disclaimers

Software license agreements usually contain detailed provisions (known as "disclaimers") that exclude all other promises regarding the quality of the licensed software. Disclaimers often provide that the express software quality warranties in the software license agreement are in place of all other promises regarding the licensed software, including promises that might otherwise be implied by law. In addition, disclaimers often specify that the customer is solely responsible for selecting the licensed software and determining the suitability of the software for the customer's particular purposes.

Entire Agreement Clause

Software license agreements often supplement disclaimers with a provision (known as an "entire agreement" clause) that confirms that the software license agreement supersedes and replaces all prior discussions, promises, understandings and agreements between the software vendor and the customer regarding the licensed software. An entire agreement clause is intended to prevent either party from relying on pre-contractual discussions or assurances (including statements in the software vendor's advertising and marketing materials and commitments made by the software vendor during sales presentations and negotiations) that are not confirmed in the software license agreement.

Recommendations

Limited warranties and disclaimers usually restrict the customer's rights and remedies if the licensed software is defective or otherwise fails to meet the customer's requirements. When negotiating a software license agreement, the customer should ensure that the software license agreement: (1) accurately confirms all of the software quality commitments made by the software vendor during sales presentations and due diligence investigations; and (2) provides the customer with reasonable and appropriate rights and remedies if the software vendor breaches those commitments. The customer should also manage and mitigate risk through prudent business practices (e.g., pre-contractual due diligence and business continuity planning). ∎

Acceptance Testing

Software license agreements often prescribe a procedure known as "acceptance testing", which allows the customer to verify that the licensed software meets specified requirements. The importance of acceptance testing will depend on the circumstances, including the customer's ability to test or evaluate the software before purchasing a software license, the extent to which the software must be implemented (configured or integrated) by or on behalf of the software vendor for use by the customer, the cost of the software license, and the customer's legal and practical ability to terminate the software license agreement if the software is deficient.

Testing Procedure

Acceptance testing provisions usually specify one or more limited periods during which the customer may test the licensed software to determine whether the software meets specified requirements. Depending on the circumstances, acceptance testing might occur not only when the licensed software is initially delivered to the customer but also after the software is implemented.

In some circumstances, acceptance testing is a collaborative process in which the software vendor assists the customer to conduct the testing. The customer is usually required to give the software vendor detailed notice of all deficiencies in the licensed software identified by the customer during testing, and allow the software vendor a reasonable opportunity to correct the deficiencies and resubmit the software for further testing. The customer is also usually required to give the software vendor prompt written notice if the licensed software passes or fails acceptance testing. Software license agreements often provide that licensed software is deemed to pass acceptance testing if the customer does not give timely notice that the software has failed acceptance testing.

Acceptance Criteria

Acceptance testing provisions often specify criteria – known as "acceptance criteria" – for the customer's acceptance or rejection of the licensed software. For example, the acceptance criteria might be the standard functionalities of the licensed software described in the software documentation. In appropriate circumstances, the customer might also require that the acceptance criteria include detailed specifications (e.g., required functionalities, operations, performance and results) that reflect the customer's particular requirements.

Acceptance testing provisions often provide that the licensed software will pass acceptance testing if the software "substantially conforms" to the acceptance criteria. However, that approach might not be appropriate in all circumstances, particularly if the customer requires that the software comply with all acceptance criteria.

Consequences

Acceptance testing provisions usually specify the consequences or remedies for successful acceptance testing and acceptance testing failure. For example, successful acceptance testing might constitute a payment milestone. On the other hand, acceptance testing failure might give the customer an option to either terminate the software license and receive a refund of pre-paid fees, negotiate revisions to the acceptance criteria and a corresponding fee adjustment, or give the software vendor more time to correct identified deficiencies in the licensed software.

Recommendations

Acceptance testing can be an important way for a customer to manage risk. If licensed software is subject to acceptance testing, then the software license agreement should specify a commercially reasonable acceptance testing procedure, acceptance criteria and the consequences of successful acceptance testing and acceptance testing failure. ■

Software Maintenance, Technical Support and Problem Resolution

Software license agreements usually require the software vendor to perform important ancillary services regarding the licensed software, known as "software maintenance", "technical support" and "problem resolution", which are essential for the customer's effective use of the licensed software. The customer should understand the nature and extent of the ancillary services, and ensure that the services, together with other risk-management practices, will reasonably satisfy the customer's requirements.

Services

Software maintenance usually consists of software patches and fixes (to correct defects and fix security vulnerabilities) and software updates or incremental releases (to provide minor improvements and maintain compatibility with operating systems and other software). In some instances, software maintenance might also include major upgrades or new versions of licensed software.

Technical support usually consists of online information and remote (telephone or online) technical advice regarding the customer's use of licensed software. Problem resolution usually consists of remote (telephone or online) technical advice and assistance to help resolve certain problems with licensed software. Technical support and problem resolution might include a help desk service for the customer's end-users of licensed software (known as "first-level" support) or be limited to assistance to the customer's own internal help desk personnel (known as "second-level" support).

Service Levels and Remedies

Some software license agreements contain limited promises (sometimes called a "service level agreement" or "SLA") by the software vendor about how quickly the software vendor will respond to and resolve problems with the licensed software. The promised service level often varies depending on the severity of the reported problem.

Some software license agreements provide the customer with specified remedies (e.g., credits against future fees payable by the customer and termination of the agreement in limited circumstances) if the software vendor fails to provide the promised level of service. Usually, the remedies must be claimed by the customer within a limited period and using a specified procedure. The specified remedies are usually exhaustive and expressly exclude all other remedies, including financial compensation for loss and damage suffered by the customer.

Exclusions/Qualifications

The software vendor's obligations to provide software maintenance, technical support and problem resolution services are usually limited by various exclusions and qualifications. For example, the software license agreement might limit software maintenance, technical support and problem resolution to relatively current versions of licensed software (e.g., the most current version and the previous version) and exclude problems caused by use of the software in breach of the software license agreement or contrary to applicable documentation. The software license agreement might also limit problem resolution to problems that can be replicated by the software vendor in its technical support environment.

