PRACTICAL LAW COMPANY®

FRIED FRANK

Navigating the IP Deal: Technology License and Services Agreements for the Non-Specialist

Presented by

Practical Law Company

and

Daniel C. Glazer
Fried, Frank, Harris, Shriver & Jacobson LLP

May 23, 2012

Terminology: "Intellectual Property" vs. "Technology"

Intellectual Property

- Patents: New and useful inventions
- Copyrights: Original works of authorship
- Trade secrets: Confidential information, know-how and non-patented inventions
- Trademarks: Brands and logos used to identify goods or services

Technology and Software

- Not "intellectual property"
- May be tangible embodiments of or otherwise reflect intellectual property rights

Terminology: Types of Agreements

- Licensed Technology/Software: Proprietary materials provided for licensee's use
- Technology Services Agreements
  - Software/Website Development
  - Software as a Service (SaaS)/“Cloud” services
  - Consulting
  - Hosting
  - Outsourcing
  - Manufacturing
  - Maintenance/Support

Issues Common to License and Services Agreements

Key Representations and Warranties

- Infringement / misappropriation
  - Non-infringement warranty vs. indemnity for infringement claims
- Sufficient rights and consents
  - Protect against provider's conflicting commitments
    - Recipient can also consider non-compete and/or "most favored nation" provision
- Worms, viruses, Trojan horses and other malware
  - Protect against introduction into recipient's systems and software
- No implied warranties (e.g., title, non-infringement, merchantability and fitness for particular purpose)
  - Provider will typically seek to limit representations to those that are specifically negotiated

Key Representations and Warranties (cont.)

- Deliverables / licensed software
  - Free from defects in material and workmanship
  - Error-free performance in accordance with requirements or specifications
  - Good title / no liens or encumbrances

- Provision of services
  - Professional, competent and workmanlike manner
  - In accordance with generally accepted industry standards
  - Using fully trained and qualified personnel

Key Representations and Warranties (cont.)

- Open Source Software (OSS): Freely available, but subject to separate license terms
  - Does licensed software/work product incorporate OSS in a manner that could jeopardize proprietary status of the licensed technology or recipient's technology?
  - Due diligence:
    - Review terms of relevant OSS license agreements
      - Many OSS license terms are available at www.opensource.org
    - Does provider have and comply with internal policies concerning use of OSS?
    - Has provider modified any OSS?
    - If concerns are material:
      - Request code logs
      - Perform source code scan (Black Duck / Palamida)
      - Retain software specialist to analyze OSS use

Open Source Software Representation/Indemnification

- Representation / indemnification for "adverse consequences"
  - Provider’s use or incorporation of OSS will not:
    - Require licensing, disclosure or distribution of source code or other technology to other persons
    - Prohibit or limit receipt of consideration in connection with licensing, sublicensing or distributing any software or products
    - Allow any person to decompile, disassemble or otherwise reverse-engineer any software or products (except as specifically permitted by law)

Infringement Indemnification

- Division of responsibility for third-party claims, typically based on the party responsible for applicable conduct
  - Actions within/outside scope of agreement
  - Compliance with recipient's specification
    - Is non-infringing compliance possible?
  - Post-delivery modifications
    - To what extent was infringement due to the modification?
  - Combinations with recipient or third-party services/materials
    - To what extent was infringement due to the combination?
    - Did the parties reasonably anticipate the combination?
  - Failure to implement a work-around
    - Would implementation have eliminated the infringement?

Other Potential Indemnification Obligations

- Breach of representations and warranties – actual vs. alleged
- Breach of confidentiality/data security obligations
- Violations of applicable law
- Product liability
- Damage to tangible property
- Personal injury / death
- Gross negligence / willful misconduct

Indemnification: Drafting Considerations

- Indemnify, defend and hold harmless
  - Risk of unanticipated meaning: "indemnify" vs. "hold harmless"
  - Address defense obligation with specificity
- Do parties intend to address only third-party claims?
  - Under NY law, an indemnity is presumed not to cover claims between parties to the indemnity
- Does indemnity extend to persons other than the contracting parties (e.g., affiliates)?
  - Avoid potential conflict with “no third-party beneficiaries” clause
- Provider obligated to replace, modify or obtain license
  - Provider should retain right to terminate as "option of last resort" to avoid treble damages for willful infringement

