Managing Risk in Technology Licensing

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Risk Management:
Ensuring Survival and Growth

- Technology (software/hardware) constitutes the crown jewels
- Software and content are intangible property & easily copied/stolen
- Software Licensors can assume too much risk by contract
- Protecting intellectual property and managing Licensor risk is essential to survival:
  - Distribution method [access to SaaS often more secure]
  - Technological protection measures [TPMs] and DRM
  - Contractual protections
  - Insurance

SaaS has evolved into a more secure platform

- Vendor/provider handles most security issues at its end
- Mainstream SaaS providers are more likely to use high level of security than small business [data protection is key]
- Small businesses don't have to worry about implementing upgrades
- Inhouse employees have less autonomy if they're merely accessing a service & not installing: greater security
- Of course ubiquity is a security challenge, and SaaS often accessible from mobile devices

Piracy Risk to Technology Companies

- Many software publishers resist copy protection: not user friendly
- “The only thing worse than piracy is if nobody pirates MY COMPANY’s program.”
- Some programs--not copy protected--require support, can be legitimized later

- Lowering price reduces some of the piracy problem
- Awareness of enforcement and strong corporate IT policies reduces piracy
- SaaS reduces risk
- Using anti-piracy organizations: BSA, SIIA

Technological Protection Measures (TPMs) - Copy Protection

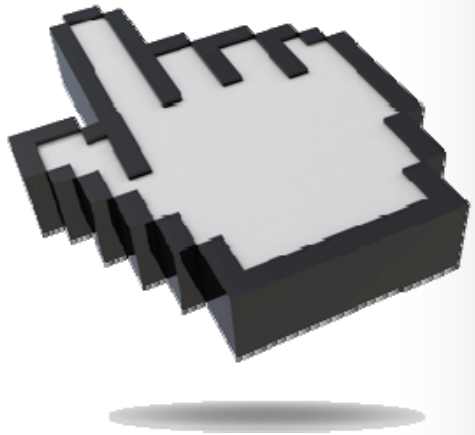
- Enshrined in Digital Millennium Copyright Act [DMCA]: anti-circumvention
- Technologies: dongles (serial numbers), keys, bus encryption, registration key, activation code, keyfiles; most tie installed software to specific machine
- Music/film: encryption, DSS, AACS [many decryption keys]
- TPMs: may not be user friendly in competitive environment
- May interfere with ability of legitimate users to modify program
- All copy protection can be hacked
- Problem most acute at low price level, not enterprise-level issue
- Enterprise-level risk is violation of license parameters; good audit rights

DRM [Digital Rights Management]

- Control use of digital media by preventing access, copying, conversion to other formats
- Legal & technical response to ripping & time-shifting [convert analog/broadcast into digital format] & easy distribution [Internet + file sharing]
  - DMCA + Art. 11, WIPO Copyright Treaty: don't interfere with DRM
  - Has not prevented anti-DRM software, e.g., DeCSS
  - DRM is most used in film and recording; iTunes, AACS for DVD, Blu-ray
  - Windows Vista has DRM: Protected Media Path (PMP) using PVP to restrict content

Protecting the Technology Company in Licenses: Procedural Issues

- Easy to ensure pro-Licensor provisions in B2C end user licenses, e.g., click-wrap
- Make sure that end user takes AFFIRMATIVE ACT to acknowledge agreement to license or terms of use
- Difficulty is in B2B transactions: large Licensee intent on negotiating
- Strive mightily to use your own template; battle of the forms with large Licensee
- Use of your own company template will speed negotiation and facilitate better terms



Protecting the Technology Company: Major Substantive License Provisions

- Representations & Warranties
- Indemnification [Infringement]
- Limitation of Liability
- Other Key Clauses:
  -Contract Enforcement

Representations and Warranties

- Licensor should try to keep its warranties as simple as possible
- Disclaim all implied warranties [merchantability, fitness for a particular purpose, infringement]
- At most warrant that the Software will function substantially in accordance with its documentation
- Exclude RFP descriptions, sales materials
- In B2C, warranty is usually “AS IS”—i.e., no warranties
- Additional warranties: matter of leverage

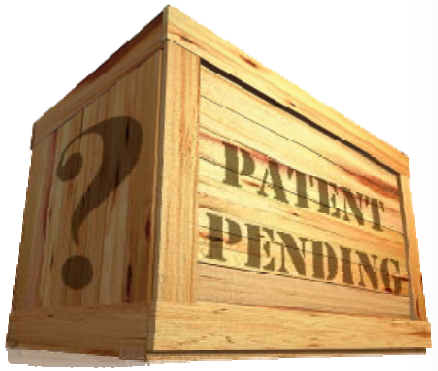
  (e.g., no virus, time bombs)

Indemnification

- Infringement indemnity is biggest risk for tech company; covers attorneys fees
- Limit as much as possible: geographic scope & liability limit
- Scope: “third party claim that Software infringes its patent rights arising as of the Effective Date in the US, copyright, trade secret, trademark”
- Try to put a cap on liability for infringement & exclude consequential damages
- Ensure that exceptions are included: e.g., if claim arose due to modification by Licensee or use on wrong equipment
- E&O insurance (& other insurance) generally does not cover IPR infringement
- OK to indemnify against breach of confidentiality, death/bodily injury, physical property damage
- Licensor should try to get Licensee indemnity for violation of license parameters/restrictions

