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Negotiating Enterprise Software Licenses

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One way a business can keep information technology costs under control is to negotiate enterprise software licenses, instead of purchasing software one product at a time. But before a general counsel's company jumps into such an arrangement, the legal department must understand the pluses and minuses associated with enterprise software acquisition.

Traditionally, enterprise licenses that allowed the use of software were limited to large, mission-critical software such as enterprise resource management, customer relationship management and databases. Now, many mid-sized and large corporations are licensing their server- and desktop-application software via enterprise agreements that govern the entire organization's use of the named software, rather than purchasing software one product at a time for each user.

An enterprise license typically allows an organization to purchase a set number of licenses for the license term, and it requires the organization to place periodic true-up orders to account for variable software needs during the term.

For example, let's say a company enters a three-year enterprise license agreement that gives it the right to use 100 software licenses in the first year, with annual true-ups required on the agreement's anniversary date. The company adds 50 workers during year one, so it's using 150 licenses on the true-up date. Since it's using 50 extra licenses on the true-up date, it will have to pay for the increase. But the increased payment only applies going forward; the company doesn't have to pay a retroactive penalty for its excess use.

When evaluating whether an enterprise agreement is appropriate in a particular situation, corporate counsel should consider the pros and cons of the various licensing models and understand what kinds of disputes generally arise related to enterprise licensing agreements.

One of the primary benefits is the flexibility provided by the annual true-up date. Businesses adding workers can increase their use of software products during the license term without fear of retroactive penalties for overage.

Another advantage is improved negotiating power. Many lawyers are familiar with the click-through license agreements that pop up when a new piece of software runs on a computer. End users or information technology staff often accept many of these retail software license agreements, which involve little or no negotiation on the license provisions. Fortunately, enterprise licenses often afford corporate counsel the opportunity to negotiate more favorable terms.

Cost-savings can be another plus, as it may be less expensive to license software across the enterprise. The more software a corporation purchases, the more discounts the publishers usually offer.

However, there also are some problems associated with enterprise licensing. Obtaining an accurate count is one. The existence of a true-up period in enterprise licenses is attractive, but many corporations find it difficult to reconcile the number of installations across the organization with the number of license entitlements. Companies often do not have the tools to identify accurately the number of software installations. Additionally, since a company may have more than one enterprise agreement for a particular software publisher, it may not have an adequate record of the software licenses the company is entitled to use during the license period. If the company cannot assess adequately its level of compliance within the specified time period, it may be in breach of the license agreement.

Another pitfall involves costs. It often is challenging to compare the total costs of software acquisition under an enterprise license with the total costs of purchasing retail software. Many enterprise agreements require companies to buy software for all computers covered under the agreement, regardless of whether people using those computers need or use the software.

LICENSING DISPUTES

Once an organization elects to license its software using an enterprise licensing model, in-house counsel should try to negotiate the key provisions in the agreement before finalizing the license agreement. That can help minimize the potential for an expensive and time-consuming licensing dispute.

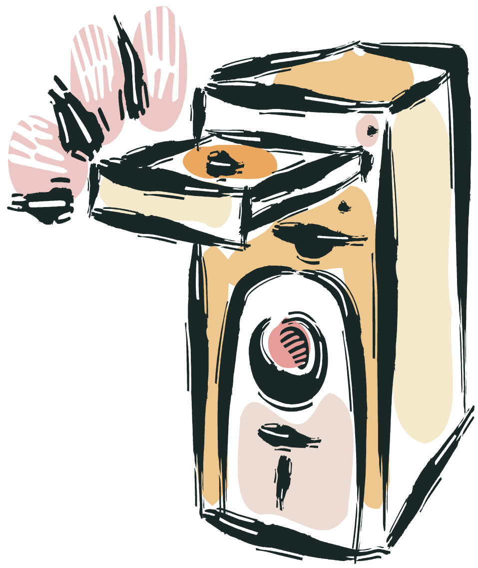
The most common causes of disputes related to enterprise software licenses are inability to comply with the true-up provisions in a timely manner, acquisition of additional entities, and a misunderstanding of the rights and benefits conveyed under the agreement.

Many companies are slow to procure the true-up licenses required under the agreement. Software companies have a number of potential remedies for this breach, including termination of the license agreement, conducting an audit and imposing compliance penalties. However, typically the account manager at the software company will work to reach a business resolution.

At this point, unfortunately, companies often discover that there has been a material misunderstanding of their obligations under the agreement. If the parties can't reach a business resolution, the software company usually escalates the matter to its compliance department, which initiates an audit of the corporation's software license use.

IF THE PARTIES CAN'T REACH A BUSINESS RESOLUTION, THE SOFTWARE COMPANY USUALLY ESCALATES THE MATTER TO ITS COMPLIANCE DEPARTMENT, WHICH INITIATES AN AUDIT OF THE CORPORATION'S SOFTWARE LICENSE USE.

When a corporation has acquired or divested other entities during the true-up period, it often is difficult to determine what software is installed or needed across the business units. Without an accurate count of the software installations, the corporation cannot assign the costs to various departments or subsidiaries; it often delays the software order until it has an opportunity to finalize a corporate strategy. Software companies often do not have the patience for this



process, and the situation turns into a dispute.

The best way to minimize the risk of a software licensing dispute related to enterprise software licensing is to negotiate favorable terms proactively. Corporate counsel should address problematic terms in advance of the software acquisition. The most important terms to negotiate are those related to the following:

• How will the parties treat related or newly acquired entities during the agreement's term?

• Is the GC's company acquiring the software on a perpetual basis or only licensing it during the term of the agreement?

• What audit rights does the software company have, e.g., can it send a third-party auditor in to inspect the corporation's software usage, or may the corporation produce a self-audit?

• What are the circumstances under which a software company can terminate the license agreement?

• Who owns any data contained within the software upon termination of the license agreement?

• Will the software company agree to release any software licensing compliance claims against the GC's company that may have arisen before the date the parties sign the enterprise agreement?

• What penalties can the software company impose in the event of future noncompliance by the GC's company?

Because switching costs related to migrating from one software platform to another can cost millions of dollars and the process can take a year or more, in-house counsel must understand the implications of the various provisions before any software product becomes an integral component of business operations. With a proactive discussion regarding the license provisions and appropriate documentation of the agreement, GCs can help their companies avoid many disputes. IHT

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