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How is your Software Licence? In need of a re-boot?

As part of a series on the legal issues that can arise with software licences, this month Anne-Marie Bohan of the Matheson Ormsby Prentice Information Technology Law Group, looks at the issues to consider when determining the scope of a software licence. Next month, Yvonne Cunnane will look at the often contentious issue of who should own the intellectual property rights in software that has been specifically commissioned as well as source code escrow arrangements.

Why is Software Licensed?

Ever thought why software is licensed and not sold? Simple. The real value of software is not in the physical medium (if there is one) on which it is supplied (e.g. a CD) (and which you as the end user will legally own) but in the intellectual property rights (principally copyright) that subsists in the software and which were created as a result of the creative efforts of the original software authors. One of the principal revenue generators for a software company is the ability to charge end users for the right to use the software (license fees/royalties). In order to be able to charge these, the software company must retain legal ownership of the intellectual property rights in the software.

Think of software as a building. Think of the software company as the landlord and think of the software user as the lessee. The software company, as the landlord, owns the freehold in the building. The end user, as the lessee, owns the legal right to occupy and use the building. The value of the lease (software license) both from the perspective of the landlord (software company) and the lessee (end user) will be reflected in the lease terms (software license terms) set out in the lease (software license). It is the scope of these lease terms (the do's and don'ts) that determine whether the landlord is getting a good rent (license fee) for the building (software) or whether the lessee is paying too much or too little rent. The issues that are relevant here are discussed below.

In the next e-Bulletin we will explore the factors that are relevant to the sometimes emotive issue of who should own the intellectual property rights in any software that is specifically developed for a customer, particularly where the customer is paying a significant amount of money for the development of the software. We will suggest some solutions and also discuss the issue of source code escrow arrangements which are sometimes put forward as a compromise.

What is a License?

A licence is a permission to do something which is otherwise prohibited. A software licence gives the licensee a legal right to use software, subject to the conditions set out in the licence, in a manner, which would, but for the licence, infringe the copyright in the software. The owner of the copyright in a software program has the exclusive right to undertake or authorise others to undertake certain “restricted acts” in relation to the software. The main “restricted act” is the making of copies. Technically, the normal operation, running and use of software involves the making of copies of the software. Other “restricted acts” include adapting the software or copying an adaptation. A person who, without the licence of the copyright owner, undertakes or authorises another to undertake, any of the “restricted acts” will be infringing the owner’s copyright.

The scope of the licence is critical as its terms set out what the licensee may do with the software without infringing the intellectual property under which he or she is licensed. Software licence terms can vary significantly depending on the type of the software and the user’s commercial requirements. Typically, standard off-the-shelf packaged software is licensed on a non-exclusive, non-transferable, limited, personal basis, which permits the licensee to run one copy of the software on a single PC for their personal use only. The licence terms of non-standard software will vary depending on the particular circumstances in which the software is being acquired and the bargaining power of the parties involved. When negotiating the terms of a software licence there are a number of key issues which should be addressed by the parties. These issues are fundamental in not only simple standard software licences but also in more complex software development contracts. They assist an end user assess the value that it is getting for the amount of the licence fee it is paying.

Subject Matter

What is being licensed? It may seem obvious but the licence must describe exactly what is being licensed. Is the software being provided in object code only or is source code also being provided (very unusual)? Will new releases and updates of the software be provided? Failure to clearly identify the subject matter of the licence could mean that the licensor is licensing more than it intended or that the licensee is not granted the right to use all the software it requires. Usually, the software is defined by reference to a defined term or an appendix to the licence, which contains a description of the software. This description should be comprehensive to ensure that it does not contain inconsistencies or unintended limitations.

Parties

Who is the licensee? Again this may seem an obvious question. The licensee is the person or legal entity (company) who is licensed to use the software. Be careful with companies. If the licensee is a company which is a member of a group of companies then, in the absence of a provision in the license to the contrary, it will only be that company (and not the group) which will be authorised to use the software. If the licensor is prepared to extend the use of the software to other group companies it will most likely insist on additional license fees. Other relevant considerations are whether the licence will extend to any other companies or entities that might come into the frame in the future e.g. as a result of any acquisition, merger or reorganisation of the licensee company.

Licensed Activities

These set out what “use” the licensee can make of the software. These are the “restricted acts” which the licensee is authorised to do. If a licensee exceeds these, then it will infringe the copyright of the software owner.

Frequently one sees licenses where the licensee is granted the right “to use” the software with no further elaboration on

what “use” means. A carefully drafted software license will elaborate on:

What use can be made? This will specify the specific use and purpose for which the software can be used. It is normal to limit use to the “internal business purposes” of the licensee and to processing the “licensee’s own data”. This would restrict the licensee from using the software to provide data processing services to a third party or process a third party’s data. Remember this could mean a company in a group could not use the software to process data for other member companies of the group.

Who can use? Is it a single user, multi-user or unlimited user licence? Frequently use is limited to use by the employees of the licensee. This would exclude non-employees such as contract workers, sub-contractors and consultants. Many licensees now outsource many of their activities. Does the licence permit use of the software by the outsource service providers on behalf of the licenseef?

Use on what? Some software licences limit use of the software to specific identified processors. A change in the processor will require consent and often involve an increase in the licence fee if the new processor is more powerful or has greater capacity.

Use where? Some licences limit use of the software to a specific location. Frequently this is tied in with the issue of maintenance and support, since if there is a change in the location, the cost of providing maintenance and support may increase. Other licences can limit use of the software to a specific country or geographic region.

Use for how long? Again an important issue. Many licences are expressed to be “perpetual” but some may be for limited periods e.g. one year, three years, five years. In this later instance the licensee really needs to understand what are the ramifications of renewing or extending the licence. Can the licensor refuse to renew. Will the cost be prohibitive?

Exclusivity. Most licences are non-exclusive so that the software company is not restricted from licensing to other end users. However, in larger scale projects the issue of exclusivity can be important, particularly where the licensee is paying a significant amount towards the development of the software. Exclusivity needs to be considered carefully by software companies. There can be Competition Law issues that need to be considered. Also, exclusivity can significantly impair their ability to realise future license fees. Exclusivity can be configured in many ways. The licensee can be granted total exclusivity (although in practice this can be tantamount to an outright sale); the licensee can be granted exclusivity in a particular field of application or industry; the licensee can be granted exclusivity in a specific geographical region or can be granted exclusivity for a specific period e.g. six months or a year (this latter exclusivity can be used to provide the licensee with some “first to market” commercial advantage).

Restricted use. Many licences in addition to specifying what use can be made of the software, also specifically state what use cannot be made of the software. Examples include restrictions on the number of back-up copies that may be made and restrictions on decompiling or reverse engineering (although by law there are certain limited circumstances in which lawful users of software can legally decompile and reverse engineer).

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