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FUNDAMENTALS OF SOFTWARE LICENSING

Ninth Annual Advanced Licensing Institute
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V. Confidentiality Provisions and Trade Secret Laws 59
A. Proprietary Information Clauses and Agreements 59
B. Trade Secret Laws 61

VI. Shrinkwrap Licenses 64

VII. The Uniform Computer Information Transactions Act ("UCITA") 65
A. General 65
B. History of Attempts to Apply the UCC to Software Licensing 66
1. Massachusetts Model 66
2. Hub and Spoke Approach 66
3. UCC Article 2B 67
C. Present Status 67

VIII. Recommended Resource Materials 68

IX. Model Forms
A. Annotated Software License and Services Agreement A1
B. Software Maintenance and Services Agreement B1
C. Consulting Agreement C1
D. Assignment D1
E. Escrow Agreement E1
F. Software License, Maintenance and Subscriber Billing Services Agreement (Service Bureau License Agreement) F1
G. Unilateral Proprietary Information Agreement G1
H. Bilateral Proprietary Information Agreement H1

FUNDAMENTALS OF SOFTWARE LICENSING

TABLE OF CONTENTS

I. Introduction 1

II. License vs Sale 1
A. The First Sale Doctrine 1
B. Transfer of Intellectual Property Rights 3

III. Grant of License 3
A. Terminology of the License Grant 4
1. Definition of the "Licensee" 4
2. Term of License 5
3. Use Restrictions 5
4. Assignability/Transferability 10
5. Geographic Restrictions 11
6. Object Code and Source Code Licenses 11
7. Irrevocable License 12
B. Significant Clauses 12
1. Representations and Warranties and Warranty Disclaimer 12
2. General Indemnification 19
3. Intellectual Property Indemnification 20
4. Limitation of Liability 23
5. Breach and Termination 27
6. Remedies 29
7. Governing Law and Forum 31
8. Alternative Dispute Resolution 32
9. Payment 33
10. Third Party Beneficiaries 35
C. Other Issues to Consider 36
1. The Work Made For Hire Doctrine and Moral Rights 36
2. Export Issues 41
3. Ownership of Custom-Developed Software 43
4. Functional Specifications 44
5. Acceptance and Acceptance Test Procedures 47
6. Specific Performance 48
7. Liquidated Damages and Service Level Credits 48
8. Maintenance 50
9. Training and Documentation 51
10. Bankruptcy 52
11. Antitrust and Copyright Misuse Issues 55
12. Self Help 57

IV. Escrow Agreements 57

(which sets forth five separate and distinct rights); See, e.g., Red Baron-Franklin Park, Inc. v. Taito Corp., 883 F.2d 275, 280 (4th Cir. 1989) and Columbia Pictures Industries, Inc., v. Aveco, Inc., 800 F.2d 59, 64 (3d Cir. 1986). See also 17 U.S.C. §109(e), (which as a response to Red Baron, provides a video game performance and display exception to the First Sale Doctrine). The First Sale Doctrine only applies to the *copyright owner's* exclusive rights of distribution and public display in its copyrighted work which are "automatically" conveyed to the buyer or the copy owner. 17 U.S.C. §109(a) and (c). Section 106(3) provides that the copyright owner has the exclusive right to distribute and to authorize distribution of copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending. Section 106(4) and (5) give the copyright owner the exclusive right to perform or display the work publicly if it is literary, musical, dramatic, or choreographic or if it is a pantomime, motion picture, or other audiovisual work. Section 106(6) gives the copyright owner the exclusive right to perform the work publicly by means of a digital audio transmission if the work is a sound recording.

The First Sale Doctrine is limited, however, in its applicability to copyrighted works such as computer software when software is licensed. 17 U.S.C. §109(b). See Allen-Myland, Inc. v. International Business Mach. Corp., 746 F. Supp. 520 (E.D. Pa. 1990) (First Sale Doctrine does not apply to computer programs). For computer software, Section 109(b) limits the First Sale Doctrine and the rights of copy owners in three ways. First, adaptations may not be transferred without permission of the copyright owner. Second, copies authorized to be made under Section 117 may be transferred without permission of the copyright owner only as part of a transfer of all rights in the underlying program. The distribution right conveyed to the buyer does not, for example, include the right to make further copies for resale. Third, it provides that the owner of a copy of computer software cannot lend or rent that copy to third parties without permission from the copyright owner. See Microsoft v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (E.D.N.Y. 1994) (unauthorized distributor of a copy of software not entitled to protection under First Sale Doctrine because owner licensed not sold software to distributor's supplier); Triad Systems Corp. v. Southeastern Express Co., 64 F.3d 1330 (9th Cir. 1995), cert. denied, 516 U.S. 1145 (1996) (software sold to customers is subject to 17 U.S.C. §117 protection while copies that are licensed are not).

Known as The Computer Software Rentals Amendments Act of 1990, Section 109(b) also addresses computer software rentals. It provides that, unless authorized by the owner of the copyright in a software program (including any tape, disk, or other medium embodying such program), no person in possession of a particular copy of software program (including any tape, disk, or other medium embodying such program) may, for the purposes of direct or indirect commercial advantage, dispose of or authorize the disposal of the possession of that computer software (including any tape, disk, or other medium embodying such program) by rental, lease, or lending, or any similar act. The transfer of possession of a lawfully-made copy of computer software by a nonprofit educational institution to another nonprofit education institution, or to its faculty, staff, and students is not considered to constitute the rental, lease, or lending for direct or indirect commercial purposes under Section 109(b). See generally, Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91, 96 n. 7 (3d Cir. 1991).

FUNDAMENTALS OF SOFTWARE LICENSING[1]

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I. INTRODUCTION

This outline addresses some of the fundamental issues that both licensors and licensees may confront in the negotiation of a software license. It focuses primarily on non-mass market agreements, as most "retail" or mass market "off-the-shelf" software is governed by non-negotiable "shrinkwrap" licenses. Nonetheless, the principles of software licensing are the same for both shrinkwrapped and custom-developed software. For a brief overview of a few of the significant issues involved in software licensing, see Davidson, Avoiding Pitfalls and Allocating Risk in Major Software Development and Acquisition Contracts, 14 Computer Law. 12 (May 1997).

The structure and context of every software license is different depending on the needs of the parties. While this outline discusses some of the most important issues and includes several forms, D. C. Toedt III, Esq. in conjunction with the Computer Programs Committee of the Information Division of the Section of Intellectual Property Law of the American Bar Association created a model license which, although voluminous, is quite thorough and educational. It is available by contacting him at (713) 787-1408. For a detailed discussion of this model license, see Toedt, The Model Software License Provisions: Precursor to a Gap-Filling Uniform License Statute, 18 Rutgers Computer & Tech. L.J. 521 (1992).

II. LICENSE VS. SALE

A. The First Sale Doctrine

The theory of the First Sale Doctrine under the Copyright Act 17 U.S.C. 101 et. seq. is that an individual who *purchases* an authorized copy may use and resell that particular copy free of any restraint by the copyright owner. 17 U.S.C. §109(a) (emphasis supplied). See Bobbs Merrill Co. v. Straus, 210 U.S. 339 (1908). A copyright owner's authorized sale of an item "exhausts" his exclusive distribution and display rights, such that the purchaser may use, resell or display that item free of any claim of infringement. 17 U.S.C. §109(a).[2] In short, the First Sale Doctrine addresses a *copy owner's rights* as opposed to the *copyright owner's* rights.

The First Sale Doctrine does not apply, however, to the separate exclusive rights of copying, derivative work preparation and public display or performance. See 17 U.S.C. §106

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[1] ©Copyright 1996, 1999, 2000, H. Ward Classen. All Rights Reserved. The author would like to thank Eric Terpening and Stacey Stepek for their insightful comments and help in preparing this outline. The opinions set forth in this outline are those of the author only and do not represent the opinions of Computer Sciences Corporation.

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

Unless otherwise indicated, all Section references refer to the corresponding sections of the Annotated Master Software License and Services Agreement in Section IX.A

A. Terminology of the License Grant (§3.1)

A typical grant of a license contains the following wording:

"Subject to the provisions of this Agreement, Licensor grants to Licensee a perpetual, personal, non-assignable, non-transferable, non-exclusive object code license to use the Software solely for Licensee's internal business purposes in the United States."

Each of the terms set forth in the above license grant has a specific meaning which fundamentally impacts the rights of the licensor and licensee. Set forth below is a brief discussion of these terms.

1. Definition of the "Licensee"

The definition of the "Licensee" is important for both financial and legal reasons. Financially, the broader the definition of the "Licensee", the more entities or individuals who will have access to and use of the licensed software, thus reducing the potential license fees a licensor may receive. Some license agreements allow "affiliates" of the licensee to utilize the licensed software as well. Many such agreements define "affiliates" to include only the licensee's parent company and those subsidiaries at least 51% owned by the licensee or its parent in order to limit the use of the licensed software.

It is also important to distinguish between allowing the "use" of the licensed software by a third party and allowing the licensee to "assign" the license to another entity. With assignment, the assignor relinquishes its license and right to utilize the software. The assignor's right to use the licensed software is transferred to the assignee, preventing both entities from using the software at the same time. Allowing both the licensee and its affiliates to utilize the licensed software may allow numerous distinct legal entities to utilize the software simultaneously, subject to any restrictions on the number of users or other constraints in the license agreement. Having such multiple users for a set license fee will likely limit the licensor's revenues.

At the same time, legally, the definition of the "Licensee" should be restricted to ensure compliance with United States export laws. If a licensee and its affiliates are granted simultaneous use of the licensed software, or the licensee has the unencumbered right to assign the license, and/or use is not restricted to the United States, the licensee's or its affiliate's use of the software outside of the United States may violate the United States export laws if the appropriate export licenses have not been obtained. Furthermore, use of the licensed software outside of the United States

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

B. Transfer of Intellectual Property Rights.

There are two means of conveying intellectual property rights: assignments (17 U.S.C. §101) and licenses (17 U.S.C. §201(d)(2)). Assignments and licenses apply to *intangible* property rights while a "sale" applies to the transfer of *tangible* property. 17 U.S.C. §202; see also Chamberlain v. Cocola Assoc., 958 F.2d 282 (9th Cir. 1992). The First Sale Doctrine, which applies to the sale of a *copy* of software, provides that such sale conveys certain rights to the buyer in the purchased software, namely the buyer's right to resell the software. 17 U.S.C. §109(a). This right is in derogation of the overall copyright and it is also "automatically" transferred to a new buyer if the software is resold. 17 U.S.C. §117. Typically, the sale of software is not a "sale" within the meaning of Section 109, but rather a license accompanied by a license agreement setting forth the rights that will or will not be conveyed to the buyer (which may be greater or lesser than would be conveyed under the sale of a copy).

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

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

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

III. GRANT OF LICENSE

may be governed by the laws of a foreign jurisdiction with which the licensor is unfamiliar, and which may not afford the licensor the same benefits and protections as the laws of the United States.

2. **Term of License (§4.2)**

The term of the license should begin on delivery of the licensed software, rather than acceptance of the licensed software, otherwise the licensee will be under no legal obligation or restriction as to the use of the software prior to acceptance. While many licensees are concerned with the concept of the license beginning upon delivery, the licensee is nevertheless protected as beginning the term of the license upon delivery does not indicate acceptance of the software or an obligation of the licensee to pay for the license prior to acceptance of the licensed software.

While shrinkwrapped software licenses traditionally have had a perpetual term, other software licenses have had a more limited term, i.e., five or ten years. Today, the distinction is less important as most software is obsolete within ten years, and licensors routinely grant perpetual licenses in recognition of the rapid obsolescence of software in general. But see Apple Computer, Inc. v. Microsoft Corporation, 35 F.3d 1435 (9th Cir. 1994) (in 1985, Apple granted, in effect, a perpetual license of its Windows® visual displays to Microsoft).

If the license fails to state a term, under the Copyright Act, the term of the license will automatically be 35 years from the date of its execution. After the 35-year period expires, the license is terminable at will by the licensor for a period of five years. 17 U.S.C. §203(3). The licensor must give the licensee, however, advance written notice of at least two but not more than ten years before such termination. 17 U.S.C. §203(a)(4)(A). Material breach of the license will also give rise to a right of recission which allows the non-breaching party to terminate the license. Costello Publishing Co. v. Potell, 670 F.2d. 1035 (D.C. Cir. 1981); 3 Melvin B. Nimmer and David Nimmer, Nimmer on Copyright, §10.15[A] at 112 (1990). If the license is not terminated, it will continue in effect for the remaining term of the copyright which protects the software being licensed (17 U.S.C. §203(b)(6)). Assuming it is an anonymous work or work made for hire, the term of the copyright will be either 75 years from the date of the software's first publication, or 100 years from the date of the software's creation, whichever expires first. 17 U.S.C. §302(c). Under §2-309(3) of the Uniform Commercial Code ("UCC"), however, a contract (license) without a fixed term is terminable at will with reasonable notice to the non-terminating party.

3. **Use Restrictions (§3.1)**

Most licensors place restrictions on the licensee as to how the licensed software may be used. The principle reason is financial, causing most restrictions to be strictly an element of price.

(a) Internal Use

Most license grants include the term "personal" and state that the licensed software may be used for the licensee's "internal business purposes only." The primary objective of this wording is to limit the licensee's use of the licensed software to the licensee's specific business needs, and to prevent the licensee from using the software to operate a service bureau or data processing center, or from using the software in outsourcing. It is prudent to state this clearly in the license agreement to avoid a subsequent dispute over the interpretation of the license grant. For a greater discussion of the issues involved, see Marenberg & Brown, "Scope of Use" Restrictions in Software Licenses, 10 Computer Law. 1 (Dec. 1993).

(b) Non-Exclusive/Exclusive Use

The term "non-exclusive" is necessary to indicate that the licensor reserves the right to license the same software to other licensees. This is important as some licensees request exclusive use of the licensed software if they believe the software provides them with a competitive advantage. This is especially likely if the licensee paid for the development of the software or educated the licensor about the need for such software in a particular industry. A non-exclusive licensee lacks the ability to sue or be joined in a suit. Ortho Pharmaceutical Corp. v. Genetics Institute, Inc. and Amgen, Inc., 52 F.3d 1026 (Fed. Cir.), cert. denied, 516 U.S. 907 (1995) (citing Overman Cushion Tire Co. v. Goodyear Tire and Rubber Co., 59 F.2d 998, cert. denied, 287 U.S. 651 (1932) (nonexclusive licensee has no right to sue or be jointed in a suit)); and Philadelphia Brief Case Co. v. Specialty Leather Products Co., Inc., 145 F. Supp. 425, 429-30 (D.N.J. 1956) (contract clause can not give right to sue where licensee would otherwise have no such right). Furthermore, the licensor can not grant such a right where one does not already exist.

On occasion a licensor may grant an exclusive license. The exclusivity may go to a geographic region, a specific industry, a set time period or the use of the entire product itself. Exclusive licenses are uncommon in that they prevent the licensor from relicensing the software and receiving additional license fees. Under the Copyright Act, exclusive licenses must be in writing. 17 U.S.C. §101; see generally I.A.E., Inc. v. Sharer, 74 F.3d 768 (7th Cir. 1996) (a non-exclusive copyright license is granted when (1) the licensee requests creation of a work, (2) the creator/licensor delivers the work to the licensee, and (3) the licensor intends the licensee to copy and distribute the work). Also note that an oral exclusive license creates an implied non-exclusive license. 17 U.S.C. §204(a); Gracen v. Bradford Exchange, 698 F.2d 300, 303 (7th Cir. 1983).

(c) Creation of Derivative Works and the Prohibition of Reverse Engineering (§3.4)

"Disassembly" or "reverse engineering" software requires making copies of the software program itself and creating "derivative works" in the process based upon the original software. Section 101 of the Copyright Act defines a "derivative work" as

> a work based upon one or more preexisting works, such as a translation, musical arrangement, dramatization, fictionalization, motion picture version, sound recording, art reproduction, abridgment, condensation, or any other form in which a work may be recast, transformed, or adapted. A work consisting of editorial revisions, annotations, elaboration, or other modifications, which, as a whole, represent an original work of authorship is a "derivative work."

Section 106(2) of the Copyright Act prohibits the creation of derivative works without the copyright owner's permission.

In certain situations, the alteration of an original work may create a copyrightable derivative work. To receive copyright protection, a work must be sufficiently original, requiring more than a "modicum of originality." Waldman Pub. Corp. v. Landoll, Inc., 43 F.3d 775, 782 (2d Cir. 1994); Simon v. Birraporetti's Restaurants, Inc., 720 F. Supp. 85 (S. D. Tex. 1989). A derivative work must be substantially different from the underlying work to be copyrightable, Cracen v. Bradford Exchange, 698 F.2d 300 (7th Cir. 1983) but yet substantially copied from prior work. Apple Computer, Inc. v. Microsoft Corp., 759 F. Supp. 1444 (N. D. Cal. 1991), on reconsideration, 779 F. Supp. 133, aff'd, 35 F.3d 1435 (9th Cir. 1994); Litchfield v. Spielberg, 736 F.2d 1352 (9th Cir.), cert. denied 470 U.S. 1052 (1984). The copyright applies only to the new work contributed by the author and not the pre-existing material. The new copyright does not imply any exclusive rights to the pre-existing copyright. 17 U.S.C. §103(b); Moore Pub., Inc. v. Big Sky Marketing, Inc., 756 F. Supp. 1371 (D. Idaho 1990). Further, if a derivative work is created using pre-existing copyrighted material, copyright protection will not extend to any part of the work in which such pre-existing copyrighted material has been used unlawfully. 17 U.S.C. §103(a).

Most licensors are very concerned with the licensee reverse engineering the object code provided to the licensee under its license. To alleviate this concern, most licensors include a clause in their licenses stating

that the licensee is prohibited from reverse engineering, decompiling or recompiling the licensed software. This prohibition is not absolute, however, as several courts have ruled that a licensee who makes an intermediate copy of software to the extent necessary to determine how such software works in order to interface the licensee's or another party's proprietary software to the licensor's software may fall under the "Fair Use" doctrine of the Copyright Act. See Sega Enterprises, Ltd. v. Accolade, Inc., 977 F.2d 1510 (9th Cir. 1992); Atari Games Corp. v. Nintendo of America, Inc. 975 F.2d 832 (Fed. Cir. 1992). Further, a licensee may modify a software program in order to make the program operate more efficiently for the licensee's internal use, including creating a derivative work. Aymes v. Bonelli, 47 F.3d 23 (2d Cir. 1995). At least one court, without deciding the ownership issue, has rejected the contention that a licensee may not obtain an enforceable copyright on a derivative work unless there was an express authorization in the governing license agreement. Liu v. Price Waterhouse LLP, 1999 WL 4702S (N.D. Ill. 1999).

The right to claim a copyright on a non-infringing derivative work arises by operation of law not by the granting of such right by the owner of the original work. Melvin D. Nimmer & David Nimmer, Nimmer on Copyright, § 3.06 n.14 (1997). While these opinions have not been fully explored, it is clear they will not permit the wholesale disassembly of a software program. These holdings are similar to the European Community's ("EC") directive that licensees may reverse engineer software to the extent necessary to create interfaces to the licensor's software. See E.C. Directive 91/250.

The courts have justified these decisions under the "Fair Use" doctrine of copyright law. Under the Fair Use doctrine, use of a copyrighted work, including use by reproduction of copies for purposes such as criticism, comment, teaching, scholarship or research, is not an infringement of the owner's copyright. 17 U.S.C. §107 (1994). Factors to be used in determining fair use include the purpose and character of the use, the nature of the copyrighted work, the amount and substantiality of the portion used in relation to the whole and the effect of the use upon the potential market for or value of the copyrighted work. Id.

At the same time, however, an entity is not allowed to reverse engineer software for the purpose of directly competing with the owners of the software. See Triad Systems Corp. v. Southeastern Express Co., 64 F.3d 1330 (9th Cir. 1995), cert. denied, 516 U.S. 1145 (1996); MAI Systems Corp. v. Peak Computer, Inc., 991 F.2d 511 (9th Cir. 1993), cert denied, 510 U.S. 1033 (1994). See Section III.C.11 for a more in depth discussion of the creation of copies of software by independent service organizations ("ISOs").

It is important to note that a copyright does not provide the copyright holder rights similar to those held by patent owners. A copyright grants the holder the exclusive right to duplicate the copyrighted material and make derivative works. 17 U.S.C. §106(1), (2); CMAX/Cleveland, Inc. v. UCR, Inc., 804 F. Supp. 337 (M.D. Ga. 1992). A patent grants the holder the right to prevent others using, making or selling the patented subject matter. 35 U.S.C. § 154 (1994). A copyright does not protect against another entity creating similar or even identical software independent from the copyrighted work. For example, it does not protect against the creation of similar screen displays, icons, the method of operation of the software or the key commands. See e.g., Lotus Development Corporation v. Borland International, Inc., 49 F.3d 807, 815-18 (1st Cir. 1995), aff'd per curiam, 516 U.S. 233 (1996) (menu-command hierarchy was an uncopyrightable method of operation) and Engineering Dynamics, Inc. v. Structural Software, Inc., 26 F.3d 1335, 1342-43 (5th Cir. 1994) (user interface, input formats and output reports are protectable); but see Whelen v. Jaslow, 797 F.2d 1222 (3d Cir. 1986) (concept of program's content not copyrightable but all functions used for implementing the program are protectable).

Although common law copyrights arise as a matter of law without registration, an author must affirmatively apply for federal copyright protection. Further, a U.S. copyright holder must register the work before bringing an infringement action. 17 U.S.C. § 411(a) (1994). Owners of copyrights registered within three months of publication are entitled to receive attorney's fees and statutory damages if they prevail in litigation. 17 U.S.C. § 412 (1994). Registering a work within five years of first publication constitutes prima facie evidence of the validity of the copyright and the facts stated in the certificate. 17 U.S.C. § 410 (c) (1994).

A copyright holder does not have to affirmatively prove actual copying. Evidence of copying can be inferred by establishing the defendant's access to the program and substantial similarities to the protectable expressions. Bateman v. Mnemonics, Inc., 79 F.3d 1532, 1541 (11th Cir. 1996).

For a general discussion, see Zimmerman, Baystate: Technical Interfaces Not Copyrightable - On to the First Circuit, 14 Computer Law. 9 (April 1997).

(d) Other Restrictions

Other common limitations include limiting use of the software to a particular central processing unit ("CPU"), to one class of computer only, or to a specific geographic site (**§§8.B, 8.C**). This allows the licensor to charge the licensee a transfer or upgrade fee if the licensee wants to change the CPU,

the class of machine, or the site where the software is utilized. See Equinox Software Sys., Inc. v. Airgas, Inc., 1996 WL 278841 (E.D. Pa. May 23, 1996) (soft copies made in violation of license restricting use on a particular CPU constituted copyright infringement).

One exception is the licensee's right to make one backup or archival copy or transfer the software to an alternative back up site for a limited period of time (60-90 days) in the case of a catastrophic failure. (§20). From the licensor's perspective, the license should clearly state that the licensee can not make more than one copy beyond a backup copy for archival purposes as Section 117 of the Copyright Act grants the purchaser of a copy of software the right to make archival copies and adapt the software to operate on its computer. Note, however, that if the licensee is not a purchaser of the software, such copying may constitute copyright infringement. See DSC Communications Corp. v. DGI Technologies, Inc., 81 F.3d 597 (5th Cir. 1996) (downloading software to hard disk by licensee for compatibility modifications was infringement where licensee had not purchased software).

Some licensors (e.g., Oracle) base their license fee on the application involved (i.e., Oracle often grants a license for a specific software application/program only). Other licensors restrict the number of users who can access their software at any one time. This type of restriction is common in a client-server, network environment.

4. **Assignability/Transferability (§3.1, §22)**

Depending on the type of license granted, a licensee may or may not be able to assign its license. In general, a nonexclusive software license is not assignable unless the license agreement expressly provides that it may be assigned (i.e., transfer rights must be specifically granted to the licensee). See, e.g., SQL Solutions, Inc. v. Oracle Corp., 1991 WL 626458 (N.D. Cal. 1991); Harris v. Emus Records Corp., 734 F.2d 1329 (9th Cir. 1984) (as to copyright license). See also, Verson Corp. v. Verson International Group PLC, 899 F. Supp. 358 (N.D. Ill. 1995) (as to patent license). A nonexclusive license is merely a contractual promise not to sue the licensee. The promise is personal to the licensee and cannot be transferred. Raymond T. Nimmer, The Law of Computer Technology §7.09 (revised ed.). Under general contract law, however, unless otherwise agreed, contract rights are freely assignable so long as such assignment does not materially change the duties of the parties. UCC §2-210.

On the other hand, if an exclusive license closely resembles an assignment of the underlying intellectual property, the license generally will be assignable by the exclusive licensee, unless the license agreement expressly provides otherwise. See In Re Sentry Data, Inc., 87 B.R. 943 (Bankr. N.D. Ill. 1988). An exclusive license that does not resemble an assignment, e.g., an exclusive license to market the software, is

arguably a nonassignable license. Id. Therefore, an exclusive license may convey only certain rights to the licensee, which is similar to the buyer's rights to resell and use the software under the First Sale Doctrine. 17 U.S.C. §117. An exclusive licensee is considered to be a copyright owner only to the extent of the exclusive rights granted by the license. Id.

Regardless, from the licensor's standpoint, the license should contain language that the license is not transferable by merger, consolidation, operation of law or otherwise. This will allow the licensor to charge a transition fee if the licensee is acquired by another company or in the case of an outsourcing transaction. If the license agreement does not contain explicit language defining assignment to include mergers, consolidations and operation of law, a court may not consider such actions as constituting an assignment because the assignment arose through the operation of law and not a formal written agreement. (A related issue in outsourcing is allowing third party contractors to access and maintain the software. See Sections III.C.8 and IV. below for a discussion of this issue). Furthermore, language that makes any attempted assignment or an assignment without the licensor's consent void is necessary to prevent the transfer. Without such language, a court may allow the assignment to be concluded and award the licensor monetary damages. See Restatement (Second) of Contracts §322(2) and comment b (1979). This area of the law is uncertain, however, as discussed above copyright law would appear to conflict with general contract law in this matter.

5. Geographic Restrictions (§3.1)

Most licensors limit the use of the licensed software to a specific country or site, i.e., the United States or "Licensee's Wilmington, Delaware site". Again, limiting location may allow the Licensor to charge an additional license fee for each additional foreign affiliate or user not at the authorized site. The failure to limit the use of the licensed software to a particular country may also give rise to a number of export issues. For example, licensing software to a Mexican company which has a subsidiary or affiliate in Cuba would violate the Trading with the Enemy Act if such software was used in Cuba. Furthermore, the use of such software outside of the United States may be governed by the laws of a foreign jurisdiction with which the licensor is unfamiliar and/or which does not grant the same protections to the licensor as the laws of the United States.

Limitation of geographic scope is closely tied to intellectual property rights indemnification. The intellectual property rights indemnification provision in the license agreement is another important concern. As discussed in Section III.B.3, a domestic licensor should limit the licensor's indemnification to intellectual property infringement of a United States intellectual property right and those of the country in which the licensed software will be used. Failure to include a geographic restriction as to the use of the software may expand the scope of indemnification granted by the

licensor.

6. **Object Code and Source Code Licenses (§3.1)**

"Object code" is the binary, machine-readable version of the software. Object code allows the licensee to operate the software but does not enable the licensee to make enhancements or modifications to the software or create derivative works. "Source code" are those human-readable statements in a computer language which, when processed by a compiler, assembler or interpreter, become executable by a computer. Source code allows the licensee to maintain the software, to make modifications and enhancements to the software, and to create derivative works. If a licensee purchases a source code license it *theoretically* does not need further assistance from the licensor as the licensee itself has the ability to maintain, as well as to modify and enhance the software, or create derivative works from it. Consequently, most licensors refuse to sell source code licenses. Those that do sell source code licenses usually charge a significant premium for a source code license, over the cost of an object code license.

In granting a source code license, the licensor should restrict the licensee from licensing any derivative works, enhancements, or modifications the licensee creates. It is important to note that derivative works will generally be owned by the copyright owner unless conveyed. 17 U.S.C. §201(d)(2) and §103(a). Finally, the standard limitations on use of the software discussed in Section III.A.3 should be imposed on the licensee.

7. **Irrevocable License (§3.1)**

Licensees often want the term "irrevocable" included in the license grant to ensure that after they accept the software and pay for the license, the licensor has no basis to revoke the license. The term "irrevocable" implies permanency, however, causing concern for licensors. This concern is alleviated by prefacing the license grant with the phrase *"Subject to the provisions of this Agreement . . . ."* This wording conditions any permanency on the licensee meeting the terms of the license, thus eliminating the licensor's concerns.

B. Significant Clauses

1. **Representations and Warranties and Warranty Disclaimer**

(a) Representations and Warranties (§§18.1, 18A-M)

(i) General

Representations and warranties are not always mutually

inclusive and can have different consequences in terms of liability.

A "representation" creates a legal risk that the licensor's sales puffery may lead to a claim of fraud in the inducement. See Restatement (Second) of Torts §§525, 526, and 552C. An action for a fraudulent misrepresentation must be predicated upon a statement relating to a past or an existing fact. Future promises are contractual and do not constitute fraud. Central On-Line Data Systems v. Filenet Corp., 1996 U.S. App. LEXIS 25261 (6th Cir. 1996).

Damages for such fraud may include the amount paid under the contract minus any benefits obtained; the cost of cover; extra labor expenses; the expense related to obtaining different computer services; the costs associated with installing and removing hardware; program conversion costs; and the costs of equipment maintenance, as well as the risk of the rescission of the license agreement without the necessary legal protections for the licensor. See Applied Data Processing, Inc. v. Burroughs Corp., 394 F. Supp. 504 (D. Conn. 1975) and Clements Auto Co. v. Service Bureau Co., 298 F. Supp. 115 (D. Minn. 1969), aff'd as modified, 444 F.2d 169 (8th Cir. 1971). In such cases the license agreement's merger clause may be voided allowing previously excluded statements to be considered. See Financial Times Publications, Inc. v. Compugraphic Corp., 873 F.2d 936, 943-44 (8th Cir. 1990). Furthermore, at least one court has held that a party may not escape liability for misrepresentation by invoking a contract's limitation of liability clause. Vmark Software, Inc. v. EMC Corp., 642 N.E. 2d 587 (Mass. App. Ct. 1994).

On the other hand, damages for breach of warranty may result in merely a reduction in price, i.e., the difference in value between what was warranted and what was delivered. UCC §2-714(2). A customer may also seek rejection under UCC §2-601 ("the perfect tender rule") or revocation of acceptance under UCC §2-608. In cases where the licensor fails to cure defects, the licensee may recover as much of the price as has been paid. UCC §2-711(1). If the licensor fails to deliver, the licensee may purchase reasonable substitute software and recover the difference between the cost of obtaining the substitute software and the contract price or, alternatively, the licensee may recover damages for non-delivery equal to the difference between the market price and the contract price of the software at the time when the licensee learned of the breach. UCC §§ 2-711(1), 2-713. As such, a licensor should never make representations, only warranties. Most licensees are willing to accept a warranty instead of a representation, and believe one is as good as the other.

A licensor must be careful as to any statement made about its software's performance or capabilities. In the extreme, a misrepresentation may void a contract's limitation of liability. Vmark Software, Inc. v. EMC Corp., 642 N.E.2d 587 (Ct. App. Mass. 1994). Every breach of contract, however, does not give rise to a cause of action under tort law. A duty under tort law arises from circumstances extraneous to and not constituting elements of the contract, even though it may be related to and dependent on the contract. Bristol-Meyers Squibb, Industrial Division v. Delton-Star, Inc., 620 N.Y.S2d 196, 197 (N.Y.A.D. 1994). Consequently, a claim of fraud will not be allowed where the only alleged fraud arises from the breach of the contract. Jackson Heights Medical Group v. Complex Corp., 634 N.Y.S.2d 721, 722 (1995). In the case of solely economic losses, recovery is limited to contract claims and not tort claims. Transport Corp. of Amer., Inc. v. Internat'l Business Machines Corp., 30 F.3d 953, 957 (8th Cir. 1994); Huron Tool and Engineering Co. v. Precision Consulting Services, Inc., 532 N.W.2d 541 (Mich. App. 1995) (fraudulent representations alleged by plaintiff were indistinguishable from terms of contract and warranties, thus plaintiff limited to contractual remedies). See also Word Management Corp. v. AT&T Info. Sys., Inc., 525 N.Y.S.2d 433 (1988).

For software licenses, there are a number of "standard" warranties which a licensor should make. A licensor should warrant that it has valid title to the software it is licensing, that it has the right to grant the license including the license to any third party software, and that the software will operate substantially in conformance with the functional specifications and current documentation. Licensors should carefully consider any warranty they make as to the software's performance when operated in conjunction with any third party software.

It is also common to warrant that, except as documented, there are no trap doors, time bombs or disabling devices. The failure to do so may create significant problems for the licensee at a later date as some licenses specifically state that the licensor may disable the software in case of a breach. **(See §18.F).** See American Computer Trust Leasing v. Jack Farrell Implement Co., 763 F. Supp. 1473 (D. Minn. 1991), aff'd, 967 F.2d 1208 (8th Cir. 1992) (license permitted licensor to disable software for licensee's non payment). At the same time, however, a licensor who disables software without contractual authority may be guilty of intentional tort and be liable to punitive damages, see, e.g., Clayton X-Ray Co. v. Professional Systems Corp.,

812 S.W.2d 565 (Mo. Ct. App. 1991), or potentially in violation of the Computer Fraud and Abuse Act ("CFAA"), 18 U.S.C. §1030. See North Texas Preventative Imaging, L.L.C. v. Eisenberg, 1996 U.S. Dist. LEXIS 19990 (C.D. Cal. 1996) (surreptitious inclusion of time bomb could lead to violation of CFAA).