Duration of Service

Software maintenance, technical support and problem resolution services might be optional at the customer's election or mandatory throughout the entire duration of the software license. Software vendors usually commit to offering software maintenance, technical support and problem resolution services for a limited time only. That kind of limitation can be problematic if the customer intends to use licensed software for a lengthy period and will require software maintenance, technical support and problem resolution services throughout the entire period.

Recommendations

Software maintenance, technical support and problem resolution services are particularly important for licensed software that is essential to the customer's daily business operations and difficult to replace promptly. In those circumstances, the customer should ensure that the software vendor's obligations regarding software maintenance, technical support and problem resolution, together with the customer's other risk-management practices, will reasonably satisfy the customer's requirements throughout the entire period that the customer expects to use the licensed software. ∎

Fees and Related Matters

Software license agreements usually require the customer to pay fees for the software license and ancillary services. The customer should ensure that the software license agreement provides certainty regarding the customer's total cost of using the licensed software throughout the entire term of the agreement.

Kinds of Fees

A software license agreement might require the customer to pay various fees, including fees for the software license, fees for ancillary services (i.e., software maintenance, technical support and problem resolution), and fees for optional professional services (e.g., software implementation and training).

The fee for a software license usually reflects the value the customer expects to derive from using the licensed software, based on the duration and scope of the software license. A software license fee is usually payable in advance, on either a one-time basis (for a perpetual license) or a periodic basis (for a fixed-term license), and the full amount of the fee is usually payable regardless of the customer's actual use of the licensed software. A software license agreement might give the customer an option to periodically adjust the scope of the license (e.g., adding additional software instances or end-users or rebalancing other usage metrics) by paying additional specified license fees, either in advance or in arrears following a prescribed true-up procedure.

The fee for ancillary services might be included in the software license fee or it might be a separate fee (often calculated using a formula based on the license fee).

Software vendors usually charge fees for optional professional services. The fees are often based on a specified fee schedule or calculated on a time and materials basis using the software vendor's specified hourly rates (which might be subject to a negotiated discount).

Fee Increases

Most software vendors change their fees periodically to adjust for inflation and changes in market conditions. Software license agreements often limit the software vendor's ability to increase fees during the term (including renewals and extensions) of the software license, which can be particularly important to the customer if the customer expects to use the licensed software for a lengthy period.

Taxes and Withholdings

Software license agreements usually require the customer to pay all applicable taxes on all amounts paid by the customer under the agreement. Software license agreements often require the customer to pay all fees in full without any withholding or deduction, and include a provision (known as a "tax gross-up") that provides that, if the customer is required by law to make a withholding or deduction from any payment to the software vendor, the customer will make an additional payment so that the total amount received by the software vendor (net of withholdings and deductions) is the full amount of the required payment.

Enforcement

Software license agreements usually allow the software vendor to suspend or terminate the software license if the customer fails to make a required payment. However, most software license agreements include procedural requirements (e.g., a reasonable opportunity for the customer to make the payment after notice of default) to protect the software vendor and the customer against the risks of inadvertent administrative errors.

Recommendations

The customer should ensure that the software license agreement: (1) provides certainty regarding the customer's total cost of using the licensed software – all software license fees (including fees for additional usage rights purchased by the customer from time to time) and fees for ancillary services – throughout the entire period that the customer expects to use the licensed software; and (2) allows the customer a reasonable opportunity to cure any inadvertent breaches of payment obligations before the software vendor suspends or terminates the software license. ∎

Object Code and Source Code

Licensed software is usually distributed in object code format only. Some software license agreements allow the customer to access and use the source code for the licensed software if one or more specified events occur. If the customer requires the right to access and use source code in appropriate circumstances, then the customer should require and properly administer an appropriate source code escrow arrangement.

Object Code and Source Code

Computer software is written in a programming language that can be read, understood and modified by knowledgeable programmers. The resulting version of the computer software is known as "source code", which is compiled into machine language format, known as "object code" or "machine code", before it is installed and run on a computer. Object code is not easily read or understood by programmers and is difficult to modify. Consequently, in most circumstances programmers must have access to the source code and related materials (e.g., explanatory notes and instructions) for computer software in order to modify (e.g., fix a software bug or error) or enhance (e.g., add a new interface or functionality) the software.

Object Code Distribution

Software vendors usually provide customers with copies of licensed software in object code format only. There are numerous reasons for this approach, including: (1) source code is the software vendor's valuable intellectual property, and unauthorized use or disclosure of source code can cause significant loss or irreparable harm to the software vendor; and (2) customers that do not have access to source code must purchase ancillary services (e.g., software maintenance and problem resolution services) from the software vendor.

Nevertheless, in some situations (e.g., if licensed software is expensive to acquire and implement, custom developed for the customer, not easily or quickly replaced or essential for the customer's daily business operations), the customer might not be willing to rely entirely on the software vendor to provide required software maintenance and problem resolution services. Instead, the customer might require the ability to access and use source code for software maintenance and problem resolution purposes if the software vendor is unwilling or unable to provide those services in breach of the software license agreement.

Source Code Escrow

Source code escrow refers to a three-way arrangement – between a software vendor, a customer and a trusted third party (known as an "escrow agent") – that provides the customer with access to the source code and related materials for licensed software if one or more specified events (each known as a "release event") occurs. The most common release events are the software vendor's bankruptcy or breach of contractual obligations to provide software maintenance and problem resolution services. If a release event occurs, the customer is entitled to access and use the source code and related materials for the limited purposes of software maintenance and problem resolution for licensed software.

The fundamental elements of a source code escrow arrangement include: (1) an obligation on the software vendor to periodically deposit with the escrow agent up-to-date versions of the source code and related materials for licensed software; (2) a procedure for the customer to verify the software vendor's compliance with the deposit obligations; (3) appropriate, clearly defined and verifiable release events; (4) a license for the customer to use the source code and related materials if they are released from escrow; and (5) a procedure for the prompt resolution of disputes (e.g., a dispute over whether a release event has occurred). Escrow agents usually have prescribed forms of escrow agreement that allow limited revisions to reflect the circumstances of the underlying software licensing arrangement.