Limitations on Liability / Damages Disclaimer

- Each party's liability limited to agreed cap / disclaimer of consequential and indirect damages
  - Potential risks and benefits
  - Consider acknowledging certain damages as "direct" or "consequential‟ to avoid future disputes
    - Direct: Immediate, natural result of breach
    - Consequential: Reasonably foreseeable by the parties
  - Potential Exceptions: Typically depends on parties‛ relative bargaining leverage
    - Indemnification obligations (especially infringement claims)
    - Breach of confidentiality/data security obligations
    - Violations of applicable law
    - Damage to tangible property
    - Personal injury / death
    - Gross negligence / willful misconduct (cannot be limited under NY law)

Confidentiality

- Clarify relationship to any existing NDA
- Confidentiality of agreement terms
  - Consider M&A exception
- Obligation to mark disclosed information as confidential
  - Consider potential benefit vs. burden
- Term limitation
  - Perpetual obligations for trade secrets
  - Some states will not enforce perpetual obligations for non-trade secret information
- Treatment of personally identifiable information (PII)
- Treatment of information on back-up tapes and leased hardware
- Avoid conflicts between “Confidential Information” and “Licensed Technology”
- Consider use of other party's trademarks to publicize relationship

Issues Specific to Technology License Agreements

Nature of Rights Granted

- Scope
  - All technology with specified functionality owned by licensor or affiliates
    - Consider effect of change of control
  - All software marketed under a particular product name
    - Consider effect of re-branded functionality
    - Consider maintenance releases and updates
- Separable rights
  - Access (appropriate for SaaS/Cloud agreements)
  - Reproduce, distribute and use
  - Modify (may be appropriate if source code license is granted)
- Geographic Scope: Worldwide, U.S. only, etc.
- Field of use: Internal business purposes vs. embedded into commercial applications

Nature of Rights Granted (cont.)

- Revocable / perpetual / perpetual & irrevocable (tie to termination provision)
- Transferable vs. non-transferable (tie to assignment provision)
- Use by other parties (e.g., use by affiliates / use by contractors for licensee's benefit)
- Number of copies provided or permitted to be made or used
- Delivery and testing obligations
- Support and maintenance obligations
  - Updates
  - Scope
  - Pricing
  - Renewals

Use Restrictions

- Licensor reserves all rights not granted to licensee
- Licensee acknowledges licensor as exclusive owner "as between the parties"
- Licensee acknowledges licensed technology is licensed, not sold, to licensee
- Prohibition on reverse engineering / reverse compiling
- <u>"Service Bureau" issue</u>: Use of licensed technology on behalf of third parties
- Obligation to replicate licensor's patent, copyright and other proprietary markings
- Compliance with applicable laws
- Licensee may not challenge validity of IP rights in licensed technology
  - Courts may not enforce provision or licensor’s right to terminate if licensee challenges validity of IP
  - Licensor still may be permitted to contract for increased royalties in the event of a validity challenge

Improvements

- May cover modifications, enhancements, improvements, updates and derivative works
- Considerations:
  - Right to create
  - Obligation to identify, disclose / deliver and/or license
  - Ownership – joint ownership creates mutual obligations unless modified by contract
    - Patents:
      - Each co-owner may license or assign its interest in the patent, without consent or duty to account
      - All co-owners must join an infringement suit to enforce against third-party infringers
    - Copyrights:
      - Each co-owner may use, license or assign its copyright interest, but must account to other owners for share of profits earned from use or licensing
      - Each co-owner can commence an infringement suit (but court may require joinder of co-owners)

Default Rules: Exclusivity and Transfer

- Licensor and Licensee should clarify intent with specificity
  - Default rules for non-exclusive licenses:
    - License grant is presumed non-exclusive unless stated otherwise
    - Right to sublicense generally not presumed
    - Licensee may not assign without licensor's consent
  - Default rules for exclusive licenses:
    - "Exclusive" license likely is exclusive even as to licensor
      - "Sole" licensee: licensor retains right to use
    - Right to sublicense may be implied
    - Split of authority as to whether licensee can assign without licensor's consent
  - Consider that analysis may differ depending on applicable IP and related rights or types of services