Some licensors may also give a "no knowledge" warranty with respect to viruses. **(See §18.F)**. See generally, Robbins, Vendor Liability for Computer Viruses and Undisclosed Disabling Devices in Software, 10 Computer Law. 20 (July 1993).

The licensor may also warrant that all services will be rendered in a professional and workmanlike manner. This obligation also arises under the common law. See, e.g., Marcus v. Lee S. Wilbur & Co., 588 A.2d 757 (Me. 1991). For software to be used outside the United States, many licensees require the licensor to certify that the licensor is ISO 9000 compliant, or that the software will be developed in compliance with ISO 9000. **(See §18.M)**. It is also customary for the licensor to state that the operation of the licensed software will not be uninterrupted or error free. **(§18.2)**.

Licensors should avoid making statements about future performance as they may unintentionally create an express warranty. In L.S. Heath & Son, Inc. v. AT&T Info. Sys.,Inc., 9 F.3d 561 (7th Cir. 1993), the court held that a statement that a computer system could meet the buyer's needs, induced the buyer to purchase the system, creating an express warranty and becoming part of the bargain. Id at 570.

A prudent licensee should insist on the inclusion of a number of representations and warranties in the agreement for a mission critical software license or system. These representations and warranties are necessary to ensure that the licensee will receive the long term benefit of its significant investment in the system or software and confirm the licensor's commitment to the software or the system

The licensee should obtain a representation and warranty that the licensor has no plans to discontinue the software in question and that the licensor is committed to enhancing the software in the future. Occasionally, a licensee will seek to have a licensor commit to investing a certain percentage of revenues/profits into the product each year. A licensor should be hesitant to make this type of commitment as it limits the licensor's flexibility in operating the licensor's business. At the same time, however, a licensee has a legitimate interest in

knowing that the software/system is not going to be "sunsetted" shortly after the transaction is consummated.

In addition, the licensee should receive a representation and warranty similar to the representations and warranties contained in acquisition agreements that the licensor has not failed to disclose any "material fact" to the licensee. This protects the licensee from the licensor misleading the licensee by omission, while creating a significant risk for the licensor, as the licensor is obligated to disclose any fact that a reasonable licensee would consider to be "material".

When purchasing a software system, the licensor should represent and warrant that the system as a whole will operate within the parameters of certain service levels. A system warranty limits the problems that may arise when each of the individual system components operate properly but when they are combined the resulting performance is less than desired. By having the licensor commit to certain service levels, the licensee is in essence guaranteed that minimum level of performance. Usually, the remedy for the breach of this warranty is the provision of pre-agreed service level credits or liquidated damages to the licensee. This remedy is also usually accompanied by language that if the service credits or liquidated damages reach a certain level, the licensor will be deemed to be in material breach of the agreement and the licensee may terminate it. The licensor has some protection in that the licensor's failure to meet the service levels does not immediately result in a material breach but rather the licensor has some period of time to correct its nonperformance while providing the licensee financial incentives during the period it tries to correct its breach. **(See §§18.A, B and E).**

Finally, the licensee should insist that the licensor represent and warrant that no "change of control" with the respect to the licensor is being considered, planned or pending. This protects the licensee from entering into an agreement with the licensor based on the licensor reputation, size, experience, etc. and then having the licensee agreement transferred to a third party, a party that the licensee might otherwise not have been interested in contracting with. A licensor should not have any difficulty in making this representation and warranty as this information should be disclosed to the licensee prior to contract signature anyway. **(See §18.K).**

For a general discussion of computer warranties, see Feldman, Warranties and Computer Services: Past, Present and Future, 10 Computer Law. 1 (1993).

(b) Disclaimer of Warranties (§18.4)

(i) *In General*

As permitted under UCC §2-316, the licensor should disclaim all warranties except those expressly made in the license agreement including all implied warranties. If the licensor does not disclaim all other warranties, under UCC §§2-313, 314 and 315 the licensor would be potentially liable for the failure of the licensed software to be merchantable or fit for the purpose for which it is intended by the licensee. The implied warranties of merchantability assures the purchaser that the product falls within the general standards of fitness for ordinary purposes under the product's description. Vision Graphics, Inc. v. E.I. du Pont de Nemours, 41 F. Supp. 2d 93 (D. Mass 1999). It does not guarantee that the product will be ideal or ever optional for a particular use. Id. Section 2-316(2) of the UCC requires that any warranty disclaimers related to merchantability must mention the word merchantability in writing and it must be conspicuous, while those relating to fitness for a particular purpose must be in writing and conspicuous.

In any license agreement, it is also important to include a provision granting the licensee a monetary refund if a "repair or replace" remedy fails of its essential purpose. Such remedies should be stated to be exclusive. Liability for special, incidental and consequential damages should also be excluded. See UCC § 2-719. If a court finds that the licensor's warranty "failed of its essential purpose" (i.e., the licensor did not provide the licensee with a viable remedy), some courts will void the licensee's contractually agreed-to exclusion of consequential damages, potentially creating unlimited liability on the licensor's behalf. See UCC §2-719(2) and Section III.B.4.(b) below.

(ii) *Magnuson-Moss*

If the software is to be supplied to consumers who will utilize the software for personal, family or household purposes, and the license contains any written warranties, the supplier will have to comply with the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act (the "Act"). 15 U.S.C. §2301 et seq; 16 C.F.R. §701. The Act does not apply if the supplier does not make any express warranties.

The Act broadly defines warranties to include any written affirmations of fact or written promises made in connection with the sale which relate to the nature of the workmanship and which affirm or promise that the material or workmanship is defect free or will meet a specified level of performance over a specified period of time. 15 U.S.C. §2301(6)(A). It also includes any written undertakings to repair, replace, refund the license or take other corrective actions if the software fails to meet certain stated functionality. 15 U.S.C. §2301(6)(B). Functional specifications or a right to return the software are not considered warranties under the Act. The Act requires full and conspicuous disclosure of a warranty's terms and conditions in simple and readily-understood language. Furthermore, the Act lists thirteen items whose inclusion may be required by Federal Trade Commission rules. 15 U.S.C. §2302 (1996).

Under the Act, certain consumer product warranties made in writing must clearly and conspicuously designate the warranty as either a "limited warranty," i.e., one that does not meet federal minimum standards set forth in Section 2304 of the Act, or a "full warranty," i.e., one that meets minimum federal standards set forth in Section 2304 of the Act. 15 U.S.C. §2303 (1996). If a full warranty is made, the supplier must correct defects within a reasonable time and without charge and may not limit the duration of implied warranties. Further, after a reasonable number of attempts to remedy a defect, the consumer may elect to receive a refund or replacement. 15 U.S.C. §2304 (1996).

In any case, the Act prohibits a supplier from disclaiming or modifying the warranties of merchantability and fitness for the purpose intended if the supplier makes a written warranty as defined under the Act, or the supplier enters into a service contract with the consumer within 90 days of the date of sale. 15 U.S.C. §2308 (1996). In addition, the Act only allows the supplier to limit the duration of these implied warranties to "the duration of a written warranty of reasonable duration." 15 U.S.C. §2308(b) (1996).

It is believed the Act applies only to the physical media on which software resides, as opposed to the software program itself, although there has been no judicial decision on this issue as of this writing. Nevertheless, written warranties as to the workings of the software itself may be covered and thus should be avoided. Moreover, warranties as to turnkey systems may fall under the Act, in which case both hardware and software would be covered as a single product. Thus, the careful licensor of software to be licensed to consumers

should make no written warranties and should not provide service contracts which become effective less than 91 days from the date of sale.

For a more detailed discussion on the effects of representations and warranties on software licensing, see Dutton, Warranties, Time-Bombs and Other Risk Allocation Issues, 69 Com. L. Adviser 69-102 (Sept. 1993); Friedman and Hildebrand, Computer Litigation: A Buyer's Theories of Liability, 4 Computer Law. 34 (Dec. 1987); Philips, When Software Fails: Emerging Standards of Vendor Liability Under the Uniform Commercial Code, 50 Bus. Law. 151 (1994). See also, Hammond, Limiting and Dealing with Liability in Software Controls, 9 Computer Law. 22 (June 1992).

(c) Length of Warranty **(§18.1)**

The length of the warranty period for the licensed software is an element of price. Industry standard is to provide a 60- or 90-day warranty effective on the date of delivery or date of acceptance of the software. It is important to recognize when the warranty begins. Many licensors state that the warranty begins on the date of installation or shipment. This is potentially troublesome for the licensee as the warranty may expire prior to acceptance and thus should not be agreed to by the licensee. The equitable solution is to have the warranty run from the date of acceptance. If the licensee requires a warranty longer than the standard warranty offered by the licensor, the licensor can provide one for an increased price. Generally, 12 months of maintenance is priced at an amount equal to 15% to 18% of the license fee. Some licensors include the first year's maintenance in the initial license fee.

Licensors must be careful to limit the length of any warranty they give. Many licensees request a one-year warranty. This creates a hidden risk for the licensor as, during the warranty period, the licensee may terminate the license agreement and seek a refund if the licensor is in material breach. During a maintenance period provided under a properly-worded and separate maintenance agreement, however, the licensee would only receive a refund of the maintenance fee if the licensor was in material breach. Thus, a prudent solution is for the licensor to grant, e.g., a 60-day warranty and ten months free maintenance under a separate maintenance agreement. At least one major software company provides no warranty period and instead gives the licensee a 90-day period in which to evaluate and test the software prior to acceptance. At the end of the 90-day period, the potential licensee can either accept the software "as is" without a warranty, or reject the software without obligation.

2. **General Indemnification (§15)**

General indemnification clauses usually address liability for personal bodily injury and/or property damage caused by one of the parties to a third party, including the other party's employees or agents. Indemnification may arise from a contract's provisions but may also be implied by a court. A majority of jurisdictions which have addressed the issue of implied indemnification obligations "hold a contractual relationship under the U.C.C. with its implied warranties, provides sufficient basis for an implied indemnity claim when the buyer incurs liability to a third party as a result of a defect in goods which would constitute a breach of the seller's implied or express warranties." Central Washington Refrigeration, Inc. v. Barbee, 133 Wash.2d 509, 946 P.2d 760 (1997).

Although the right of indemnification may arise under common law, the inclusion of indemnification clauses contractually allocates risk between the parties with respect to such liability. Novak v. BASF Corporation, 869 F. Supp. 113 (N.D.N.Y 1994). Moreover, the failure to include an indemnification provision may limit an injured party's recovery under the laws of those states that have not adopted the doctrine of comparative negligence and still recognize the doctrine of contributory negligence. A correctly-worded indemnification clause will also allow for the recovery of attorney's fees which traditionally are not recoverable in a legal action. The indemnification provisions contained in a license agreement are often mutual for the protection of both parties. The interaction between the license's indemnification clause and the indemnifying party's insurance policies should be closely scrutinized as the waiver of its insurance company's right of subrogation may raise the indemnifying party's insurance rates.

Washington Refrigeration also held that the statute of limitations on an indemnity claim begins to run when the claim is settled, even if the statute on the underlying warranty has already expired. Id at 517-18, 946 P.2d at 765.

Traditionally, there has been no dollar limit on indemnification for personal bodily injury or personal property damages. In consumer transactions, such limits may be held to be against public policy. UCC§ 2-719(3). As such, the limitation of liability clause discussed in Section III.B.4. below often contains "carve out provisions" excluding the license agreement's indemnification provisions.

Indemnification usually does not cover the indemnified party's damages but only third party claims. The indemnifying party must make sure that the indemnity is tightly drafted and should never agree to indemnify the other party for its general negligence or for damages arising from the breach of the license/agreement. The underlying reasoning for this position is that the licensee can limit its liability through the licensee's contracts with its own customers.

3. **Intellectual Property Indemnification (§14)**

Intellectual property indemnification protects a licensee if a third party brings a claim that the licensee's use of the licensed software violates such third party's intellectual property rights. Usually these intellectual property rights are copyright, patent, trademark and trade secrets. Trade secrets create the greatest risk for the licensor as they are not usually recorded in any location where the licensor would be able to determine whether the intellectual property in question infringed upon a third party's trade secrets. Similarly, many licensors are hesitant to provide patent indemnification for software given the unsettled nature of the validity of software patents, and also given the fact that licensors are unable to know what inventions are disclosed in competitors' patent applications that can take two years or more to issue and become publicly available. Trademark infringement is not as serious a concern in software licensing as only infrequently will the licensee be using the licensor's trademarks.

Upon granting a license to the licensee, the licensor is assumed to have made an implied warranty of title under Section 2-312(3) of the UCC. Section 2-312(3) of the UCC provides that unless otherwise agreed, a seller who is a merchant regularly dealing in goods of the kind sold, warrants that the goods delivered will be free of any rightful, claim of infringement by any third party. It also provides that a buyer who furnishes the specifications, must likewise indemnify the seller for any claim arising from the seller complying with the buyer's specifications. UCC §2-312(3); Bonneau Co. v. AG Industries, Inc., 116 F.3d 155 (5th Cir. 1997). This indemnity is limited to third party rights existing at the time of delivery. Yttro Corporation v. X. Ray Imaging Assoc., Inc., 223 N. J. Super. 347, 351, 559 A. 2d. 3, 5 (1989).

A patent license, however, does not usually contain an implied warranty of non-infringement. Deller, Deller's Walker on Patents 406 (1981). See Motorola, Inc. v. Varo, Inc., 656 F. Supp. 716 (N. D. Tex. 1986) and Chevron, Inc. v. Aqua Products, 830 F. Supp. 314 (E. D. Va. 1993) (under the doctrine of federal preemption, UCC §2-312(3) does not impose an indemnity obligation on a party that would not otherwise bear infringement liability under federal patent law). But see Cover v. Hydramatic Packing Co., 83 F.3d 1390 (7th Cir. 1996) (UCC §2-312(3) is not preempted by federal law.)

The defense of intellectual property indemnification suits can be costly even if the licensor eventually prevails, and during their pendency the licensee may be prohibited from using the software it needs to operate its business. As such the licensor/indemnifying party should carefully limit the indemnity it offers, while the licensee should make sure it obtains the protection it needs to operate its business.

From the licensor's perspective, the indemnification clause should be limited to *existing* United States intellectual property rights at the time the license agreement is executed. This eliminates any right to indemnification for intellectual property rights created subsequent to the grant of the license. At the same time, it limits

indemnification only to those United States intellectual property rights, significantly limiting the licensor's risk. With foreign transactions, indemnification should be limited to the United States and the country in which the software will be used. At the same time, any foreign indemnification should be granted only after sufficient due diligence has been performed with respect to the product market in the particular foreign country, and even then it should be limited solely to patent and copyright indemnification, since a number of foreign jurisdictions have "first to file" trademark laws that encourage manipulation of the rights of foreign trademark owners. Including the phrase "finally awarded" limits the licensor's obligation to make payments to the licensee until all appeals have been exhausted. The licensor should also be careful to limit indemnification to a specific licensee and not a broad class of entities such as "the licensee and its affiliates" or "the licensee and its customers."

The licensee should insist, however, that any attempt to limit indemnification to U.S. intellectual property should be limited only to patents. Copyright infringement, for example, should not be limited solely to U.S. copyrights, as under the Berne Convention a foreign copyright holder may enforce its copyrights in the United States. Berne Convention for the Protection of Literary and Artistic Works, July 24, 1971, S Treaty Doc. No. 99-27, AT 39 (1986) Art. 4.

Indemnification by the licensor should be predicated on several requirements. First, the licensee must promptly notify the licensor of any claim; second, the license must assist and cooperate in the claim's defense. Third, the licensor must control the defense of the suit as the licensor ultimately bears the financial responsibility. Fourth, upon notice of a claim, the licensor may, at its option, either make the licensed software non-infringing, obtain a license to use such software from the party trying to enforce its rights, or provide functionally equivalent software. Alternatively, if none of these options is practicable, at the licensor's option, the licensor may refund the license fee to the licensee. Usually this refund is reduced by the benefit the licensee received prior to the software's removal, based on a five-year amortization. This remedy is usually in full satisfaction of the licensor's liability to the licensee.

All agreements should exclude indemnification where the licensor acts on the licensee's direct instructions, the licensee utilizes superseded software, or if the claim arises from the licensee's use of the software in conjunction with commercially-available, third-party software. A licensee will want to ensure that the licensor warrants that the software will be non-infringing, whether standing alone or in conjunction with the hardware or software with which it was designed to operate. The failure to obtain such a warranty, in practicality, leaves the licensee without a real remedy, in the event an integrated system fails to perform properly.

A licensee must make sure it is comfortable with language that allows a licensor to refund the licensee's license fee, especially if the software is important to the operation of its business, as the licensee may receive only a refund of its license fee

in the event of a claim of infringement. Similarly, if the licensee insists on removing the licensor's option to refund the license fee in full satisfaction of an infringement claim, the licensor must be comfortable with the concept that it could be forced to expend its entire net worth obtaining a work around or a license for a functionally-similar software package. The solution will usually be an element of price as the licensor will usually expand its indemnification for an increased license fee.

Finally, the licensee should insist on including language allowing the licensee to assume its own defense at the licensor's cost if the licensor fails to promptly assume any defense.

For a more in depth discussion of the issues surrounding intellectual property indemnification and model clauses, see Ocampo, Curtin & Moss, Infringement Indemnity, 14 ACCA Docket 64 (July/August 1996).

4. **Limitation of Liability**

(a) Cap on Monetary Liability **(§16.2)**

Every software license should have a limitation of liability clause. The failure to include a limitation of liability clause potentially subjects the licensor to unlimited liability. Although the licensee may not want to accept limits on the licensor's liability, it is unreasonable for a licensor to risk its entire company on a single license. A smart licensee will also limit its own liability, a point many licensees forget to make, and refuse to accept any limit on the licensor's liability for the licensor's intentional breach. In at least one case, a court has upheld a limit of liability where the licensor intentionally failed to perform. See, Metropolitan Life Insurance Co. v. Noble Lowndes Int'l., Inc., 84 N.Y.2d. 430, 618 N.Y.S.2d. 882 (1994); but see, Hosiery Corp. of America, Inc. v. International Data Processing, Inc., 1991 U.S. Dist. LEXIS 2501 (D.N.J. 1991) (court failed to dismiss breach claim due to factual issue of whether licensor breached agreement by willfully failing to install latest software). A smart licensor will carve out breach of the license grant and violation of the agreement's confidentiality provisions from this limitation of the licensee's liability. Depending on the type of license agreement, the licensor's liability is usually limited to either the total dollar amount of the license agreement, the amount of money received by the licensor from the licensee in a set time period (i.e., in the previous twelve month period), or a predetermined amount.

Like many of the already-mentioned issues, the amount of the cap is an element of price. While most licensors limit their liability to the amount received from the licensee, many are willing to increase the limit of their liability in return for an increased license fee from the licensee. The traditional

tradeoffs for increasing the limit of liability are that the licensor's price must rise in response to the increased risk because the licensor's original price was based on the initially-stated cap. In trying to justify the increased price, some licensor's argue that they must purchase additional errors and omissions insurance.

Consequential damages for personal bodily injury cannot be limited in some circumstances (see UCC §2-719 (3) and comments 1 and 3), and a limitation of liability may not be valid for tort claims of gross negligence, willful or intentional acts, misrepresentation or fraud. See Boss and Woodward, Scope of the Uniform Commercial Code, Survey of Computer Contracting Cases, 43 Bus. Law. 1513 (1988). See also Shelby Mutual Insurance Company v. City of Grand Rapids, 6 Mich. App. 95, 148 N.W.2d 260 (1967) (a party may contract against liability for harm caused by its negligence but may not do so for gross negligence.) Further, there is usually no limitation of liability for intellectual property infringement, and often none for personal property damage or violations of the license agreement's confidentiality provisions.

Any cap must be reasonable and not be so low as to be considered unconscionable, or it may not be upheld as failing of its essential purpose. See, Wayne Memorial Hospital, Inc. v. Electronic Data Systems Corp., N. 87-905-CIV-S-D (E.D.N.C. filed October 5, 1990) ($4,000 limit of liability on a $2 million contract is unconscionable). See also, UCC §2-719 comment 1. If the limited warranty is deemed to have failed its essential purpose, the limit on consequential damages may be removed. See e.g., McKernon v. United Technologies Corp., 717 F. Supp. 60 (D. Conn. 1989) and Section III.B.4.(b) below for a more detailed discussion. In commercial contracts, there is a presumption of conscionability. Siemens Credit Corp. v. Marvik Colour, Inc., 859 F. Supp. 686, 695 (S.D.N.Y. 1995). In determining whether a contract is unconscionable, a court will look at the bargaining power of the parties, whether the terms were actively negotiated and the terms themselves. Id. At the same time, however, a contract between merchants is rarely found to be unconscionable. D. S. Am. (E.), Inc. v. Chromagraph Imaging Sys., Inc., 873 F. Supp. 786 (E.D.N.Y. 1995).

A court seeks to ensure that the innocent party is made whole. See, Ragen Corp. v. Kearney & Trecker Corp., 912 F.2d 619 (3d Cir. 1990). Thus, the smart licensor always includes in the license a back up remedy, such as refunding the purchase price, to avoid a specified remedy failing of its essential purpose. See, Ritchie Enterprises v. Honeywell Bull, Inc., 730 F. Supp. 1041, 1047 (D. Kan. 1990).

In accordance with UCC §2-316(2), most jurisdictions require that a

limitation of liability be conspicuous. See e.g., Estey v. Mackenzie Eng'g., Inc., 902 P.2d 1220 (Or. 1995). While "conspicuous" is defined under UCC §1-201(10), whether or not a particular disclaimer is conspicuous is subject to the interpretation of the court. Printing any disclaimer in block letters has been held to be sufficient. Window Headquarters, Inc. v. MAI Basic Four, Inc., 1994 WL 673519 (S.D.N.Y. 1994); but see Sierra Diesel Inj. Service v. Burroughs Corp., 656 F. Supp. 426 (D. Nev. 1987), aff'd, 874 F.2d 653 (9th Cir. 1989) (disclaimer in bold type not conspicuous when it appeared on reverse of contract). The failure to make a limitation of consequential damages conspicuous is one factor in determining whether a limitation is unconscionable. D.S. Am. (E), Inc. v. Chronografix Imaging Sys., Inc., 873 F. Supp. 786 (E. D. N. Y. 1995).

Finally, every limitation of liability clause should clearly provide that the stated limit applies regardless of whether the licensee brings a claim based on contract, tort or another theory. The failure to do so may result in the licensee potentially circumventing the cap by bringing a claim under tort theory if the licensor's liability is limited only in contract. See generally, Committee Reports Tort Theories in Computer Litigation, 38 Rec. Ass'n. Bar N.Y. 426 (1983); Budget Rent A Car v. Genesys Software System, 1996 U.S. Dist. LEXIS 12123 (D.N. Ill. 1996) (claims for fraud, fraudulent inducement and negligent misrepresentation allowed even though contract claims were disallowed under the license's integration clause).

At least one court has held that a licensor may not limit its liability for misrepresentations based on a contract's limitation of liability clause. Vmark Software, Inc. v. EMC Corp., 642 N.E.2d 587 (Mass. App. 1994). See Section III.B.1 for a discussion of a licensor's potential liability under tort and contract law theories.

For a detailed discussion of the validity of limitation of liability clauses see Katz, Caveat Vendor: Limitation Clauses in Software Agreements May Not Withstand Judicial Scrutiny, 9 Computer L. Ass'n. Bull. 12 (No. 2 1994) and Hammond, Limiting and Dealing with Liability in Software Contracts, 9 Computer Law. 22 (June 1992).

(b) Disclaimer of Consequential Damages **(§16.1)**

Under Section 2-719(3) of the UCC, the parties to a contract may exclude consequential and incidental damages, provided such exclusions are not unconscionable and there are no other explicit exceptions. An issue exists, however, as to whether exclusion of consequential damages are valid when a remedy fails of its essential purpose. Compare Bishop Logging Co. v. John Deere Indus. Equip. Co., 455 S.E.2d 183 (S.C. Ct. App. 1995) (permitting

consequential damages even when remedy failed of its essential purpose) and McNally Wellman Co. v. New York State Elec. & Gas Corp., 63 F.3d 1188 (2d Cir 1995) (allowing consequential damages despite contractual exclusion when remedy failed of its essential purpose) with Int'l. Fin. Serv. v. Franz, 534 N.W.2d 261 (Minn. 1995) (consequential damage exclusion enforceable notwithstanding failure of remedy's essential purpose). One court has found that a limitation of consequential damages applies only to a breach of warranty and not for non-performance. PC COM, Inc. v. Proteon, Inc., 906 F. Supp. 894 (S. D. N. Y. 1995).

The Ninth Circuit upheld an award of consequential damages despite a disclaimer contained in the parties' contract where the seller failed to deliver a working software system and the contract contained an exclusive "repair or replace" remedy. RRX Indus. V. Lab-Con, Inc. 772 F.2d 543 (9th Cir. 1985). In a later case, the Ninth Circuit held that a limitation on consequential damages was inapplicable because the limit was tied to the limited repair remedy contained in the contract. The court concluded that because a working software system was never delivered, the limited remedy and limit on consequential damages never came into effect. Hawaiian Tel. Co. v. Microform Data Sys., 829 F.2d 919 (9th Cir. 1987).

Thus, to strengthen a disclaimer of consequential damages, any such disclaimer should distinct from the warranty provisions of a contract. **See e.g. §16.1 and §18.**

Unlike Section 2-316 of the UCC, which imposes a conspicuousness requirement for disclaimers of warranty related to merchantability and fitness, Section 2-719(3) does not contain a conspicuousness requirement. Comment 3 to Section 2-719(3), which discusses exclusion of consequential damages, also fails to address conspicuousness. The failure to make a limitation of consequential damages conspicuous is one factor in determining whether a limitation is unconscionable. D. S. Am. (E), Inc. v. Chronografix Imaging Systems, Inc., 873 F. Supp. 786 (E. D. N. Y. 1995). Nonetheless, to err on the side of caution, any such disclaimer should be conspicuous to avoid a court imposing such a requirement and potentially voiding any limitation of liability. See generally, Krupp PM Eng'g. v. Honeywell, Inc., 530 N.W.2d 146 (Mich. 1995).

For a more indepth discussion of consequential damages, see Note, Consequential Damage Limitations and Cross-Subsidization: An Independent Approach to Uniform Commercial Code Section 2-719, 66 S. Cal. L. Rev. 1273 (1973).

(c) Reducing the Statute of Limitations **(§16.1)**

Traditionally, a statute of limitations bars a potential plaintiff from bringing a claim after a set period of time after the action which gave rise to the claim first arose. See, e.g. A.B Alexander d/b/a A.B. Alexander and Associates v. The Perkin Elmer Corp., 729 F.2d 576 (8th Cir. 1984). Most states have statutorily codified this time period as three or four years. See, e.g., California: Calif. Stat. Ann. §337 (1996) (4 years), and Maryland: Md. Stat. Ann §5-101(1996) (3 years). By default, Section 2-725(1) of the UCC provides for a four-year statute of limitations beginning when the cause of action first accrues, but allows the parties to reduce the statute of limitations by mutual agreement to a minimum of one year. By agreeing to a period less than the statutory time period, the licensor may reduce the time period in which the licensee may bring a claim, thus limiting the licensor's risk and, consequently, its liability. A smart licensee will make such clause mutual to also reduce its liability. Courts have been reluctant to extend the four-year statute of limitations. See, e.g., Grus v. Patton, 790 S.W.2d 936 (Mo. App. 1990) (seller's unsuccessful attempts to repair defects over eight-year period did not toll four-year statute of limitations).

5. **Breach and Termination (§5)**

A license's termination provisions are extremely important from both the licensor's and licensee's perspective's as each has different concerns about the ability to terminate the license agreement and the rights of each party upon such termination.

(a) The Licensee's Breach

The licensor is very concerned with the protection of its intellectual property and, to a lesser degree, receiving payment. While a "cure period" of thirty days is standard for most breaches by a licensee, most licensors seek to include a provision allowing the licensor to immediately terminate the license or obtain an injunction if the licensee violates any of the terms of the license grant or the license agreement's confidentiality provisions. The basis for immediate termination stems from the licensor's desire to immediately stop the misuse of its software or confidential information, as these breaches cannot be cured. Other issues such as payment, which are not so critical and can be easily cured, are subject to a standard 30-day cure period.

At the same time, the licensee wants to make sure the licensor can only terminate the license and take possession of the software for a material breach. In addition, the licensee should carefully consider any self-help measures the licensor seeks to include in the license and any language regarding the licensor's ability to disable the software without liability. Many licensees insist that the license contain a provision allowing the licensee to use the software

until any dispute is resolved.

The licensor should insert language stating that the licensee must correct any non-conformance and that the licensee cannot walk away from a contract if it becomes unprofitable to perform. At least one court has recognized that a licensee's failure to perform due to a contract's unprofitability is not an intentional breach of contract. Metropolitan Life Ins. Co. v. Noble Lowndes Int'l. Inc., 643 N.E.2d 504 (N.Y. 1994). In essence, the licensee seeks to ensure a form of specific performance.

(b) The Licensor's Breach (§5.1.A)

Except for breach of the confidentiality provisions, almost all breaches by the licensor are subject to a cure period, usually no less than thirty days. Furthermore, the licensee's right to terminate the license agreement for breach should be for the licensor's *material* breach only.

Software, especially customized software, is often very complex. Thus it may require quite some time to diagnose a problem, code the solution, and then install and test the software. The licensee can protect itself from the resulting late delivery by including a provision for liquidated damages should the licensor fail to deliver the software in a timely manner or if the software fails to operate in accordance with the functional specifications. However, the amount of liquidated damages must not be so high as to be considered unconscionable or it will be unenforceable. See UCC §2-718 comment 1.

In addition to timeliness, licensees are very concerned with the agreement's termination for the licensor's *material* breach in failing to deliver the contracted software. In such an event, the licensee is faced with a dilemma: the licensor has not delivered a working product, but if the licensee terminates the agreement its business may be severely affected. As such, many licensees want the option of either receiving the software's source code to complete the project itself, the right to receive monetary damages, or both. To ensure it receives the source code when licensor breaches the license agreement, most licensee's insist on the execution of an escrow agreement. While this ensure the release of the software's source code to the licensee, receipt of the source code does not necessarily solve the licensee's problems. See Section IV. for a greater discussion of this issue.

(c) Termination for Convenience (§4.1.A)

Often, software development contracts will contain a termination for convenience clause which allows one or both parties to terminate a contract without cause. These clauses are usually inserted at the insistence of the

licensee, as it allows the licensee to terminate its contractual obligations upon payment of a predetermined fee to the licensor. Licensors do not favor termination for convenience clauses as they often prevent the licensor from recognizing the full value of the agreement. Each party should carefully consider the inclusion of such clauses. If included, the parties should include language which protects them financially in the event of such termination and clearly delineate how any termination fee will be calculated. The licensor should insist that if the licensee terminates for convenience, the licensee shall be entitled to recover its termination costs which may or may not include lost profits. At the same time, the licensee should insist the cost for terminating for convenience cannot in any circumstance exceed the total contract price.

6. **Remedies (§§ 5.2, 5.3)**

(a) Licensee Remedies (§ 5.3)

To protect itself in the event of the licensor's breach, the licensee should seek to include of a number of rights and remedies in the parties' contract. The actual rights and remedies included in a particular contract will be dictated by the needs of the parties and the level of protections the licensor is willing to concede. Set forth below are several rights and remedies the licensee should consider including in its contract.

(i) Termination (§ 5.3.1)

In the event of a "material breach", the licensee should have the right to terminate the agreement and seek monetary damages under traditional contract law. This remedy is standard in most agreements with a large portion of the negotiations between the parties focused on what constitutes a "material breach".

(ii) Equitable Relief

(y) Specific Performance (§§ 5.3.4, 28.A.5)

The licensee should try to include the right to specific performance. Specific performance protects the licensee from having the licensor cease the performance of its obligations in the event it was no longer profitable to perform. See e.g., Metropolitan Life Ins. Co. v. Noble Lowndes Int'l, Inc., 643 N.E.2d 504 (N.Y. 1994). The licensor, however, will most likely be unwillingly to include such a provision as it creates potentially unlimited liability on its behalf by requiring the

licensor to work on a project until it is completed. Further, given the imperfect nature of software, it gives the licensee significant leverage over the licensor in any dispute.

(z) Right to Set Off (§§ 5.3, 8.7)

Another equitable remedy the licensee should seek to include is the right to set off any damages the licensee incurs against any monies owed to licensor by the licensee. Even if the parties' contract fails to include this right, most licensees will exercise "self-help" by refusing to make payment until the issue has been resolved. While a smart licensor will seek to exclude language acknowledging the licensee's right to set off and perhaps even specifically prohibit the right of set off, there is little the licensor can do to prevent the licensee from withholding any money due the licensor. See Section III B.9(c) for a more detailed discussion of set off.

(iii) Cover (§ 5.3.5)

A smart licensee will seek to include language allowing the licensee to seek "cover" in the event of the licensor's breach. This provision requires the licensor to be financially liable for any costs, in excess of the contract price, incurred by licensee in having a third party fulfill the licensor's contractual obligations. Most licensors will not agree to such a provision as it creates essentially a *carte blanche* for the licensee and the entity that is hired to perform the work. At a minimum, the licensor should include language that limits the licensor's liability to the predetermined limits of liability set forth in the agreement.