The need for a source code escrow arrangement, and the benefits it will provide to the customer, will depend on the circumstances, including: (1) the importance of the licensed software to the customer; (2) the cost and time to replace the licensed software; (3) the probability that the software vendor will fail to provide promised software maintenance and problem resolution services; (4) the quality and completeness of deposited source code and related materials; (5) the probability of a dispute over whether a release event has occurred and the customer's ability to resolve the dispute in a timely manner; and (6) the customer's technical and financial ability to use the source code to maintain and resolve problems regarding the licensed software.

In many situations, the customer might be better off replacing licensed software rather than attempting to use source code to maintain and resolve problems regarding the software if the software vendor fails or refuses to do so. Nevertheless, a source code escrow arrangement might benefit the customer by creating an incentive for the software vendor to properly perform software maintenance and problem resolution services.

Recommendations

When negotiating a software license agreement, the customer should carefully consider whether a source code escrow arrangement is necessary and appropriate. If the customer requires the self-help remedy that source code can provide, then the customer should request a comprehensive and properly documented source code escrow arrangement with reasonable release conditions and an appropriate license to use released source code, and the customer should properly administer the arrangement by periodically verifying that the software vendor has deposited the source code and related materials for the licensed software. ■

General Indemnity

Software license agreements often include a provision – known as a "general indemnity" – that requires a party (usually the customer, but sometimes also the software vendor) to protect the other party against certain kinds of claims by third parties and resulting liabilities to third parties. The customer should understand the burdens and benefits of general indemnity provisions and manage risk through prudent business practices and insurance for residual risk.

Purpose of Indemnity

A general indemnity is a means of contractually allocating the risk of claims by persons who are not parties to the software license agreement (known as "third parties") against the contracting parties. The risk allocation can be based on fault (e.g., risk is assigned to the party whose acts or omissions caused the third-party claim), efficiency (e.g., risk is assigned to the party who is best able to manage or control the risk of the third-party claim) or other considerations.

A general indemnity usually imposes two distinct obligations on the indemnifying party for the benefit of the other party and specified other persons (each a "beneficiary"): (1) an obligation to defend the beneficiary against third-party claims, including paying legal costs of defending the claims; and (2) an obligation to indemnify (pay or reimburse) the beneficiary against obligations and liabilities (including court judgments and settlement amounts) resulting from third-party claims.

Scope of Indemnity

The scope of a general indemnity can be adjusted in various ways, including the following:

- **Beneficiaries:** The indemnity might be for the benefit of a party only or might also benefit the party's personnel (e.g., directors, officers and employees) or other related persons (e.g., affiliates/subsidiaries, service providers and subcontractors).

- **Covered/Excluded Claims:** The indemnity might be limited to certain kinds of third-party claims (e.g., claims for bodily injury or damage to tangible personal property), third-party claims resulting from specified events (e.g., the indemnifying party's breach of contract or willful misconduct) or third-party claims made in specified countries.

- **Excluded Claimants:** The indemnity might exclude claims by certain third parties (e.g., a beneficiary's affiliates/subsidiaries or customers).

- **Time Restriction:** The indemnity might apply only during the term of the software license agreement, or it might continue to apply after the software license agreement ends.

A general indemnity is usually subject to exclusions for third-party claims and liabilities resulting from the beneficiary's breach of the software license agreement or other specified misconduct.

Financial Limits

A general indemnity might be subject to limits on the indemnifying party's financial obligations (i.e., legal fees paid to defend third-party claims and amounts paid to settle or satisfy resulting liabilities) under the indemnity. For example, there might be a limit on the indemnifying party's financial obligations in respect of each third-party claim and an aggregate limit on the total amount of the indemnifying party's financial obligations in respect of all third-party claims. A general indemnity might also specify different financial limits (or no limit at all) for different kinds of third-party claims. The limits might be specified in the general indemnity provisions or in other provisions that limit or exclude the contracting parties' liability under the software license agreement.

Procedural Requirements

A general indemnity usually requires the beneficiary to comply with specified procedural requirements regarding each third-party claim for which the beneficiary seeks indemnity, such as giving prompt notice of the claim to the indemnifying party, allowing the indemnifying party to control the defence and settlement of the claim, and reasonably assisting the indemnifying party to defend and settle the claim. A beneficiary's failure to comply with procedural requirements might preclude the beneficiary from claiming the benefits of the general indemnity.

Other Considerations

A general indemnity can be drafted broadly to indemnify the beneficiary for its own damage and loss. Those kinds of broad indemnity provisions (known as "first-party indemnification") can significantly affect the allocation of risk between the parties, and should be carefully considered.

Many software license agreements either do not contain any general indemnity by the software vendor for the benefit of the customer, or contain a general indemnity by the software vendor for the benefit of the customer that is much narrower (in scope and limits) than the general indemnity by the customer for the benefit of the software vendor. Whether differences between general indemnities are reasonable and appropriate will depend on the nature of the licensed software and other circumstances.

Recommendations

When negotiating a software license agreement, the customer should understand the burdens and benefits of the general indemnities included (or omitted) in the agreement, and should manage and mitigate risk through prudent business practices (e.g., administrative practices and procedures to minimize risk, and risk allocation provisions in contracts with potential third-party claimants) and insurance for residual risk. ■

IP Infringement Indemnity and Remedies

Software license agreements often include a provision – known as an "intellectual property ("IP") infringement indemnity" – that requires the software vendor to defend and indemnify the customer, and provide additional remedies, if a third party claims that the customer's use of the licensed software infringes the third party's intellectual property rights. The customer should understand the limited protections and remedies provided by an IP infringement indemnity, and consider procuring insurance for residual risk.

IP Infringement Indemnity

An IP infringement indemnity provides the customer with limited protection against claims by persons who are not parties to the software license agreement (known as "third parties") that the customer's use of licensed software or related documentation infringes the third party's intellectual property rights (e.g., copyright, patents and trade secrets). An IP infringement indemnity usually imposes two distinct obligations on the software vendor for the benefit of the customer and related persons (each a "beneficiary"): (1) an obligation to defend the beneficiary against IP infringement claims, including paying legal costs of defending the claims; and (2) an obligation to indemnify (pay or reimburse) the beneficiary against obligations and liabilities (including court judgments and settlement amounts) resulting from IP infringement claims.

