Guide to Negotiating Software Contracts
About the author

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Introduction

Many purchased commercial software packages fail to meet corporate expectations for usability, ease of administration and total cost of ownership. Some companies place the blame on having paid too high an initial price, but that blame is likely misplaced. Sometimes it’s missed requirements, poor implementation or integration support. But typically, it’s a lack of future contractual planning leading to unexpected expenses that causes the most trouble. Additionally, with so many platform options now available (on-premises, cloud, hybrid) it’s easy to lock yourself into a suboptimal choice where change becomes costly. With a prudent approach, you can mitigate many of these problems with a well-constructed software license agreement (SLA).

This guide will help you draft low-risk, high-return SLAs. You’ll learn how to avoid the most common mistakes and manage the obligations of the agreement from initial purchase through maintenance and termination. Also included is a sample software license agreement (Appendix 1) and a glossary of terms. In this edition we include typical license provisions and suggest contracting best practice tips.

Who should use this guide

This guide is designed to be an introduction to software license agreements for a broad audience and to provide a foundation even for individuals with no legal or contract management expertise. We assume, however, that our reader has basic familiarity with business concepts and experience in a commercial, government or educational work environment.

In fact, today the wide variety of individuals involved in IT service management—from software and hardware inventory, to purchasing, technical support, contract management and legal services—could all benefit from a solid foundation in software contract management practices. Non-IT staff, including business unit managers, project managers and administrative and support staff involved in acquiring, approving or distributing software, should also understand the essential elements of software licenses.

Organizations of all sizes, industries and countries have a need to manage software licenses and contracts. For small organizations with fewer than 500 desktop computers and a few servers, typically one person is responsible for software license management, and there may be some effort to acquire and manage software centrally. For larger organizations with upwards of 5,000 PCs and many servers, several people may be dedicated to software license management, and the job of reviewing contracts and negotiating terms is usually handled by the IT procurement or vendor management department.
The Practitioners Certificate in Software License Agreements (PCSLA)

Software costs continue to increase as a percentage of an IT department’s budget. Software plays an ever-larger strategic role in business success (or failure). Because of these two trends, many companies are no longer comfortable trusting critical software and supply chain decisions to those without certification credentials. The information in this guide is the basis of the Practitioners Certificate in Software License Agreements (PCSLA) certification program, sponsored by the International Business Software Managers Association (IBSMA.com). Those obtaining the PCSLA show an essential mastery of the materials in this guide.

SOFTWARE LICENSE AGREEMENT (SLA):

A contract between parties detailing the terms of use of the software. The contract may contain terms specifically pertaining to intellectual property rights, a general set of contractual terms (boilerplate) and a software schedule listing and describing the software being licensed or purchased.

Ten essential SLA considerations

Software license agreements, with few exceptions, include terms and conditions in 10 broad areas. This guide presents the subject in plain English in the form of questions to ask and points to consider during the negotiation or contract evaluation process. Our approach aligns IT procurement’s objectives with the business user’s needs. Here are the 10 key considerations:

1. What software are you buying and what services does the contract include?
2. What usage (licensing) rights come with the software you’re buying?
3. Where is the software running and who controls it (cloud, software-as-a-service and virtualized environments)?
4. When will you pay for the software?
5. How much does the software cost now?
6. How much might the software cost later?
7. How is a contract dispute or suspected contract variance handled?
8. What happens if the relationship ends or changes significantly?
9. What common terms (“boilerplate”) help define a complete legal agreement?
10. For custom development or custom implementation, what constitutes acceptance of the customized software? Who will support and control the customizations?

At the end of the guide you’ll find a sample license agreement template, related schedules referring to fees, maintenance and ASP/SaaS provisions, plus a glossary of terms.
What software are you buying and what services does the contract include?