(iv) Access to Source Code, Documentation, Employees and Contractors (§§ 5.3.6, 5.3.7)

A licensee should also include language in the contract allowing the licensee to obtain a free or discounted copy of the software's source code and all available documentation in the event of licensor's material breach. While this provision cannot ensure that the licensee will be able to avoid damages from the licensor's breach, it will provide the licensee a means to further limit its risk. The licensee should also insist on language waiving any prohibition on the licensee soliciting and hiring the licensor's employees and contractors in the event of the licensor's material breach. This is important, as without access to the licensor's employees and contractors, possession and use of the source code and documentation will most likely be of little help to the licensee.

(v) Attorney's Fees (§ 5.4)

In the event the licensee brings a successful legal action as a result of a breach of contract by the licensor, the licensee should be entitled to recover its legal fees. This provision provides a disincentive for the licensor to breach the contract or dispute any issue in bad faith. A licensor that agrees to this provision should make sure that it is mutual. By making the provision mutual, both parties are incented to quickly and fairly settle any matter.

(vi) Transition Rights (§ 5.3.3)

If the software licensed by the licensee is critical to the operation of the licensee's business, the licensee should require that the licensor provide transition services in the event of any termination of the agreement regardless of whether the contract was terminated for one party's breach. A contractual transition period reduces the licensor's leverage in those situations where the licensee is in breach but the services provided by the licensor are important to the continuing business operations of the licensee. Similarly, it requires the licensor to cooperate in the event the licensor is being terminated, where the licensor might otherwise have no incentive to do so. Regardless of the cause of breach, the licensor should be willing to provide the required services so long as it is compensated accordingly.

(b) Licensor Remedies (§ 5.2)

(i) Termination (§ 5.3.1)

In the event of a "material breach", the licensor should have the right to terminate the agreement and seek monetary damages under traditional contract law. This remedy is standard in most agreements with a large portion of the negotiations between the parties focused on what constitutes a "material breach". The licensee should carefully consider the licensor's ability to terminate the agreement if the licensee will need to utilize the software on an ongoing basis. The licensor's ability to terminate the agreement gives the licensor significant leverage over the licensee in these situations.

(ii) Attorney's Fees (§ 5.4)

In the event the licensor brings a successful legal action as a result of a breach of contract by the licensee, the licensor should be entitled to

recover its legal fees. This provision provides a disincentive for the licensee to breach the contract or dispute any issue in bad faith. A licensee that agrees to this provision should make sure that it is mutual. By making the provision mutual, both parties are incented to quickly and fairly settle any matter.

(iii) Equitable Relief

(y) Injunctive Relief (§28.A.5)

The licensor should include a provision allowing the licensor to obtain injunctive relief in the event the licensee breaches the licensing terms or misuses the software. The ability to obtain injunctive relief is important as the licensor needs to quickly and efficiently prevent the licensee from misusing its software. Requiring the licensor to use traditional dispute mechanisms such as arbitration, mediation or use of the judicial system may significantly delay the licensor's ability to protect its intellectual property.

(z) Self Help (§5.2)

The licensor should reserve the right to utilize the quasi equitable relief of "self help" by retaining the ability to stop work in the event of the licensee's breach. The licensee, however, will want a specific provision included in the contract prohibiting the licensor from utilizing any self help until any dispute has been resolved in accordance with the contract's dispute resolution mechanism as self help provides the licensor with significant leverage in the event of a dispute.

7. Governing Law and Forum (§28)

While most parties desire to be governed by the laws and forum of their own jurisdiction, the choice of governing law and forum is not always a "fall on your sword" issue in domestic software agreements. Many licensors are anxious, however, to avoid Texas as it has strong consumer protection laws, while favored jurisdictions include New York, which generally benefits licensors.

To settle any dispute as to the forum, some licensors and licensees include language in their license agreements stating that the forum will be the licensor's choice if the licensee elects to arbitrate or litigate, and that the forum will be the licensee's choice if the licensor elects to bring an action. The benefit is that such language serves

to discourage parties from bringing claims. This solution is not viable for the choice of governing law as there must be one pre-agreed governing law to interpret the license agreement prior to any action being commenced. If the parties agree on a venue, the respective contract language should state that the chosen venue is the "exclusive" venue to avoid any later claim that the language is permissive and not exclusive.

A choice of forum in a license agreement will not always be honored or enforced by a court. If, however, the court finds the choice of forum clause to be valid, reasonable and fairly-negotiated as part of the licensing agreement, the burden is on the party opposed to the forum to show why it should not be enforced. George Jumara and Evangelina Jumara v. State Farm, Inc. Co., 55 F.3d 873, 880 (3d Cir. 1995). To limit potential disputes over the enforceability of such clauses, the contractual language should state that the forum selection clause applies to "any dispute" which would include tort as well as contract claims. See Terra International, Inc. v. Mississippi Chemical Corp., 922 F. Supp. 1334 (N.D. Iowa 1996).

Internationally, it is imperative to utilize the laws of the United States, United Kingdom, Sweden or other western countries as most countries do not have developed software laws or case law for software. An exclusive forum selection clause is also important as most local courts have a bias against foreign licensors and do not always enjoy the same level of competency as the judiciary in the United States.

8. **Alternative Dispute Resolution (§28)**

In general, each party should carefully consider whether to accept alternative dispute resolution ("ADR") for the resolution of any disputes. ADR can take many forms, including but not limited to arbitration, mediation, mini trials and neutral evaluation. Each has its benefits and drawbacks which are magnified in intellectual property disputes. Given the ever-increasing expense of litigation in court, the uncertainty of juries and the diversion of corporate resources even when a party prevails, an increasing number of parties are choosing ADR. The two principal forms of ADR, arbitration and mediation, are discussed below.

(a) Arbitration

Arbitration in some ways is quicker than the court system but may be slower for certain important issues. For example, a licensee would not want to arbitrate whether a licensor must indemnify the licensee for an alleged intellectual property infringement. Alternatively, a court can quickly issue an injunction in the licensor's favor if the licensee breaches the terms of the license grant. For a discussion of the issues involved in obtaining an injunction, see Friedman and LaMotta, When Protecting Software Through an Injunction, How Do You Spell Relief?, 18 Computer Law. 18 (March 1994). While there is a strong public policy in favor of arbitration, a court can not

compel the parties to arbitrate a matter which they did not agree to submit to arbitration. Shopsmith Woodworking Promotions, Inc. v. American Woodworking Academy, Inc., 1995 WL 614355 (Ohio 1995). As such, if the parties desire to utilize arbitration, the license agreement should clearly indicate that intent.

Another issue arises when an entity attempts to enforce an award for an injunction in a foreign jurisdiction. Most courts are hesitant to enter a court order for injunctive relief based on a decision of a foreign jurisdiction. At the same time, they are much more likely to support an arbitral award for injunctive relief. The New York Convention on the Enforcement and Recognition of Foreign Arbitral Awards (the "Convention") has been adopted by 108 countries. The Convention addresses not only the enforcement of foreign arbitral awards, but also agreements to arbitrate. As a result of the widespread acceptance of the Convention, arbitration in some situations may be preferable to a judicial decision for injunctive relief.

Arbitration is advantageous in terms of cost, particularly when used in smaller disputes. Even with large cases, there is cost savings, mainly due to the absence of extensive and protracted discovery and the lack of an appeals process. In addition, there is no need for hiring court reporters for depositions or expert witnesses, as most arbitrators are themselves experts in the field. Arbitrators are not bound by legal precedent, thus even if a party has a solid legal case, arbitration may result in a totally unpredicted outcome. They need not articulate a rationale for their decision. As such, arbitration may or may not be a prudent choice if the dispute is one commonly dealt with by the courts in a more predictable fashion. There are no evidentiary rules in arbitration, however. If there is crucial evidence in the dispute that would not likely be admissible in court and would negatively impact the party in question, a court may be the better choice.

Another consideration is the business relationship between the parties to the dispute. An ongoing relationship, e.g., in the performance of long-term contracts, is often more likely to be preserved through an arbitration proceeding than by litigation. Arbitration is less stressful on the parties and it is private. The lack of publicity can also help protect the present and future business relationship between the parties as well as relationships with other clients or vendors.

Arbitration may benefit a breaching party due to the potentially greater time period needed to reach a resolution than in a court of law. Furthermore, an entity must disclose its claims in arbitration, which puts a licensor at a disadvantage assuming the licensee is in breach. Finally, under arbitration all actions must be by mutual agreement, allowing one party to potentially delay

the proceedings if it chooses.

(b) Mediation (§ 28.A.3)

Mediation is usually a much quicker process than arbitration due to the limited nature of discovery and the desire of the parties to move quickly through mediation given its non-binding nature. This is extremely important if the nature of the dispute is time-sensitive. The absence of discovery also avoids potentially damaging admissions or the production of damaging documentation. Further, the use of a qualified expert as the mediator ensures that the neutral party will be well-versed in the law governing the issues in dispute. Mediation also offers lower costs and greater confidentiality due to the limited discovery and the fact that any decision is not publicly reported. Finally, the often acrimonious nature of litigation is usually avoided due to the more relaxed nature of the proceedings.

9. **Payment** (§8)

Payment terms will usually depend on the type of license granted and whether the contract requires any software development work to be performed.

(a) Service Bureau Licenses

Most software license agreements require payment in advance or upon installation and acceptance. Service bureau licenses are usually priced and paid on a per "transaction" basis and billed monthly. The actual billing structure is dependent on the type of software involved. For example, with cellular telephone billing software, the license fee may be based on the number of subscriber bills printed or with electronic medical records on the number of patients in the database. Service bureau licenses are usually utilized when the software is very expensive and the licensee wishes to conserve cash flow by paying by the transaction instead of purchasing an outright license. On a long-term basis, a service bureau license is usually less cost-effective, although it may allow a licensee to switch vendors more easily as the licensee has less money "invested" in the software.

(b) Development Contracts

Most license agreements with a software development component provide for payment on a time and materials basis or on the basis of certain pre agreed milestones. Each structure has certain benefits for both the licensor and the licensee. The ultimate payment structure chosen by the parties will reflect the allocation of risk agreed to by the parties.

(i) Time and Materials vs. Fixed Price (§8.E)

Payment on a time and materials basis is preferred by the licensor as the licensor is paid as it renders its services, greatly reducing the risk of non-payment while, at the same time, eliminating the risk of underestimating the cost of a project. The greatest risk to a developer in a fixed price contract is that it significantly underestimates the costs involved. If a large contract experiences overruns in the time and labor to finish the project, the overrun can cost the developer tens of millions of dollars. At the same time, without a fixed price, the licensee can never be certain what the cost of the software will be until acceptance. Cynical licensees believe that the developer/licensor has no incentive to limit costs in the absence of a fixed price contract because it bears no economic risk, thus increasing the cost to the licensee.

The licensee is usually billed on a monthly basis for time and materials contracts. For complex projects, payment on a time and materials basis is not favorable for licensees as the licensee cannot be sure that at the end of the project the services will have been satisfactorily performed. Making substantial contemporaneous or even upfront payments to the licensor, greatly reduces the licensee's leverage in the event of a dispute with the licensor.

(ii) Milestone Payments (§§8.2, 8.3)

Pre agreed milestones provide greater protection for the licensee while assuring the licensor will receive progress payments necessary to fund its development efforts. This method also provides the licensee greater leverage in the event a dispute arises with the licensor. The use of milestones is not without risk, as the parties must agree what triggers payment (i.e., delivery, acceptance, etc.), which has ramifications on both parties. A licensee should be wary of payment on delivery before the software has been tested, while the licensor must carefully consider accepting payment upon acceptance, as the licensee has greater leverage in not accepting the milestone. A compromise is to have the licensee make payment on delivery, but state that such payment is only an "advance" and that all such payments are immediately repayable to the licensee if the ultimate deliverable is not accepted. Coupling these payments to the establishment of an advance payment bond in an amount equal to the amount of these "advances," effectively limits the licensee's risks. At the same time, the licensor has complete use of its money less the minimal cost of the bond.

(c) Setoff (§§ 5.3.2, 3.B.2)

Many licensees seek to include language in the license agreement allowing the licensee to set off payments owed to the licensor in the event of a dispute between the parties. A licensee must specifically state that it possesses the right of setoff as this right is statutorily based and does not exist under common law. 80 *C.J.S. SetOff and Counterclaim 4.* See also Stanley v. Clark, 159 F. Supp. 65, 66 (D.N.H. 1957) (citing C. J.S.); Carfoss Const. Corp. v. MMSG Ltd. Partnership; 904 F. Supp. 450 (D. Md. 1995) (as right of set off does not exist under Maryland common law it may be exercised only with respect to statutory authority or incident to a courts' equity jurisdiction). Licensors uncertain as to the status of applicable statutory law should insist on an affirmative statement that the licensee may not offset payment to prevent the licensee from gaining additional leverage over the licensor. Removing the right of offset eliminates the licensee's leverage through the ability to withhold payment. In practice, however, a dissatisfied licensee will offset monies owed to the licensor regardless of any contractual prohibition to the contrary or applicable statutory law.

10. **Third Party Beneficiaries** (§38)

A licensor should always make certain that it disclaims that the license agreement creates any third party beneficiaries. This is especially important in relation to any representations or warranties granted by the licensor under the license agreement.

As a general rule, under common law, a third party who is not an intended beneficiary cannot assert a claim for breach of warranty. OFW Corp. v. City of Columbia, 893 S.W.2d 893 (Mo. App. 1995); See also Restatement (Second) of Contracts, Chapter 14 (1979). The determination of whether someone is an incidental or intended beneficiary is made by looking within the four corners of the contract.

The general rule has at least three recognized exceptions. The first is for personal injury or tangible damage to property. In such incidences, contractual privity is not required. See Prosser, The Fall of the Citadel, 50 Minn L. Rev. 791 (1996).

The second is that under Article 2 of the UCC, warranty protection extends under UCC Section 2-318 to one of three classes of persons injured in their person, depending on which alternative the respective state enacted. Two classes are narrow with the third broader. This warranty extension cannot be contractually waived.

The third is created by those states that have abolished privity requirements, even when the loss is only economic. See, e.g. Dual Building Restoration, Inc. v. 1143 East Jersey Avenue Assocs., Inc., 279 N.J. Super. 346, 652 A.2d. 1225 (1995)

(building owner could sue paint manufacturer for peeling paint even though owner's contract was only with his painting contractor).

C. Other Issues to Consider

1. The Work Made For Hire Doctrine and Moral Rights

(a) Work Made for Hire Doctrine

United States law holds that the copyright in a work is initially vested in the person who creates it. 17 U.S.C.§ 201(a) (1994). Therefore, an independent contractor, as the "author" of a product, usually retains all copyrights to that product unless he or she assigns the rights to the buyer. 17 U.S. C. § 201(d) (1994). Absent any assignment, the buyer is only deemed to hold a non-exclusive license. See MacLean Associates, Inc. v. Wm. M. Mercer-Meidinger Hansen, Inc., 952 F.2d 769 (3d Cir 1991) (contracting party had obtained an "implied" but limited non-exclusive license); Effects Associates v. Cohen, 817 F.2d 72 (9th Cir. 1987), aff'd, 908 F.2d 555 (9th Cir. 1990), cert. denied sub nom. Danforth v. Cohen, 498 U.S. 1103 (1991). Such a limited and non-exclusive license to use the work may place a buyer at a severe disadvantage vis-à-vis its competitors. A contractor, for instance, could potentially disclose a buyer's proprietary information in licensing the work to others, and thereby nullify any competitive advantage the employer gained by commissioning the work. In addition, as the "owner" of the copyright in the work, a contractor could limit a buyer's right to use or distribute the work if such use is outside the scope of the original commission. See Graham v. James, 144 F.3d 229 (2d Cir 1990) (creation of a program by an independent contractor remains the property of the contractor and any unauthorized use is actionable).

An independent contractor retaining ownership in software specified and funded by the buyer may seem counterintuitive. A buyer may invest large sums of money and significant technical input in a project only to find that the contractor claims ownership of the work when the project results in a commercially saleable product. The courts have attempted to soften the effect of this situation by implying a fully paid-up license in the employer to use the software for all purposes intended in the contract and, importantly, to modify the software as necessary to support those uses. See e.g., Clifford Scott Aymes v. Jonathan J. Bonnelli d/b/a Island Swimming Sales, Inc., 47 F.3d 23 (2d Cir. 1995). While these softening interpretations help avoid the harsh results of the rule granting ownership to independent contractors, the courts ultimately hold that, absent an explicit assignment to the employer, the independent contractor owns software produced pursuant to contractual arrangement. Notably, independent contractors rarely demand additional consideration or concessions

for such assignments. Failure to secure an assignment from a contractor may result in the loss of a significant asset to the employer, especially where a product may have commercial value apart from the internal use contemplated by the employer.

There are instances where a company will be presumed to be the owner of a commissioned work under the so-called "work made for hire" doctrine. In the United States an employer may be considered the original author of a commissioned work if the work qualifies as work made for hire under the United States Copyright Act. 17 U.S.C. §201(b) (1994). Section 201 of the Copyright Act provides that "[i]n the case of a work made for hire, the employer or other person for whom the work was prepared is considered the author for purposes of this title, and, unless the parties have expressly agreed otherwise in a written instrument signed by them, owns all of the rights comprised in the copyright." 17 U.S.C. §201(b) (1994). Classifying the work as work made for hire determines not only the initial ownership of copyright, but also the copyright's duration (§302 (c)), the owner's renewal rights (§304(a)), termination rights (§203(a)), and the right to import certain goods bearing the copyright (§601(b)(1)). See 1 Nimmer & Nimmer, Nimmer on Copyright, §5.03[A] 5-10 (1990). Work made for hire is defined as: "(1) a work prepared by an employee within the scope of his or her employment; or (2) a work specially ordered or commissioned for use as a contribution to a collective work, as a part of a motion picture or other audiovisual work, as a translation, as a supplementary work, as a compilation, as an instructional text, as a test, as answer material for a test, or as an atlas, if the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire." 17 U.S.C. §101 (1994).

Since most computer software does not automatically fall within one of the nine types of works enumerated in category (2) above, writing a software program will generally qualify as work made for hire only if it was "prepared by an employee, within the scope of his or her employment." However, an independent contractor will not usually qualify as an "employee" within the meaning of the Copyright Act. In Community for Creative Non-Violence v. Reid, 490 U.S. 703 (1989) ("CCNV"), the Supreme Court declared that an artist, who was commissioned by a non-profit organization to create a sculpture, was an "independent contractor" and not an employee within the meaning of the Copyright Act, even though the non-profit organization directed enough of the sculptor's work to ensure that he produced a sculpture that met their specifications. CCNV, at 753. The United States Supreme Court later unanimously generalized CCNV as the appropriate standard for defining an employee outside of the copyright area as well. Nationwide Mutual Ins. Co. V. Darden, 503 U.S. 318, 322 (1992). If the independent contractor does not qualify as an employee, the employer can only gain title to the work product of

the contractor by having the contractor execute an assignment transferring his or her ownership rights in the work to the employer. CCNV, 490 U.S. at 750.

Therefore, in order to be guaranteed sole and exclusive ownership of the copyright, a buyer would be well advised to have the contractor execute an assignment transferring to the buyer the contractor's entire right, title and interest in the work. (See Section IX. C for a Model Consulting Agreement with an assignment clause).

If a contractor previously executed an agreement without an assignment clause, the employer should have a comprehensive assignment agreement executed by the contractor and should be sure to list the consideration that the contractor is receiving for signing the assignment agreement. (See Section IX.D for a Model Assignment Agreement). For any such assignment to be valid, it must be in writing, signed by both parties BancTraining Video Systems v. First American Corp., 956 F.2d 268 (6th Cir. 1993), prior to the work's creation. Schiller & Schmidt, Inc. v. Accent Publishing Co., Inc., 969 F.2d 410 (7th Cir. 1992) (subsequent writing can not correct the fact that there was no written agreement as required by statute at the time the work was created) but see Playboy v. Dumas, 53 F.3d 549 (2d Cir. 1995), cert. denied, 516 U.S. 1010 (1995) (prior oral agreement that work is work made for hire may later be memorialized in writing as the work is created).

(b) Moral Rights

Under the Berne Convention, "moral rights" in a work may exist in the author regardless of the author's status as an employee or contractor. Furthermore, moral rights may be viewed as separate and distinct from any other ownership rights generally provided for in copyright laws.

Under the Berne Convention an author's moral rights are inalienable, and thus it is not likely that such rights could be contractually transferred by a contractor to an employer. Berne Convention Article 6 bis. Furthermore, a waiver of such rights may be difficult or impossible to enforce in some jurisdictions. Some countries allow moral rights to be waived but not assigned. In such countries, an employer hiring a contractor to perform work would be well-advised to include a waiver provision in any legal document with the contractor to protect against ownership claims by the contractor at a later point in time. While signatories to the Berne Convention are typically required to recognize and comply with the Berne Convention's requirements on an author's moral rights, the United States does not recognize broad moral rights. The United States recently enacted legislation affording limited moral rights to

prevent mutilation or destruction of visual works of art only, and only under certain circumstances. 17 U.S.C. § §106, 113 (1988), amended by Pub. L. 101-650, §604, Dec. 1, 1990. The unwillingness of the United States to recognize moral rights is evidenced by its insistence that the General Agreement on Tariffs and Trade (GATT) and NAFTA specifically provide that the United States is under no obligation to recognize such rights.

The question of whether a U.S. employer would have to recognize an offshore contractor's moral rights under the Berne Convention is closely tied to the issue of how the Berne Convention is implemented in countries which do not deem treaties to be self-implementing. See Melville B. Nimmer & Paul E. Geller, International Copyright Law and Practice, §3 pp. 69-76 (1993). The answer to that question is found in Article 36 of the Berne Convention, which provides that:

> (1) any country party to the Convention undertakes to adopt, in accordance with its constitution, the measures necessary to ensure the application of this Convention.
>
> (2) It is understood that, at the time a country becomes bound by this Convention, it will be in a position under its domestic law to give effect to the provisions of this Convention. Berne Convention Article 36.

Therefore, the Berne Convention appears to leave the decision about self-implementation of the treaty to each individual member country.

This has also been the position of the United States, which has never viewed the Berne Convention to be self-implementing. The United States acceded to the Berne Convention by means of the Berne Convention Implementation Act of 1988. Pub. L. No. 100-568 (Oct. 31, 1988). In doing so, the United States included an express provision denying the self-implementation of the Berne Convention. Id. Since the Berne Convention is not self-implementing, the Berne Convention's provisions are not by themselves enforceable in U.S. courts. Moreover, the United States Copyright Act specifically declares that no right or interest in a work protected under Title 17 may be claimed by virtue of, or in reliance upon, the Berne Convention's provisions or the United States' adherence to the Convention. Pub. L. No. 100-568 §4(c) (Oct. 31, 1988). In other words, neither the Berne Convention itself, nor the fact of adherence to the Convention, will affect the current law of the United States. Since U.S. law does not recognize most moral rights, a U.S. employer hiring an offshore contractor in a jurisdiction that is a signatory to the Berne Convention need be less concerned about the applicability of moral rights if the employer can ensure that U.S. law will govern in case of a

copyright dispute between the parties, and if the work will only be used in the United States. In an attempt to accomplish this, the U.S. employer may select U.S. law by including in a contract with the offshore contractor a choice of law clause. However, this approach is not entirely free of problems.

(c) Independent Contractors in General

It is important to note that the Internal Revenue Service ("IRS") has recently issued new guidelines for determining whether an individual is an employee or an independent contractor. The definition of an "employee" remains unchanged, and is still determined on the ability of the employer to control the method and results of an individual's work.

Under the new guidelines, the IRS has abandoned its 20-point test in favor of a new test involving "categories of evidence." Under this new test, a business must divide factors pertaining to a given worker's status into three categories: behavioral control, financial control and type of relationship. "Behavioral control" includes facts pertaining to whether or not the business controls how the individual does his or her job (e.g., training and instructions given). "Financial control" comprises evidence related to the business aspects of the worker's job (e.g., the worker's investments and expenses). "Type-of-Relationship" examines relational indicators (e.g., written contracts and length of association). These "categories of evidence" allow a broader and more flexible examination of an individual's status than the prior 20-point test, as the IRS publication indicates that all evidence as to degree of control and independence will be considered. See Publication 15A of the Internal Revenue Service (1997).

For a more detailed discussion of the issues involved with the use of independent contractors from an international perspective, see Classen and Paul, Increasing Global Competitiveness by Utilizing Offshore Independent Contractors, 2 Int'l. Computer Law. 2. (No. 11 1994); as to domestic concerns, see Classen, Paul and Sprague, Increasing Corporate Competitiveness by Utilizing Independent Contractors, 11 Computer L. Ass'n. Bull. 2 (No. 1 1996) and Schulze, Watch Out What You Wish For - You May Get Your Wish or Ownership Issues Continued: More on Applying the Work Made for Hire Doctrine to Computer Programmers, 8 Computer L. Ass'n. Bull. 12 (No. 2 1993).

2. Export Issues

(a) General

Under the United States' export regulations, an individual may

"undertake transactions subject to the Export Administration Regulations[3] ("EAR") without a license or other authorization, unless the regulations affirmatively state such a requirement." 15 CFR §736.1. The EARs are consistent with the position of many European governments' that anything not prohibited is allowed, in contrast to the Bureau of Export Administration's previous position that everything is prohibited unless an exception exists. Under the EAR, licenses are not required for most shipments to Canada and shipments to U.S. territories, possessions and commonwealths. The export regulations can be found at ***www.bxa.doc.gov***.

(b) Definitions

Section 734.2(b)(1) of the EARs defines "export" as:

(i) an actual *shipment* or *transmission* of items subject to the EAR out of the United States; or

(ii) "release" of technology or software subject to the EAR to a foreign national in the United States.

Section 734.2(b)(2) defines "export of technology or software" as:

(i) any "release" of technology or software subject to the EAR in a foreign country; or

(ii) any release of technology or software subject to the EAR to a foreign national.

In the context of this definition, Section 734.2(b)(3) of the Export Administration Regulations defines "release" as:

(i) Visual inspection by foreign nationals of U.S.-origin equipment and facilities;

(ii) Oral exchanges of information (with foreign nationals) in the United States or abroad; and

(iii) The application to situations abroad of personal knowledge or technical experience acquired in the United States.

(c) Export of Software and Technology

3 The Export Administration Regulations are issued by the Department of Commerce and administered by the Bureau of Export Administration ("BXA") to implement the Export Administration Act of 1979, as amended.

The first step in exporting any software or technology is to determine whether an export license is needed. Under 15 C.F.R. 736.2(b), the exporter must apply a ten-step process to determine whether the exporter's software or technology requires a license under the EAR. Based on the results, software or technology will fall into one of three categories:

(i) No License Required ("NLR"). If software or technology to be exported is either not subject to the EAR or does not require a license as a result of the ten-step process under 15 C.F.R. 736.2(b), it is considered to be No License Required or "NLR". Software or technology classified as EAR 99 falls into this category.

(ii) License Exceptions. If a determination is made that the software or technology requires a license under the EAR, the exporter must determine whether a License Exception is available. A "License Exception" is the authorization to export under stated conditions that would otherwise require a license. 15 C.F.R. 740.1(a). For software and technology, two potential License Exceptions are available under Section 740.

(y) ***Technology and Software Under Restriction ("TSR").*** Section 740.6(d) allows export and re-export of software and technology, subject to national security controls, to Country Group B upon receipt of a Letter of Assurance. This License Exception is similar to the old GTDR.

(z) ***Technology and Software-Unrestricted ("TSU").*** Section 740.13 of the EAR provides a License Exception for certain "Operation Technology" and software, software updates and mass market software permitting their export without a license. This License Exception covers certain mass market software such as software sold over the counter through mail order transactions and telephone call transactions, sales technology, and software updates. "Operation technology" is defined as "the minimum technology necessary for the installation, operation, maintenance (checking), and repair of those products that are lawfully exported or re-exported under a license, License Exceptions or NLR." 15 C.F.R. 740.13(a)(1). This License Exception is similar to the old GTDU.

(iii) If a License Exception does not exist, the exporter must apply for a license under 15 C.F.R. 748.

3. Ownership of Custom-Developed Software (§§3.2, 3.5, §12.1)

Ownership of software developed by the licensor for a specific customer is often a contentious issue. Usually, the licensee claims ownership based upon the fact that it has paid the licensor to develop the software and that the software would not have been otherwise developed. The licensor desires to retain ownership to keep the integrity of its software (i.e., the licensor does not want its customers owning portions of its proprietary software, especially parts of the program's core code) and to potentially profit from relicensing the custom piece of software.

This issue is often resolved by having the licensor retain ownership of the custom-developed portion of the licensor's software but have the licensor pay the licensee a royalty based on future license fees received by the licensor from relicensing the custom portion. Another potential solution is to have the licensee retain ownership of the custom software and grant to the licensor the right to market the custom software and have the licensor pay a royalty to the licensee for each license sold.

These are not the only solutions. If the licensor is solely concerned with the licensee owning part of the licensor's core code, the licensee can retain ownership of the custom portion without the right of sub-license or assignment. Another alternative, but one which is less attractive, is to have the licensor and licensee jointly own the custom software. This would allow each party to market the software to whomever it chooses, while at the same time having the right to make modifications and enhancements. This alternative may be detrimental to the licensor as the licensee may license the software to the licensor's direct competitors. Under joint copyright ownership, however, each owner has a duty to account to the other. 1 Nimmer & Nimmer, Nimmer on Copyright, §6.12[A] (1990); See, e.g. Oddo v. Ries, 743 F.2d 630 (9th Cir. 1984). At the same time this approach is probably unrealistic as most likely the custom portion is of little value unless it is licensed in conjunction with the rest of the software. Other alternatives include having the licensor give the licensee a significant price discount to recognize the intrinsic value the licensor will receive by retaining ownership of the custom developed software.

4. Functional Specifications (§1.7)

The software's functional specifications are the technical architecture that the software must meet once it has been developed to the licensee's requirements. The functional specifications should be extremely detailed and should be agreed upon prior to execution of the license agreement, as they will determine the cost and extent of the effort exerted by the licensor in the software's development. If the functional specifications have not been agreed upon in detail, it is impossible for the licensor to determine with confidence the price of the development effort as the scope of the development effort has not been limited or fixed. The licensee is also at risk because it

does not have a document describing in detail the deliverable it will receive for the fixed price.

A significant amount of litigation has arisen as a result of agreements being executed containing general language that the "parties shall negotiate in good faith the functional specifications immediately upon execution of this Agreement." After execution, a dispute often arises because the parties are unable to agree on the functional specifications given that the licensor is usually constrained by a fixed price, a limit a licensee is not usually concerned with. Several courts have recognized the licensee's obligation to provide the licensor with the needed information to develop a system. See, H/R Stone, Inc. v. Phoenix Business Systems, Inc., 660 F. Supp. 351 (S.D.N.Y. 1987) (licensee breached implied covenant of good faith and fair dealing by failing to provide sufficient information to allow licensor to undertake development.); Truktax, Inc. v. Hugh M. Gray & Associates, Inc., 1987 WL 13150 (1987) (Customer breached contract for computer software by hindering its development and installation and owed developer the remainder of contract price.) Further, by failing to set forth definitive specifications, the parties run the risk of having a court disregard the contract's integration clause and include the parties correspondence and other writings. See L.S. Heath & Son, Inc. v. AT&T Info. Sys., Inc., 9 F.3d 561 (7th Cir. 1993) (If allegedly integrated writing does not, without reference to another document or other coordinating information, reveal what the basic transaction entailed, then the writing is not integrated; where master agreement did not identify prices, products, services, software applications or configurations).

In the extreme, a court may find the lack of a contract under the theory of contractual indefinitiveness, e.g., the functional specifications were such a material portion of the contract that the contract could not exist without them. See generally, Rates Technology, Inc. v. New York Telephone Co., 1995 WL 438954 (S.D.N.Y. 1995) and U.C.C. §2-204. This possibility finds support under the U.C.C., which requires an agreement to (a) evidence a contract for the sale of goods, (b) be signed by the parties, and (c) specify a quantity in order to be legally enforceable. U.C.C. §2-201 comment 1.

The prudent methods of contracting are to: (1) enter into a two-phase contract with the first phase consisting of a fixed price engagement to draft the functional specifications, and assuming that the parties can agree on the functional specifications, a second phase consisting of the development effort at a fixed price; (2) jointly develop the functional specifications prior to execution of a fixed price contract; or (3) enter into a time and materials contract. The first option is less attractive to the licensor as once the functional specifications have been agreed to, the potential licensee can shop the functional specifications to other potential software developers to get the best price. The second alternative is less attractive to the licensor's business people who want to obtain a binding commitment from the licensee and who do not want a long, drawn-out process in order to reach a final agreement during which time the licensee could select

another licensor. From the licensee's perspective, the third option does not provide the price protection needed to protect against cost overruns and necessary for its budgeting process. Finally, the parties must decide whether the licensed software when delivered or accepted meets the functional specifications or the current documentation for the licensed software.

Both the licensor and the licensee should be wary of incorporating the licensee's Request for Proposal ("RFP") and the licensor's RFP response into the contract. Many contracts incorporate these documents in an often ill-fated attempt to incorporate each party's understanding of their obligations. The licensee often wants to include the RFP to bind the licensor to the standards set forth in the RFP and the standards the licensee expects the licensor to meet. The licensor often desires to incorporate its RFP response for its own protection as the licensor will often reject certain of the RFP's requirements in the licensee's RFP response. At the same time, the licensee often wants to include the licensor's RFP response to hold the licensor to statements set forth in the licensor's RFP response. A problem arises, however, when the delivery requirements set forth in the RFP and RFP response differ from each other and from the specifications included in the contract from the parties' negotiations. Further disputes often arise in trying to resolve any differences between the RFP and the RFP response and what the parties agreed to. To avoid these potential issues, it is preferable to agree on and attach functional specifications negotiated after the successful bidder has been selected. The RFP and RFP response in turn should then be negated by the contract's "integration" or "entire agreement" clause.