The scope of an IP infringement indemnity can be adjusted using the same variables – beneficiaries, covered/excluded claims, excluded claimants and time restriction – that apply to a general indemnity. An IP infringement indemnity can also be subject to financial limits or caps. An IP infringement indemnity usually requires the customer to comply with the same kinds of procedural obligations – prompt notice of an IP infringement claim, conduct and control of defence and settlement of an IP infringement claim and cooperation regarding an IP infringement claim – that apply to a general indemnity.

Additional Remedies

Software license agreements usually require the software vendor to provide the customer with additional remedies if an IP infringement claim affects the customer's continuing use of licensed software. Those remedies typically include some or all of the following: (1) the software vendor will obtain rights for the customer to continue to use licensed software without a risk of the IP infringement claim; (2) the software vendor will replace or modify licensed software so that the software is no longer infringing but provides the same benefit to the customer, in which case the customer must use the replacement/modified software instead of the infringing software; or (3) the software vendor will terminate the customer's software license and refund the unused portion of pre-paid software license fees, in which case the customer must stop using the licensed software.

Exclusive Remedies

Software license agreements often provide that an IP infringement indemnity and additional remedies are the customer's only remedies against the software vendor if a third party makes an IP infringement claim against the customer. This exclusivity means that if an IP infringement claim prevents the customer from using licensed software or causes the customer to suffer loss, damage or liability that is not covered by the IP infringement indemnity, then the customer might not be entitled to compensation from the software vendor.

Recommendations

When negotiating a software license agreement, the customer should understand the limited protections provided by the IP infringement indemnity and the potential risks (e.g., early termination) presented by the additional remedies. Customers should consider procuring insurance for residual risk. ∎

Confidentiality Obligations

Software license agreements often impose restrictions and requirements regarding each party's use and disclosure of the other party's confidential information. The customer should ensure that the confidentiality obligations are sufficient, reasonable and practicable.

Confidentiality Restrictions/Requirements

Confidentiality provisions impose restrictions and requirements on a party (the "Receiving Party") regarding the use and disclosure of the confidential information of the other party (the "Disclosing Party"). Those obligations can be adjusted to reflect the nature of the Disclosing Party's confidential information, the purposes for which the Receiving Party may access and use the information and the potential risks to the Disclosing Party if the information is misused. For example:

- **Definition of "Confidential Information":** The information to be treated as confidential might be defined broadly (e.g., all non-public information disclosed or made available by the Disclosing Party) or narrowly (e.g., information that is expressly identified in writing as confidential).

- **Exceptions:** The confidentiality obligations might not apply to certain kinds of information (e.g., information already known to the Receiving Party or subsequently obtained by the Receiving Party from another source that is not subject to confidentiality obligations).

- **Permitted Use:** The purposes for which the Receiving Party may use confidential information might be narrow (e.g., only the specific purpose for which the information was disclosed) or broad (e.g., as reasonably required to perform obligations and exercise rights under the software license agreement).

- **Permitted Users:** There might be restrictions on the individuals who may access and use confidential information (e.g., only the Receiving Party's employees on a need-to-know basis).

- **Restricted/Permitted Disclosures:** There might be express or implied restrictions on the Receiving Party's disclosure of confidential information to subcontractors, service providers and advisors. There might be procedural requirements for compliance with mandatory disclosures required by law (e.g., prior notice to and cooperation with the Disclosing Party).

- **Protection/Standard of Care:** The Receiving Party's obligation to protect confidential information might be absolute or limited to a specific standard of care (e.g., the same measures the Receiving Party uses to protect the Receiving Party's own confidential information, but not less than reasonable care).

- **Duration:** The confidentiality obligations might last for a specified period (e.g., five years after the end of the software license agreement) or until an item of information is no longer confidential.

Return/Destruction Obligation

Confidentiality provisions usually require the Receiving Party to return to the Disclosing Party or permanently delete and destroy all records of confidential information in the Receiving Party's possession or control when the Receiving Party no longer has a legitimate need to use or retain the records or when requested to do so by the Disclosing Party. However, there are often exceptions that permit the Receiving Party to retain specified records of confidential information (e.g., secure electronic archives) or records of confidential information required for legal compliance or contract administration/enforcement purposes.

Confidentiality provisions often require the Receiving Party to confirm in writing that it has complied with its obligation to delete and destroy confidential information.

Liability/Enforcement

The parties' liability for breach of confidentiality obligations is often an exception to provisions that exclude or limit the parties' liability for breach of the software license agreement. In those circumstances, the Receiving Party faces a risk of unlimited liability for all damage and loss suffered by the Disclosing Party as a result of the Receiving Party's breach of confidentiality obligations.

Confidentiality provisions often give the Disclosing Party special enforcement remedies, including a right to inspect and verify the Receiving Party's compliance with the confidentiality obligations, and confirm the Disclosing Party's right to judicial remedies (e.g., an injunction) to prevent the Receiving Party from breaching the confidentiality obligations.

Administrative Practices

Confidentiality provisions might require the Receiving Party to implement administrative practices (e.g., internal policies and procedures) for handling the Disclosing Party's confidential information. In some circumstances, required administrative practices can be a significant burden and impose potentially substantial costs on the Receiving Party.

Recommendations

When negotiating a software license agreement, the customer should ensure that the confidentiality obligations in the agreement are sufficient, reasonable and practicable in the circumstances (including the kinds of information that each party will disclose to the other party and the manner in which each party will use the other party's information). The customer should also carefully consider the customer's ability to establish and implement administrative practices required to comply with confidentiality obligations regarding the software vendor's confidential information. ∎

Remedy Restrictions/Liability Limitations and Exclusions

Software license agreements usually contain provisions that limit the customer's rights and remedies against the software vendor for damage, loss or liabilities caused by the software vendor's breach of the agreement or other misconduct. The customer should understand the risk allocation resulting from those provisions, and manage and mitigate risk through prudent business practices and insurance.