Patent Infringement

- Comments of Morgan Chu, one of the leading patent litigators in Southern Cal.:
- Many patent litigations end up being multi-jurisdictional: patents arising both in US and abroad, hence attempt to limit scope
- But many components (esp. for hardware, e.g., chips) produced abroad, Licensees may resist scope limitation
- Small patent cases generate $4-$5 million in attorneys fees; many cases are in the $10-$15 million range in attorneys fees, especially in a worldwide battle



Limitation of Liability

- Licensor : try to limit liability to amount equal to payments by Licensee in 12 months preceding claim
- Licensee will fight for carve-outs for indemnification and breach of confidentiality (and perhaps death, bodily injury, physical property damage, esp. in prof. services engagements)
- Licensee will want consequential damages for the carved-out categories
- Secondary cap would be good for carved-out categories (e.g., three times amounts paid under agreement, or $1 million)
- Licensor should try to carve out of the cap license violations by Licensee (use exceeding restrictions/parameters in license)

Other Key Clauses: Contract Enforcement

- Click-wrap & Shrink-wrap licenses
- Delivery terms: FOB, FCA
- Enforcing license restrictions/audit
- Interest on unpaid amounts
- Attorneys fees clauses
- Liquidated damages
- Reverse engineering
- Termination provisions
- Arbitration vs. Courts
- Governing law & venue
- Non-solicitation clauses
- Non-compete clauses

Additional Risk-Related Issues

- Employee issues in agreements
  - Invention assignments & Ownership
  - Confidentiality Clauses
  - Non-solicitation covenants
  - Subcontractors
  - Work-for-hire clauses
- Open Source Software issues
- Software Patents
- Offshore Development of Code
- Protecting Trade Secrets

Additional Risk-Related Issues *continued...*

- Support issues
  - Escalation methodology
  - SLA's (uptime in SaaS engagements)
  - Supporting older versions: how far back?
  - End of life issues
  - No support: source code escrow
- Professional Services issues
  - Proofs of concept
  - Acceptance & testing
  - Revenue Recognition implications
  - Ownership of Deliverables
  - Change in scope in fixed-price engagements
- FCPA & Bribery

Insurance for the Tech Company

- Focus on technology companies of $15-$50 million in revenues (mid-market)
- Interviewed Mark Landwehr of Arthur J. Gallagher & Co. [4th largest broker] in SF Technology Practice
- Essential part of risk management analysis & many companies are underinsured
- Make sure all subcontractors show you their insurance coverage, or risk is magnified

General Liability Insurance

- Coverage from slip & fall to advertising injury
- Also obtain Products: Completed Ops coverage, for harm caused by released products (more important for toy manufacturers than software companies)
- Recommended coverage: $1 million each occurrence, $2 million aggregate; $2 million Products Comp/Op

Errors & Omissions/Cyber-Liability

- Essential for technology company, but lots of exclusions
- IPR infringement is not covered by standard policy: excluded [very costly separate Patent Infringement Policy]
- Data loss caused by your products generally is covered; harm caused to another's system
- Ensure Company has Data Breach coverage:

  hacking & misuse of data by third parties covered
- Covers monetary, not tangible injury
- $2 million each claim
- $2 million aggregate

Business Personal Property

- Covers all personal property: computers, furniture, office equipment, building itself
- Premium is based on assessment of replacement value

Business Income/Business Interruption

- May make sense in California with heightened earthquake, fire, tsunami risk
- Pays out if building inaccessible, enables continuity
- Covers temporary rental cost, utility costs
- Redundancy coverage: premium cost varies based on many considerations

Fidelity Bond/Employee Dishonesty Policy

- All companies should carry (and most do)
- Covers fraud or dishonesty by employee against the Company (e.g., embezzlement)
- Add Rider for fraud/dishonesty against third parties
- Recommend $500,000 limit for smaller companies, $1 million for larger cos.

Automobile Liability

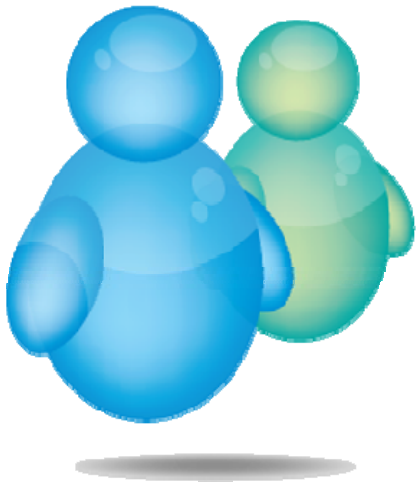
- $1 million per accident
- $1 million aggregate

Umbrella Liability

- $2-5 million each occurrence
- $5-10 million aggregate
- Available after General Liability or Auto is exhausted

Workers Compensation & Employers' Liability

- $1 million each accident
- $1 million disease/each employee
- $1 million disease/policy limit



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