5. **Acceptance and Acceptance Test Procedures** (§§1.14, 17)

The concept of acceptance and the corresponding acceptance test procedures are extremely important in custom software development contracts. Off-the-shelf shrinkwrap licenses deem acceptance to have occurred with the opening of the cellophane surrounding the box containing the software or, alternatively, with the use of the software. While uncertain, the enforceability of off-the- shelf acceptance has recently been upheld. See ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996).

With custom software, the concept of acceptance is not difficult to understand, but in practicality it is difficult to quantify, as at the time the license agreement is executed, the functional specifications for the software may not have been agreed to. Thus it is difficult, if not impossible, to agree on the acceptance tests if the parties do not know what will be needed to test the software, much less know what the software will look like in the completed product. Furthermore, there is the question of what level of "bugs" is acceptable.

The acceptance test procedures should be objective in nature such that an independent third party should be able to determine whether the licensed software has satisfied the tests. Any acceptance test procedures should be mutually agreed to by the

parties to ensure fairness. The licensor usually drafts the test's procedures protocol document given its familiarity with its own software and submits this document to the licensee for its approval. The licensee then either accepts the document or suggests potential modifications. To ensure that there is mutual agreement as to what constitutes "acceptance," the term should be carefully defined. Otherwise, a court itself may determine what is "acceptable" software. See, Sha-I Corp. v. City and County of San Francisco, 612 F.2d 1215 (9th Cir. 1980) (satisfactory completion of 95% of acceptance requirements constituted acceptance).

Software by its nature is considered imperfect and bugs will always exist in a program's code. Consequently, most agreements contain language to the effect that the software will "substantially conform" to the functional specifications or "comply in all material respects." Thus, many agreements classify and delineate the levels of errors and then quantify how many of each level are acceptable. For an example of the classification of errors, see Appendix A to the Model Software Maintenance and Services Agreement attached hereto in Section IX.B.

Like off-the-shelf software, custom software contracts should include a provision that the use of the software in a commercial context shall be deemed acceptance. Otherwise, the licensee may have an incentive not to accept the software while receiving all commercial benefits of the software from its use. **(§17.3)**

6. **Specific Performance (§5.3.4)**

Most smart licensees try to include the remedy of specific performance in their license agreements. Sections 2-711 and 2-716 of the UCC specifically identify specific performance as an acceptable remedy. Licensors are hesitant to include this remedy because, if included, a licensee may be able to force the licensor to deliver the software regardless of cost. Given that the risk of large cost overruns is always present with software development, the risk to the licensor is great if such remedy is included. Smart licensees also seek to include a statement that they are entitled to specific performance to force the licensor to place its software in escrow if the license agreement requires the licensor to do so, as well as to enforce the license agreement's indemnification provisions.

Licensors should carefully consider the risks when the licensee seeks to include broad statement such as "the right to obtain equitable relief" in the license agreement. While the equitable remedy of injunctive relief for breach of the agreement's confidentiality provisions is important to include," all equitable remedies" are broader than necessary and should be limited solely to injunctive relief. Smart licensors will try to include language in the license agreement that, upon the licensor's breach of the warranty, the licensee shall be entitled to monetary damages only, or to specifically state that the licensee is not entitled to obtain an equitable remedy.

7. **Liquidated Damages and Service Level Credits. (§§3.B, 3.C)**

Licensees often seek to include a provision for liquidated damages for the late delivery of software in development contracts. Usually these damages amount to 0.5% of the contract value (excluding the value of hardware and third party software) for each week a delivery is late for up to 10% of the contract value. The licensor must carefully consider what will trigger payment. Payment should be based on late delivery of the software and not acceptance of the software by the licensee.

Many licensees will try to tie payment to acceptance of the software by a certain date and not the contractual delivery date. This creates significant risk for the licensor as acceptance is totally within the control of the licensee. At the same time a licensee may be hesitant to base such damages on late delivery as the licensor may deliver poor quality software just to avoid paying liquidated damages, believing that the poor quality of the software can be corrected during any cure period. The licensee should include language allowing the right of offset against future progress payments if the licensor does not pay the liquidated damages as required.

The licensor should ensure that the payment of liquidated damages is in full satisfaction of any liability the licensor may have for late delivery. The licensee may want to provide further protection by providing for termination of the agreement if the licensor has not delivered the software when the maximum payment amount has been reached to avoid giving the licensor an additional cure period. Finally, the licensee should carefully word the liquidated damages provision and limit the liquidated damages to a reasonable level to avoid the appearance of a penalty. Liquidated damages that are out of proportion to the probable loss or grossly in excess of the actual damages may be found to be a penalty and thus unenforceable. Gordonsville Energy L.P. v. Virginia Electric & Power Co., 512 S.E.2d 811 (Va. 1999). The Customer should be careful, however, to include a provision that provides that if the liquidated damages reach a certain level, the Licensor shall be deemed to be in material breach and the Customer may terminate the contract.

Similarly, the licensor should seek to include a combination of liquidated damages and bonuses payable to the licensor in the event of certain Customer actions or inactions. If the customer has certain contractual responsibilities beyond payment such a site readiness or the obligation to promptly accept the licensor's deliverables, the licensor should insist that the customer pay liquidated damages for the customer's failure to promptly meet its obligations. At the same time, the licensor should receive a bonus for the early delivery of the software or other material deliverables. This bonus counters the damages payable for late delivery and is consistent with the goal of liquidated damages to incent the licensor to deliver on time.

Licensors often seek to raise their prices when the licensee asks for liquidated damages, claiming the licensor's initial price did not reflect the additional element the

licensee has asked them to assume through the payment of liquidated damages. This argument holds little validity if the customer's initial RFP or the model license contained in the RFP put the licensor on notice that the customer expected the resulting contract to contain a liquidated damages provision. See generally UCC §2-2-718(1) and Annotation, Contractual Liquidated Damages Provisions Under UCC Article 2, 98 A.L.R.3d 586 (1980).

Service level credits usually address the failure of the software fully to meet certain service levels or standards after the software has been accepted. These credits are usually more common in outsourcing transactions then in general software license agreements. The licensor should think carefully before agreeing to service level credits as the software's performance may be affected by a number of factors outside the control of the licensor such as the hardware and collateral third party software. As such, any provisions for service level credits should be carefully drawn.

8. **Maintenance (Section IX. B.)**

Maintenance may function like an extended warranty. Any maintenance provisions, however, should be separate and distinct from the warranty in the license agreement, and should ideally be in a separate agreement. This is important due to the difference in the licensor's liability for breach of the warranty contained in the license agreement and breach of a separate maintenance agreement. Under some license agreements the warranty begins on acceptance. Under others, acceptance does not occur until the expiration of the warranty. During the warranty, the licensee may terminate the license agreement if the software does not meet the functional requirements or perform in accordance with the license's other requirements and potentially receive a refund of the entire license fee. If the software does not meet the functional specifications during the maintenance period, however, the licensee can terminate the maintenance agreement but will usually only be entitled to receive a refund of the maintenance fee provided the maintenance provisions are contained in a separate agreement.

Annual maintenance charges are generally set at the rate of 15% to 18% of the original license fee. Some licensor's calculate the maintenance fee on the aggregate of the license fee plus the cost of any enhancements or modifications made by the licensor, while others consider any enhancements or modifications to be consulting services or professional services and not included in the base fee for calculating the maintenance fee. In addition, the licensor usually agrees to maintain only the one or two most recent versions of the software because of the difficulty of keeping track of all the different versions and whether they are comparable. Many agreements provide that if the licensor ceases to provide maintenance, the licensor will provide the licensee with a copy of the software's source code so that the licensee can maintain the source code itself. Licensees should realize, however, that it may be impractical for them to maintain the system itself given the complex nature of many large software systems and

the large learning curve necessary to master the system.

Most maintenance agreements void any obligation to maintain the software if the licensee modifies the software in any way, or if any problems with the software result from the negligent or unauthorized actions by the licensee. Finally, a smart licensor will claim ownership of any modifications, enhancements or derivative works created by the licensor while performing maintenance for the licensee.

Licensees often want the licensor to agree to offer maintenance for a set period of the 5-10 years from acceptance without committing to actually purchasing maintenance from the licensor. This requirement is understandable as an expensive software system is worthless unless it is properly maintained. At the same time, a reasonable licensee can not expect the licensor to fix or project its prices ten years into the future. The solution is to include language that the licensor will provide such services at "licensor's then-existing price." Both the licensor and licensee should be concerned about any increase in the maintenance fees tied to the Consumer Price Index ("CPI") as the CPI does not adequately reflect the true cost to the licensor. In the 1970s and 1980s, the CPI rose significantly driven by higher real estate prices while technology salaries remained constant, while in the mid-1990s the CPI experienced only minor increases while technology salaries rose rapidly.

Finally, all maintenance agreements should require the licensor to update the product documentation in connection with any enhancement or alteration to the software and ensure the documentation is consistent with the licensed software. An aggressive licensee will seek to require that the licensor's software as maintained will be compatible with all third party software or hardware upgrades such as Oracle or Informix. This creates great risk for the entity providing maintenance given the uncertainty of when such upgrades will occur and the cost to make the licensor's software compatible.

One issue of great concern to licensors is when the licensee seeks to maintain the software through the use of independent service organizations ("ISO's"). Licensors are often concerned that these independent third parties may be their competitors who will learn the licensors' trade secrets or siphon off the licensors' maintenance revenue, which is usually a significant portion of their profits. See, e.g., Hodge Business Computer Systems, Inc. v. U.S.A. Mobile Communications, Inc., 910 F.2d 367 (6th Cir. 1990). This area is very complicated as the failure to allow third parties to provide maintenance support potentially exposes the licensor to antitrust concerns. For a more detailed discussion of these Antitrust issues, see Section III. C.11 below. See Johanson and Zollman, Computer Maintenance Raises Antitrust Issues, Nat'l. L. J., May 20, 1996, at C40, col.3.

9. **Training and Documentation (§§11, 13.1)**

(a) Training (§ 11)

A detailed description of the training to be provided by the licensor is important to both the licensor and the licensee. The licensor wants to put distinct limits on the training to be provided to the licensee to fix the licensor's cost. This is especially important when to reduce costs both parties want to use a "train the trainer" approach. The description should set forth absolute time limits, the class size, class location, materials to be provided and the language in which the classes will be taught. A licensor will also want to delineate the skills the attendees must have to attend the specific training. This is to ensure that the licensor does not spend time teaching basic programming skills that the attendees should already possess. The licensor also wants to carefully state which skills will be taught, and what skills the attendees will possess upon completion of the course. For example, training should teach the attendees how to operate the software, but the licensor should not make statements to the effect that the licensee's attendees will be able to maintain the software unless such training will be provided.

At the same time, the licensee wants to clearly state that upon completion of training, the licensee will be able to fully operate the software, that future training will be available at a mutually agreed-to time if the licensee desires to purchase extra training and that all documentation and training provided by the licensor to the licensee will be accurate and current. Further, the licensee's attendees will receive copies of all documentation used during the course.

(b) Documentation (§ 13.1)

All documentation provided by the licensor should be in sufficient detail to allow a reasonably-skilled programmer to operate and use the software. The licensor should warrant that the documentation is the most current version of the documentation, complete and free from any errors and omissions and that the documentation corresponds to the licensee's current version of the software installed at the licensee's site and not a base line version of the software. Further, the licensor should promptly provide the licensee with updated documentation reflecting any changes made to the software utilized by the licensee.

A smart licensee will also want the licensor to warrant that the software meets the specifications provided in any documentation or that the documentation is applicable to the version of the software delivered to the licensor. Unless the licensor desires to make a profit on duplicating the documentation, the licensee should be free to reproduce the documentation without cost provided the license reproduces the licensor's protective marks

(i.e., copyright notices) and does not modify the documentation.

10. **Bankruptcy (§5.1)**

(a) Licensor's Bankruptcy.

In response to the concern of the software industry and licensees in particular, the federal bankruptcy laws were rewritten to protect licensees in the event of a licensor's bankruptcy. Section 365(n) of the United States Bankruptcy Code (11 U.S.C. §365(n)) (the "Bankruptcy Act"), provides that in the event the debtor/licensor rejects the license agreement, the non-debtor licensee has two options. First, it can bring a claim for damages to the extent the rejection caused the licensor to fail to meet the licensor's obligations under the license agreement. 11 U.S.C. § 365(n)(1)(A). Under this option, the licensee forgoes any right to use the licensed technology/software in the future. Id.

Second, it can retain the rights to use the software/intellectual property for the period provided for under the license and any contractual extension periods. 11 U.S.C. §§ 365(n)(1)(B). The trustee in bankruptcy can still reject the license agreement causing any executory provisions to become null and void, but the licensee can elect to retain its rights under the software license. If the licensee elects to retain its intellectual property rights, it must continue to pay the license fees due the licensor, and must forego certain remedies otherwise due under the Bankruptcy Act for the termination of the license agreement (e.g. rights to set off or any §503(b) claims and any priority claim). Under the Bankruptcy Act, the licensee does not need to act to preserve its license. 11 U.S.C. §365(n)(1)(B), but see In re E.I. International, 123 B.R. 64 (Bankr. D. Idaho 1991).

Most licensees elect the second option to continue using the software. While the licensee may continue using the software, it cannot compel the licensor to perform except for any exclusivity provisions in the contract. The licensor is relieved of its obligations to provide any ancillary services such as training, maintenance, support, documentation or updates. The licensee must continue, however, to pay all royalties due licensor. 11 U.S.C. § 365(n)(2)(B).

Other executory provisions of the contract are not enforceable by the licensee, such as maintenance and any unfinished development work. The licensee is able to require the trustee to turn over any embodiments of the licensed technology, provided they were stated in the license, including any exclusivity right. 11 U.S.C. §§365(n)(1)(B) and 365(n)(3).

To ensure the protections of Section 365(n) are available to the

licensee, the licensee should make sure the license specifically provides that the licensed software is "intellectual property" under § 101(56) and that the license is governed by Section 365(n) in the event the licensor files for bankruptcy protection. To limit its financial risk, the licensee should delineate the payments made for collateral obligations like training and support and from general royalty/license fees. By lumping all fees together, the licensee could be obligated to pay for the entire amount even though it did not receive the collateral services whose price was included in the lump sum royalty fee.

In order to perfect a security interest in a debtor's software, the creditor must comply with both the Uniform Commercial Code and copyright law which requires that a notice be filed with the Copyright Office. The grant of a security interest is considered to be the transfer of copyright ownership. In re Avalon Software, Inc., 209 B.R. 517 (Bankr. D. Ariz. 1997).

For a more detailed discussion, See Kupetz, Beware When Dealing With Licensor's of Intellectual Property: Avoiding Potential Pitfalls Facing Licensees and Lendors When Bankruptcy Intervenes, 17 Computer Law. 21 (Jan. 2000). See also, Bartlett, Effects of Bankruptcy on Licensing Under 11 U.S.C. §365(n), 5 J. Proprietary Rts. 20 (July 1993); Brown, Hansend, Salerno, Technology Licenses Under Section 365(n) of the Bankruptcy Code: The Protections Afforded The Technology User, 95 Com. L.J. 170, (1990); The Protection of Intellectual Property Rights of a Licensee When a Licensor Goes Into Bankruptcy Under the Amended 11 U.S.C. 11 §365, 73 J. Pat. & Trademark Off. Soc'y 893 (1991).

(b) Licensee's Bankruptcy.

Under Section 365(b) of the Bankruptcy Act, an intellectual property license is considered to be an unexpired lease or executory contract. As such, a licensee who declares bankruptcy and desires to assume the license agreement must cure all breaches, fully perform its obligations under the license agreement, and provide adequate assurances that it will perform in the future. If the licensee fails to do so, it must reject the license agreement and relinquish all rights to the underlying intellectual property.

To provide a greater level of protection, a licensor can include certain financial requirements in the license agreement which would allow the licensor to terminate the license agreement for the licensee's failure to abide by such requirements. These rights are separate and distinct from those provisions typically placed in a license agreement allowing the licensor to terminate the license for the licensee's bankruptcy. These termination provisions are void under the Bankruptcy Act. 11 U.S.C. § 365(e)(1); see also, In re: Computer Communications, Inc., 824 F.2d 725 (9th Cir. 1987).

Furthermore, there is a limit on the ability to assign a license held by a debtor to third parties. A trustee can not assign a license to another entity without the licensor's consent, regardless of whether such transfer is allowed under the license agreement. In re Alltech Plastics, Inc., 71 B.R. 686 (Bankr. W.D. Tenn. 1987); 11 U.S.C. § 365(c). Similarly, at least one court has held that a licensee cannot use a non-exclusive license after its bankruptcy reorganization absent the licensor's consent. Perlman v. Catapult Entertainment, Inc., 1999 WL 33702 (9th Cir. 1999) ("where applicable nonbankruptcy law makes an executory contract nonassignable because the identity of the nondebtor is material, a debtor in possession may not assume the contract absent consent of the nondebtor party"); but see Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489 (1st Cir.) cert. denied 117 S. Ct. 2511 (1997).

In addition, a personal services contract can not be assigned or assumed by a debtor under the Bankruptcy Code. In re Catron, 158 B.R. 624 (E.D. Va. 1992), aff'd, 158 B.R. 629, aff'd, 25 F.3d 1038. But see In re Fastrax, Inc., 129 B.R. 274 (Bankr. M. D. Fla. 1991) (subcontract for installation of storage, retrieval and distribution computer center not a personal service contract and could be performed by another computer software company).

11. Antitrust and Copyright Misuse Issues (§3.6)

a) Antitrust Issues.

Traditionally, the provision of maintenance, enhancement and support services has been very lucrative for licensors, due to the high margins involved with such work. Licensees are often at the mercy of the licensor, as the licensor has the familiarity with the software and the necessary proprietary software tools to undertake such work. With the advent of outsourcing, the proliferation of competent third parties to maintain proprietary software, and the increasing desires of licensees for other alternatives, some licensors have sought injunctions to prohibit third-party access to licensors' proprietary software without a license, see, e.g. Triad Systems Corp. v. Southeastern Express Co., 64 F.3d 1330 (9th Cir. 1995), cert. denied, 516 U.S. 1145 (preliminary injunction granted and affirmed on appeal); Independent Services Organizations Antitrust Litigation, 910 F. Supp. 1537 (D. Kan. 1995) (counterclaim for preliminary injunction against ISO granted) or seeking damages for such use. See, e.g., Data General Corp. v. Grumman Systems Support Corp., 36 F.3d 1147 (1st Cir. 1994) (jury awarded damages for copyright infringement for unlicensed use of diagnostic software). The licensors' actions are based on their claims that their software is a copyrightable, proprietary asset, and that the third party has not purchased a license for the software.

At the same time, however, a licensor's attempt to exploit its software may be subject to liability based on the antitrust laws. Antitrust claims are usually based on illegally tying or monopolization. Licensees and other third parties have often claimed that licensors "tie" the use of their software to the purchase of maintenance services from the licensor in a violation of the antitrust laws. A tying arrangement is "an agreement by a party to sell one product only on the condition that the buyer also purchase a different product, *or at least agree not to purchase that product from any other supplier.*" (Emphasis supplied.) Northern Pacific Ry. v. United States, 356 U.S. 1, 5-6 (1958).

In Data General Corp. v. Grumman System Support Corp., 36 F.3d 1147 (1st Cir. 1994), Data General sued Grumman for utilizing Data General's copyrighted diagnostic software which had been provided to Data General's customers on the specific condition that the customer not allow a third party service provider such as Grumman access. Grumman in turn counter-claimed that Data General's actions violated the antitrust laws. The First Circuit held that Data General as a copyright holder had presumptively a valid business reason for refusing to license its copyrighted software. Id. at 1187. This holding is consistent with other similar cases in this area. See, MAI Systems Corp. v. Peak Computing, Inc., 991 F.2d 511 (9th Cir. 1993), cert. denied, 510 U.S. 1033 (1994); Advanced Computer Services of Michigan v. MAI Systems Corp., 845 F. Supp. 356 (E.D. Va. 1994), but see Electronic Data Systems Corp. v. Computer Associates Int'l., Inc., 802 F. Supp. 1463 (N.D. Tex. 1992) (allegation of tying of licenses for certain software to licenses for maintenance software is a valid claim of action), see also, Service and Training, Inc. v. Data General Corp., 963 F.2d. 680 (4th Cir. 1992), (refusal of the licensor to license maintenance software, except to computer purchasers who self-maintained, held not to be an antitrust violation or a violation of copyright policy, but rather the right of a copyright owner to exercise control over its copyright). At least one court has held, however, that the mere refusal to license a patented invention or copyrighted work may give rise to liability if the holder does so with an "anticompetitive" interest. Image Technical Services, Inc. v. Eastman Kodak Co., 125 F.3d 1195 (9th Cir. 1997).

b) Copyright Misuse Issues

A copyright owner may not seek monopolies beyond those granted under the copyright statute. Broadcast Music, Inc. v. Columbia Broad. Sys., Inc., 441 U.S. 1 (1979); Lasercomb Am. Inc. v. Reynolds, 911 F.2d 970 (4th Cir 1990). Copyright misuse arises when the copyright holder seeks an exclusive right or monopoly beyond those granted by copyright law and against public policy. Lasercomb, 911 F.2d at 977. A finding of copyright misuse prevents the enforcement of the copyright or any copyright license from such misuse but does not invalidate the copyright itself. Alcatel USA, Inc. v. DGI Technologies, Inc. 166 F.3d 772 (5th Cir 1999). Thus, a licensor must be careful not to violate public policy by placing unlawful prohibitions on a licensee.

Courts have been quick to recognize the copyright misuse defense when the copyright owner uses its copyright in a manner which violates public policy. See e.g. Alcatel USA, Inc. v. DGI Technologies, Inc., 166 F.3d 772 (5th Cir 1999) (copyright license limiting use of operating software system software to the copyright owner's hardware constituted copyright misuse.); Lasercomb Am. Inc. v. Reynolds, 911 F.2d 970 (4th Cir 1990) (prohibiting licensee from developing competing software program during term of 99 year license is copyright misuse); Practice Mgmt. Info. Corp. v. Am Medical Ass'n., 121 F.3d 516, 520 (9th Cir 1997) (requiring licensee not to buy products that compete with licensed product is copyright misuse).

Moreover, a copyright licensor may not continue to collect royalties from the licensee after the copyright underlying the licensed software has expired. April Productions, Inc. v. G. Schirmer, Inc., 126 N.E.2d 283 (Ct. App. N.Y. 1955). Attempts to collect such payments after the copyright has expired may be considered copyright misuse and a violation of the antitrust laws. See, DSC Communications Corp. v. DGI Technologies, 81 F.3d 597 (5th Cir. 1996). See, also, Brulotte v. Thys Co., 379 U.S. 29, 33 (1964) (attempts to collect royalties under expired patent constituted an improper use of patent monopoly, analogous to tying purchase or use of patented article to purchase or use of unpatented one).

For a more in-depth discussion, See Davidson & Enisch, A Survey of the Law of Copyright Misuse and Fraud on the Copyright Office: Legitimate Restraints on Copyright Owners or Escape Routes for Copyright Infringers, Intellectual Property Antitrust 489 (Practising Law Institute 1996).

On October 28, 1998, Congress enacted legislation known as the "Computer Maintenance Competition Assurance Act" (17 U.S.C. §117) to partly overturn the MAI case and make it easier for ISO's to service computer hardware. Incorporated as Title III of the Digital Millennium Copyright Act, the law is directed solely to the copying of software as part of the act of servicing computer hardware. Under the law, the making of a RAM copy of a computer program by an ISO as part of servicing computer hardware will not be an act of copyright infringement. The law provides a limited immunity to copyright infringement only and does not address ISO maintaining and modifying software in and of itself. 17 U.S.C. §117.

For a general discussion of the antitrust issues in maintenance, enhancement and support services. See Soobert, Antitrust Implications of Bundling Software and Support Services, 21 U. Dayton L. Rev. 63 (1995); Hamilton, Software Tying Arrangements Under the Antitrust Laws: A More Flexible Approach, 71 Denv. U.L. Rev. 607 (1994); Johanson & Zollman, Computer Maintenance Raises Antitrust Issues, Nat'l. L. J. C40 col. 3 (May 20, 1996).

12. **Self Help (§28.A.5)**

At least one court has upheld a licensor's right to remotely deactivate a licensee's software for breach of the license's payment provisions. American Computer Trust Leasing v. Jack Farewell Implement Co., 763 F. Supp. 1473 (D. Minn. 1991), 967 F.2d 1208 (8th Cir. 1992). The Central District Court of California has held, however, that disabling devices/codes may violate the Computer Fraud and Abuse Act, 18 U.S.C. §1030. North Texas Preventative Imaging v. Eisenberg, No. CV 96-71 Att. S. (C. D. Ca. Aug. 19, 1996).

IV. ESCROW AGREEMENTS

Escrow agreements are usually entered into to protect the licensee by providing it with access to the licensed software's source code in the event of either a material breach of the license agreement by the licensor, the failure of the licensor to properly maintain the software or offer maintenance for a set period of time (at least five years), or the bankruptcy/insolvency of the licensor. Furthermore, some licensees seek to include language in the license agreement that, in the event of a dispute, the licensor must place all advance license payments in escrow until the software has been accepted or the dispute resolved. A smart licensor will ensure that in the event of bankruptcy, the software will not be automatically released to the licensee, but rather the bankruptcy must be in conjunction with a material breach of the licensor's obligations. Otherwise, it would be inequitable to cause a release when the licensor is not in material breach but for its financial trouble.

Disputes often arise as to whether the software to be "escrowed" must be placed with an independent third party, i.e., an escrow agent, or held by the licensor. The licensor is usually hesitant to place its source code in the hands of a third party where the licensor is unable to control release of the source code, while the licensee should insist on the use of an independent third party as the licensor may wrongfully refuse to release the source code to the licensee in contravention of the escrow agreement. In the event the source code is escrowed with a third party, the third party should have the right/obligation to verify that the source code escrowed is complete and optional.

Releasing the source code to the licensee, however, does not necessarily solve the licensee's problems. It may take some time for the licensee to understand the operation of the software and make the software system operational. Furthermore, placing fully- documented software in escrow does not immediately allow a licensee to support the system. In actuality, the source code is probably of little value without an employee/programmer of the licensor to support it and explain the software's operating to the licensee. Finally, there is the administrative burden on the licensee to see that the licensor has indeed placed a working copy of the source code and documentation in escrow and has also escrowed all enhancements, modifications, etc.

A smart licensee will require that the licensor escrow the software, tools, encryption keys, compilers and documentation necessary to operate the software. The licensor should update all escrowed documentation and software no less than quarterly and warrant that the software escrowed is the current version of the software presently utilized by the licensee. The licensor should also escrow

all tools needed by the licensee if it took possession of the software. In addition, the licensee should receive the right to recruit and hire the licensor's employees in the event the source code is released to the licensee. The licensee should also make sure all escrow terms allow the licensee to utilize third parties and contractors to work on the source code if the original license grant does not allow this. Finally, the licensee should require the licensor to escrow the names, phone number and addresses of the licensor's programmers so that the licensee can contact them and hire them if needed.

Use of the licensed software's source code which is released under an escrow agreement should still be subject to the terms of the license agreement and its use should be restricted solely to maintaining the licensee's copy for the licensee's internal purposes only. In addition, strict confidentiality restrictions should apply. From the licensee's perspective, the licensee should have the automatic right to receive the source code once it files a claim with the escrow agent, without having to arbitrate or invoke the escrow agreement.

In selecting and escrow agent, a licensee and licensor should look for an entity specializing in technology escrows with a technical staff to verify the deposit. The escrow agent should carry errors and omissions insurance, be ISO 9000 certified and employ significant security measures, both as to the vault and the deposit material. For a more detailed discussion of the issues involved in escrowing software, visit www.fortknoxescrow.com.

See Section IX. E for a model Escrow Agreement.

V. CONFIDENTIALITY PROVISIONS AND TRADE SECRET LAWS

A. Proprietary Information Clauses and Agreements (§12)

Proprietary information agreements, which are also known as confidentiality agreements or non-disclosure agreements, are essential when dealing with intellectual property. While trade secrets are often protected under state trade secret laws (which are usually based on the Uniform Trade Secrets Act), proprietary information agreements provide an added level of protection. While it is not required that this legal protection appear in a separate agreement from the license agreement, it is preferable that such a separate and distinct agreement exist. A separate agreement avoids any claim that the parties' confidentiality obligations do not survive the termination of the license agreement. This is especially important for the licensor.

Often, licensors and licensees have no choice but to release proprietary information to the other. Release of such information could, for instance, be incidental to instructing the licensor as to the specific requirements a product must meet or as to specific functions a product must perform. In such cases, the execution of a proprietary information agreement is imperative to protect the licensee's proprietary information.

Proprietary information agreements provide the terms and conditions under which one party's proprietary information will be provided to another party, and also limitations on the

use of such information by the receiving party. By executing a proprietary information agreement, the parties may agree upon what information will be exchanged, under what conditions the information will be returned to the disclosing party, the period for which the information will be kept confidential, and the right of the disclosing party to obtain equitable as well as monetary relief if the receiving party breaches its obligations under the agreement.

Most agreements provide for either a "strict liability" standard or "commercially reasonable" standard for the protection of confidential information, i.e. some agreements provide that the receiving party will not disclose any confidential information while others provide the receiving party will use the same standard of care to protect its own confidential information but no less than a reasonable of standard of care. The first creates a strict liability standard, creating liability on the receiving party's behalf if information is disclosed while the later requires the disclosing party to prove the receiving party did not exercise a reasonable standard of care to find it liable.

The receiving party must carefully consider accepting a strict liability standard especially if it is responsible for unauthorized disclosures made by its employees, consultant's or agents. Any such breach could create significant liability for the receiving party with little basis for a defense.

Proprietary information agreements can not actually prevent an independent contractor from disclosing an employer's proprietary information. Rather, proprietary agreements should be viewed as providing a framework for enforcing the employer's rights upon the contractor's breach. Every agreement should, therefore, include a provision for equitable relief which would allow the injured party to obtain injunctive relief without prejudicing its rights to obtain other remedies. The availability of equitable relief is very important, since it entitles an injured party to immediate relief when a breach of the proprietary information agreement occurs. This is especially important as monetary damages alone can be inadequate once proprietary information has been widely disseminated.

A proprietary information agreement should also include clauses addressing governing law, choice of forum, personal jurisdiction, arbitration, and the survival of the obligation of confidentiality beyond the termination of the agreement.

It is important to make sure that the agreement provides that all software shall be considered proprietary and confidential, regardless of whether or not it is marked as such. This is important because although most agreements require confidential and proprietary information to be marked, the media (disk or tape) containing the software will usually not be marked by the programmer who may be unfamiliar with the confidentiality agreement or the importance or marking the media.

Proprietary information agreements may be unilateral or bilateral. A unilateral agreement protects only one party's information, while a bilateral agreement would protect both party's information. (See Sections IX. G and H for model unilateral and bilateral

proprietary information agreements).

Licensees should be cognizant that a licensor may transfer trade secret material as part of the deliverable work. Occasionally, cases of trade secret infringement arise out of criminal acts such as trespass and larceny against the premises or property of another, usually a direct competitor. However, the fact that no clandestine raids on competitors' source code or design documents has occurred should not lure the licensee into believing that no trade secret misappropriation has taken place. Software engineers and programmers carry so-called "tool kits" around in their heads and in their personal files. They consider stock routines to handle common programming exercises such as input/output, disk access, data capture, and graphics generators to be the building blocks of their work. The suggestion that such software would be proprietary to the entity that paid the development costs associated with the routines if often a radical departure from what they consider fair and equitable. The fact that they may be subject to confidentiality and invention assignment agreements does not always change their point of view on this issue.

Consequently, licensees should exercise caution when retaining licensors to avoid unwittingly committing trade secret misappropriation from one of the licensor's previous customers. The licensor should be interviewed and screened to ensure that its engagements did not involve the licensee's direct competitors or products likely to tempt the contractor into taking shortcuts by copying prior work. The licensor should be cautioned against using stock routines, and the contractor's reputation within the industry should be verified. Finally, the licensee should obtain a representation and warranty from the licensor that the deliverables will not include the intellectual property of any third party and that the licensor will indemnify the licensee for all damages incurred by the licensor for the breach of any such warranty.

For a more detailed discussion, See Bowden, Drafting and Negotiating Effective Confidential Agreements, 14 Corp. Couns. Rev. 155 (1995).

B. Trade Secret Laws

(i) General

In addition to the contractual protection provided by a proprietary information agreement, most proprietary and confidential information is protected under the relevant state trade secret laws, almost all of which are derived from the Uniform Trade Secret Act. See e.g. California: Cal. Civ. Code § 3426 et. seq.; Maryland: MD Code Ann. Com. Law §11-1201 et. seq.; Pennsylvania: 18 Pa. C.S. §3930; New York, however, has not adopted the Uniform Trade Secret Act.

State trade secret laws offer broader protection than copyright laws because the trade secret laws apply to concepts and information which are both excluded from protection under federal copyright law. See 17 U.S.C. § 102(b). Information eligible for protection includes computer code, Trandes Corp. v. Guy F. Atkinson Co., 996 F.2d 655, 663 (4th Cir.), cert.

denied, 510 U.S. 965 (1993); University Computing Co. v. Lykes-Youngstown Corp., 504 F.2d 518 (5th Cir.), reh'g denied, 505 F.2d 1304 (5th Cir. 1974); Integrated Cash Management Servs., Inc. v. Digital Transactions, Inc., 732 F. Supp. 370 (S.D.N.Y. 1989), aff'd 920 F.2d 171 (2d Cir. 1990); program architecture, Trandes, 996 F.2d at 661; Computer Assocs. Int'l, Inc. v. Bryan, 784 F. Supp. 982 (E.D.N.Y. 1992); and algorithms, Vermont Microsystems, Inc. v. Autodesk, Inc., 88 F.3d 142 (2d Cir. 1996); Micro Consulting, Inc. v. Zubeldia, 813 F. Supp. 1514, 1534 (W.D. Okla. 1990), aff'd without opinion, 959 F.2d 245 (10th Cir. 1992). Mathematical algorithms are also protectable under patent law. Arrhythmia Research Technology v. Corazonix Corp., 958 F.2d 1053 (Fed. Cir.) reh'g denied, 1992 U.S. App. LEXIS 9888 (Fed. Cir. 1992); In re Iwashi, 888 F.2d. 1370 (Fed. Cir. 1989).