Restrictions on Transfer

- General rule: Non-assignment provisions triggered if licensee doesn't survive the transaction (e.g., asset sales, forward mergers)
  - Minority view
    - Reverse subsidiary merger constitutes an assignment (*SQL Solutions v. Oracle* (*N.D. Cal. 1991*))
    - Reverse subsidiary merger *may* violate provision restricting assignment "by operation of law." (*Meso Scale v. Roche* (*Del. Ch. 2011*))
- Change-of-control provisions are often triggered by a merger, asset sale and certain sales of stock/membership interests
- "Divested Entity" provisions: Avoids need to obtain certain consents upon a divestiture
  - Divested affiliate may use licensed technology and former parent can use on behalf of divested affiliate
  - Licensor may be obligated to negotiate new license in good faith with divested affiliate

Bankruptcy

- Contractual restrictions on bankrupt licensee's assignment typically are ineffective
  - Look to "applicable non-bankruptcy law"
  - Same rules as if agreements were silent on transferability
- Section 365(n) of U.S. Bankruptcy Code protects licensees of patents, copyrights and trade secrets from unilateral termination by bankrupt licensors
  - 365(n) does not protect trademark licensees
  - Parties should acknowledge that Section 365(n) applies to all non-trademark IP licenses in the agreement
  - Licensee must continue to perform and pay applicable license fees

Source Code Escrow

- Ensure present license grant
  - License grant contingent on licensor's bankruptcy may be unenforceable
  - Licensee's rights should expand to include rights to modify licensed software and provide support for customers (if applicable)
- Ensure escrow contains all necessary materials
  - Obtain representation that source code is accurate, complete and sufficiently documented to allow a reasonably skilled developer to compile into object code
    - Licensor should cooperate with escrow agent to verify
  - Initial deposit and identification of programmers
    - Bankruptcy exception to non-solicitation provision
  - Ongoing update obligation
- Common release events: Failure to provide support or update escrow, bankruptcy and pre-bankruptcy “warning signs”

IP Issues Specific to Technology Services Agreements

Intellectual Property/ Proprietary Rights

- Ownership of work product
  - Scope of “work product” should be clearly defined and appropriate
    - "Inventions" / "works of authorship"/ "ideas" (see *Mattel v. MGA*)
    - All items created or developed in performance of services vs. deliverables specifically identified in work order
    - <u>License vs. assignment</u>: To what extent does each party require ongoing rights to use, license to others or assert rights against unauthorized users?
  - Further assurances / power of attorney
- Pre-existing Rights
  - Incorporated in or otherwise necessary to use work product
  - Identification in work order
  - Recipient typically requires broad license to use
  - Use of government, military or university resources?

IP Ownership

- Consider including both assignment and “work made for hire” language
  - Work made for hire vests ownership of copyright, not all IP
    - Works made for hire are not subject to statutory termination right
      - For post-1977 works, author retains irrevocable right to terminate copyright assignment within five-year window beginning 35 years after that assignment
    - Only nine types of works qualify as works made for hire when prepared by a non-employee (i.e., a contractor)
      - Atlases, translations, tests, instructional texts, etc.
      - Software code typically does not qualify
      - Parties must agree in writing that commissioned works are works made for hire
  - Present transfer of rights ("hereby assign") vs. promise to transfer ("will assign" or "agree to assign") (see *Stanford v. Roche* (*S.Ct. 2011*))

Contact

Daniel C. Glazer

Fried, Frank, Harris, Shriver & Jacobson LLP
One New York Plaza
New York, New York 10004
212.859.8674
daniel.glazer@friedfrank.com

Matthew Fagin

Practical Law Company
747 3rd Avenue, 36th Floor
New York, New York 10017
646.231.3350
matthew.fagin@practicallaw.com

PRACTICAL LAW COMPANY®

About Practical Law Company

Practical Legal Know-how for
Law Firms • Law Departments • Law Schools

Practical resources covering **18** practice areas

Overviews, model documents, trend articles and more created by our expert attorneys

Dedicated areas for law firms, law departments and law schools

Practice centers for specialists

Instant custom market trend reports

Updates on the latest legal and market developments

Practical Law The Journal magazine covering today's transactional and compliance topics

Meet the PLC Experts

The quality of PLC's services starts with their people. Their editors practiced at the world's leading law firms and in-house departments.