Remedy Restrictions

Software license agreements usually restrict the customer's remedies against the software vendor if the licensed software or ancillary services fail to comply with contractual requirements. For example, the customer's remedies for deficient licensed software might be limited to repair or replacement of the software and limited financial credits against future license fees. The customer might also be entitled to limited financial credits against future fees if ancillary services fail to meet contractual requirements. If the specified remedies are exclusive, then the customer might not be able to terminate the software license (unless expressly permitted by the software license agreement) or obtain from the software vendor any compensation for damage, loss or liabilities caused by the deficient licensed software or ancillary services.

Liability Limitations and Exclusions

Software license agreements usually contain provisions – known as "liability limitations" – that limit or cap the amount of the software vendor's potential liability to the customer for damage, loss and liabilities caused by the software vendor's breach of the agreement or other misconduct. Liability limitations often impose a cap that is a specified amount or is determined by a formula based on the fees paid by the customer.

Software license agreements also usually contain provisions – known as "liability exclusions" – that limit the software vendor's potential liability to "direct damages", and exclude liability on the part of the software vendor for all other kinds of damages (e.g., indirect damages, consequential damages, special damages and punitive damages) and specific losses (e.g., loss of business, loss of revenue, loss of profit, loss of data and loss of customer goodwill) suffered by the customer regardless of the cause. Liability exclusions often prevent the customer from recovering from the software vendor financial compensation for the kinds of damage and loss that are most likely to result from deficient licensed software or ancillary services or wrongful conduct by the software vendor.

Liability limitations and exclusions are often subject to exceptions for specific kinds of damage and loss (e.g., bodily injury or physical damage to tangible property), for damage and loss caused by breach of specified contractual obligations (e.g., confidentiality and data protection obligations) or specified kinds of misconduct (e.g., infringement of intellectual property rights), or for certain financial obligations (e.g., indemnity obligations). The exceptions can significantly reduce the protection that the liability exclusions and limitations provide to the software vendor and the customer.

Recommendations

When negotiating a software license agreement, the customer should understand the risk allocation resulting from contractual remedy restrictions, liability limitations and liability exclusions, and should manage and mitigate risk through prudent business practices (e.g., business continuity plans, data backups and risk allocation provisions in contracts with potential third-party claimants) and insurance for residual risk. ∎

Term, Suspension and Termination

Software licenses and ancillary services are usually time-limited and subject to suspension or early termination in specified circumstances. The customer should understand the term of each software license and ancillary services and take reasonable precautions to properly exercise renewal rights and avoid suspension or unintended early termination.

Term

A software license agreement usually specifies the "term" or duration of the software license and the software vendor's ancillary services (e.g., software maintenance, technical support and problem resolution). A software license can be perpetual or time-limited, and ancillary services can be available during the entire term of the software license or for a limited period.

A perpetual software license continues unless and until the license is lawfully terminated, but the customer's right to receive ancillary services necessary for the effective use of the software is usually limited to a specified period, which might be subject to renewal or extension on specified conditions. A time-limited software license expires when the specified license term ends, but the software license agreement might provide for the renewal or extension of the license term.

A renewal or extension of a software license or ancillary services might be automatic (unless a party opts out), at the customer's sole option, or require the agreement of both the software vendor and the customer. Optional renewals and extensions are usually subject to pre-conditions, such as timely renewal notice and prompt payment of fees. Optional renewals and extensions that can be invoked by the customer provide certainty (e.g., specified fees) but usually afford limited flexibility. Renewals that require the agreement of both the software vendor and the customer provide flexibility but no certainty.

Fees payable for a software license usually reflect the length of the license term and the customer's ability to renew or extend the license term. Fees payable for automatic or optional license term renewals or extensions are usually pre-determined or based on a formula that permits reasonable fee increases.

Suspension

Software license agreements often permit the software vendor to suspend the software license or the provision of ancillary services if the customer breaches specified obligations under the agreement (e.g., the customer fails to make a required fee payment) or in other specified circumstances. A software vendor's suspension rights are often subject to procedural requirements (e.g., notice to the customer and a reasonable opportunity for the customer to remedy the breach). A software vendor is usually required to reinstate a suspended software license or suspended services when the reasons for the suspension have been resolved.

Termination

Software license agreements usually allow the software vendor and the customer to terminate the software license agreement as a whole (i.e., all software licenses and ancillary services) or only specific software licenses and services. Even software licenses described as "perpetual" are usually subject to termination in specified circumstances.

Software license agreements usually contain different kinds of termination provisions. For example, termination for convenience (which allows a party in its discretion to terminate for the party's sole convenience), termination for breach (which allows a party to terminate if the other party breaches the agreement or specified provisions in the agreement), and termination in other specified circumstances (e.g., if the other party becomes insolvent or bankrupt). Termination provisions often include procedural requirements (e.g., a notice to the breaching party and a reasonable opportunity for the breaching party to remedy the breach) and restrictions (e.g., exercise of termination rights within a specified period) designed to prevent unreasonable termination.

The software vendor and the customer might also have implied termination rights under generally applicable law. The nature and extent of implied termination rights will depend on the particular circumstances and the provisions of the software license agreement.

Recommendations

When negotiating a software license agreement, the customer should understand the term of the software license and ancillary services (including the customer's renewal and extension rights) and the circumstances in which the software license and ancillary services may be suspended or terminated by the software vendor or the customer. The customer should take reasonable precautions to properly exercise renewal or extension rights and avoid circumstances that present a risk of suspension or early termination by the software vendor, particularly if the licensed software is essential for the customer's daily business operations. ∎

Consequences of Expiration/Termination and Surviving Rights and Obligations

Software license agreements often specify important rights and obligations that are triggered when the software license ends, or that continue to apply after the software license agreement ends. Those rights and obligations often vary depending on whether the software license agreement expires at the end of its prescribed term or is terminated early. The customer should understand those rights and obligations, and be prepared to enforce and comply with them.

Consequences of Expiration/Termination

Software license agreements usually require the customer to stop using the licensed software, and delete or destroy all copies of the software and related documentation, when the software license ends, and often require the customer to certify in writing that the customer has complied with those obligations.

Software license agreements often give the software vendor a right to inspect the customer's information technology systems and premises to verify the customer's compliance with the customer's obligations that arise when the software license agreement ends. Some software vendors use license management technologies (e.g., time-limited or user-specific license keys) to prevent the customer from continuing to use licensed software after the customer's software license ends.