Courts are divided as to the application of trade secret protection for customer lists. See Morlife, Inc. v. Perry, 1997 WL 464807 (Cal. App. 1997) (file of customer business cards maintained by sales manager are trade secrets) and In re American Preferred Prescription, Inc., 186 B.R. 350 (Bankr. E. D. N. Y. 1995) (client list is trade secret). See also, DeGiorgio v. Megabyte Int'l., Inc., 468 S.E.2d 367 (Ga. 1996) (only tangible customer lists are subject to protection as a trade secret), and Ed Nowogroski Insurance v. Rucker, 944 P.2d 1093 (Wash. 1997) (memorized client list constitutes trade secret), but see Vigoro Indus. v. Cleveland Chem. of Ark., 866 F. Supp. 1150 (E. D. Ark. 1994) (customer lists alone not considered a trade secret), and WMW Machinery Company, Inc. v. Koerber A.G., 658 N. Y.S.2d 385 (App. Div. 1997) (customer lists are not trade secrets where lists are readily ascertainable from sources outside employee's business). Further, at least one court has held that the execution of a non-disclosure agreement by an employee does not in and of itself create trade secret status for the employer's customer lists. Equifax Servs., Inc. v. Examination Management Servs., Inc., 453 S. E.2d 488 (Ga. App. 1994).

A majority of courts have held that claims based on trade secret laws are not pre-empted by federal copyright law. Bishop v. Wick, 11 U.S.P.Q.2d 1360 (N. D. Ill. 1988); Brignoli v. Balch, Hardy & Scheinman, 645 F. Supp. 1201 (S.D.N.Y. 1986), but see, Computer Associates International v. Atari, 775 F. Supp. 544 (E.D.N.Y. 1991); Enhanced Computer Solutions, Inc. v. Rose, 927 F. Supp. 738 (S. D. N. Y. 1996); Benjamen Capital Investors v. Cossey, 867 P.2d 1388 (Or. Ct. App. 1994). At the same time, however, two commentators have suggested that trade secret laws may be the only method of protection for the ideas incorporated in the functionality of mass distributed commercial software. Johnston & Crogan, Trade Secret Protection for Mass Distributed Software, 11 Computer Law. 1 (Nov. 1994).

To maintain a concept's or information's status as a trade secret, the owning entity should undertake a number of actions to protect the confidential nature of the information. These actions include marking all tangible property containing such confidential information, including any disks or tapes as "Proprietary and Confidential." All employees and consultants should execute a confidentiality agreement prior to their access to confidential information, and the owning entity should limit the dissemination of the information to a need-to-know basis.

Matters of public knowledge, general knowledge of an industry or routine or small differences in procedures or methodology are not considered to be trade secrets. Anaconda Co. v. Metric Tool & Die Co., 485 F. Supp. 410, 421-22 (E.D. Pa. 1996). Furthermore, any skill or experience learned during the course of employee's employment is not considered to be a trade secret. Rigging Int'l Maintenance Co. v. Gwin, 128 Cal. App.3d 594 (1981), but see Air Products and Chemicals, Inc. v. Johnson, 442 A.2d 1114 (Pa. Super. 1982) (details of research and development, projected capital spending and marketing plans are trade secrets); Den-Tal-Ez, Inc. v. Siemens Capital Corp., 566 A.2d 1214 (Pa. Super. 1989) (detailed units costs, profit margin date and pricing methods are trade secrets.

For a general overview of trade secret issues, see Peterson, Trade Secrets in an Information Age, 32 Hous. L. Rev. 385 (1995) and Dodd, Rights in Information: Conversion and Misappropriation Causes of Action in Intellectual Property Cases, 32 Hous. L. Rev. 459 (1995).

(ii) Restatement (Third) of Unfair Competition

Section 39 of the Restatement (Third) of Unfair Competition sets forth two factors to determine whether a concept or information is a trade secret: (1) the extent to which the information can be used in the operation of a business or other enterprise, and (2) is sufficiently valuable and secret to afford an actual or potential economic advantage to others. Thus, the determination of whether a piece of information is a trade secret depends on whether it meets these requirements. The definition of "trade secret" under the Restatement is consistent with the definition of trade secret in §1(4) of the Uniform Trade Secrets Act.

(iii) Uniform Trade Secrets Act

Under the Uniform Trade Secrets Act ("UTSA"), for "information" to be found to be a "Trade Secret" it must meet a two-pronged test. First, a Trade Secret is defined broadly to include "information, including a formula, pattern, compilation, program, device, method, technique or process." Second, such information must derive actual or potential economic value from not being known and not being readily ascertainable by proper means by other persons, who can obtain economic value from its disclosure or use, and such information is subject to reasonable efforts by the owner to maintain its secrecy. UTSA §1(4); see, e.g., MD Code Ann. Com. Law §11-201(e).

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

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

Given the differences in state trade secret laws, the choice of governing law is very important. For example, South Carolina has recently enacted legislation providing that written agreements not to disclose trade secrets will be enforced without limitation on duration or geographic scope when the employee knows or has reason to know of the trade secret's existence. S.C. Code Ann. §39-8-30(d) (Law Co-op. 1997), while the Wisconsin Court of Appeals in an unpublished decision declined to enforce a non-disclosure provision in an agreement because it was unlimited as to time and overly broad. Williams v. Northern Technical Services, Inc., 568 N.W.2d 784, No. 95-2809 Wis. Ct. App. (1997).

(iv) Economic Espionage Act of 1996

The new Economic Espionage Act of 1996 makes certain misappropriations of a trade secret a federal crime and provides enhanced penalties for the theft of trade secrets. 18 USC § 1831 (1996). Under this law, anyone who seeks to steal a trade secret related to or included in a product that is produced for or placed in interstate or foreign commerce that injures the owner of that trade secret shall be subject to a fine not more than $5 million or imprisonment of not more than ten years, or both. 18 USC §1832.

The Economic Espionage Act defines trade secrets broadly as:

> all forms and types of financial, business, scientific, technical, economic, or engineering information, including patterns, plans, compilations, program devices, formulas, designs, prototypes, methods, techniques, processes, procedures, programs or codes, whether tangible or intangible, and whether or how stored, compiled or memorialized physically, electronically, graphically, photographically, or in writing if: (A) the owner thereof has taken reasonable measures to keep such information secret; and (B) the information derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable through proper means by the public.

18 U.S.C. §1839(3) (1996).

This law is also applicable to anyone who receives, buys, or possesses such information knowing that such information has been stolen or appropriated, obtained or

converted without authorization. 18 U.S.C. §1832 (a)(3). The Economic Espionage Act does not preempt or displace any other remedies, whether civil or criminal, provided by United States federal, state, commonwealth or territory law for the misappropriation of trade secrets. 18 USC §1838 (1996). Individuals who violate the act are subject to fines of $500,000 and ten years in prison, while a corporation may be fined up to $5,000,000. 18 U.S.C. §1832(a).

While the Economic Espionage Act contains criminal penalties unlike the USTA, a plaintiff under the EEA must prove guilt "beyond a reasonable doubt." Further, the due process requirements for criminal acts must be satisfied.

VI. SHRINKWRAP LICENSES

Shrinkwrap licenses derive their name from the practice of containing them on (or currently in) a shrinkwrap package which also contains the software and documentation. The license is visible through the cellophane packaging and usually provides that the purchaser is bound by the terms of the license upon opening the shrinkwrap. If the licensee does not agree with and therefore does not wish to be bound by the terms of the license, it should return the unopened package to the licensor for a full refund. There is no opportunity to negotiate the terms of the license.

Until recently, courts had been hesitant to enforce shrinkwrap licenses, based on the Uniform Commercial Code. See generally, Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir. 1991) (shrinkwrap license not enforceable under Section 2-207 of UCC as license terms mutually altered the contract between the parties); Arizona Retail Systems v. Software Link, 831 F. Supp. 759 (D. Ariz. 1993) (shrinkwrap license not binding under UCC 2-207 and 2-209). See also Vault Corporation v. Quaid Software, Ltd., 847 F.2d 255 (5th Cir 1988) (provisions of shrinkwrap license unenforceable to the extent their validity is based on Louisiana Software License Enforcement Act which is pre-empted by federal copyright law.)

In ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996), the Seventh Circuit held that "shrinkwrap licenses are enforceable unless their terms are objectionable on grounds applicable to contracts in general" (i.e. unconscionable). The court rejected the applicability of UCC §2-207 stating that a battle of the forms could not exist if only one form existed. Thus, there is a dichotomy of opinion as to the enforceability of shrinkwrap licenses. See also, Hill v. Gateway 2000, Inc., 105 F.3d 1147 (7th Cir. 1997), cert. denied, 118 S. Ct. 47 (1997) (contract terms in computer box enforceable, including arbitration clause).

Given that most shrinkwrapped software is utilized in the consumer market it is subject to the Magnuson-Moss Act. Consequently, to avoid coverage under the Magnuson-Moss Act, and the accompanying limitations, a licensor must be very careful as to the warranties it makes. See Section III.B.1(b)(ii) for a detailed discussion of the Magnuson-Moss Act.

For a more detailed discussion, see, Lemley, Intellectual Property and Shrinkwrap Licenses, 68 S. Cal. L. Rev. 1239 (1995); Moore and Hadden, On-Line Software Distribution: New Life for

"Shrinkwrap" Licenses?, 13 Computer Law. 1 (April 1996); Recent Legal Developments in Shrink Wrap License Agreements, 12 Computer L. Strategist 1 (April 1996); Miller, The Enforceability of Shrinkwraps as Bare Intellectual Property Licenses, 9 Computer Law. 15 (August 1992).

VII. THE UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT ("UCITA")

A. General

Article 2 of the UCC applies to "transactions in goods" and is the fundamental law applied in commercial transactions. UCC §2-102. At the time Article 2 was adopted in 1951, the use of software was not foreseen and certainly was not a significant part of commercial business transactions as it is today. As such, business people and lawyers have not had a uniform law to look to in commercial transactions involving software, creating uncertainty as to how business disputes involving software should be resolved.

Software is neither fish nor fowl as it is bought and sold like a good but yet it is not a tangible product. In the past, courts have looked to whether a software transaction was primarily the sale or license of software (in which case software has been found to be a good) or the provision of services such as software development (see, e.g., Micro Managers Inc. v. Gregory, 434 N.W.2d 97, 100 (Wis. Ct. App. 1988)) to determine whether the UCC Article 2 would apply to a particular transaction. If the contract is primarily for the provision of a software program, the UCC will apply. The trend has been to recognize that the UCC governs software transactions. Advent Sys. Ltd. v. Unisys Corp., 925 F.2d 670, 674-75 (3d Cir. 1991); RPX Indus., Inc. v. Lab-Con, Inc., 772 F.2d 543, 546 (9th Cir. 1985); Triangle Underwriters, Inc. v. Honeywell, Inc., 604 F.2d 737, 742-43 (2d Cir. 1979), including those transactions involving customized software. See, e.g., Advent at 674; Colonial Life Inc. Co. v. Electronic Data Systems, 817 F. Supp. 235, 239 (D.N.H. 1993). See also, Note, Computer Programs as Goods Under the UCC, 77 Mich. L. Rev. 1149 (1979).

The application of UCC Article 2 to software transactions creates significant unforeseen liability for the licensor. See Phillips, When Software Fails: Emerging Standard of Vendor Liability Under the Uniform Commercial Code, 50 Bus. Law. 151 (1994). Numerous sections of Article 2 on their face appear to be inapplicable to software, or at least fail to recognize the nature of software. For example, the perfect tender rule under Section 2-601 would require that the software tendered by the licensor be in total conformity with the contract. See generally, Cohn, Kirsh & Nimmer, License Contracts Under Article 2 of the Uniform Commercial Code: A Proposal, 19 Rutgers, Computer & Tech. L.J. 281 (1994). Yet it is uniformly acknowledged that software by its nature is imperfect. As such, while there has been a great desire for a uniform law to address software licensing and add certainty in commercial transactions, there has been a great hesitancy to apply Article 2 as is.

B. History of Attempts to Apply UCC Article 2 to Software Licensing

1. Massachusetts Model

In 1990 a committee headed by Stephen Y. Chow (Phone (617) 854-4000), in conjunction with the Business Law Section of the Massachusetts Bar Association drafted a model UCC Article 2B to serve as a discussion point for adapting the UCC to software licensing. The committee created a completely new article by modifying those sections of Article 2 which it thought were inapplicable to software while maintaining the majority of Article 2. Although this article was widely circulated, there was no attempt to adopt it under Massachusetts law or elsewhere.

2. Hub and Spoke Approach

As a result of the increasing need for a uniform law for software licensing, the National Conference of Commissioners for Uniform State Laws ("NCCUSL") began to create plans to adapt Article 2 to software. The committee discussed utilizing a hub and spoke approach to apply UCC Article 2 to software licensing.

Under a hub and spoke approach, existing UCC Article 2 would serve as a "hub" and from that hub, spokes, i.e., those portions of UCC Article 2 that needed to be amended for software licensing such as the perfect tender rule, would protrude. In August of 1995, after reviewing several drafts of a revised Article 2 utilizing the hub and spoke approach, the NCCUSL Conference Board decided not to pursue the hub and spoke approach but instead to support a totally new Article 2B to directly address software licensing. For a general discussion of the hub and spoke concept, see Nimmer, Intangibles Contracts: Thoughts of Hub, Spokes and Reinvigorating Article 2, 35 Wm. & Mary L. Rev. 1337 (1994) and Feldman, A New Draft of UCC Article 2: A High Tech Code Takes Form, 12 Computer Law. 1 (1995).

3. Article 2B

In September 1995, the NCCUSL Conference Board in conjunction with the American Law Institute ("ACI") began discussing a proposed UCC Article 2B. Article 2B was to be a completely new article drafted along the lines of the Massachusetts model. When approved in final form, the Article needed to be voted on by the full NCCUSL Conference Board and ALI and then sent to the individual states to adopt into law. After going through many revisions and being subject to much criticism from many consumer groups and the Federal Trade Commission for being too vendor-oriented, the proposed Article "died" in March 1999 when it became clear NCCUSL and ALI lacked a consensus to approve its ratification. On April 17, 1999, NCCUSL announced that there would be no proposed Article 2B of the UCC.

Previous drafts of Article 2B are available from the University of Houston Law School's World Wide Web Home Page at *http://www.lawlib.uh.edu/ucc2b* or the University of Pennsylvania's Law Library at *http://www.law.upenn.edu/library/*

ulc/ucc2.

C. **Present Status**

NCCUSL decided to move forward without ALI renaming the proposed UCC Article 2B, the "Uniform Computer Information Transactions Act" ("UCITA"). NCCUSL approved UCITA in July 1999. In the fall of 1999, a number of states including Arizona, Illinois, Indiana, Maryland and Virginia began to consider its adoption. In March 2000, Virginia enacted UCITA effective July 2001. Maryland approved UCITA in April 2000 effective October 1, 2000.

NCCUSL believes that a uniform law is needed given the considerable diverse legislative activity within the states regarding electronic commerce issues. The diversity of legislation is particularly troublesome since electronic transactions can, and frequently are, conducted across state lines. NCCUSL sees the UCITA as an intermediate step that will bring uniformity and clarity to this area of law until it can develop further. Copies of UCITA are available at **www.law.upenn.edu/library/ulc/ulc.htm#ucita**. Papers on UCITA can be found at www.nccusl.org/pressrel/UCITAQA.HTM and **UCITAnews.com.**

VIII. RECOMMENDED RESOURCE MATERIALS

A. Beutel, Contracting for Computer Systems Integration, Michie.
B. Douglas and Binder-Arain, Computer and Information Law Digest, Warren, Gorham & Lamont.
C. Feldman and Nimmer, Drafting Effective Contracts, Aspen Law & Business.
D. Gordon, Computer Software: Contracting for Development and Distribution, John Wiley and Sons.
E. Hancock, Data Processing Agreements, Business Laws, Inc.
F. Nimmer, The Law of Computer Technology, Warren, Gorham & Lamont.
G. Raysman and Brown, Computer Law, Law Journal Seminars Press.
H. Ridley, Quittmeyer, and Matuszeski, Computer Software Agreements, Warren, Gorham & Lamont.
I. Scott, Scott on Computer Law, Aspen Law & Business.
J. Software Transactions, Business Laws, Inc.

Useful newsletters include The Computer Lawyer published by Aspen Law & Business, Phone: (800) 638-8437, The Computer Law Association Bulletin, Phone: (703) 560-7747 and The Intellectual Property Law Counsellor published by Business Laws, Inc., Phone: (800) 759-0929.

IX. MODEL FORMS

A. Annotated Software License and Services Agreement
B. Software Maintenance and Services Agreement
C. Consulting Agreement
D. Assignment
E. Escrow Agreement
F. Software License, Maintenance and Subscriber Billing Services Agreement (Service Bureau License Agreement)
G. Unilateral Proprietary Information Agreement
H. Bilateral Proprietary Information Agreement

[5.26.00]

Section IX.A.

SOFTWARE LICENSE AND SERVICES AGREEMENT*

***©Copyright H. Ward Classen 1996, 1999, 2000.
All rights reserved.**

THIS SOFTWARE LICENSE AND SERVICES AGREEMENT is made this _____ day of ____, 2000 by and between _____, a _____ corporation with its principal address at _____ (hereinafter "**Licensor**") and _____, a _____ corporation (hereinafter "**Customer**"), with offices located at _____.

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

BACKGROUND

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

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

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

1. DEFINITIONS

The following words shall have the following meanings when used in this Agreement:

1.1 "Affiliate(s)" or "Affiliate Company" shall mean those companies that are initially listed on Appendix 1.1 attached hereto, which may be amended from time to time with the prior written consent of an authorized executive officer of Licensor.

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

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

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

1.3 "Custom Software" means those Deliverables which are classified in Appendix 1.4 hereto as Custom Software, as well as the documentation related thereto; an exhaustive list of Custom Software is set forth in Appendix 1.3 hereto.

1.4 "Deliverable" means the Hardware, Software and Documentation to be delivered hereunder; an exhaustive list of all Deliverables is set forth in Appendix 1.4 hereto.

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

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

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

1.7 "Functional Specifications" shall mean those specifications to which the Software shall conform as set forth Appendix 1.7.

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

1.8 "Hardware" means those Deliverables which are classified in Appendix 1.4 hereto as Hardware, as well as the documentation furnished therewith in the normal course of business; an exhaustive list of Hardware is set forth in Appendix 1.8 hereto.

1.9 "License(s)" shall mean any personal, non-exclusive, non-transferable, non-assignable license or licenses for Customer's internal use only granted by Licensor to Customer to use the Software under this Agreement.

1.10 "Object Code" shall mean the binary machine readable version of the Software.

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

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

1.13 "Software" means the aggregate of the Standard Software and the Custom Software including all physical components, that are provided by Licensor, including but not limited to, magnetic media, job aids, templates and other similar devices; an exhaustive list of all Software is set forth in Appendix 1.4.

1.14 "Software Acceptance Plan" shall mean that plan set forth in Appendix 1.14.

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

1.15 "Source Code" shall mean those statements in a computer language, which when processed by a compiler, assembler or interpreter become executable by a computer.

1.16 "Standard Software" means those Deliverables which are classified, in Appendix 1.4 hereto as Standard Software, as well as the documentation furnished therewith by Licensor or its subcontractors in the normal course of business; an exhaustive list of the Standard Software is set forth in Appendix 1.16 hereto.

- ***The "Definitions" section of any agreement is very important as this is where the Customer or Licensor may try to insert a definition which has a favorable implication later in the Agreement based upon its use. For example, many Customers try to define the "Agreement" to include the RFP. This is dangerous as the deliverables may have changed from the RFP or Licensor may never have intended to meet certain requirements of the RFP by listing such requirements in the "Exceptions" portions of Licensor's RFP response. Further, if the RFP and RFP response are incorporated in the Agreement the two documents may be inconsistent, leading to internal inconsistencies and potential problems of interpretation.***

2. SCOPE OF THIS AGREEMENT

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

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

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

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

3. SOFTWARE AND SERVICES

3.1 ***License Grant.*** Subject to the provisions of this Agreement as well as the payment of all applicable license fees for the term of such license, **Licensor grants Customer** and Customer accepts **a limited, personal, non-exclusive, non-transferable, non-assignable Object**

Code [Source Code] license to use the [Standard] Software for Customer's internal use only in the United States [on the Central Processing Units ("CPUs") listed on Appendix 3.1.]

- ***Customer - Who is the Customer?***
- ***License - Licensor "licenses" its software, Licensor does not "sell" it. "Selling" indicates a transfer of ownership meaning the Customer could potentially "resell" the Software to a third party.***
- ***Limited - Customer has only limited rights in the software.***
- ***Personal - Use of the software is "personal" to the Customer only.***
- ***Non-exclusive - Other customers may receive a license to use the same software.***
- ***Non-transferable - The Software cannot be transferred to other entities.***
- ***Non-assignable - The Software cannot be assigned to other entities.***
- ***Object code – Unless source code is being licensed, the Customer will receive object code only.***
- ***Internal use - The Software cannot be used for outsourcing, timesharing, service bureaus, etc.***
- ***United States - To avoid export issues and the potential diversion of the Software, the Customer may use the Software only in the United States.***

- ***This Section assumes that the Licensor shall own all Software including the Custom Software in contradiction of Section 6.4 and 12.1 which assume that the Customer will own the Custom Software. Section 3.1.A below provides additional language which allows the Licensor to retain ownership but grants the Customer an exclusive license to use the Custom Software.***

- ***The entire license grant is preceded by the clause "Subject to the provisions of this Agreement" which allows Licensor to terminate the license grant if the Customer breaches any other terms of the Agreement.***

- ***The scope of the license grant is directly related to pricing. For example, while Licensor may not initially grant a source code license which could potentially limit Licensor's ability to earn revenue from maintaining the software or developing enhancements, licensors will often license source code for an appropriately larger license fee.***

ADDITIONAL LANGUAGE GRANTING THE CUSTOMER AN EXCLUSIVE LICENSE IN RETURN FOR FUNDING DEVELOPMENT.

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

- ***This language provides a compromise to the Customer claiming ownership of the Custom Software. It allows the Licensor to retain ownership of the Custom Software while providing the Customer with the benefit of any competitive advantage that the Custom Software may provide. This language is too broad from the Licensor's perspective. Not only does it provide the Customer with an exclusive license but it also prohibits the Licensor from developing any functionality equivalent software. This prohibition may severely impact the Licensor's ability to sell future work. Section 8.H provides alternative language allowing the Customer to recoup its investment in funding the development of the Custom Software from royalties payments for future licenses of the Custom Software granted by the Licensor.***

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

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

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

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

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

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

3.6 *Third Party Access.* Customer shall not allow any third party to have access to the Software without Licensor's prior written consent. Further, Customer shall neither engage in nor permit any use of a Software such that a copy would be made of such Software solely by virtue of the activation of a machine containing a copy of the Software.

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

ALTERNATIVE/ADDITIONAL LANGUAGE

3.A Commitment to Research and Development. **Licensor acknowledges that research and development is an integral part of being able to continue to improve functionality and meet the increasing business needs of the [name of] industry in the future. Having acknowledged the foregoing, Licensor shall invest on a yearly basis a minimum of [XX] percent (XX%) of the gross revenues it collects from all customers using and receiving services related to the Software into research and development efforts related to the Software. In the event that Licensor fails to invest the required amount into the research and development of the Software, Customer shall: (a) have the right to migrate to the new services or system that Licensor offers to its customers, which migration shall be at no additional cost to Customer and shall include the retro-fitting of all custom programming; or (b) have the right, at any time, to terminate this Agreement and: (i) obtain all Source Code and other deposit material to all Software and/or to provide Services to Customer; and/or (ii) transition to a new software vendor, pursuant to Customer's rights under Section 5.5.3.** [Transition Rights in the event of Licensor breach.] All Services provided by Licensor during any such transition period shall be provided at no cost to Customer.

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

same time, the clause creates significant risks for the Licensor and will likely be hotly debated in most licensing negotiations.

3.B Service Level Standards.

3.B.1 General. **Licensor shall provide the Software, and any other Services, as applicable, according to the performance criteria and at the service level standards ("*Service Level Standards*") set forth in Appendix 3.B.1.** Licensor and Customer shall meet on a semi-annual basis to discuss whether changes to the Service Level Standards are necessary due to any changes business needs of Customer. Any changes to the Service Level Standards agreed upon in writing by both parties shall replace the then existing Appendix 3.B.1.

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

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

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

3.C Liquidated Damages

3.C.1 Liquidated Damages Payable By Licensor.

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

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

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

3.C.2 Liquidated Damages Payable by Customer

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

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

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

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

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

- ***Liquidated damages are a pre-determined estimate of damages the Customer will incur by Licensor's breach which eliminates the requirements that the Customer prove its damages. Once the Customer demonstrates that the Licensor breached its obligations it is entitled to collect the preagreed damages. If there are concerns about the ability to collect payment, the Customer can require the Licensor to establish an irrevocable bond.***

- ***Any provision for liquidated damages should be mutual as the Licensor may also suffer damages, for example if the Customer's performance is delayed.***

4. TERM OF AGREEMENT AND LICENSE

4.1 *Term of Payment.* The term of this Agreement shall commence upon the execution of this Agreement, and shall continue for ____ years unless terminated upon the breach of this Agreement by either party.

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

ADDITIONAL LANGUAGE ALLOWING CUSTOMER TO TERMINATE FOR CONVENIENCE

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

- ***This clause usually benefits the Customer as it allows the Customer the terminate the agreement at the Customer's convenience and depending on the wording it may not allow the Licensor to collect its termination costs, investment etc. The Licensor should make sure that if the Licensor accepts such a clause that the negotiated termination fee allows the Licensor to recover its investment and the cost of money. The language set forth above does not favor the Licensor as the termination fee is not specifically stated and is tied to revenues. This creates the risk of an unanticipated event which reduces revenues and in turn lowers the termination fee.***

- ***This clause must be carefully worded to clearly state how any termination fee will be determined. Usually the Customer must pay for work completed, Licensor's termination costs and Licensor's lost profit. The Licensor business person must determine whether the Customer should compensate Licensor based on Licensor's costs (a cost plus model) or on a percent complete (of the project) basis. In either case, the agreement should provide that Licensor is entitled to recover Licensor's lost profit or at least a pro rata portion of its lost profits.***

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

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

5. EVENTS OF DEFAULT AND REMEDIES

5.1. Events of Default. Licensor and Customer acknowledge and agree that the following shall constitute events of default ("***Events of Default***") and that the occurrence of one (1) or more of such Events of Default shall constitute a material breach of this Agreement which shall allow a party, as applicable, to seek the rights and remedies set forth in this Section:

(a) Licensor's failure to deposit the Deposit material as required by the Source Code Escrow Agreement within the time frames specified therein;

(b) Licensor's breach of the Regulatory Requirements warranty set forth in Section 18.C, and in no event shall such failure be subject to a cure period;

(c) Except for breaches that constitute a Section 5.1.(d) Event of Default, Licensor's material breach of any license obligation as provided in Section 3 provided that such breach is not cured within thirty (30) calendar days following written notice of such breach;

(d) Licensor's failure to materially conform to the Service Level Standards set forth in Appendix 3.B **OR** The occurrence of Service Level Credits for any three months during a twelve (12) month period in the amount of _____ ($) or more per month; provided that Customer shall have provided Licensor with written notice of Licensor's non-compliance after the second month of non-compliance with such written notice being provided to Licensor within thirty (30) calendar days of the second month of Licensor's non-compliance of Service Level Standards;

(e) Licensor's continuous failure to timely provide to Customer monthly performance reports regarding Licensor's performance in relation to the Service Level Standards as set forth in Section 9.6.4.;

(f) Licensor's failure to maintain insurance coverage as specified in Section 36, provided that such failure is not cured within thirty (30) calendar days following receipt of written notice of such failure;

(g) Customer's failure to timely pay any undisputed amount owed to Licensor, provided that such failure is not cured within thirty (30) calendar days following receipt of written notice of such failure;

(h) Customer's breach of Sections 3, 12 or 13 or if Customer otherwise misuses the Software in contravention of this Agreement;

(i) Either party's material breach of any representation or warranty set forth in this Agreement, provided that such breach, if curable, is not cured within the time frames specified in Section 18, if applicable, or if such Section 18 does not apply to the breach, then within thirty (30) calendar days following receipt of written notice of such breach;

(j) Failure of a party to perform any other material obligation under this Agreement, provided that such failure is not cured within thirty (30) calendar days following receipt of written notice of such failure;

(k) The institution of bankruptcy, receivership, insolvency, reorganization or other similar proceedings by or against either party under any section or chapter of the United States Bankruptcy Code, as amended, or under any similar laws or statutes of the United States or any state thereof, if such proceedings have not been dismissed or discharged within thirty (30) calendar days after they are instituted; or the insolvency or making of an assignment for the benefit of creditors or the admittance by either party of any involuntary debts as they mature or the institution of any reorganization arrangement or other readjustment of debt plan of either party not involving the United States Bankruptcy Code; or any corporate action taken by the Board of Directors of either party in furtherance of any of the above actions.

(l) Appointment of a receiver for all or substantially all of either party's assets or any corporate action taken by the Board of Directors of either party in furtherance of the above action; and

- ***A Customer should carefully consider what actions or inactions on the Licensor's behalf should constitute a material breach. Some issues such as (e) and (f) are not as important as the failure to deliver a working product. At the same time, the Licensor should seek to limit the number of events of default to limit its risk.***

- ***Licensor must have the immediate right to terminate the Agreement without granting a cure period if the Customer breaches the Agreement by misusing the Software. This position is justifiable because a cure period cannot "absolve" the breach.***

- ***Licensor must have a time period in which to "cure" any defaults. The time period must be long enough to allow Licensor to be able to do so. Given the nature of software, this period can be no less than 30 days.***

5.2 Rights and Remedies of Licensor Upon Default of Customer. Upon the occurrence of an Event of Default by or with respect to Customer, subject to Customer's rights set forth in **Section 5.3.3**, Licensor shall be entitled to any of the following remedies:

(a) terminate, in whole or in part, this Agreement; and/or

(b) subject to the terms of **Section 16**, seek to recover damages from Customer; and/or

(c) if applicable, seek to obtain the additional rights and remedies set forth in **Section 28.A.5 [Equitable Relief]**.

Notwithstanding anything contained herein to the contrary, Licensor expressly waives and disclaims any right or remedy it may have to discontinue the performance of the Services or any portion thereof or terminate the License without due process of law.

- ***This clause seeks to prevent the Licensor from exercising any form of "self help" such as stopping the delivery services or disabling its software without following the dispute resolution procedure set forth in Section 28. Note that Section 5.3.2***

specifically allows the Customer to exercise a form of self help. This limitation conflicts ideologically with Customer's right of setoff in Section 5.3.2. and 3.B.2. Consequently, the Licensor should insist on parity for self help.

5.3 Rights and Remedies of Customer Upon Default of Licensor.

5.3.1 General. Upon the occurrence of an Event of Default by or with respect to Licensor, Customer shall be entitled to any of the following remedies:

(a) terminate, in whole or in part, this Agreement; and/or

(b) subject to the terms of **Section 16**, seek to recover damages from Licensor; and/or

(c) if applicable, obtain the additional remedies described in **Sections 5.3.2-5.3.7**; and/or

(d) if applicable, seek to obtain the additional rights and remedies set forth in **Section 28.A.5 [Equitable Relief]**.

5.3.2 Right to Set Off. Customer shall have the right to set off any **undisputed** amounts owed to Licensor against any damages or charges including, without limitation, Service Level Credits, assessed by Customer against Licensor.

- ***Note that this section allows the Customer to set off only undisputed amounts owed to Licensor.***
- ***The parties should specifically state and agree as to whether they have the right of set off against the other. The common law of many states allows the right of set off even if it is not set forth in the contract. The Licensor is more likely to be concerned as the Customer will want to offset any payments due the Licensor in the event of the Licensor's breach.***

5.3.3 Transition Rights.

(a) Termination by Customer. In the event Customer terminates this Agreement pursuant to the terms of this Agreement in whole or in part, Customer shall provide to Licensor a written notice of transition ("***Transition Notice***"), setting forth the target date on which Customer plans to cut-over from Licensor's system to a new system or otherwise not require the future services of Licensor (the "***Target Cut-Over Date***"). At least thirty (30) days prior to the actual cut-over date ("***Actual Cut-Over Date***"), Customer shall provide Licensor with written notice of the Actual Cut-Over Date. Licensor shall continue to provide to Customer all Services required by Customer ("***Transition Period***"). Services provided by Licensor during the Transition Period shall include all conversion and other Services necessary for an orderly transition to another system. Customer shall place the Services Fees that accrue from and after the date of Transition Notice to the Actual Cut-Over Date into a Customer reserve account, and such reserved funds shall be disbursed as follows: (i) fifty percent (50%) of the reserve funds shall be distributed to Licensor on a pro-rata monthly basis over the first twelve (12) months after the Actual Cut-Over Date; and (ii) the remaining fifty percent (50%) of the reserve funds shall be paid to Licensor in

one lump sum upon the completion of all Outsourcing Services obligations under this Agreement relating to the Prior Claims.