HELENA SUNG

Then MTV Networks ı Baker & McKenzie
Now Editor, PLC Labor & Employment

ERIC BERMAN

Then Sidley Austin
Now Editor, PLC Finance

ERIC LEE

Then Medtronic | Georgia-Pacific | Becton, Dickinson and Company | Dorsey & Whitney
Now Editor, PLC Intellectual Property & Technology

Then American Express | Shearman & Sterling | US Treasury Department
Now Head of PLC Finance

CAROLINE DANFORD

ROBERT LAPLANTE

Then Simpson Thacher (NY and Tokyo)
Now Editor, PLC Corporate & Securities

Then CompuCredit | Delta Air Lines | Pillsbury | Alston + Bird
Now Head of PLC Commercial

SYLVIE MOTZ

TASHA HUTCHINS

Then Pfizer | Skadden | Dorsey & Whitney
Now Editor, PLC Corporate & Securities

PRACTICAL LAW COMPANY®

PLC Law Department Panel Firms

PLC's editors collaborate with a panel of law firms that contribute a collection of materials in specific practice areas.

- Alston + Bird
- Baker & Mckenzie
- Cahill, Gordon & Reindel
- Davis Polk & Wardwell
- Dorsey & Whitney
- Drinker Biddle & Reath
- Gibson Dunn & Crutcher
- Groom Law Group
- Hogan Lovells
- Holland & Knight
- Hughes Hubbard & Reed
- Jackson Lewis
- Kelley Drye & Warren
- Kilpatrick Townsend & Stockton
- Kirkland & Ellis
- Latham & Watkins
- Littler Mendelson
- Loeb & Loeb
- Morrison & Foerster
- Ogletree, Deakins, Nash, Smoak & Stewart
- O'Melveny & Myers
- Orrick, Herrington & Sutcliffe
- Richards, Layton & Finger
- Ropes & Gray
- Seyfarth Shaw
- Shook, Hardy & Bacon
- Simpson Thacher & Bartlett
- Sive, Paget & Riesel
- Skadden, Arps, Slate, Meagher & Flow
- Thompson Hine
- Vinson & Elkins
- Wachtell, Lipton, Rosen & Katz
- Weil, Gotshal & Manges
- White & Case
- Willkie, Farr & Gallagher