If licensed software is essential for the customer's daily business operations or difficult and time-consuming to replace, then the software license agreement might give the customer an optional transition period during which the customer may continue using the licensed software while the customer transitions to replacement software or services. The customer's right to invoke an optional transition period might be subject to restrictions (e.g., on expiration but not early termination of the software license) and requirements (e.g., timely notice and advance payment of applicable fees).

Software license agreements might also specify other consequences of early termination of a software license, such as a refund of pre-paid fees (if the customer terminates the software license because of the software vendor's breach of the software license agreement) or accelerated payment obligations (if the software vendor terminates the software license because of the customer's breach of the software license agreement).

Surviving Rights and Obligations

Software license agreements usually identify provisions that continue to apply, for a limited period or indefinitely, after the agreement ends. For example, provisions regarding intellectual property and confidential information, liability limitations and exclusions, indemnity obligations and dispute resolution procedures. Surviving provisions can impose substantial burdens and potentially significant risks and liabilities on the software vendor and the customer.

Recommendations

When negotiating a software license agreement, the customer should ensure that the customer's rights and obligations that are triggered when the software license ends, or continue after the software license agreement ends, are consistent with the customer's business requirements and legal obligations. The customer should be prepared to enforce and comply with those rights and obligations. ■

Governing Law and Dispute Resolution

Software license agreements usually specify the law that governs the agreement and a procedure and venue for resolving disputes relating to the agreement. The customer should ensure that the governing law is appropriate and the dispute resolution procedure and venue are suitable and fair to both the software vendor and the customer.

Governing Law

To properly negotiate a software license agreement and to perform obligations and exercise rights under the agreement, the software vendor and the customer must understand the legal rules that govern the interpretation and enforcement of the agreement. Those legal rules will be determined primarily by the law of a particular jurisdiction, which is commonly known as the "governing law". The governing law is important because different jurisdictions have different legal rules relevant to software license agreements, and even a small difference in legal rules can have a significant effect on the rights and obligations of the software vendor and the customer.

Under Canadian law, a software license agreement is usually governed by the law specified in the agreement or, if the governing law is not specified, the law of the jurisdiction that has the most real and substantial connection to the agreement. If there is a dispute regarding a software license agreement that does not specify the governing law and has connections to multiple jurisdictions (e.g., the software vendor and the customer are in different countries), then a court or arbitrator will determine the governing law by identifying the jurisdiction that has the most real and substantial connection to the agreement.

It is usually best if a software license agreement specifies the governing law, so that the software vendor and the customer know with certainty the law that governs the interpretation and enforcement of the agreement. Most parties prefer their local law to be the governing law, but a different law might be better. The software vendor and the customer should select a governing law based on careful consideration of the law's potential effect on all aspects of the interpretation and enforcement of the agreement.

The selection of a governing law presents considerations of cost and risk. A party that is not familiar with a proposed foreign governing law must either obtain legal advice from a lawyer qualified to provide advice regarding the governing law or accept the risk that the governing law is materially different from the law of the party's jurisdiction.

Dispute Resolution

Software license agreements usually specify a procedure for resolving disputes between the software vendor and the customer, and often confirm that the software vendor and the customer will continue to perform their respective obligations under the agreement during the resolution of disputes. If a software license agreement does not specify a dispute resolution procedure, then all disputes relating to the software license agreement will be resolved through conventional litigation unless the software vendor and the customer agree to resolve a dispute using an alternative dispute resolution procedure.

There are four basic dispute resolution procedures:

- **Negotiation** – one or more rounds of direct confidential negotiation by representatives of the software vendor and the customer, with each round involving more senior representatives.

- **Mediation** – confidential negotiation facilitated by an independent and neutral individual (known as a "mediator") who assists the software vendor and the customer to negotiate a settlement of the dispute, but does not have authority to make binding decisions or impose a binding resolution.

- **Arbitration** – adjudication through a private and confidential adversarial process in which the software vendor and the customer present evidence and argument to one or more independent decision-makers (known as "arbitrators") who have authority to make binding decisions and impose a binding resolution that is subject to review by a court in limited circumstances.

- **Litigation** – adjudication through a public adversarial process in the applicable court system in which the software vendor and the customer present evidence and argument to a judge who has authority to make binding decisions and impose a binding resolution that is subject to review by an appellate court.

Each dispute resolution procedure has comparative advantages and disadvantages, including varying degrees of privacy/confidentiality, speed and finality. The optimal dispute resolution procedure will depend on the nature and circumstances of the software license transaction and the preferences of the software vendor and the customer.

The location (also known as "venue") of dispute resolution proceedings does not have to be in the governing law jurisdiction. The dispute resolution venue can impose significant costs and logistical burdens on either or both the software vendor and the customer. Dispute resolution proceedings in a party's local venue can be much more convenient than proceedings in a foreign venue. If the software vendor and the customer are in different jurisdictions, then they might negotiate a compromise by selecting a neutral dispute resolution venue or agreeing that the party commencing dispute resolution proceedings will do so in the other party's preferred venue.

Recommendations

When negotiating a software license agreement, the customer should: (1) understand the legal rules that govern the interpretation and enforcement of the agreement; (2) ensure that the dispute resolution procedure is reasonable and appropriate in the circumstances; and (3) ensure that the dispute resolution venue is reasonable and fair based on the relative convenience/inconvenience of the venue to both the software vendor and the customer. ■

Boilerplate Provisions

Software license agreements usually contain numerous provisions – known as "boilerplate" provisions – that deal with various miscellaneous matters. Boilerplate provisions can have a significant effect on the interpretation of the software license agreement and the rights and obligations of the software vendor and the customer.

Publicity

Software license agreements often include a provision that allows the software vendor to publicize the customer's use of the licensed software and use the customer's branding for those purposes. If that kind of publicity is not acceptable to the customer, or if the customer requires control over the use of the customer's branding, then the customer should negotiate a revision to the publicity provision to require the software vendor to obtain the customer's prior written approval of the software vendor's use of the customer's name and branding.