(b) Termination by Licensor. In the event Licensor terminates this Agreement pursuant to the terms of this Agreement, and provided Customer pays all undisputed amounts owed to Licensor, Licensor shall provide to Customer a minimum of twelve (12) months of all Services. Services provided by Licensor during this period shall include all conversion and other Services necessary (at Licensor's Service Rates) for an orderly transition to another system.

- ***In both 5.3.3(a) and (b), the parties should carefully negotiate the payment terms. In the event of 5.3.3(b), the Licensor may want to require the Customer to make payment in advance. At the same time, the Licensor may want to soften the payment terms in Section 5.3.3(a).***

5.3.4 *Specific Performance.* Licensor acknowledges that, in the event it breaches (or attempts or threatens to breach) its obligation to provide termination/expiration assistance as provided in Section 6.6.3, Customer will be irreparably harmed. In such a circumstance, Customer may proceed directly to court. If a court of competent jurisdiction should find that Licensor has breached (or attempted or threatened to breach) any such obligations, Licensor agrees that without any additional findings of irreparable injury or other conditions to injunctive relief, it shall not oppose the entry of an appropriate order compelling performance by Licensor and restraining it from any further breaches (or attempted or threatened breaches).

- ***A Licensor should carefully consider the risks before including any language that allows the Customer to invoke the remedy of specific performance. Specific performance may have a significant impact on the Licensor's profitability and may serve to circumvent the limits of liability set forth in the agreement.***

5.3.5 Cover. In the event that this Agreement is terminated in whole or part for Licensor's breach, Customer shall have the right, at Licensor's expense, to engage third parties to correct Licensor's breach and to deliver any software or services that Licensor failed to deliver. Licensor shall continue performance of this Agreement to the extent not terminated.

- ***The Licensor should limit the cost to the overall limit of liability of the contract and seek to prevent the Licensee from retaining the Licensor's competitors to complete the work.***

5.3.6. Access to Source Code. In the event that this Agreement is terminated for Licensor's breach, Customer shall have the right obtain, and Licensor shall have the obligation to grant to Customer, **[upon payment to Licensor by Customer of a fee of _____ US Dollars (US$ _____),]** such non-exclusive, **[royalty-free]**, non-transferable, personal, Source Code license for the Software as may be necessary in order to permit Customer to complete the development, installation, deployment, operation and maintenance of the **Software** system as contemplated hereby. Set forth in Paragraph X of Appendix Y are the terms and conditions of the Source Code license contemplated by this Section **5.3.6.**

OR

In the event that this Agreement is terminated for Licensor's breach, all rights, title and interest and all copyrights and other intellectual property rights including the right to use, reproduce, adapt, enhance and commercialize the same, in and to the Custom Software or any part thereof, therefore developed pursuant hereto, shall immediately vest in Customer upon the effective date of termination agreed between the parties.

OR

Customer shall have the right to obtain, and Licensor shall have the obligation to grant to Customer, such non-exclusive, world-wide, permanent licenses as may be necessary or appropriate in order to permit Customer, or a third party engaged by Customer for such purpose, to complete the development, installation, deployment, operation and maintenance of the **Software system** as contemplated hereby. The licenses so granted shall (a) be to all such Standard Software and other software, tools and materials, in object and/or source form, as may be necessary and appropriate as aforesaid and (b) be limited to the exclusive purposes of the completion of the obligations assumed by Licensor hereunder. The royalties payable by Customer with respect to the licenses so granted shall be equal to fifty percent (50%) of the royalties charged by Licensor in the normal course of business. At Customer's request, Licensor shall: (A) obtain any required consents from third parties and thereafter assign to Customer or its designee leases for some or all of the Equipment that was used primarily in providing the Services as of the date of termination/expiration of this Agreement, and Customer shall assume all obligations under such leases that relate to periods after such date; and (B) sell to Customer or its designee, at the lower of Licensor's then current book value, unrecovered capital payments or fair market value, some or all of the Equipment owned by Licensor that was used primarily in providing the Services as of such date. Licensor shall also provide all user and other documentation relevant to such Equipment which is in Licensor's possession. Customer will assume responsibility under any maintenance agreements for such Equipment to the extent such responsibilities relate to periods after the date of termination/expiration of this Agreement. Licensor shall obtain any necessary rights and thereafter make available to Customer or its designee, pursuant to reasonable terms and conditions, any third party services then being utilized by Licensor in the performance of the Services including services being provided through third party service or maintenance contracts on Equipment and Software. Licensor will be entitled to retain the right to utilize any such third party services in connection with the performance of services for any other Licensor Customer.

*5.3.7. **Licensor Employees and Contractors.*** In the event that this Agreement is terminated for Licensor's breach, Customer or Customer's designee shall be permitted to undertake, without interference from Licensor, to hire any Licensor employees primarily performing the Services as of the date Licensor receives notice of termination, or, in the case of expiration, within the six (6) month period (or longer period requested by Customer) prior to expiration. Licensor shall waive, and shall cause its subcontractors to waive, their rights, if any, under contracts with such personnel restricting the ability of such personnel to be recruited or hired by Customer. Customer or its designee shall have reasonable access to such personnel for interviews and recruitment. If Customer is entitled pursuant to this Agreement to a sublicense or other right to use any Software owned or licensed by Licensor and utilized in performing the Services, Licensor shall provide such sublicense or other right.

- ***In the event of the Licensor's breach, it is important that the Customer have access to the Licensor's employees and contractors. Access to the source code alone will usually not permit the Customer to maintain, support or modify the software. The Customer's ability to do so will be significantly greater if it is allowed to hire the Licensor's employees and contractors. Thus, any prohibition on their solicitation should be waived in the event of the Licensor's breach.***

5.4 Attorneys' Fees. In the event of an alleged breach of this Agreement, the prevailing party shall be entitled to reimbursement of all of its costs and expenses, including reasonable attorneys' fees, incurred in connection with such dispute, claim or litigation, including any appeal therefrom. For purposes of this Section, the determination of which party is to be considered the prevailing party shall be decided by the court of competent jurisdiction or independent party (*i.e.*, mediator or arbitrator) that resolves such dispute, claim or litigation.

6. DELIVERY OF DELIVERABLES - RISK OF LOSS - TITLE

6.1 ***Delivery By Licensor of Deliverables.*** Licensor shall deliver the Deliverables to Customer at _____ ("Delivery Place") on the Delivery Dates.

6.2 ***Risk of Loss of Deliverables.*** The risk of loss appurtenant to all Deliverables shall be transferred to Customer upon the issuance of an Acknowledgment of Receipt with respect thereto at the Delivery Place.

6.3 ***Title to Standard Software.*** It is hereby acknowledged and agreed that Customer shall not obtain title to any Standard Software. In lieu thereof, Customer shall obtain the license rights relating thereto stipulated in Section 3 hereof.

- ***Generally the Customer does not have a legitimate basis for claiming ownership of the Licensor's core software which the Licensor owned prior to entering into the license agreement. It is common, however, to negotiate ownership of any custom developed software as discussed in Section 6.4 below.***

6.4 ***Title to Custom Software.*** Without prejudice to the provisions of Section 3 hereof, Customer shall obtain good and clear title in and to the Custom Software upon the due payment by Customer of the sums relating thereto. Licensor hereby agrees to provide to Customer, upon its written request, with such title certificates, acknowledgments and other documents as may be necessary or appropriate to establish Customer's good and clear title in and to the Custom Software.

- ***Section 6.4 and Section 12.1 assume that the parties have agreed that the Customer will own any Custom Software. See Sections 3.1 and 3.1.A which assume the Licensor will retain sole ownership of all software.***

- ***Ownership of any Custom Software is often one of the most negotiated sections in a software license. The Licensor usually insists on retaining ownership to ensure the sanctity of its product while the Customer usually believes that because it has paid for the development, it should own the resulting product. A compromise can usually***

be reached based upon the needs of each party. For example, if the Licensor wants to retain ownership to ensure it owns its products, the Customer may be willing to accept royalty payments for future licenses granted by the Licensor as a tradeoff to ownership. If, however, the Customer wants to own the Custom Software to ensure its competitors do not receive a license to the software, the Customer may be willing to accept an exclusive license to the Custom Software and allow the Licensor to retain ownership. This exclusive license may or may not be limited to a set time period. See Section 3.1.A for an example of an exclusive license.

6.5 ***Title to Hardware.*** Customer shall obtain good and clear title in and to the Hardware upon the payment in full by Customer of the sums relating thereto. Licensor hereby agrees to provide to Customer, upon its written request, with such title certificates, acknowledgments and other documents as may be necessary or appropriate to establish Customer's good and clear title in and to the Hardware.

6.6 ***Title to Documentation, Contractual Documents and Deliverables Other than Those Prescribed by Sections 6.1 - 6.5 Hereof.*** It is hereby acknowledged and agreed that Customer is, and shall remain, the owner of (a) all Documentation other than **[list exceptions]** (b) the Functional Specifications hereto and (c) any and all information contained therein. Licensor shall obtain the license rights relating thereto stipulated in Section 12.1 hereof.

- ***This section assumes that the Customer will own the intellectual property rights developed by Licensor.***

7. OBLIGATIONS THAT SURVIVE TERMINATION

The parties recognize and agree that their obligations under Sections 8, 12, 14, 15, 16 and 28 of this Agreement survive the cancellation, termination or expiration of this Agreement or the License granted under Section 3.1.

- ***The obligations of the parties that will survive termination of the Agreement, i.e., payment to Licensor, confidentiality, limitation of liability, governing law etc. should be specifically listed because these obligations would otherwise "terminate" with the Agreement. As a result, Licensor may be unable to get paid or protect its proprietary information since the Agreement is no longer in existence and thus the Customer is no longer bound by the terms of the Agreement. Avoid use of imprecise language such as "Any terms of this Agreement that would, by their nature, survive the expiration or termination of this Agreement shall so survive." to avoid disputes over the intent or meaning of this or similar language.***

8. PRICE AND PAYMENTS

8.1 ***Price.*** Without prejudice to the other provisions of this Section 8, in consideration of the development and delivery by Licensor of the Deliverables and the provision of the Support Services pursuant to Section 11 hereof, Licensor shall invoice Customer and Customer shall pay Licensor, pursuant to the terms and conditions of this Section 8, the following aggregate sums:

US Dollars

For Hardware:
For Standard Software:
For Custom Software:
Grand Total:

The aforesaid aggregate sums shall be paid in _____ (___) installments, ____ (___) of which are to be made pursuant to Section 8.2 hereof and _____ (___) of which are to be made pursuant to Section 8.3 hereof.

8.2 ***Cash Advances.*** The Parties have agreed that Customer is to make the following cash advances in order to provide Licensor with some of the working capital necessary to perform hereunder:

Cash Advance Number	Event Giving Rise to the Cash Advance	Amount of the Cash Advance
1	Letter of Intent	
2	Contract Signature	
3	Milestone 1	
4	Milestone 2	
5	Delivery	
TOTAL		

All cash advances so paid by Customer shall not, when paid, be deemed to have been earned by Licensor, either for accounting purposes or for purposes of this Agreement. Consequently, each cash advance shall be deemed to constitute an advance payment for the Deliverables to be delivered by Licensor subsequent thereto and shall be deemed to be "earned", in part or in full, if and when the payment against which it is taken as a credit is made pursuant to said Section 8.3 hereof. In the event that this Agreement is terminated, by Licensor, Customer or operation of law, Licensor shall forthwith place in escrow, pursuant to the terms and conditions of the Escrow Agreement attached hereto and made a part hereof as Appendix 8.2, that portion of the cash advances theretofore paid which have not then been earned.

- ***Section 8.2 characterizes progress payments or milestone payments as "advances". By characterizing these payments as an "advance", the Customer seeks to undercut any claim by the Licensor that the Licensor is entitled to retain any monies in the event Licensor breaches the contract. The advances are matched against the payment schedule set forth in Section 8.3.***

- ***Section 8.2 provides a mechanism for the Customer to advance money to the Licensor for cash advances to help the Licensor eliminate cash flow problems.***

8.3 ***Payments To Be Made With Respect to Deliverables.*** Licensor shall issue invoices for the amounts set forth in the following table upon the occurrence of the following

events, at which time the payments corresponding to such events shall be deemed "earned"; Customer shall remit the net payment stipulated in said table pursuant to the provisions of Sections 8.1 and 8.2 hereof:

Payment Number	Event Giving Rise to Payment	Amount of Payment	Credit From Cash Advance Earned	Net Payment
1	Deliverable A	X	Cash Advance A and B	X – (A+B)
2	Deliverable B	Y	Cash Advance C	Y – C
3	Final Acceptance Certificate	Z	N/A	Z
Totals				

* The amounts in the foregoing table which are marked with an asterisk (*) are subject to adjustment pursuant to the provisions of Section 8.4 hereof.

- ***Section 8.3 corresponds with Section 8.2. Section 8.3 provides the mechanism to vest payment in the Licensor after Licensor's successful performance.***

8.4 ***Adjustment of Prices.*** The amounts expressed in XXX XXX in the table set forth in Section 8.3 hereof which are marked with an asterisk (*) shall be subject to adjustment pursuant to the following formula:

$$P = P_0 (0.15 + 0.7 * S_1/S_0 + 0.15 * Psdc_1/Psdc_0)$$

P	Amount of Net Payment after adjustment
P_0	Amount of the Net Payment prescribed in the table set forth in Section 8.3 hereof prior to adjustment
S_1	Syntec salary index value for the month of invoicing
$Psdc_1$	Syntec products and services index value for the month of invoicing
S_0	Syntec salary index value for _____ 2000
$Psdc_0$	Syntec products and services index value for ___ 2000

Notwithstanding the foregoing, in the event that Licensor is obligated to pay liquidated damages with respect to the late issuance of the Acceptance Certificates or the Provisional Acceptance Certificates, the payment to be made upon the issuance of one of the aforesaid Acceptance Certificates shall not be adjusted pursuant to this Section 8.4 with respect to the period extending from the Delivery Date for the issuance of the Acceptance Certificate in question up to and including the date on which the invoice for the said payment is issued.

ALTERNATIVE LANGUAGE TO SECTION 8.4

8.4.A The fees charged by Licensor for the Services may be increased by Licensor once annually commencing on the date one (1) year from the Effective Date; provided, however, that such annual increases shall not exceed the percentage increase in the ECI for the applicable

Service period. In no event shall such increases exceed the following percentages over the previous year rates nor shall such increases be cumulative from year to year:

Date	Maximum Percentage Increase
September 1, 2000 to August 31, 2001	*X%*
September 1, 2001 to August 31, 2002	*X%*
September 1, 2002 to August 31, 2003	*X%*
September 1, 2003 to August 31, 2004	*X%*

On or after September 1, 2002, Licensor shall have the right to request a meeting between the parties to propose a fee adjustment. If the parties cannot agree upon a fee adjustment within ten (10) business days of the request, Customer shall have the right to: (c) terminate this Agreement and Customer shall have no termination fee obligations; or (d) continue this Agreement by paying Licensor adjusted Service fees based on the actual ECI increase for the fiscal years commencing September 1, 2002 and September 1, 2003, respectively and as applicable. Any invoice relating to fees for any Services shall detail: (e) the Services performed (e.g., each activity, task and/or milestone); (f) the identity of the Licensor personnel performing the Services; and (g) the number of hours and corresponding fees attributable to each such person's performance of the Services.

Insert this definition in the "Definitions" Section of your agreement: "'ECI' shall mean the official Employment Cost Index, Civilian Workers, Not Seasonally Adjusted, Compensation Costs, published by the Bureau of Labor Statistics United States Department of Labor."

8.5 *Interest.* Licensor may charge Customer a one and one-half percent (11/2%) monthly finance charge to be calculated monthly with respect to all outstanding amounts not paid within thirty (30) days following the date of Licensor's invoice(s), but in no event shall any finance charge exceed the maximum allowed by law.

- ***Licensor must have the right to charge interest on unpaid balances, otherwise the Customer may not have a motivation to pay its bills on time. If a dispute occurs, Licensor may be unable to charge the Customer interest while the dispute is being resolved or afterwards if Licensor is successful in its claim. The interest rate should be high enough so that the Customer does not view the Licensor as a bank. At the same time, the Customer should include a license provision allowing the Customer to charge interest on any unpaid amounts the Licensor owes the Customer.***

8.6 *Taxes.* There shall be added to the charges provided for in this Agreement amounts equal to any taxes, whether federal, state, or local, however designated, that may be validly levied or based upon this Agreement or upon the Software, Hardware and Services furnished hereunder, excluding, however, taxes based on or measured by Licensor's net income, and any taxes or amounts in lieu thereof paid or payable by Licensor in respect of the foregoing. Taxes payable by Customer shall be billed as separate items on Licensor's invoices and shall not be included in Licensor's prices. Customer shall have the right to have Licensor contest with the

imposing jurisdiction, at Customer's expense, any such taxes that Customer deems are improperly levied.

- ***The Customer as the purchaser should pay all taxes except taxes on Licensor's income. If the Customer claims a tax exemption it must produce the appropriate documentation to prove its exemption.***

8.7 ***Disputed Amounts.*** If an invoiced amount is disputed in good faith by Customer then, until resolution of the dispute occurs pursuant to Article 28, Customer may suspend disputed payments and toll the running of time for default by: (a) paying the undisputed amount, if any; and (b) sending a written statement of exceptions to Licensor. All of Licensor's obligations shall continue unabated during the duration of the dispute resolution. In the event that, as a result of the dispute resolution process, Customer is found to have inappropriately withheld payment two (2) times in any twelve (12) month period, Customer shall pay interest to Licensor on the second withheld payment and any subsequent withheld payments at a rate equal to the then-applicable Prime Rate plus ____ percent as published in the *Wall Street Journal*.

- ***To protect against the Customer wrongfully withholding payment from the Licensor, the Licensor should include language allowing the Licensor to charge interest for any amounts wrongfully withheld. See also Section 8.5 providing for interest on undisputed amounts.***

ADDITIONAL LANGUAGE FAVORING CUSTOMER

8.A Most Favored Customer. **Licensor represents and warrants to Customer that all of the pricing terms set forth in this Agreement are comparable to or better than the equivalent pricing terms being offered by Licensor to any present customer of Licensor of the same or lesser [insert limiting factors] as customer licensing similar Software and Services. If, during the term of this Agreement, Licensor enters into arrangements with any other customer of the same or lesser [insert limiting factors] as Customer to receive similar Software and Services and provides such customer more favorable pricing terms than those set forth herein, Licensor shall immediately provide Customer with a detailed written notice of such terms (without disclosing Licensor's customer) and, upon such notice, this Agreement shall be deemed amended to provide the same pricing terms to Customer.**

- ***Customers usually desire "Most Favored Customer" wording to ensure they receive the best price offered by the Licensor. The Licensor, however, should avoid the insertion of this language to avoid having its prices*** **ratcheted** ***down to the lowest common denominator. Licensors often try to dilute the effect of such language by inserting qualifying language (i.e., "if Customer purchases like quantities, under similar terms and conditions") that makes it difficult for the Customer to ever claim the benefit of its perceived bargain. The language set forth above is self initiating and benefits the Customer as it requires the Licensor to take the affirmative step of notifying the Customer that the Customer is entitled to a lower price rather than having the Customer have to claim the benefit from the Licensor.***

8.B The machine class of each Software License, where applicable, shall be determined at the time of execution of this Agreement, **in accordance with Licensor's then current price list as may be amended from time to time [and initially set forth in Appendix 8.B]**. Unless Customer moves the Software to a higher class Central Processing Unit ("CPU"), said machine class shall not change for any existing License and Licensor shall not restructure machine classes or License fees in any way that will cause an increase in any License fees for Licenses already acquired by Customer, other than in accordance with this Section.

- ***Pricing should be determined by the type of license granted.***
- ***Depending on the type of pricing utilized by Licensor paragraphs 8.B, 8.C or 8.D may not be applicable.***
- ***Licensor must have the ability to amend its pricing, otherwise the Customer may claim the price is fixed for the duration of the license or the Agreement.***

8.C If Customer moves the Software to a higher machine class CPU, Customer shall notify Licensor in writing thirty (30) days prior to the move and shall incur and pay an upgrade charge that will be the difference between the License fee charged for functionally identical Software placed on the higher class CPU, after any associated discounts are applied, and the License fee paid by Customer for the Software being moved.

8.D If Customer desires, subject to obtaining Licensor's prior written consent, to operate the Software subsequent to a change in control of Customer, other than with the designated CPU's or other than at Customer's site identified in this Agreement, Customer will be required to pay Licensor a transfer fee according to Licensor's then-existing fee structure.

- ***Section 8.D allows Licensor to charge the Customer a transfer fee for a change of control. See Section 22.B for alternative language for the Customer's rights upon a change of control.***

8.E **Service Fees**

8.E.1 Fixed Fee Services. All Services identified in a purchase order or statement of work as Services to be paid at a fixed rate shall be invoiced according to the following:

% of Services Fee	Event
25%	Execution of the Purchase Order/ Statement of Work
50%	Spread equally among no less than two (2) Critical Path Milestones
25%	Project Acceptance

8.E.2 Time-and-Materials Services. All Services identified in a purchase order or statement of work as Services to be paid on a time-and-materials basis shall be invoiced in accordance with the terms set forth in this Section. Licensor shall invoice Customer for an amount equal to eighty-five percent (85%) of the fees for all Services rendered by Licensor as

such Services are rendered. The remaining fifteen percent (15%) of such fees shall be invoiced by Licensor upon Acceptance.

8.F . ***Customer Credit Risk.*** If in Licensor's reasonable judgment, Customer's financial condition does not justify the terms of payment specified above, unless Customer immediately pays for all Software, Software Products and Services which have been delivered, and pays in advance for the balance of Software, Software Products and Services remaining to be delivered during the term of this Agreement, Licensor may terminate this Agreement without further liability to Customer.

8.G ***Parent Company Guarantee.*** Licensor/Customer shall within twenty-one (21) days from the date hereof provide a guarantee from its parent company**[List if Possible]** and in the form of Appendix 8G. The cost of obtaining the guarantee shall be at the sole expense of Licensor/Customer. The parent company guarantee shall be valid from the date of this Agreement until **[final payment][thirty (30) days after the expiry of the warranty period of the software].**

8.H ***Customer Royalty.*** In consideration of Customer partially funding the development of the Custom Software, Licensor shall pay Customer a royalty on the future licensing of the Software as set forth in this Section 8.H. Licensor shall pay to Customer a royalty based on the "Gross License Fee" ("Fee") of the Custom Software for all third party licenses of Custom Software by Licensor made within _____ ( ) months from the earlier of **[Acceptance]** or the Licensor licensing such module to any third party.

8.H.1. ***Fee.*** Subject to the limitations of Section 8.H above, Customer shall receive five percent (5%) of the Fee received by Licensor for all licenses of the Custom Software licensed by the Licensor.

- ***Both parties should carefully review any language describing the Customer's right to receive a royalty. For example, the Licensor would want to revise the above language to limit the Customer's right to receive a royalty to those funds actually received by the Licensor. The above language places the risk of a bad debt on the Licensor, as the Licensor may be obligated to pay the Customer a royalty on license fees the Licensor did not receive.***

8.H.2. ***Fee Cap.*** Notwithstanding anything contained in this Section 8.H, Customer shall not be entitled to receive royalties once it has received an aggregated _____ ($ _____) in royalties from Licensor's licensing of the Custom Software.

- ***The Licensor should seek to place an absolute cap on the royalties payable to the Customer. The Customer should be happy with recovering an amount equal to the fees it paid the Licensor. An alternative it to cap the Customer's recovery at a multiple of the fees paid by Customer to the Licensor for the module's development. In no event should the Licensor allow the royalty payments to be unlimited in either amount or the period of time in which the Customer is entitled to receive them.***

8.H.3. Payment. On or before the last business day of the first month following the end of each calendar quarter, Licensor shall generate a report which shall document the number of licenses of the Custom Software granted by the Licensor in the previous calendar quarter and all license fees received by the Licensor from the licensing of the Custom Software in the previous calendar quarter. Licensor shall calculate the fees, if any, that are due to Customer under the terms of this Section 8.H. and within thirty (30) days of such date, Licensor shall pay to Customer all such monies due Customer.

8.H.4. Audit. Licensor keep all usual and proper books and records pertaining to the licensing and use of the Custom Software. During the Term of this Agreement and for three years thereafter, Customer and/or its designated representatives, shall have the right to audit (including by inspecting and copying any such books and records) Licensor, in order to verify its compliance with the terms of this Agreement. Customer shall conduct such audits during the Licensor's normal business hours and in such a manner as not interfere unreasonably with Licensor's normal business operations. Customer may conduct such audits from time to time, as Customer deems necessary, but shall use any information obtained or observed during the course of the audit solely for the purposes of determining (i) whether the Licensor is making the proper royalties in compliance with the terms of this Agreement, and is otherwise in compliance with this Agreement and any applicable laws; and (ii) of enforcing its rights under this Agreement and any applicable laws. Except to the extent necessary to enforce its rights, Customer and its representatives will hold all such information in confidence.

- ***The Customer should always provide for the right to audit the Licensor even if the Customer never plans to invoke it.***

9. PERSONNEL, MANAGEMENT, NEW PROJECTS AND TESTING

- ***The Sections set forth below generally favor the Customer in that the Licensor is contractually obligated to commit certain individuals to the project. By doing so, the Licensor potentially limits its ability to operate and manage its overall business. Consequently, the Licensor may want to delete some of the provisions set forth below.***

9.1 Cooperation with Customer. Licensor shall cooperate fully with Customer as necessary to provide the Services, and shall disclose such information to Customer relating to Licensor, the ABC System and Software as may be required or necessary to provide the Services. The parties agree that joint planning and experienced personnel are critical factors for successfully providing the Services.

9.2 Licensor Personnel.

9.2.1 General. Licensor shall provide sufficient qualified personnel to perform Licensor's obligations hereunder, which personnel shall have a minimum of twelve (12) months of experience similar or related to the tasks to which they are assigned to perform. All Licensor personnel described in this Agreement shall be intimately familiar with Customer, its networks, operations, needs and requirements. Additionally, all such personnel shall be intimately familiar with [industry] functions and the regulatory requirements of the [Regulatory Agency] with respect

to [industry] functions. Such individuals shall be equipped with all necessary infrastructure in terms of tools, networks and documentation regarding the ABC System and the Services and shall be sufficiently mobile to allow on-site assistance at Customer's location at any time. The individuals described in Sections 9.2.2, 9.2.3 and 9.2.4 below are designated as key personnel ("Key Personnel") and are identified in Schedule 9.2.

- ***The Licensor should limit the number of individuals identified as key personnel to retain the greatest degree of flexibility in allocating its employees among the many different projects it is performing. The Customer, however, should insist that any Licensor employee who is important to the project be listed. This prevents the Licensor from transferring an important member of the production team to another client's project if that customer's project were to need assistance. A complete listing of all important employees will give the Customer greater leverage if the Licensor ever sought to reassign those employees important to the Customer's project.***

9.2.2 Licensor Services Manager. The Licensor manager for the Services (the "*Licensor Services Manager*") is identified in Schedule 9.2. The Licensor Services Manager shall act as a liaison between *Licensor* and Customer for all matters related to this Agreement and shall have overall responsibility for ensuring Licensor's performance of its responsibilities and obligations as set forth in this Agreement.

9.2.3 Licensor Services Support Team. The individuals identified in Schedule 9.2 shall serve as a designated group of experts experienced with the ABC System and Licensor's Services who shall be available via telephone or pager continuously (twenty-four (24) hours per day, seven (7) days per week, three hundred sixty-five (365) days per year) for Customer to consult with regarding issues related to the ABC System and/or the Services (the "Licensor Services Support Team"). The Licensor support representative identified in Schedule 9.2 (the "Licensor Services Support Representative") shall serve as the liaison between Customer and Licensor with respect to Support matters, which shall include attending all Planning/Review Meetings. The Licensor Services Support Team shall provide the Information Technology Support and Maintenance Services described in Exhibit IX.A, which shall include, without limitation:

(a) Answering ABC System related technical, functional and operational questions and resolving all ABC System problems reported by Customer;

(b) Coordinating all activities of Licensor personnel and Third Party personnel to implement appropriate actions and resolve ABC System problems;

(c) Serving as the single point of contact for any Equipment-related problems;

(d) Providing any on-site Support and Maintenance Services.

(e) Such other items and/or matters as may be requested by either Customer or Licensor.

9.2.4 Licensor Technical Support Team. The individuals identified in Schedule 9.2 shall serve as a select number of highly qualified technical staff to assist Customer in all technical matters related to the ABC System and/or the Services (the "*Licensor Technical Support Team*").

The Licensor technical support representative identified in Schedule 9.2 (the "*Licensor Technical Support Representative*") shall serve as the liaison between Customer and Licensor with respect to technical support matters, including providing input at all Planning/Review Meetings. The Licensor Technical Support Team shall be knowledgeable about and capable of discussing with Customer the following subjects, without limitation:

(a) The design and architecture of the ABC System;

(b) Licensor 's current research and development efforts and activities;

(c) Suggestions made by Customer representatives as to future Licensor research and development efforts;

(d) Changes to Licensor 's preferred equipment platforms for the ABC System;

(e) Emerging technologies and the role such technologies can and should play in future research and development efforts;

(f) Licensor short-term and long-term business strategies vis-à-vis Licensor's decisions to invest in the development of certain products or services over others;

(g) Licensor's internal research and development budget proposals (before finalized) for the future fiscal year; and

(h) Such other items and/or matters as may be requested by either Customer or Licensor.

9.3 Selection and Continuity.

9.3.1 Selection. For any new or additional Licensor personnel, Licensor shall provide Customer with a listing of the qualifications required of the personnel who will be assigned to accomplish the tasks described in this Agreement and a list of the personnel Licensor proposes to assign to perform such tasks. Licensor shall notify Customer if any of the proposed individuals have less than twelve (12) months experience related to such tasks. The list shall include the professional qualifications of each individual, along with their proposed role. Customer shall have the right to review the qualifications of the proposed Licensor personnel, interview all such personnel and reject any personnel whom Customer reasonably determines to be unqualified to perform the tasks assigned to them under this Agreement. Any Licensor personnel who are assigned or designated to perform such tasks who have less than the required twelve (12) months of experience shall be clearly identified by Licensor to Customer as "*Trainees*". Licensor shall obtain Customer's written consent prior to deploying any Trainees to work under this Agreement and shall not charge Customer for the services of any such Trainees.

9.3.2 Continuity. Except for changes in personnel due to resignation, termination, promotion, geographic transfers or leaves of absence, Licensor shall maintain the same Licensor Services Manager and other Key Personnel throughout the term of this Agreement. Licensor shall not reassign away from Customer the Licensor Services Manger or any member of the Licensor Services Support Team or the Licensor Technical Support Team. Licensor shall not promote an

employee for the purpose of avoiding its obligations under this Section. For any transfers approved by Customer, any required transitions will be accomplished in an orderly and businesslike manner upon four (4) weeks advance written notification and with on-going telephone consultation with the departing individual in order to achieve a seamless transition and minimize any disruption that may be experienced by Customer as a result of such transitions.

- ***Although the Customer may seek to limit the transfer of certain key employees it is unreasonable to prevent the Licensor from operating its business in the normal course. Consequently, the contract should provide for the ability the Licensor to replace certain key employees upon the occurrence of certain events.***

9.4 Replacement. Customer shall have the right to require Licensor to replace the Licensor Services Manager and other Key Personnel whom Customer deems to be unfit or otherwise unsatisfactory to perform Licensor's duties hereunder. In the event Customer requests that Licensor replace any such Licensor personnel, Licensor promptly shall replace such personnel with qualified replacement personnel. For the purpose of this Section, "qualified" means that the proposed replacement personnel possess comparable experience and training as the Licensor personnel being replaced. At no additional cost to Customer, such replacement personnel shall work with the replaced Licensor personnel for a transition period that will be specified by Customer, the duration of which shall be based upon the duties and responsibilities of the person being replaced and any other applicable criteria. In addition to the foregoing, and provided the replaced Licensor personnel remain in the employ of Licensor, such personnel shall continue to be available by telephone to answer any project-related questions in order to achieve a seamless transition and minimize any disruption that may be experienced by Customer as a result of such replacement. The cost and expenses associated with the replacement of any Licensor personnel shall be paid by Licensor. Race, gender, age, religion, national origin and other legally discriminatory characteristics shall not be valid grounds for any such request by Customer.

9.5 Customer Personnel. Customer shall provide personnel to perform its responsibilities under this Agreement, including a manager for the Services (the "*Customer Services Manager*"), who shall act as a liaison between Licensor and Customer, coordinate Customer resources, coordinate Customer personnel and have overall responsibility for meeting Customer's responsibilities and obligations.

9.6 Meetings and Reports.

9.6.1 On-site Readiness Meetings. On a bi-weekly basis, the Licensor Services Manager and the Customer Services Manager shall be available to meet at Customer's facility to review the status of Licensor's performance under this Agreement including, without limitation, the timely and accurate generation of all required reports as set forth in Attachment ___ to Schedule ___. Customer shall reimburse Licensor for all reasonable travel and out-of-pocket expenses incurred by the Licensor Services Manager in connection with such meetings, provided that such expenses conform to Schedule ___.

9.6.2 Contract Management Meetings. On a monthly basis, or more often if Customer requests, the Licensor Services Manager and other applicable Key Personnel, the Customer Services Manager, other appropriate representatives of the parties and any necessary Third Parties

shall meet at a Customer-designated site to discuss Licensor's compliance with the terms and conditions of this Agreement, and to review, without limitation, the following items:

(a) All financial arrangements; including invoices submitted by Licensor;

(b) A detailed status report as described in **Section 9.6.4**, including, without limitation, reporting on Licensor's compliance with all Service Level Standards and the status of any Project;

(c) Any specific difficulties or issues that may exist; including any personnel issues and any proposed changes to the Agreement or any Service Level Standards; and

(d) Such other matters as may be requested by either party.