PRACTICAL LAW COMPANY®

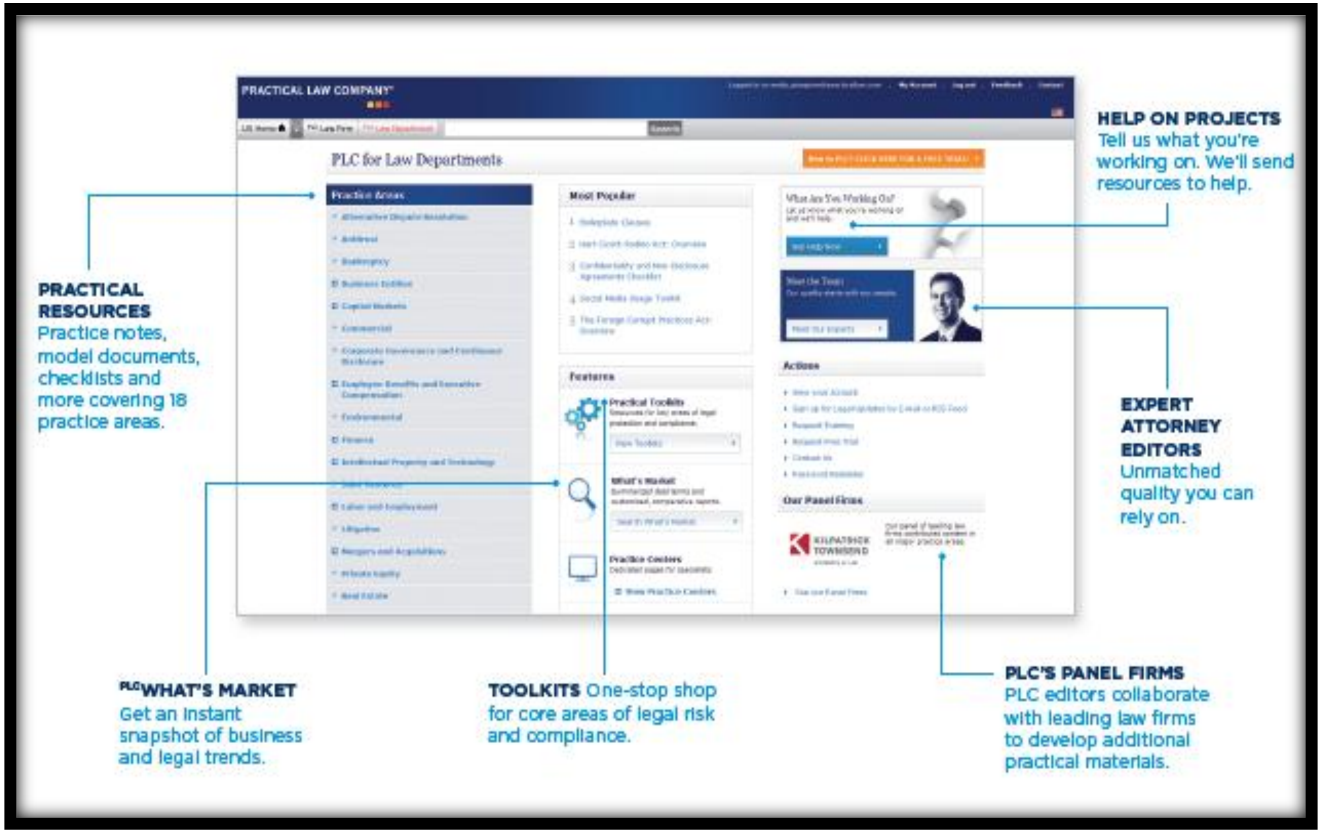
Practice Areas

PLC covers the following 18 practice areas:

- Alternative Dispute Resolution
- Antitrust
- Bankruptcy
- Business Entities
- Capital Markets
- Commercial
- Corporate Governance and Continuous Disclosures
- Employee Benefits and Executive Compensation
- Environmental
- Finance
- Intellectual Property and Technology
- Joint Ventures
- Labor and Employment
- Litigation
- Mergers and Acquisitions
- Private Equity
- Real Estate
- Tax