It seems obvious that a contract for software, or any product or service, should clearly identify what purchases are covered under the agreement. However, in many software contracts, the description is vague or too general for the buyer to be certain of the components and services purchased. It’s in your best interest to ensure that the contract clearly details what is covered, especially if the software has many components or options. Include references to any services you expect as part of the purchase price, such as prepaid maintenance, installation, training, data conversion, testing and migration. Also, SLAs should spell out the options included, such as components, databases, operating system, languages, APIs (application program interfaces) and converters. If you do not clearly know what you are purchasing, you may pay later for options you thought were included.

The contract should clearly spell out the list of software you are purchasing by name, quantity and any versions associated (e.g., version number 3.5) and be as detailed as possible. A surprising number of contracts fail to specify such basic information as the manufacturer’s part number, title and description.

Information about which platforms and operating systems the software will run on should also be listed. The list of software and its description should be in an attachment to the main contract (i.e. not the body of the contract itself), which is called a product schedule. This allows you to easily add products later or negotiate price modifications without affecting the main contract.

Your contract should detail the software you are licensing. Include the following as applicable:

- Products by name, number, version (or state that the latest released version must be shipped)
- License fee (and future license purchase fees)
- Delivery terms and dates
- Form and media (download, physical media – and download/delivery contact)
- License upgrade fees (if differently priced versions are currently offered)
- Acceptance criteria
- Object and/or source code
- Documentation (describing what the software does) and in what format (CD, book or other). Note how many copies you are allowed to make of the documentation.
- Education and training
- Installation services
- Password, authorization code or license key required to run the software who will receive it

**TEMPLATE CONTRACT REFERENCES:** Paragraphs 2, 3 and 4, Schedule A, Schedule B.
BEST PRACTICE TIP:
Source code versus object code

What is source and object code? Source code is the set of human-readable programmatic statements created in a structured (programming) language by developers permitting software to execute intended functions. Object code is the output of a compiler after it processes the source code, allowing a CPU to interpret the code (binary instructions). The compiler transforms the source code into a program the computer can execute.

License grants are usually limited to object code. In a software escrow agreement, the vendor may make source code available. At a minimum, the licensee should be entitled to withdraw the source code from escrow in the event the vendor becomes bankrupt or insolvent, or ceases to conduct business or ceases to adequately support or maintain the software in accordance with the agreement. In software asset management, escrow is a legal arrangement whereby source code for acquired software is stored under the trust of a neutral third-party and released only when a contractual contingency or condition is met, such as bankruptcy or when a party goes out of business.

Other breaches of the agreement may also serve as the basis for obtaining the source code (e.g., assignment to a licensee’s competitor). Determining the need for a software escrow, along with negotiating a software escrow agreement, is a complex process beyond the scope of this document. One key suggestion: When you are paying for the escrow arrangement, add audit provisions to ensure the vendor lives up to its obligations (e.g., vendor pays for audit if you discover material omissions in vendor’s escrow deposit).
**BEST PRACTICE TIP:**

Be aware of shrinkwrap, clickwrap and shareware

Clickwrap: Where a user must click on an “I Agree” button to accept the SLA terms before the first use of the software. Shrinkwrap: Literally meaning that the terms on or within the physical box containing the software will apply as soon as you install the software (and often the shrinkwrap comes with clickwrap).

The primary contractual issue with both clickwrap and shrinkwrap is that continued user acceptance of usage terms may be interpreted to override the terms in your SLA. You need to ensure (via SLA language) that, in the event of conflict between your negotiated SLA and the terms of any clickwrap or shrinkwrap, your SLA will prevail.

Shareware (or freeware): This is software that others have produced and distributed at no charge. However, you should be aware that most shareware has licensing terms and conditions (popular terms are from GNU/GPL and Apache and within those families are additional versions). Two takeaways if you are acquiring shareware or software containing shareware: First, if directly acquiring shareware, ensure you know the license under which the shareware is distributed (and if your intent is to redistribute, you must ensure you are compliant with the underlying license). And second, if licensing software which incorporates shareware into its executables or run-time libraries (and many software packages do), ensure that the licensor indemnifies you for any intellectual property disputes for all software it furnishes on the same terms. See 7, and the Appendix 1, paragraph 7 sample license agreement for indemnification terms.
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