Licensor shall keep minutes of all Contract Management Meetings in form and substance reasonably satisfactory to Customer, and Licensor shall issue copies of the minutes to all meeting attendees within forty-eight (48) hours of each meeting.

9.6.3 Planning/Review Meetings. On a quarterly basis, or more often if Customer requests, the Licensor Services Manager, the Customer Services Manager, the Licensor Technical Support Representative, the Licensor Technical Support Representative, any other appropriate representatives of the parties and any necessary Third Parties, shall meet at a Customer-designated site to review Licensor's compliance with the terms and conditions of this Agreement and to plan for Customer's acquisition of any new services and to discuss, without limitation, the following items:

(a) Performance of the ABC System and plans for improving Licensor's performance;

(b) Performance of the Licensor Services Support Team and plans for improving Licensor's performance;

(c) Performance of the Licensor Technical Support Team and plans for improving Licensor's performance;

(d) The status of any Projects, including Custom Programming Projects;

(e) A description of any change in recommended Equipment platforms; and

(f) Such other matters as may be identified for discussion by either party.

The parties jointly shall prepare and distribute a meeting agenda for each quarterly Planning/Review Meeting at least ten (10) calendar days prior to the date of the Planning/Review Meeting. Each party shall be responsible for its own travel or out-of-pocket expenses incurred in connection with attending the Planning/Review Meeting.

9.6.4 Reports. Licensor shall provide to Customer the specific reports listed in Attachment ___ to Schedule ___ in accordance with the terms and conditions set forth therein. In addition, at least five (5) business days before each monthly Contract Management Meeting,

Licensor shall present to Customer written reports of the performance of the ABC System and the Services in forms substantially similar to the forms attached as Schedule 9.6.4. The report shall include a summary, in such detail as Customer shall reasonably request, of: (a) the monthly performance of the ABC System and Services in relation to the Service Level Standards; (b) any accomplishments and difficulties encountered during the prior reporting period; (c) suggestions and proposed actions for dealing with and resolving any identified difficulties and the anticipated results during the next reporting period; and (d) a comprehensive and consolidated log of all outstanding support and technical problems identified by Customer and Licensor that remain to be resolved. Customer shall have the right to assume that Licensor does not know of any problems, difficulties or issues that may have an adverse impact on the Services (whether from a timing, cost or performance standpoint) unless Licensor specifically identifies such problems, difficulties or issues in its written performance reports. Licensor's failure to provide such reports within the time frames set forth in this Section shall result in a $1,000/day per report late charge to be paid by Licensor to Customer.

*9.7 **Administration of the Agreement.*** The Customer Services Manager and the Licensor Services Manager shall administer the Change Order process set forth in Section 9.8 and all decisions requiring the consent and/or approval of the other party, except for those decisions requiring the consent and/or approval of Customer pursuant to the terms set forth in Sections 22 and 40, which consent and/or approval shall be effective only upon a written notice signed by a Vice President or higher-level officer of Customer. All consents and/or approvals made in contravention of the terms set forth in this Section shall be void and of no force and effect. Such Managers shall be responsible for identifying within their respective organizations the individual(s) authorized to sign a Change Order based on the dollar value of such Change Order.

*9.8 **Change Order Procedure.*** If either party believes that a change in the Services and/or a Project (whether in time frames, costs or deliverables) is necessary or desirable, such party shall submit a written change request to the other (a "*Change Request*"). **Licensor represents to Customer that it has factored into Licensor's fee adequate contingencies for *de minimis* change orders. Accordingly, if Change Requests are made, they will be presumed not to impact the fees under this Agreement; provided, however, that if the Change Request consists of other than a *de minimis* deviation from the scope of the Services and/or Project, Licensor shall provide Customer with written notification of such other deviation within five (5) business days after receipt of the Change Request.** If agreed to by Customer, a change in the fee shall be made. In the event of a Customer-initiated Change Request, within five (5) business days of Licensor's receipt of such Change Request, Licensor shall provide to Customer a written statement describing in detail: (a) the impact on the ABC System performance, if any, and the modifications to the ABC System that will be required as a result of the Change Request including, without limitation, Change in Software, Equipment, if any, and Services; and (b) an estimate of the cost to implement each Change Request (collectively, the "*Change Response*"). If Licensor submits a Change Request to Customer, such Change Request shall include the information required for a Change Response. Customer shall accept or reject any Change Response or Licensor-initiated Change Request, as applicable, within five (5) business days after receipt of same from Licensor. If Customer accepts a Change Response or Licensor initiated Change Request in writing, such Change Response, together with Customer's Change Request, or such Licensor-initiated Change Request, shall be deemed to be a "*Change Order*" and shall become part of this Agreement. If Customer rejects Licensor's Change Response or Licensor-initiated Change Request, Licensor shall proceed to fulfill its obligations under this Agreement.

- ***The change order procedure section is one of the most important sections in any license but yet it often receives little attention in the negotiation process. Many disputes that arise under a software license are directly related to "scope creep", changes to the functional specifications or other delivery obligations. The process for implementing these or other similar changes should be clearly documented to eliminate the potential for future disagreements. Licensors should avoid language like that above which allows the customer to make de minimis changes without additional cost to the customer. This subjective standard can create many problems of interpretation potentially leading to litigation.***

9.9 New Projects. Licensor shall provide any new product and/or functionality to Customer as part of a project (each a "*Project*") to be implemented and managed pursuant to the terms and conditions set for in Schedule 9.9.

9.10 Testing Process. Customer shall have the right to test all new Services, Software and Custom Programming obtained or licensed from Licensor, as applicable, and shall have the right to test any and all Enhancements thereto in accordance with the terms set forth in Schedule 9.10.

10. INVOLVEMENT OF CUSTOMER EMPLOYEES IN LICENSOR'S TEAM

10.1 Involvement of Customer Employees/Consultants In Licensor's Development Team

10.1.1 In order to permit a transfer of know-how relating to the Custom Software, Customer shall have the right, but not the obligation, to cause up to three (3) of its employees and/or consultants to work at Licensor Licensor's offices in [Location] as part of each of the Licensor teams that develop the Custom Software and Licensor hereby agrees to welcome such Customer employees/consultants into such teams pursuant to the terms and conditions of Sections 10.1.1 - 10.1.3 and 10.3.1 - 10.3.6 hereof. If Customer wishes to avail itself of this possibility, it must notify Licensor, no later than thirty (30) calendar days before the date on which the said Customer employees/consultants will join the Licensor development team(s). The said employees/consultants shall join Licensor's development team(s) no earlier than the date of issuance of the Functional Specifications Acceptance Certificate, as the case may be, and shall cease to work with Licensor no later than the date on which the Acceptance Certificate is issued.

10.1.2 Customer shall ensure that its aforesaid employees/consultants possess a minimum level of engineering competence in (a) the general field of software and documentation development, in particular, as concerns Unix systems, telecommunications protocols, local area networks (LANs) and wide area network systems (WANs) and (b) Type B technology or EDI or 9.400 technologies.

10.1.3 During the time of involvement of the aforesaid Customer employees/consultants, Licensor shall have full authority to direct such employees/consultants.

10.2 Involvement of Customer Personnel In Licensor's Integration and Acceptance Team

10.2.1 In order to permit the training of Customer employees/consultants with respect to the use and operation of the Deliverables, Customer shall have the right, but not the obligation, to cause up to two (2) of its employees/consultants to work at Licensor Licensor's offices in the [Location], or at the Site, as part of each of the Licensor integration and acceptance teams. Licensor hereby agrees to welcome such Customer employees/consultants into such teams pursuant to the terms and conditions of Sections 10.2.1 – 10.3.6 hereof. If Customer wishes to avail itself of this possibility, it must notify Licensor, no later than fifteen (15) calendar days before the date on which Licensor commences the factory tests at its premises with respect to the project on which the said employees/consultants will work; in this connection, Licensor hereby agrees to give Customer no less than thirty (30) calendar days prior written notice of the date on which it intends to commence its factory tests. The said Customer employees/consultants will join Licensor's integration and acceptance team(s) no earlier than the date on which Licensor commences its factory tests for the project in question and shall cease to work with Licensor no later than the date on which the Delivery Acceptance Certificate is issued.

10.2.2 Customer shall ensure that its aforesaid employees/consultants possess a minimum level of engineering competence in (a) the general field of software integration and acceptance, in particular, as concerns Unix systems, telecommunications protocols, local area networks (LANs) and wide area network systems (WANs), (b) Type B or 9.400 or and (c) the content of the Acceptance Tests.

10.2.3 During the time of involvement of the aforesaid Customer employees/consultants, Licensor shall have full authority to direct such employees/consultants.

10.3 *General*

10.3.1 Notwithstanding the foregoing, Licensor shall have the right, (a) prior to Customer employee's/consultant's relocation to Licensor, to reject said employee/consultant on the basis of his credentials or (b) subsequent to an employee's relocation to Licensor, to require Customer to recall the said employee on the basis of his job performance. In the event of a rejection or recall of a Customer employee/consultant, Customer shall have the right but not the obligation to provide a replacement for such employee/consultant. In no event shall any such rejection or recall diminish or void Customer's assurance relating to the technical competence of its employees/consultants, as aforesaid.

10.3.2 Each of the aforesaid Customer employees/consultants shall, before commencing any work, execute and deliver to Licensor and Customer a Non-Disclosure Agreement in the form of Appendix 10.3.2 attached hereto. Customer acknowledges that a material breach by one of its employees/consultants of the aforesaid Non-Disclosure Agreement shall, for the purposes of this Agreement, constitute a breach by Customer under Section 6 of this Agreement.

10.3.3 Licensor shall be responsible for any and all work performed by the aforesaid Customer employees/consultants; in no event shall Licensor be relieved of any of its obligations hereunder, as a result of (a) any rejection/replacement of a Customer employee/consultant pursuant to Section 10.3.3 hereof, (b) the activities of Customer employees/consultants,

except where such activities are in direct opposition to instructions given by Licensor or constitute intentional or grossly negligent acts or omissions which affect Licensor's performance hereunder or (c) the election by Customer not to cause any of its employees/consultants to be integrated into the Licensor team. In no event shall Licensor be liable for the tortuous acts or omissions of any Customer employee/consultant and Customer shall indemnify and hold harmless Licensor from any third party claims, actual losses, costs (including reasonable attorneys fees) and direct damages or liabilities arising therefrom.

10.3.4 The Parties hereto expressly agree that the Customer employees/consultants relocated to Licensor as per above shall not be considered to be employees/consultants of Licensor. Customer shall, at all times, be responsible for any compensation, insurance or other employee benefits to which such employees/consultants are, or may become, entitled and, under no circumstances, shall Licensor be required to make payment of any kind to any such employee/consultant on Customer's behalf.

10.3.5 The Parties hereto further expressly agree that said Customer employees/consultants shall not have the authority (a) to make representations on behalf of or to otherwise bind Customer or Licensor in any manner whatsoever and (b) to convey any information or Deliverable to Licensor for or on behalf of Customer. Consequently, if Licensor relies on any representations and statements of the aforesaid Customer employees/consultants, it shall do so at its own risk.

- ***A Customer should insist on inserting into its contract language similar to that set forth in this Section 10 to avoid the Licensor selling a project with its experienced personnel and later staffing the Customer's project with less experienced people. It is unlikely, however, that a Licensor would accept the language as written.***

- ***The language set forth above allows the Customer's employees to participate in the development process. The Customer's goal is two fold. The first is to allow the Customer's employees to become educated in the operation and development of the software. This will reduce the Customer's dependency on the Licensor's employees. To some extent, it will also allow the Customer's employees to provide maintenance, potentially reducing the Customer's maintenance costs. The second it will allow the Customer to keep closer track of the development process. If problems develop, the Customer will have an unbiased view of the nature of the problem and its significance. It will avoid any lack of candor on behalf of the Licensor if a problem arises. The Licensor may have concerns about including this language but there are no legitimate reasons for not including it if the Customer's employees sign appropriate non-disclosure agreements and the Customer's assumes responsibility for any delays caused by its employees.***

11. SUPPORT SERVICES

11.1 ***Training Services***. In addition to the training prescribed by Section 10 hereof, Licensor undertakes to provide training services to Customer personnel with a view to permitting them to operate, administer and maintain the ABC System. In the event that Customer wishes to obtain such training services, Customer and Licensor shall agree upon a

statement of work pursuant to the provisions of Section 11.4 hereof. Customer shall designate, in this regard, such members of its personnel which are sufficiently qualified and skilled to participate in such training, and the said training shall take place in compliance with the conditions to be defined at a later date by mutual agreement between the Parties.

11.2 ***Installation Services***. It is hereby acknowledged and agreed that Licensor shall provide such installation services as are classified, pursuant to the provisions of Appendix 11.2 hereto, as prerequisites for the appropriate Acceptance Procedures. In the event that Customer wishes to receive installation services above and beyond same, Customer and Licensor shall agree upon a statement of work pursuant to the provisions of Section 11.2 hereof.

11.3 ***Hardware and Software Support Services***. Licensor shall provide the Hardware Support Services, the Standard Software Support Services, and Custom Software Support Services pursuant the terms and conditions of Appendix 11.3 hereto

11.4 ***Additional Support Services***. In the event that Customer wishes to receive services above and beyond those contemplated by Section 11.1 - 11.3 hereof, Customer and Licensor shall agree upon a statement of work pursuant to the provisions of Appendix 3 hereto.

12. PROPRIETARY RIGHTS, CONFIDENTIALITY AND SECURITY

12.1 Ownership of Intellectual Property. Pre-existing intellectual property and all improvements thereto that Licensor uses in connection with performing the Services, providing any Deliverables and performing any other Services hereunder shall remain the sole and exclusive property of Licensor, and Licensor shall mark any such written materials as "confidential" and/or "proprietary". **Any Custom Programming, including all source code and materials developed by Licensor, all intermediate and partial versions thereof, as well as all specifications, program materials, flow charts, notes, outlines and the like created in connection therewith (collectively, "*Custom Programming Materials*") shall be the sole and exclusive property of Customer.** All written reports, requirements documents (including newly created technical and non-technical data embodied therein), specifications, program materials, flow charts, notes, outlines and the like that are developed, conceived, originated, prepared or generated by Licensor in connection with Licensor's performance under this Agreement including, without limitation, all copyright, trademark, trade secret and all other proprietary rights therein and derivative works created therefrom (collectively, "Written Deliverables"), shall be the sole and exclusive property of Customer. Such ownership of Custom Programming Materials and Written Deliverables shall inure to the benefit of Customer from the date of the conception, creation or fixation of the Custom Programming Materials and Written Deliverables in a tangible medium of expression, as applicable. All newly created copyright aspects of the Custom Programming Materials and Written Deliverables shall be considered a "work-made-for-hire" within the meaning of the Copyright Act of 1976, as amended. If and to the extent the Custom Programming Materials and Written Deliverables, or any part thereof, are found by a court of competent jurisdiction not to be a "work-made-for-hire" within the meaning of the Copyright Act of 1976, as amended, Licensor agrees that all exclusive right, title and interest in and to those newly created copyrightable aspects of the Custom Programming Materials and Written Deliverables, and all copies thereof,

are hereby expressly assigned automatically to Customer without further consideration. Any agreement entered into by Licensor and a Third Party in connection with Services related to Custom Programming Materials and Written Deliverables under this Agreement shall require the prior consent of Customer as set forth in Section 12.3, and shall further include substantially the same terms as those appearing in this Section to ensure that Customer obtains the same rights in the Custom Programming Materials and Written Deliverables generated under such Third Party agreement as those set forth in this Section. Licensor agrees to assist Customer in obtaining and enforcing all rights and other legal protections for the Custom Programming Materials and Written Deliverables and to execute any and all documents that Customer may reasonably request in connection therewith, including any copyright assignment document(s). Licensor shall ensure that all Custom Programming Materials and Written Deliverables created hereunder (including each page of any document produced) will be marked as follows:

Confidential and Proprietary
© Copyright [2000/Year Developed] Customer
All Rights Reserved

Licensor shall not re-use the Custom Programming Materials or Written Deliverables, or any intermediate or partial version thereof, or any derivative work based upon the Custom Programming Materials or Written Deliverables without Customer's express written consent, which consent may be withheld by Customer in its sole discretion.

- ***This language assumes that the Customer will own the work product created by the Licensor under this Agreement. The Licensor should think carefully before agreeing to give up ownership rights as this decision may limit the Licensor's ability to perform similar work in the future or impact the Licensor's future profit margins.***

12.2 Confidential Information. "*Confidential Information*" means any material, data or information in whatever form or media of a party to this Agreement that is provided or disclosed to the other, except for any information that is: (a) publicly available or later becomes available other than through a breach of this Agreement; (b) known to the Receiving Party or its employees, agents or representatives prior to such disclosure or is independently developed by the Receiving Party or its employees, agents or representatives subsequent to such disclosure; or (c) subsequently lawfully obtained by the Receiving Party or its employees, agents or representatives from a Third Party without obligations of confidentiality. Confidential Information shall include the following categories of information whether disclosed orally or not marked as confidential: Written Deliverables, network configurations, network architecture, Services rendered by Licensor to Customer, financial and operational information, and other matters relating to the operation of the parties' business, including information relating to actual or potential customers and customer lists, customer usage or requirements, business and customer usage forecasts and projections, accounting, finance or tax information, pricing information, and any information relating to the corporate and/or operational structure of Customer and its Affiliates, Software, Equipment, Deliverables or Services rendered under the Letter Agreement and any amendments thereto, any information exchanged between the parties pursuant to the Non-Disclosure Agreement, and all information and materials relating to Third Party vendors, systems integrators or consultants of Customer that have provided or that may provide in the future any part of Customer's information or communications infrastructure to Customer. The party that has received Confidential Information (the "Receiving Party") shall exercise the same degree of care

and protection with respect to the Confidential Information of the party that has disclosed Confidential Information to the Receiving Party (the "Disclosing Party") that it exercises with respect to its own Confidential Information and shall not directly or indirectly disclose, copy, distribute, republish or allow any Third Party to have access to any Confidential Information of the Disclosing Party. Notwithstanding the above: (d) Customer may disclose Licensor Confidential Information to Authorized Users who have a need to know; (e) Licensor may disclose Customer's Confidential Information to its employees and agents who have a need to know, provided that for Licensor's agents, such agent is acceptable to Customer in its sole discretion and the agent has previously executed the Confidentiality Agreement as set forth in Exhibit 2 ("Confidentiality Agreement"); and (f) either party may disclose Confidential Information if so required by law (including court order or subpoena), provided that such disclosure is made in accordance with the terms of Section 12.5.

*12.3 **Privileged Information.*** Licensor shall keep and maintain all Privileged Information in strict confidence and shall protect all such Privileged Information from disclosure to third parties without the prior written consent of Customer.

*12.4 **Return of Confidential Information.*** Unless otherwise authorized, upon the earlier of termination of this Agreement or request of the Disclosing Party, with respect to the Disclosing Party's Confidential Information and/or Privileged Information (except for any Software licenses and related Documentation paid for by Customer, which Customer shall have the right to retain) the Receiving Party shall promptly either: (a) return such Confidential Information and/or Privileged Information and provide certification to the Disclosing Party that all such Confidential Information and/or Privileged Information has been returned; or (b) destroy such Confidential Information and/or Privileged Information and provide certification to the Disclosing Party that all such Confidential Information and/or Privileged Information has been destroyed.

*12.5 **Notification Obligation.*** If the Receiving Party becomes aware of any unauthorized use or disclosure of the Confidential Information and/or Privileged Information of the Disclosing Party, the Receiving Party shall promptly and fully notify the Disclosing Party of all facts known to it concerning such unauthorized use or disclosure. In addition, if the Receiving Party or any of its employees or agents are requested or required (by oral questions, interrogatories, requests for information or documents in legal proceedings, subpoena, civil investigative demand or other similar process) to disclose any of the Confidential Information and/or Privileged Information of the Disclosing Party, the Receiving Party shall not disclose the Confidential Information and/or Privileged Information without providing the Disclosing Party at least twenty-four (24) hours prior written notice of any such request or requirement so that the Disclosing Party may seek a protective order or other appropriate remedy and/or waive compliance with the provisions of this Agreement. Notwithstanding the foregoing, the Receiving Party shall exercise its best efforts to preserve the confidentiality of the Confidential Information and/or Privileged Information including, without limitation, by cooperating with the Disclosing Party to obtain an appropriate protective order or other reliable assurance that confidential treatment will be accorded the Confidential Information and/or Privileged Information by such tribunal.

*12.6 **Non-Aggregation of Data.*** Licensor shall not compile and/or distribute statistical analyses and reports utilizing aggregated data derived from information and data obtained from Customer.

12.7 Employee/Agent Acknowledgment. Licensor and Customer shall not disclose Confidential Information or Privileged Information to any of their employees, agents or representatives unless and until such employee, agent or representative has been made aware that his or her obligations under this Agreement are subject to confidentiality restrictions and unless such employee, agent or representative is the subject of a written confidentiality or non-disclosure agreement and has executed the Confidentiality Agreement.

12.8 Survival; No Limitation of Liability. The terms of this Article shall survive the expiration or termination of this Agreement. Notwithstanding anything contained in this Agreement to the contrary, the terms of any limitation of liability set forth in this Agreement shall not apply to any breach by a party of its confidentiality obligations under this Article.

ALTERNATIVE/ADDITIONAL LANGUAGE

Notwithstanding the previous paragraphs, all information provided by either party to the other under this Agreement shall be kept confidential in conformance with and subject to the terms of a certain Proprietary Information Agreement dated _____, 2000 by and between the parties hereto.

- ***The parties may want to execute a separate proprietary information agreement to eliminate any survivability issues arising upon the termination of the license agreement.***

13. REPRODUCTION OF DOCUMENTATION, OBJECT CODE AND SOURCE CODE

13.1 *Documentation.* **Customer shall have the right, at no additional charge, to reproduce solely for its own internal use, all Documentation furnished by Licensor pursuant to this Agreement regardless of whether such Documentation is copyrighted by Licensor. All copies of Documentation made by Customer shall include any proprietary notice or stamp that has been affixed by Licensor.** Licensor shall furnish for each License purchased by Customer, and at no additional charge to Customer, one (1) copy of the Documentation **sufficient to enable Customer to operate the Software.** All Documentation shall be in the English language.

- ***Licensor usually does not make money from reproducing its manuals, thus Licensor is not concerned that the Customer makes copies so long as the Customer incorporates Licensor's protective notices. The Licensor should be careful about including language that the Documentation will allow the Customer to operate the software. At the same time, the Customer should insist on the inclusion of language that provides some level of comfort as to the level of detail of the Documentation.***

13.2 *Object Code.* One copy of the Object Code may be reproduced by Customer, at no additional charge, only for back-up or archival purposes. Customer shall notify Licensor in writing of its methods and procedures for archiving the Object Code prior to doing so.

13.3 *Source Code.* Upon purchase of a Source Code license, one additional copy of the Source Code may be reproduced by Customer, at no additional charge, only for back-up or

archival purposes. Customer shall notify Licensor in writing of its methods and procedures for archiving the Source Code prior to doing so.

- ***When a Customer purchases a Source Code license it buys only one copy of the Source Code with the right to make a backup copy for archival purposes. The Customer must buy a second copy of the Source Code if it wants to modify the Source Code while using the original copy in production.***
- ***The Customer is prohibited under Section 3.4 from reverse engineering the Software.***

14. PATENT AND OTHER PROPRIETARY RIGHTS INDEMNIFICATION

14.1 ***Indemnification***. The following terms apply to any infringement or claim of infringement of any **existing United States** patent, trademark, copyright, trade secret or other proprietary interest based on the licensing or use of any Software, and/or Services furnished to Customer under this Agreement or in contemplation hereof. **Subject to the limitations contained in this Agreement,** Licensor shall indemnify Customer for any loss, damage, expense or liability, including costs and **reasonable attorney's fees, finally awarded,** that may result by reason of any such infringement or claim, except where such infringement or claim arises **solely** from **modifications made by Customer to the Software or Services or Licensor's adherence to Customer's written instructions** or directions which involve the use of merchandise or items other than (1) commercial merchandise which is available on the open market or is the same as such merchandise, or (2) items of Licensor's origin, design or selection; and Customer shall so indemnify Licensor in such excepted cases. Each party shall defend or settle, at its own expense, any action or suit against the other for which it has indemnification obligations hereunder. Each party shall notify the other promptly of any claim of infringement for which the other is responsible, and shall cooperate with the other in every reasonable way to facilitate the defense of any such claim.

- ***This section addresses the infringement on third party intellectual property rights by Licensor's software.***
- ***The infringement is limited to existing United States intellectual property. With foreign transactions indemnification should be limited to the United States and the country in which the software will be used.***
- ***"Finally awarded" limits Licensor's obligation to pay until all appeals have been exhausted.***
- ***Licensor must be careful to limit indemnification to a specific entity and not a broad class of entities, i.e., all Affiliates of Customer.***
- ***Including "attorney's fees" allows the indemnified party to collect attorney's fees which are usually not recoverable under common law.***
- ***The Customer should indemnify Licensor if an infringement claim arises from modifications or uses undertaken by the Customer which were not authorized by the license.***
- ***The contract's limit of liability should not apply to intellectual property indemnification, breach of the confidentiality provisions and the indemnification for bodily injury or personal property damage.***

14.2 ***Assumption of Defense.*** If the indemnifying party fails to assume the defense of any actual or threatened action covered by this Section 14 within the earlier of (a) any deadline established by a third party in a written demand or by a court and (b) thirty (30) days of notice of the claim, the indemnified party may follow such course of action as it reasonably deems necessary to protect its interest, and shall be indemnified for all costs reasonably incurred in such course of action; provided, however, that the indemnified party shall not settle a claim without the consent of the indemnifying party.

- ***This language allows a party to undertake its own defense itself if the indemnifying party fails to do so.***

14.3 ***Remedies.*** In addition, in the event an injunction or order shall be obtained against Customer's use of any item by reason of any such infringement allegation or if, in Licensor's sole opinion, the item is likely to become the subject of a claim of infringement or violation of any **existing United States** patent, copyright, trademark, trade secret, or other proprietary right of a third party, Licensor will, without in any way limiting the foregoing, in Licensor's sole discretion and at Licensor's expense either: (a) procure for Customer the right to continue using the item; (b) replace or modify the item so that it becomes non-infringing, but only if the modification or replacement does not, in Licensor's reasonable sole opinion, adversely affect the functional performance or specifications for the item or its use by Customer; or (c) **if neither (a). nor (b). above is practical, remove the item from Customer's Site and refund to Customer any license fees paid by Customer less a pro rata portion for periods of use subsequent to removal,** and release Customer from any further liability under the applicable order.

- ***Although intellectual property indemnification is usually excluded from any limit of liability, in actuality the licensor is protected by the limits set forth in sub-sections (a), (b) and (c).***
- ***Licensor always needs the option to refund the Customer's money if Licensor cannot alter the software to make it non-infringing or obtain a license for the Customer to use the Software, otherwise Licensor could potentially be obligated to provide a software fix/license regardless of cost or Licensor's ability to do so.***
- ***Traditionally, there is no limitation of liability for patent indemnification claims.***

14.4 ***Cessation of Fees.*** In no event shall Customer be liable to Licensor for any charges after the date that Customer no longer uses the item because of actual or claimed infringement.

15. INDEMNITY

15.1 ***Indemnity.*** **Subject to the limitations contained in this Agreement,** Licensor agrees to indemnify and hold harmless Customer, and Customer agrees to indemnify and hold harmless Licensor respectively, from any liabilities, penalties, demands or claims **finally awarded** (including the costs, expenses and **reasonable attorney's fees** on account thereof) that may be made by any **third party** for personal bodily injuries, including death, resulting from the indemnifying party's gross negligence or willful acts or omissions or those of persons furnished by the indemnifying party, its agents or subcontractors or resulting from use of the Software, Software Products and/or Services furnished hereunder. Licensor agrees to defend Customer, at Customer's request, and Customer agrees to defend Licensor, at Licensor's request, against any

such liability, claim or demand. Customer and Licensor respectively agree to notify the other party promptly of any written claims or demands against the indemnified party for which the indemnifying party is responsible hereunder. The foregoing indemnity shall be in addition to any other indemnity obligations of Licensor or Customer set forth in this Agreement

- ***Indemnification by its nature acts as a risk shifting device with respect to third party liability; i.e., it protects the indemnifying party's actions, negligence, etc.***
- ***This section addresses personal injury, property damage, and economic injury to third parties. The first clause limits Licensor's liability to the amounts set forth in Section 16 (i.e., to the amount of money received from the Customer). For public policy reasons many jurisdictions forbid tortfeasors from limiting their liability for personal injuries arising from consumer goods. See UCC §2-719(13).***
- ***"Finally awarded" limits Licensor's obligation to pay the Customer until all appeals have been exhausted.***
- ***An indemnification clause allows a recovery in those states which recognize the doctrine of contributory negligence and not the doctrine of comparative negligence. It also allows for the recovery of attorneys fees which are usually not recoverable.***

15.2 ***Assumption of Defense.*** If the indemnifying party fails to assume the defense of any actual or threatened action covered by this Section 15 within the earlier of (a) any deadline established by a third party in a written demand or by a court and (b) thirty (30) days of notice of the claim, the indemnified party may follow such course of action as it reasonably deems necessary to protect its interest, and shall be indemnified for all costs reasonably incurred in such course of action; provided, however, that the indemnified party shall not settle a claim without the consent of the indemnifying party.

- ***This language allows a party to undertake its own defense itself if the indemnifying party fails to do so.***

16. LIMITATION OF LIABILITY

16.1 LICENSOR SHALL NOT BE LIABLE FOR ANY (A) **SPECIAL, INDIRECT, INCIDENTAL, PUNITIVE, OR CONSEQUENTIAL DAMAGES, INCLUDING LOSS OF PROFITS,** ARISING FROM OR RELATED TO A BREACH OF THIS AGREEMENT OR ANY ORDER OR THE OPERATION OR USE OF THE SOFTWARE AND SERVICES INCLUDING SUCH DAMAGES, **WITHOUT LIMITATION, AS DAMAGES ARISING FROM LOSS OF DATA OR PROGRAMMING, LOSS OF REVENUE OR PROFITS, FAILURE TO REALIZE SAVINGS OR OTHER BENEFITS, DAMAGE TO EQUIPMENT, AND CLAIMS AGAINST CUSTOMER BY ANY THIRD PERSON, EVEN IF LICENSOR HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES;** (B) DAMAGES (REGARDLESS OF THEIR NATURE) FOR ANY DELAY OR FAILURE BY LICENSOR TO PERFORM ITS OBLIGATIONS UNDER THIS AGREEMENT DUE TO ANY CAUSE BEYOND LICENSOR'S REASONABLE CONTROL; OR (C) **CLAIMS MADE A SUBJECT OF A LEGAL PROCEEDING AGAINST LICENSOR MORE THAN TWO YEARS AFTER ANY SUCH CAUSE OF ACTION FIRST AROSE.**

- ***Licensor should disclaim all "speculative" and "third party" damages. Damages recoverable by the Customer should be limited to Customer's actual direct damages. The Uniform Commercial Code does not requires that any disclaimer be "conspicuous" although this requirement may be imposed by the courts. Therefore this section should be in large block letters.***
- ***Licensor will not be liable for any damages suffered by the Customer's customers or any other third party.***
- ***By requiring claims be brought within 2 years, Licensor limits its risk/liability by shortening the statute of limitations which may be up to 12 years.***

16.2 NOTWITHSTANDING ANY OTHER PROVISION OF THIS AGREEMENT, BUT EXCLUDING ANY CLAIMS FOR INDEMNIFICATION UNDER SECTION 14.1 LICENSOR'S LIABILITIES UNDER THIS AGREEMENT, **WHETHER UNDER CONTRACT LAW, TORT LAW, WARRANTY OR OTHERWISE SHALL BE LIMITED TO DIRECT DAMAGES NOT TO EXCEED THE AMOUNTS ACTUALLY RECEIVED BY LICENSOR [UNDER THIS AGREEMENT OR IN THE _____ MONTHS PRIOR TO THE DATE OF THE ACTION GIVING RISE TO THE CLAIM].**

- ***Licensor seeks to limit its liability under both contract and tort theories which have different statues of limitations and different bases for which a recovery can be made.***
- ***Licensor must limit its liability (to the amount received from the Customer) or it could potentially be liable for Licensor's entire net worth. (Traditionally, there is no limitation of liability for patent indemnification claims and in consumer transactions for personal bodily injury).***
- ***Limitation of liability is an element of price. Licensor has based its pricing on limiting Licensor's liability at the amount received from the Customer, or alternatively 19 contract value. If the Customer wants a higher limitation of liability, Licensor can raise its limit of liability but: (a) the license fee must increase because Licensor is now bearing more risk; or (b) Licensor must buy errors and omissions insurance and charge the Customer for the cost.***
- ***It is important to retain a default remedy provision, otherwise a court may find Licensor's warranty "failed of its essential purpose" (i.e., did not provide the Customer with an adequate remedy) and void Licensor's limitation of liability and disclaimer for consequential damages.***

17. ACCEPTANCE OF SOFTWARE AND SERVICES

17.1 *Acceptance Tests.* Licensor and Customer shall jointly conduct Software and Services acceptance tests in accordance with the Software Acceptance Plan during the installation process at a Customer designated location(s) during a thirty (30) day acceptance period. The acceptance period will commence once the Software is operational in the Customer designated location(s). The Software and Services shall (1) materially comply with the Functional Specifications; (2) function substantially in accordance with Licensor's specifications; (3) be compatible and substantially conform to the Documentation; and (4) substantially comply with the Software Acceptance Plan.