PRACTICAL LAW COMPANY®

PLC Law Department Homepage

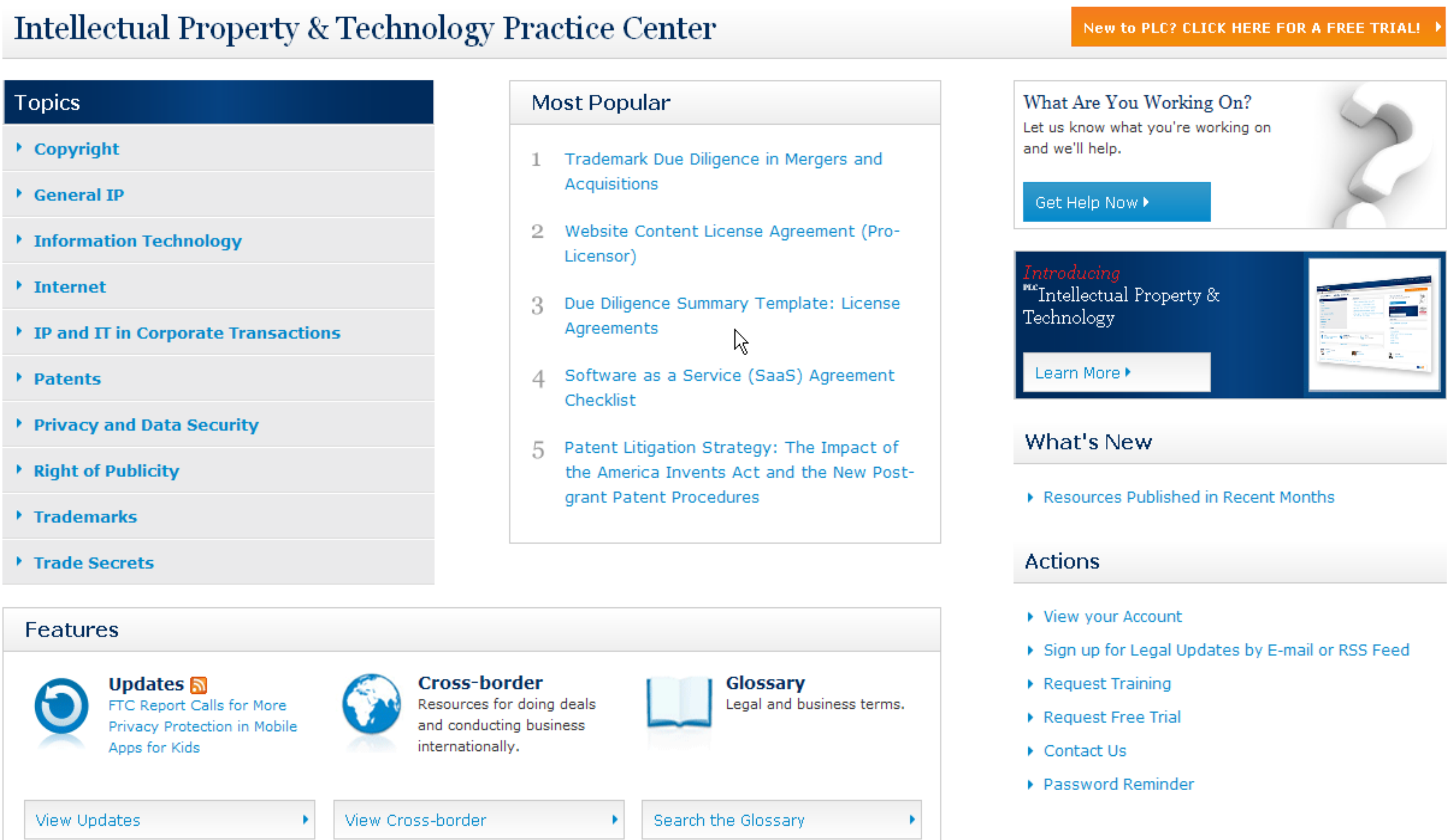


PLC's job is to make you better at yours. PLC helps you:

Get up to speed quickly | Increase efficiency
Save wasted time | Stop reinventing the wheel
Better control legal spend