Notices

Software license agreements usually include a provision that requires all notices under the agreement be given in writing and delivered by specified methods to designated addresses. The customer should ensure that the specified delivery methods are appropriate for the kinds of important notices (e.g., notices regarding software license renewal or extension, breach, termination, and dispute resolution) that might be given by the customer and the software vendor under the agreement. The customer should strictly comply with the notice requirements when giving a notice to the software vendor.

Waivers/Consents

Software license agreements usually include a provision that purports to render ineffective any consent by a party to the other party's non-compliance with the agreement, or any waiver by a party of its rights under the agreement, unless the consent or waiver is confirmed in writing and signed by the consenting or waiving party. Consequently, the customer should obtain the software vendor's signed written confirmation of each consent or waiver.

Amendments and Changes

Software license agreements usually include a provision that purports to render ineffective any amendment to the agreement that is not confirmed in writing and signed by both the software vendor and the customer. Consequently, the customer should ensure that all amendments to the software license agreement, including promises by the software vendor made after the agreement is signed, are confirmed in a written and signed document.

Some software license agreements permit the software vendor to unilaterally change important ancillary documents that are incorporated by reference into the agreement (e.g., documents that specify details of the licensed software or ancillary services). The customer should ensure that any unilateral changes by the software vendor are subject to reasonable restrictions (e.g., no changes that diminish the quality of the licensed software or ancillary services) and requirements (e.g., prior notice of all changes).

Assignment

Software license agreements usually include a provision that prohibits the customer from assigning the agreement without the software vendor's prior consent. That restriction might present significant difficulties for the customer if the licensed software is costly, difficult to replace or essential to the customer's daily business operations. In those circumstances, the customer might require a revision to the assignment provision to permit the customer to assign the agreement without the software vendor's consent in limited circumstances (e.g., in connection with the customer's participation in a corporate merger, acquisition or internal restructuring or a sale of all or substantially all of the customer's business and assets) and subject to reasonable requirements (e.g., the assignee agrees in writing to be bound by the software license agreement).

Rules of Interpretation

Software license agreements usually include a provision that specifies rules for the interpretation of the agreement. For example, headings are for reference only, "days" means calendar days, and "including" means including without limitation or restriction. Those rules of interpretation are important because they can affect the meaning and effect of the software license agreement.

Recommendations

When negotiating a software license agreement, the customer should be mindful of the boilerplate provisions that affect the meaning and effect of the agreement and the customer's rights and obligations under the agreement. The customer should consider whether the boilerplate provisions require revision to be appropriate in the circumstances. ■

Contract Interpretation Principles

When negotiating a software license agreement, the customer should understand the basic legal principles that will govern the interpretation of the agreement in the event of a dispute. In most circumstances, the customer's rights and obligations will be defined and limited by the express words of the agreement (including external documents incorporated by reference into the agreement), which will be given their ordinary and natural meaning.

Interpretation Rules

A court will interpret a software license agreement by following generally applicable contract interpretation rules. A court will read a software license agreement as a whole, giving the words in the agreement their ordinary and grammatical meaning consistent with the surrounding circumstances known to the parties at the time the agreement is made. The meaning of the words in a software license agreement may be derived from contextual factors (e.g., the purpose of the agreement and the nature of the relationship created by the agreement), but a court will not rely on the surrounding circumstances to overwhelm the words in the agreement and effectively make a new agreement for the parties. In addition, a court will not consider evidence of the parties' subjective intention or understanding regarding the meaning or effect of a software license agreement.

External Contract Documents

Some software license agreements are presented as a relatively short and simple document that incorporates by reference other documents (e.g., standard form terms and conditions, service level agreements and data processing addenda) that are available to the customer (e.g., on the software vendor's website) when the agreement is signed by the customer but are not physically attached to the agreement. In most cases, those external contract documents, which often deal with important business, technical and legal issues, will be part of the software license agreement even if the customer does not access or read the documents.

Signatures and Acceptance

In most circumstances, a signature (including an electronic signature) on a contract document or the electronic acceptance of a contract document (e.g., by clicking an "I Agree" or similar online button) is a binding confirmation that the signer accepts and agrees to the contract. A person who signs or electronically accepts a contract will usually not be permitted to later reject the contract on the basis that the person did not read or understand the contract (including external documents incorporated by reference into the contract) or intend to be bound by the contract. Consequently, in most cases, a customer will be bound by a software license agreement signed or electronically accepted by or on behalf of the customer regardless of the customer's actual, subjective understanding or intention.

Recommendations

When negotiating a software license agreement, the customer should carefully review the entire software license agreement (including external documents incorporated by reference) to ensure that the agreement as a whole, when given its ordinary and grammatical meaning, accurately and completely sets out the intended agreement regarding the licensed software and all related matters. ■

Key Questions for Software License Agreement Negotiation

Following are some key questions that a customer should consider when negotiating a software license agreement.

Software License

- Does the software license agreement properly identify all licensed software?

- Do the duration and scope of the software license allow the customer and other relevant persons (e.g., corporate affiliates and subsidiaries) to use the licensed software as required for current and reasonably anticipated future needs?

- Does the customer have the right to periodically change the scope of the software license?

- If the software license agreement requires the customer to periodically report the customer's use of the licensed software, then are those reporting obligations reasonable and practicable?

- If the software license agreement gives the software vendor audit rights, then are those audit rights reasonable and practicable?

- Can the customer implement reasonable measures to prevent use of the licensed software and documentation in breach of the software license agreement?

Software Warranty and Remedies

- Does the software license agreement contain appropriate promises by the software vendor regarding the quality of the licensed software, and specify sufficient and reasonable remedies if the licensed software is deficient?

- Does the software license agreement accurately confirm all of the commitments made by the software vendor during sales presentations and negotiations, and provide the customer with reasonable and appropriate rights and remedies if the software vendor breaches those commitments?

Acceptance Testing

- If the customer requires an opportunity to conduct acceptance testing of the licensed software, then does the software license agreement: (1) permit the customer to conduct reasonable acceptance testing of the software; (2) specify appropriate acceptance criteria; and (3) provide the customer with reasonable remedies if the software fails acceptance testing?

Ancillary Services

- Does the software license agreement contain appropriate commitments by the software vendor regarding ancillary services, including software maintenance, technical support and problem resolution?