- ***Because the Licensor has greater familiarity with its own software, the Licensor should create the first draft of the Software Acceptance Plan. The licensee should then modify it to make sure the plan reflects the parties' intent.***

17.2 ***Failure to Comply.*** If, during the acceptance period, Customer determines that the Software and/or Services do not substantially meet the above requirements, Customer shall so notify Licensor in writing, specifying in detail the area of noncompliance. Licensor shall use its good faith efforts to correct all conditions that prevent the Software and/or Services from substantially meeting the requirements within fifteen (15) calendar days following receipt of notice from Customer. If all Customer reported conditions that prevent the Software and/or Services from substantially complying with the acceptance criteria are not corrected by the end of acceptance period, the Customer will notify the Licensor, in writing, within two (2) calendar days following the end of the acceptance period identifying the specific areas of non-compliance. Failure to notify Licensor in writing will constitute acceptance of the Software and/or Services. Upon receipt of written notice of non-compliance an extension period of sixty (60) calendar days begins which will supply Licensor with the time necessary to correct the deficiencies identified in the notice. Within five (5) days after such sixty (60) day period the Customer will provide written notice to Licensor indicating Customer's acceptance of the Software and/or Services, Customer's desire to extend the "extension period" or the Customer's intent to terminate this Agreement without penalty or further financial obligation.

17.3 ***Deemed Acceptance.*** Notwithstanding anything contained herein, **Customer shall be deemed to have accepted the Software or Services if Customer uses the Software or Services in the operation of Customer's business prior to accepting the Software.**

- ***The Agreement must provide that use of the Software in the operation of the Customer's business constitutes acceptance. Otherwise there is no incentive for the Customer to start or complete acceptance test procedures. If the Customer is using the software in conducting its business the software most likely meets the Customer's requirements.***

18. WARRANTY AND WARRANTY DISCLAIMER

- ***Because Section 2-316 of the UCC requires that warranty disclaimers be "conspicuous" this paragraph is broken into several shorter paragraphs to allow ease of reading and comprehension and Section 18.4 which contains the actual disclaimer is in block letters.***

18.1 ***Warranty.*** Licensor warrants that it owns all rights, title and interest in and to the Software, or that in the case of any third party software that it has the right to grant a sublicense to use such third party software, that all Software shall substantially conform to the Functional Specifications, and that the Software and Services shall be free from material defects in workmanship and materials that prevent them from substantially meeting the aforementioned criteria. Licensor further warrants that any Services provided by Licensor under this Agreement shall be performed in a workmanlike manner and in accordance with the prevailing professional standards of the software industry. This warranty coverage shall include any modifications made to the Software by Licensor. **Such warranty shall extend for sixty (60) days from acceptance and shall survive inspection, test, acceptance, use and payment.**

- ***Licensor carefully limits what it warrants. Licensor only warrants that (1) Licensor owns the Software or has the right to license the software, (2) the software substantially conforms to the Functional Specifications, and (3) the Software is free from material defects in workmanship and materials. By using the phrases "substantially conforms" and "material defects", Licensor allows itself a small level of error as software by its nature is imperfect.***
- ***Licensor's warranty is sixty (60) days. Warranty is an element of price. If the Customer wants a one year warranty, Licensor can provide one at an increased price.***
- ***Avoid stating "Licensor represents and warrants". A "representation" creates a legal risk that Licensor might be held to have "misrepresented" (which is fraud) its software leading to stronger penalties.***

18.2 *Operation of Software.* **Licensor does not warrant that the operation of the Software or the operation of the Software Products will be uninterrupted or error free.**

- ***The licensor should always state that the operation of the software will not be error free or uninterrupted to avoid creating any implied warranties.***

18.3 *Remedy.* In the event of any breach of the warranties set forth in this Agreement, Licensor's sole and exclusive responsibility, and Customer's sole and exclusive remedy, shall be for Licensor to correct or replace, at no additional charge to Customer, any portion of the Software or Services found to be defective; provided, however, that **if within a commercially reasonable period Licensor neither corrects such defects nor replaces the defective Software or Services, then Customer's sole and exclusive remedy shall be to receive direct damages not to exceed the license fees paid to Licensor for use of the defective Software or Services.** In the event of any breach of any provision of this Agreement other than the warranties set forth in this Agreement, Customer's sole and exclusive remedy shall be to receive direct damages not to exceed the amounts received by Licensor pursuant to this Agreement. For the avoidance of doubt, Customer's monetary remedies for any breaches of any provision of this Agreement (including, without limitation, the warranty provisions) shall not, in the aggregate, exceed an amount equal to the amounts actually received by Licensor from Customer.

18.4 *Warranty Disclaimer.* **EXCEPT AS SET FORTH IN THIS SECTION 18, LICENSOR MAKES NO EXPRESS OR IMPLIED REPRESENTATIONS OR WARRANTIES** WITH RESPECT TO THE SOFTWARE, OR SERVICES OR THEIR CONDITION, MERCHANTABILITY, FITNESS FOR ANY PARTICULAR PURPOSE OR USE BY CUSTOMER. LICENSOR FURNISHES THE ABOVE WARRANTIES IN LIEU OF ALL OTHER WARRANTIES, E9PRESSED OR IMPLIED, INCLUDING THE WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE.

- ***UCC Section 2-316 requires all warranty disclaimers to be "conspicuous". Therefore the disclaimer should be in capital block letters.***
- ***If Licensor does not disclaim all other warranties, Licensor may be liable for certain implied warranties including the failure of the software to function as the Customer thought it would.***

18.5 *Voiding of Warranties.* Any and all warranties and indemnifications shall be void as to Services or Software damaged or rendered unserviceable by (1) the acts or omissions of non-Licensor personnel; (2) misuse, theft, vandalism, fire, water, or other peril; (3) moving or relocation not authorized by Licensor; or (4) any alterations or modifications made to any Software by the Customer, it representatives or agents.

- ***Licensor should not be held liable for a breach of warranty if the Customer was the cause of any such breach.***
- ***While the Licensor wants to limit its liability in the event the Licensee modifies the software, the Licensee should insist or more limiting/exacting language which excuses the Licensor only to the extent any failure was caused by the Licensee's modifications (i.e., to protect against those cases where the infringement was not caused by the modification but rather by the Licensor's existing code). The limiting language mirrors the language for any intellectual property infringement set forth in Section 14.1.***

*** It is important to note that there is a difference between warranty and maintenance. Warranty is much more comprehensive including modifying the software to make it work. Maintenance involves only maintaining an ongoing operating system to a lesser standard. Breach of the maintenance provisions will usually result in a refund of the maintenance fees paid to Licensor but a breach of warranty may entitle Customer to a refund of all development and services fees paid to Licensor, which usually is a much larger amount.***

ALTERNATIVE/ ADDITIONAL WARRANTIES BENEFITTING THE CUSTOMER

18.A Services Warranty. Licensor represents and warrants to Customer that it shall perform the Services and provide the Deliverables required by this Agreement in accordance with industry practices and standards generally applicable to such Services; provided, however, that where this Agreement specifies a particular standard or criteria for performance, this warranty is not intended to and does not diminish that standard or criteria for performance.

18.B ABC System Warranty. **Licensor represents and warrants to Customer that the ABC System shall function without Critical Error in accordance with the applicable Specifications, Performance Standards, Documentation and Regulatory Requirements.**

- ***This warranty ties together all of the appropriate items that set forth the performance of the software system as a whole. This warranty is much broader and goes to the collective operation of the hardware, the Licensor's proprietary software and any third party software. This is a significant risk for the Licensor as it is essentially warranting the operation of the system as a whole as well as any third party components over which it potentially has no control. By tying together the specifications, performance standards, documentation and regulatory requirements, if any, the Customer has guaranteed that is will receive the complete benefit of its bargain.***

18.C Regulatory Requirements Warranty. **Licensor represents and warrants to Customer that the Software meets and satisfies all Regulatory Requirements.**

- ***To the extent the Customer is subject to any regulatory requirements such as in the healthcare, insurance or telecommunications industries, the Licensor should warrant that the software meets and satisfies all applicable regulatory requirements.***

18.D Documentation Warranty. Licensor represents and warrants to Customer that it has provided to Customer all Documentation for the ABC System and that such Documentation is detailed and complete and accurately describes the functional and operational characteristics of the ABC System. **Licensor further represents and warrants that it will provide to Customer updated versions of all such Documentation when it provides to Customer Enhancements to the ABC System and that all such updated Documentation will be complete and accurate and will be at least as detailed as the Documentation issued to Customer with the initial version of the ABC System.**

- ***The Licensor should warrant that not only is the initial Documentation detailed and complete but that the Documentation should reflect any customizations or modifications made to the Customer's system. Licensor should also warrant that any subsequent documentation delivered with any modifications or enhancements is complete and accurate and as detailed as the documentation initially delivered to Customer.***

18.E Performance Warranties. **Licensor represents and warrants to Customer that the Software shall meet the Performance Standards set forth in Schedule 3.B.1, including maximum response times and availability. Licensor shall correct any failure of Software to operate in accordance with the performance warranties set forth in this Section by acquiring all necessary additional software, equipment and/or services at no additional cost to Customer.** In the event Licensor is unable to correct such failure within a forty-eight (48) hour period, Customer shall receive from Licensor credits in the amounts set forth in **Schedule 3.B.2. In the event Licensor is unable to correct such failure within thirty (30) calendar days, an Event of Default shall be deemed to have occurred.**

- ***The warranty contained in Section 18.E contains an additional remedy if the Licensor fails the meet the performance standards. In addition to the Customer's right to receive service level credits and to terminate the agreement, the Licensor has the obligation to purchase all necessary hardware, software and services necessary to meet the performance standards. This place significant risks and financial burden on the Licensor.***

18.F Disabling Code Warranty. **Licensor represents and warrants to Customer that in connection with the licensing of the Software, Customer will not receive or experience any virus, worm, trap door, back door, timer, clock, counter or other limiting routine, instruction or design that would erase data or programming or otherwise cause any Customer system to become inoperable or incapable of being used in the full manner for which it was designed and created (collectively, a "*Disabling Code*"). In the event a Disabling Code is identified, Licensor shall take all steps necessary, at no additional cost to Customer, to restore and/or reconstruct any and all data lost by Customer as a result of such Disabling Code.**

- ***This warranty should be mutual as it is possible that the Customer's employees or consultants may introduce Disabling Code into the system.***

18.G Third Party Warranties and Indemnities. For any Third Party Software provided by Licensor to Customer, Licensor hereby assigns to Customer all end-user warranties and indemnities relating to such Third Party Software. To the extent that Licensor is not permitted to assign any of such end-user warranties and indemnities through to Customer, Licensor shall enforce such warranties and indemnities on behalf of Customer to the extent Licensor is permitted to do so under the terms of the applicable Third Party agreements.

18.H Intellectual Property Warranty. Licensor represents and warrants to Customer that Customer's use of the Software does not and shall not infringe upon any **[U.S.]** patent, trademark, copyright, trade secret or other intellectual property or proprietary right of any Third Party, and there is currently no actual or threatened suit against Licensor by any Third Party based on an alleged violation of such right. This warranty shall survive the expiration or termination of this Agreement.

- ***The Licensor will want to reduce its potential risks by limiting liability to the infringement of U.S. intellectual property rights.***

18.I Warranty of Authority. Each party represents and warrants to the other that it has the right to enter into this Agreement. Licensor further represents and warrants that there are no outstanding assignments, grants, licenses, encumbrances, obligations or agreements (whether written, oral or implied) that are inconsistent with this Agreement and the rights granted or transferred herein. This warranty shall survive the expiration or termination of this Agreement.

18.J Pending Litigation Warranty. Licensor represents and warrants to Customer that there is no action, suit, claim, investigation or proceeding pending, or to the best of Licensor's knowledge, **threatened** against, by or affecting Licensor or the ABC System which, if adversely decided, might adversely affect Licensor's ability to enter into this Agreement, Licensor's performance of its obligations herein, or Customer's use of the Software. Licensor further represents and warrants that it does not know of any basis for any such action.

- ***This warranty protects the Customer by requiring the Licensor to disclose any threatened or pending litigation that may interfere with the Customer's license rights. This is especially important with regards to any third party intellectual property infringement claims. A prudent Licensor would not agree to this warranty because it is so broad.***

18.K Change of Control Warranty. **Licensor represents and warrants to Customer that no Change of Control with respect to Licensor is being considered, planned or pending by the Board of Directors, shareholders or management of Licensor or by any Affiliate of Licensor.**

- ***A prudent Licensor would not agree to this warranty because it is so broad and may place the Licensor in the position of inadvertently violating the securities laws or breaking the agreement.***

18.L Material Misstatements or Omissions. **No representation or warranty by Licensor that is contained in this Agreement or in any Schedule, Exhibit or other Attachment hereto contains any untrue statement of a material fact or omits to state a material fact necessary to make the statements and facts contained herein or therein not materially misleading.**

- ***A prudent Licensor would not agree to this warranty as it is so broad that it creates a significant level of risk for the Licensor.***

18.M ISO 9001. **Licensor warrants that during the term of this Agreement, Licensor shall utilize a quality system in accordance with Exhibit 18.M. This quality system shall also be in accordance with ISO 9001.**

19. ERROR CORRECTION UNDER WARRANTY

19.1 During the warranty period, Customer will notify Licensor verbally of Errors, and provide written notification to Licensor within seventy-two (72) hours of such verbal notification. Licensor shall provide Customer with a telephone number which is answered from 9:00 a.m. to 6:00 p.m. Washington, D.C. Time, Monday through Friday, except for Licensor holidays, a list of which is set forth on Appendix 19.1. Customer shall have access via this telephone number to individuals who shall accept Error reports and are qualified to assist Customer with the verification of suspected Errors and who may provide solutions for said Errors. Customer shall be provided with a telephone number which is answered for all hours outside of Monday through Friday, 9:00 a.m. to 6:00 p.m. Washington, D.C. Time by individuals who shall accept Error reports.

19.2 During the warranty period, Licensor shall use its good faith efforts to immediately correct any Critical Errors affecting Customer's continued business use of the Software after Licensor's notification of the Error. Licensor will use its good faith efforts to correct all other Errors within twenty (20) days after Licensor's notification of the Error.

20. RIGHT TO MOVE **[IF APPLICABLE]**

Any Software License may be temporarily transferred to a backup computer while the licensed computer is inoperative or for emergency testing purpose. The backup computer may be at the same Customer Site, another Customer Site, or an off-site location under emergency conditions and after sufficient advance notice has been given to Licensor of the name and location of the off-site operator. Customer may redesignate the Site or the CPU on which the Software will be used for on-going operations with Licensor's consent. Customer shall be permitted concurrent operation at the new and old Site or CPU for not more than thirty (30) days and such operation will require no additional fees. Customer shall provide Licensor written notice of the redesignation within a reasonable length of time of the Software being moved to the new Site or CPU. In the event Licensor consents to the Customer moving the Software to another Customer Site or CPU, or Customer assigning the Software licensed under this Agreement, Licensor agrees that it shall continue the warranty and assist in its transfer to such other Site, CPU or assignee.

21. CUSTOMER PREPARATION

If the Software is to be installed by Licensor, the Customer shall have all things in readiness for installation, including, but not limited to, other equipment, connections and facilities for installation at the time the Software is delivered. In the event the Customer shall fail to have all things in readiness for installation on the scheduled installation date, the Customer shall reimburse Licensor for any and all expenses caused by Customer's failure to have things in readiness, unless Customer has notified Licensor at least thirty (30) business days prior to the scheduled installation date. Customer agrees to provide and bear the cost of all communications costs incurred by Licensor from the Customer site and the costs of a dedicated dial up communications facility equipped with 56KB Hayes compatible modem for the purposes of remote access and support by the Licensor consultant or phone support group. In addition, Customer shall fully cooperate with Licensor during the term of this Agreement.

- ***The contract should set forth in detail any actions the Customer is obligated to undertake to prepare for the installation of the software. This list should be very detailed and include any physical requirements such as air conditioning, modem lines, etc. The Customer should be subject to liquidated damages for its failure to meet these obligations.***

22. ASSIGNMENT

22.A Customer may not assign or transfer its interests, rights or obligations under this Agreement by written agreement, merger, consolidation, operation of law or otherwise, without the prior written consent of an authorized executive officer of Licensor . Any attempt to assign this Agreement by Customer shall be null and void. Furthermore, for the purposes of this Agreement the acquisition of an equity interest in Customer of greater than 25 percent by any third party shall be considered an "assignment."

- ***Licensor must limit the ability of the Customer to assign the Agreement to avoid losing potential license fees. In a merger or acquisition, the entity being acquired will seek to assign its pre-merger contracts to the acquiring party to avoid paying a transfer or license fee. By stating that any assignment is "void" a court will not allow the assignment. In the absence of such language the court will allow the assignment and award Licensor monetary damages even though the Agreement states it may not be assigned without Licensor's permission.***

ADDITIONAL LANGUAGE BENEFITTING CUSTOMER

22.B In the event that Licensor, with Customer's written consent, assigns or otherwise transfers this Agreement, or any part hereof, or delegates any of its duties hereunder, whether by operation of law or otherwise, to any Third Party or Affiliate and, within eighteen (18) months after such transfer, Customer, in its sole discretion, is not satisfied with the level of service provided under this Agreement, Customer shall have the right to terminate this Agreement and, pursuant to Customer's rights under Section 4.1.A, [Termination/Termination for Convenience] transition to a new software vendor. All Services provided by Licensor's transferee during the Transition Period shall be provided at no cost. Customer may assign this Agreement to any Affiliate at any time upon written notice to Licensor. Any rights granted to Customer under this Agreement to use the Software and Documentation shall inure to the benefit of any acquirer of, or successor in

interest to, Customer, whether by merger, consolidation, purchase, operation of law or otherwise.

- ***This language attempts to protect the Customer in the event that a new entity provides services or software in the Licensor's stead. While the language as written gives the Customer broad discretion as to whether the quality of services has degraded under the new provider a more objective standard should be selected such as a material increase in the failure to meet the service level standards.***

23. AMENDMENTS, MODIFICATIONS OR SUPPLEMENTS

Amendments, modifications or supplements to this Agreement shall be permitted, provided all such changes shall be in writing signed by the authorized representatives of both parties, and all such changes shall reference this Agreement and identify the specific articles or sections of this Agreement or the particular order that is amended, modified or supplemented.

24. INDEPENDENT CONTRACTOR

All work performed by Licensor in connection with the Software and/or Services described in this Agreement shall be performed by Licensor as an independent contractor and not as the agent or employee of Customer. All persons furnished by Licensor shall be for all purposes solely Licensor's employees or agents and shall not be deemed to be employees of Customer for any purpose whatsoever. Licensor shall furnish, employ and have exclusive control of all persons to be engaged in performing Services under this Agreement and shall prescribe and control the means and methods of performing such Services by providing adequate and proper supervision. Licensor shall be solely responsible for compliance with all rules, laws and regulations relating to employment of labor, hours of labor, working conditions, payment of wages and payment of taxes, such as employment, Social Security, and other payroll taxes including applicable contributions from such persons when required by law.

25. COMPLIANCE WITH LAWS

Licensor and Customer each shall comply with the provision of all applicable federal, state, county and local laws, ordinances, regulations and codes including, but not limited to, Licensor's and Customer's obligations as employers with regard to the health, safety and payment of its employees, and identification and procurement of required permits, certificates, approvals and inspections in Licensor's and Customer's performance of this Agreement.

26. SECURITY, ACCESS AND SAFETY REQUIREMENTS

Licensor shall instruct its employees, agents and subcontractors that they shall comply with Customer's security, access and safety requirements for the protection of Customer's facilities and employees while on Customer's premises.

27. RELEASES VOID

Neither party shall require waivers or releases of any personal rights from representatives of the other in connection with visits to Licensor's and Customer's respective premises. No such

releases or waivers shall be pleaded by Licensor or Customer or third persons in any action or proceeding against an employee.

28. GOVERNING LAW

The validity, construction, interpretation and performance of this Agreement shall be governed by and construed in accordance with the **domestic laws** of the State of Maryland **except as to its principals of conflicts of laws** and the parties hereto irrevocably submit to the **exclusive** jurisdiction and venue of the Federal District Court for the District of Maryland to resolve any disputes arising hereunder or related hereto.

- ***Licensor would like the Agreement to be governed by the laws of Maryland although there is some flexibility as to the particular state law. It is also important to have the venue (the location of any trial) be in Maryland. Some states such as Texas favor the Customer while others such as New York favor the Licensor.***
- ***Be certain to use the word "exclusive" to ensure that the relevant venue is the exclusive venue and the clause is not interpreted to be the "permissive" venue.***
- ***Licensor wants to avoid arbitration or alternative dispute resolution (ADR) because arbitrators tend to "split the baby". In addition, it may be very difficult to get an immediate injunction to halt the misuse of Licensor's Software. Advantages of arbitration are quicker resolution, lower cost, and lower profile.***
- ***Think carefully before including language that any software or services delivered to Customer will be considered "goods" under the Uniform Commercial Code. There may be unintended consequences to Licensor, i.e., the "perfect tender" rule.***

ADDITIONAL LANGUAGE RELATED TO DISPUTE RESOLUTION

28.A.1 Manager Level Performance Review. The applicable Licensor Manager and Customer Manager shall meet as often as shall reasonably be required to review the performance of the parties under this Agreement and to resolve any disputes. Written minutes of such meetings shall be kept by Licensor for review and approval by Customer. If these representatives are unable to resolve a dispute within ten (10) calendar days after the initial request for a meeting, then the dispute shall be submitted to an executive-level performance review as described in **Section 28.A.2.**

28.A.2 Executive-Level Performance Review. Face-to-face negotiations shall be conducted by senior executive officers of Customer and Licensor. If these representatives are unable to resolve the dispute within ten (10) calendar days after the representatives have commenced negotiations, or twenty (20) calendar days have passed since the initial request for negotiations at this level, then the parties may agree in writing to submit the dispute to mediation.

28.A.3 Voluntary, Non-Binding Mediation. If executive-level performance review is not successful in resolving the dispute, the parties may, but shall not be obligated to, mutually agree in writing to submit the dispute to non-binding mediation. Mediation must occur within five (5) business days after the parties agree to submit the dispute to mediation, and the duration of the mediation shall be limited to one (1) business day. The parties mutually shall select an independent mediator experienced in commercial information systems contract disputes, and each

shall designate a representative(s) to meet with the mediator in good faith in an effort to resolve the dispute. The specific format for the mediation shall be left to the discretion of the mediator and the designated party representatives and may include the preparation of agreed-upon statements of fact or written statements of position furnished to the other party.

28.A.4 Continued Performance. Except where clearly prevented by the area in dispute, both parties shall continue performing their obligations under this Agreement while the dispute is being resolved under this Section unless and until the dispute is resolved or until this Agreement is terminated as provided herein.

28.A.5 Equitable Relief. Notwithstanding anything contained in this Agreement to the contrary, the parties shall be entitled to seek **injunctive or other equitable relief** whenever the facts or circumstances would permit a party to seek such equitable relief in a court of competent jurisdiction.

- ***The language set forth above in Section 28.A.5 favors the Customer and should be limited. While injunctive relief is commonly accepted, specific performance is not. Thus, the language set forth above should be reduced in scope to limit equitable relief solely to injunctive relief. See Section 5.3.4 for a discussion of Specific Performance.***

29. WAIVER OF BREACH

No waiver of breach or failure to exercise any option, right or privilege under the terms of this Agreement or any order on any occasion or occasions shall be construed to be a waiver of the same or any other option, right or privilege on any other occasion.

- ***This provision states that if Licensor fails to enforce any of its rights now, Licensor is not prohibited from enforcing such rights at a later date.***

30. FORCE MAJEURE

Neither party shall be responsible for any delay or failure in performance of any part of this Agreement to the extent that such delay or failure is caused by fire, flood, explosion, war, embargo, government requirement, civil or military authority, act of God, act or omission of carriers or other similar causes beyond its control. If any such an event of force majeure occurs and such event continues for ninety (90) days or more, the party delayed or unable to perform shall give immediate notice to the other party, and the party affected by the other's delay or inability to perform may elect at its sole discretion to: (a) terminate this Agreement upon mutual agreement of the parties; (b) suspend such order for the duration of the condition and obtain or sell elsewhere Software, Software Products, or Services comparable to the Software, Software Products, or Services to have been obtained under this Agreement; or (c) resume performance of such order once the condition ceases with the option of the affected party to extend the period of this Agreement up to the length of time the condition endured. Unless written notice is given within thirty (30) days after the affected party is notified of the condition, option (c) shall be deemed selected.

- ***All force majeure clauses must be carefully reviewed to ensure that the Customer cannot automatically terminate the Agreement. It is preferable that the Agreement be put on hold until the force majeure dissipates.***

31. SEVERABILITY

If any of the provisions of this Agreement shall be invalid or unenforceable under the laws of the jurisdiction where enforcement is sought whether on the basis of a court decision or of arbitral award applicable to the entire Agreement, such invalidity or unenforceability shall not invalidate or render unenforceable the entire Agreement but rather the entire Agreement shall be construed as if not containing the particular invalid or unenforceable provision or provisions and the rights and obligations of Licensor and Customer shall be construed and enforced accordingly.

32. NOTICES

All notices, demands, or other communications herein provided to be given or that may be given by any party to the other shall be deemed to have been duly given when made in writing and delivered in person, or upon receipt, if deposited in the United States mail, postage prepaid, certified mail, return receipt requested, as follows:

Notices to Licensor:	Notices to Customer:
_____	_____
_____	_____
_____	_____
Attn:_____	Attn:_____

With a required copy to:

_____
_____
_____
_____
Attn: General Counsel

or to such address as the parties may provide to each other in writing from time to time.

- ***Always include the business person and the legal department in the notices to avoid any notice "falling through he cracks".***
- ***By requiring a second copy be delivered to the General Counsel, Licensor limits the risk that a notice could be misplaced or lost.***
- ***All notices should be effective upon receipt not mailing because the notice may get lost in the mail or delayed, potentially allowing the Customer to terminate the Agreement without Licensor ever knowing it was in breach.***

33. DISASTER RECOVERY

Licensor shall provide the telecommunications connections, data back up and disaster recovery services set forth in Appendix 33.

- **The Customer should make certain that the Licensor provides reasonable assurances as to the Licensor's disaster recovery plans. These plans should be set forth in detail in an exhibit. If the Licensor is unwilling to do so, the Licensee should retain another vendor.**

34. BACKGROUND, ENUMERATIONS AND HEADINGS

The "Background," enumeration's and headings contained in this Agreement are for convenience of reference only and are not intended to have any substantive significance in interpreting this Agreement.

35. INCORPORATION OF APPENDICES AND EXHIBITS

Appendices **[list]** referred to in this Agreement and attached hereto are integral parts of this Agreement and are incorporated herein by this reference.

36. INSURANCE

Licensor shall maintain in effect at all times during the term of this Agreement insurance with a carrier with an A.M. Best rating of A XII or better. Such insurance shall include, without limitation, worker's compensation in statutory amounts, and products/completed operations liability, errors and omissions, business interruption, comprehensive general liability and automobile insurance in amounts not less than $10 million per occurrence and $25 million annual aggregate for all claims against all losses, claims, demands, proceedings, damages, costs, charges and expenses for injuries or damage to any person or property arising out of or in connection with Licensor's performance or non-performance under this Agreement and shall designate Customer and its Affiliates as "additional insurers" on such insurance policies. Licensor shall, on or before the Effective Date and thereafter upon Customer's reasonable request, provide Customer with certified copies of all applicable endorsements and certificates of insurance, both evidencing such coverage, which shall also state that Customer shall be provided a minimum of thirty (30) calendar days prior written notice of any proposed cancellation, or expiration without renewal, and five (5) business days prior written notice of any proposed change in carriers or material terms of coverage. Upon Customer's request, Licensor shall also provide Customer with certified copies of the involved insurance policy or policies within fifteen (15) calendar days of such request. Licensor shall obtain or otherwise arrange for appropriate levels of insurance coverage for all subcontractors. Licensor shall maintain, in its files, evidence of all subcontractors' insurance coverage and shall provide proof of such coverage to Customer upon Customer's request. In the event coverage is denied or reimbursement of a properly presented claim is disputed by the carrier for insurance provided as described above, upon written request, Licensor shall provide Customer with a certified copy of the involved insurance policy or policies within ten (10) business days of receipt of such request. **Customer may withhold an amount equal to fifty percent (50%) of all monies due and to become due to Licensor under this Agreement should Licensor not comply with any terms of this Section.** The terms of this Section shall not be deemed to limit the liability of Licensor hereunder, or to limit any rights Customer may have including, without limitation, rights of indemnity or contribution.

- ***Most Customers require Licensor to provide a certificate of insurance evidencing Licensor has the required insurance from an acceptable company. Language should also be included that Licensor has the right to self-insure. Do not waive Licensor's/Licensor's insurer's right of subrogation (the right of Licensor or its insurer to sue any co-tortfeasor for their pro-rata portion of any damages award) as the waiver of this right may raise Licensor's insurance rates. This paragraph should be mutual if the Licensor is working on the Customer's property as the Licensor's employees may be injured by the Customer's employees, agents or contractors. The Licensor should never accept language that allows the Customer to purchase insurance for the Licensor or allow the Customer to offset money due Licensor for the Licensor's failure to obtain insurance.***

37. THIRD PARTY SOFTWARE

Customer shall have sole responsibility to obtain and pay for any third party software necessary or desirable to operate the Software or ABC System.

- ***Licensor will not provide any third party software unless the cost of third party software was included in Licensor's pricing.***

38. THIRD PARTY BENEFICIARIES

This Agreement is entered into solely for the benefit of Licensor and Customer. No third party shall have the right to make any claim or assert any right under it, and no third party shall be deemed a beneficiary of this Agreement. The foregoing notwithstanding, the Parties acknowledge and agree that **[list exception]** is the intended third-party beneficiary of this Agreement and, as such, **[list exception]** is entitled, subject to the terms and conditions of this Agreement, to all remedies entitled to third-party beneficiaries under law.

- ***A licensor must be careful to disclaim any third party beneficiaries to avoid a third party claiming the benefit of a warranty granted under the license. This is especially important when the software will process information or tasks for a third party.***

39. NO CONSTRUCTION AGAINST DRAFTER

The parties agree that any principle of construction or rule of law that provides that an agreement shall be construed against the drafter of the agreement in the event of any inconsistency or ambiguity in such agreement shall not apply to the terms and conditions of this Agreement.

40. ENTIRE AGREEMENT

This Agreement, the appendices, and subordinate documents referenced in this Agreement constitute the entire agreement between the parties with respect to the subject matter contained herein, superseding all previous agreements pertaining to such subject matter, and may be modified only by an amendment executed in writing by the authorized officers of both parties hereto. All prior agreements, representations, warranties, statements, negotiations, understandings and undertakings are superseded hereby **and Customer hereby represents and acknowledges that in entering into this Agreement it did not rely on any representations or warranties**

other than those explicitly set forth in Section 18 of this Agreement. Both parties hereto represent that they have read this Agreement, understand it, agree to be bound by all terms and conditions stated herein, and acknowledge receipt of a signed, true and exact copy of this Agreement.

- ***This statement prevents the Customer from trying to hold Licensor to any statements by Licensor's salespeople or those contained in Licensor's RFP response that are not specifically included in the Agreement.***
- ***The acknowledgment that Customer did not rely on any representations or warranties other than set forth in Section 18 attempts to avoid any liability for tort claims as well as contract claims.***
- ***Avoid incorporating by reference any RFP or RFP response as this may create an internal conflict with the Functional Specifications contained in the Agreement.***

ADDITIONAL LANGUAGE BENEFITTING CUSTOMER

ARTICLE Z —TIME IS OF THE ESSENCE

The Parties hereto acknowledge that the performance by Licensor and Customer of their obligations hereunder is to be done on a "time is of the essence" basis. This expression is understood to mean that Licensor and Customer are to deliver their respective Deliverables no later than the Delivery Dates therefor and that any delay in connection therewith will cause the other Party damage; it is for this reason that the Parties have agreed, pursuant to Section 3.C hereof, that liquidated damages will be imposed if delays are experienced.

- ***This clause provides that Licensor will deliver the Software on time. If Licensor is even one minute late, the delay is considered material allowing the Customer to terminate the Agreement and collect damages from Licensor. Consequently, the Licensor should think carefully before including this language. At a minimum, the language should be made mutual.***

IN WITNESS WHEREOF, the parties have executed this Agreement **under seal** as of the day and year first written above.

- ***An actual corporate "seal" is not necessary as the word (seal) is legally valid because many corporations no longer have actual "seals". The use of a "seal" in Maryland extends the statute of limitations from the three to twelve years.***

ATTEST: **CUSTOMER**

_____ **By:** _____ **(Seal)**

ATTEST: **LICENSOR:**

_____ **By:**_____**(Seal)**

- ***To be legally binding, persons signing for the Customer and Licensor must be authorized and have "signing authority".***
- ***Always use "By" and your title to limit personal liability by indicating you are signing in your corporate capacity.***
- ***"Attest" is used for a corporate licensee, "Witness" for an individual licensee.***

[6.9.00]

- ***Check the date of the form to make sure the draft you begin with is the "original" form and not a negotiated contract.***

SCHEDULES

The Schedules are very important as they may contain the crucial details of the Agreement, i.e., payment, deliverables, acceptance test procedures etc. The deliverables should be very detailed and not high level requirements documents.

DO NOT UNDER ANY CIRCUMSTANCES FAIL TO READ OR UNDERSTAND THE SCHEDULES.