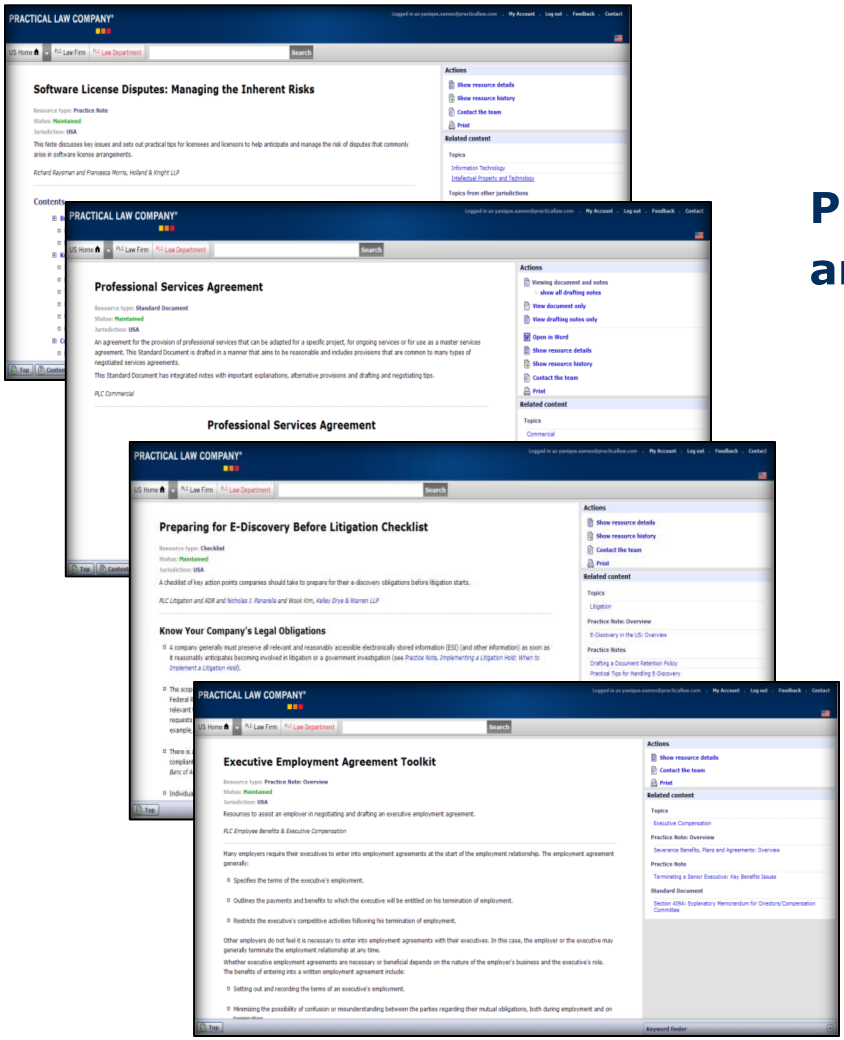
PRACTICAL LAW COMPANY®

Practice Centers



PRACTICAL LAW COMPANY®

PLC Core Resources



PLC materials reflect the highest-quality analysis and up-to-date guidance.

- How-to guides and Practice Notes
- Standard Documents and Clauses
- Checklists and timelines
- Toolkits focused around key issues

PRACTICAL LAW COMPANY®

Practice Notes

Open-source Software: Use and Compliance

Resource type: Practice Note
Status: Maintained
Jurisdiction: USA

This Note discusses key issues and sets out practical tips for companies to consider to effectively govern its use of open-source software, both internally and when developing products.

Richard Raysman, Holland & Knight LLP

Contents

Top

How and Why Companies Use OSS

Companies originally used OSS as stand-alone software primarily to support their internal operations. Today many companies:

- Combine OSS with their proprietary internal management or operations software.
- Include OSS in their customer-facing proprietary software.
- Integrate OSS into products, either as stand-alone software or with proprietary software, to be sold to customers.

For more information on how companies use OSS, see *Practice Note, Open-source Software: OSS: The Business Context*.

OSS provides several commercial advantages for businesses. These include:

- **No license fees.** Businesses can avoid paying significant license fees by using OSS instead of similar proprietary software. For example, a business could use a Linux-based operating system instead of licensing the right to deploy a fee-based operating system. From a cost-basis standpoint, OSS is especially valuable for small businesses and start-ups looking to use effective software on a tight budget.
- **Reduced development time and expense.** Software developers are often under pressure to meet deadlines and expense budgets. For a developer, it may be more efficient to download and integrate existing OSS code instead of writing new code.
- **Use of reliable code.** Instead of developing untested software, software developers can use OSS source code that has been openly tested, used and improved by others.
- **Ability to maintain and improve the code.** To have workable software that a software developer can modify and maintain, the developer must have access to the source code. However, most proprietary software is licensed solely in object code format, making it impossible for the licensee to actively maintain or improve the software. If the software's functionality declines and requires maintenance, the licensee must go back to the software owner or a third party authorized by the licensor to perform maintenance. In contrast, an OSS user can modify the code on its own.
- **Access to third-party improvements.** Some OSS licenses require licensees to disclose any modifications or improvements they make to the OSS code to the licensing organization. This disclosure requirement allows other licensees to access and implement improvements that they may be

PRACTICAL LAW COMPANY®

Standard Documents

Master Software Development Agreement (Pro-customer)

Resource type: **Standard Document**

Status: **Maintained**

Jurisdiction: **USA**

A master services agreement for the procurement of software development and related services. While drafted in favor of the customer, this Standard Document aims to be reasonable and includes provisions commonly negotiated in software development agreements. This Standard Document has integrated notes with important explanations and drafting and negotiating tips.