- Does the software license agreement contain promises by the software vendor regarding the quality of ancillary services and provide the customer with reasonable remedies if the ancillary services are deficient?

Fees

- Does the software license agreement specify the fees payable for the software license and ancillary services throughout the expected duration of the license?

- Does the software license agreement specify the fees for changes to the scope of the software license (e.g., additional usage rights) and ancillary services?

- Does the software license agreement provide the customer with reasonable protection against future fee increases for additional usage rights and ancillary services?

- Does the software license agreement allow the customer a reasonable opportunity to cure any inadvertent breaches of payment obligations before the software vendor suspends or terminates the software license?

Source Code Escrow

- If the customer requires the self-help remedy that source code can provide, then does the software license agreement establish an appropriate source code escrow arrangement with proper release conditions and an adequate license to use released source code?

Indemnities

- Does the software license agreement contain reasonable and appropriate general indemnities against relevant third-party claims?

- Does the software license agreement contain a reasonable and appropriate intellectual property infringement indemnity and sufficient additional remedies for intellectual property infringement claims?

- Is the customer able to establish and implement practices to manage and mitigate risks of third-party claims and liabilities, and obtain insurance for residual risk?

Confidentiality

- Does the software license agreement contain confidentiality provisions that are sufficient, reasonable and practicable?

- Is the customer able to establish and implement administrative practices required to comply with confidentiality obligations regarding the software vendor's confidential information?

Restricted Remedies

- If the software license agreement imposes restrictions on the customer's remedies for deficient licensed software or services, then are those restrictions reasonable in the circumstances?

Liability Limitations/Exclusions

- If the software license agreement imposes limits on the liability of the software vendor or the customer, then are the limits reasonable and subject to appropriate exceptions?

- If the software license agreement excludes liability on the part of the software vendor or the customer for certain kinds of damage and loss, then are the exclusions reasonable and subject to appropriate exceptions?

- Is the customer able to establish and implement practices to manage and mitigate risks of damage and loss, and obtain insurance for residual risk?

Term and Termination

- Is the duration (term) of the software license sufficient?

- If the software license is fixed-term, then in what circumstances can the license term be extended or renewed by the customer, and is there certainty regarding fees payable during the extension or renewal period?

- In what circumstances can the software license or the entire software license agreement be suspended or terminated by the software vendor or the customer, and is suspension or termination subject to appropriate restrictions and procedural requirements?

Consequences of Expiration/Termination

- What are the consequences of the expiration or termination of the software license or the entire software license agreement?

- What rights and obligations are triggered when the software license ends or continue after the software license agreement ends, and do those rights and obligations satisfy the customer's business requirements and legal obligations?

Governing Law and Disputes

- What law governs the software license agreement, and how does the governing law affect the interpretation and enforcement of the agreement and the rights and obligations of the software vendor and the customer?

- Does the software license agreement specify an appropriate procedure for resolving disputes relating to the software license agreement?

- Does the software license agreement specify a venue for resolving disputes relating to the software license agreement, and is the venue reasonable and fair to both the customer and the software vendor?

Miscellaneous

- Are the software vendor's publicity rights acceptable?

- Is the procedure for giving contractual notices appropriate?

- Can the customer assign the software license agreement without the software vendor's consent in appropriate circumstances? ∎

Glossary

Acceptance criteria: The requirements for the functionality, performance, operation and results of software.

Acceptance testing: A procedure for the customer to review and test software to determine whether the software conforms to the applicable acceptance criteria.

Disclaimer: A contract provision that excludes specified promises or obligations, including promises or obligations that might otherwise be implied by law.

Entire agreement clause: A contract provision that confirms that the contract supersedes and replaces all prior discussions, promises, understandings and agreements between the parties regarding the subject matter of the contract.

Exclusive license: A license that implicitly prohibits the licensor from exercising the licensed rights or permitting any other person (except the licensee) to exercise the licensed rights.

Fixed-term license: A license that has a limited, specified duration, unless the license is terminated earlier in accordance with the license agreement.

Indemnity: A contractual obligation that requires a person (known as the "indemnitor") to protect another person (known as the "indemnitee") against specified claims against the indemnitee, specified damages and losses suffered by the indemnitee or specified liabilities incurred by the indemnitee.

IP infringement indemnity: An indemnity that protects the indemnitee against claims that the indemnitee has infringed third-party intellectual property rights.

Liability exclusion: A qualitative restriction on the kinds of damages for which a person may be liable.

Liability limitation: A quantitative limit or cap on the amount of a person's liability.

License: A legal permission given by a person (known as the "licensor") to another person (known as the "licensee") to do something that would otherwise be an infringement of the licensor's legal rights.

License key: A code required to install or activate licensed software, which is used by the software vendor to help prevent unauthorized installation or use of the software.

Non-exclusive license: A license that does not prohibit other persons (e.g., the licensor and other licensees) from exercising the same rights as the licensee.

Object code: A version of computer software that can be installed and run on a computer but cannot be easily read or modified by a knowledgeable computer programmer.

Perpetual license: A license that has a perpetual duration, unless the license is terminated in accordance with the license agreement.

Problem resolution: A service that provides technical assistance to resolve problems with software.

Representation: A promise about a present fact.

Service Level Agreement or SLA: An agreement, or part of an agreement, that sets out a software vendor's promises about the level or quality of specific services.

Software maintenance: A service that provides updates (e.g., patches, bug fixes and minor improvements) and upgrades (e.g., significant improvements or new versions) to software.

Software-as-a-Service or SaaS: An internet-based service that makes computer software and related information technology infrastructure available as a utility or consumption-based service.

Sole license: A license that implicitly permits the licensor to exercise the licensed rights but implicitly prohibits the licensor from permitting any other person (except the licensee) to exercise the licensed rights.

Source code: A version of computer software that is in a programming language that can be read and modified by a knowledgeable computer programmer.

Source code escrow: An arrangement that involves the deposit of source code for licensed software with a trusted third party (known as an "escrow agent") and provides a person (known as a "beneficiary") with access to the source code if one or more specified events (each known as a "release event") occurs.

Technical support: A service that provides technical advice regarding the use of software.

Warranty: A promise about a future fact.

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