PLC Intellectual Property & Technology

Note: Read This Before Using Document

Hide Note

Read This Before Using Document

This Standard Document and the integrated drafting notes are for guidance in preparing and negotiating an agreement to engage an outside service provider to develop software. It is drafted as a master agreement under which, for a specified term, the customer may purchase software development and related services at agreed prices. In a master agreement, the parties set out:

- In the main body of the agreement, terms that are to apply:
  - to all software and services provided under the agreement; or
  - as a default if the parties do not specify otherwise for particular software and services.
- In separate statements of work, project-specific terms and details negotiated when each project is requested by the customer.

Master software development arrangements vary in length and complexity depending on many factors including:

- The particular services the developer may provide.
- Whether the developer is primarily creating entirely new code or customizing existing software.
- The allocation between the parties of the *intellectual property* (IP) rights in the software.
- Whether the customer is to receive the software's *source code*.

This Standard Document is drafted from the perspective of the customer. However, it takes an overall balanced approach. One-sided agreements often lead to more protracted negotiations. The drafting notes contain commentary from the perspective of each party and, where appropriate, se out alternative provisions.

Master Software Development Agreement

This Master Software Development Agreement (the **"Agreement"**), dated as of [DATE] (the **"Effective Date"**), is by and between [DEVELOPER NAME], a [STATE OF ORGANIZATION] [TYPE OF LEGAL ENTITY] with offices located at [ADDRESS] (**"Developer"**), and [CUSTOMER NAME], a [STATE OF ORGANIZATION] [TYPE OF LEGAL ENTITY] with offices located at [ADDRESS] (**"Customer"**).

Note: Parties

WHEREAS, Developer is engaged in the business of providing software development and related services and work product; and

WHEREAS, Customer wishes to retain Developer to provide the software development and related services and work product described herein and from time to time in separately executed statements of work, and Developer wishes to provide the same to Customer, each on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual covenants, terms and conditions set forth herein, and for other good and valuable consideration

PRACTICAL LAW COMPANY®

Checklists

Software as a Service (SaaS) Agreement Checklist

Resource type: Checklist

Status: Maintained

Jurisdiction: USA

A Checklist of common provisions and negotiating points for a software service provider and business subscriber to consider when entering a Software as a Service (SaaS) agreement.

Matthew A. Karlyn, Julie H. Kim and David R. Albertson, Foley & Lardner LLP

Software as a Service (SaaS) has become an increasingly popular method of software delivery to business customers. In a typical SaaS arrangement, the provider remotely hosts and manages software applications, such as e-mail, word processing and spreadsheets, which are made available to multiple customers over the internet or a private network.

In traditional software licensing, the licensor provides one or more copies of the software to the customer for on-site possession and use. The licensee-customer's top priorities in this scenario generally include the configuration, implementation and acceptance of the software.

In the SaaS model, many customers share access to the software through the provider's remotely located server, on which the customers store and process data. The customers' top priorities in this shared environment are data use, data security and service requirements ensuring software responsiveness and availability (service levels).

Because the SaaS model involves the distribution of identical or nearly-identical services to multiple subscribers, SaaS providers typically offer customers a standard set of terms. These terms may be negotiable depending on:

- The customer's bargaining power.
- The type of service.

Additional Features

Practical Law The Journal:
Latest transactional and compliance topics that impact your practice.

PLCWhat's Market:
A proprietary database of deal documents and filings.

Practice Centers:
Dedicated pages for specialists.

Cross-border Guidance:
Comparative guides to overseas jurisdictions on a variety of legal and commercial topics.

Legal Updates:
Email alerts that examine important legal, market and practice developments

PRACTICAL LAW COMPANY®

To request a free trial, visit:

WWW.PLCTRIAL.COM