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Better IT & Services Contracting

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A professional services firm specializing in IT and business services contracts, outsourcing, on demand, e-contracting, contracts processes, and contracts management staffing

Newsletter

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Feature Article

Advanced Strategies for Winning SaaS & Cloud Computing Customer Contracts

Back in the early 1970's, in the dawn of the commercial computing industry, how software should be sold was an open question. Specifically, there was no consensus on what type of legal transaction should be used. Given the then prevailing view of computing hardware and software as being indistinguishable from each other, and doubts about the copyrightability of software (software became copyrightable under the Computer Software Copyright Act of 1980), software was just as likely to be leased, licensed, or sold like a service.

Today licensing is the universally recognized transaction model under which software is sold. But software licensing continues to evolve. Open source or "copyleft" software is now commonly used in business worldwide. Entitlement management, an advanced form of user identity that administers rights to use the computing resources surrounding programs, has grown in popularity as a form of enterprise licensing.

Today, the status quo of software licensing is being called into question by SaaS and Cloud Computing. Licensing continued to make sense in the ASP days because a copy of the software program was still licensed to the customer. But SaaS and the Cloud are more about consumption than about rights to use property. SaaS customers never receive an actual copy of a program or development kit, only access at a point in time. Multi-tenancy and virtualization computing architectures on the back end further obviate the ingrained notion of a customer using a copy of software.

Open source further weighs against the use of software licenses for SaaS and Cloud Computing offerings. GPL v. 3, the Free Software Foundation's current open source license, continues the "network loophole" allowing ISVs to make open source software available as SaaS for a fee and without releasing the source code, doing an end run around the objectives of copyleft. This is because the GPL is not a true set of legally binding terms that

govern all downstream transactions. Rather the GPL acts as preconditions for further code "distribution." If the customer doesn't download a copy of the executable software or get a copy on CD and install it, no distribution takes place. The FSF seems to agree, since they approved another model license to cover the loophole. Other commentators like Tim O'Reilly also take this literal view of distribution.

Given as much, it would be both self-defeating and nonsensical to write sales contracts for open source-based SaaS products in a way that reads like a software license. Yet many if not most SaaS and Cloud Computing sales contracts read like traditional on premise software licenses or like licenses with contractual service terms mixed in. Still others boot strap service terms onto the terms of use for the Web site serving as the login portal.

Technology law professor Raymond Nimmer has pointed out the blurring of licenses and service contracts across technology industries. What has been lost with the blurring is the ability to strategically structure SaaS and Cloud Computing transactions using distinct transaction models.

The first step in forming a SaaS/Cloud transaction strategy is to define the transaction types and understand the business and legal motivations behind them.

In its strictest legal meaning, a "license" is a conveyance of property rights in something intangible; here the intangible something is software, but software made available over a network but for which no whole copy of the software is delivered into the possession of the user. Because licenses are based on property rights, any permissions and restrictions imposed on users in licenses are limited to the use of the property itself.

When SaaS apps are written in proprietary code, the first instinct of ISVs is to protect their investment by treating the software as property, creating limited customer rights in the software, and then administering the rights through conventional license terms. Second, ISVs want long term *(Continued on other side)*



About James River

James River Consulting specializes in the development, negotiation, and management of IT and business services contracts with emphasis on IT and business outsourcing and on software-as-a-service/cloud computing/managed services. James River's offerings range from short-term staffing of contracts personnel, to sales contract processes, to e-Contracts, to competitive bidding, to SaaS and BPO contracts negotiation and management. James River's president, Eric Esperne, has over 15 years experience as an in-house legal counsel and director of contracts for both large and small IT companies.

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Feature Article continued

commitments to enhance revenue numbers. But unless they are giving customers substantial rights in return, it may become difficult to justify the commitment, possibly even establish a non-illusory, legally binding contract. License-like SaaS contracts are also driven by customer fear of loss of control and the need to maintain operations without disruption.

With creating and transferring property rights comes complications, though. Providers must actively defend property rights against unauthorized use through auditing and license administration tools, which creates significant transaction costs. Providers have to worry about a variety of warranties that may arise where property is transferred. Intellectual property baggage like combination patents, reverse engineering, and archival copies must be handled. Escrow becomes more likely. Less likely but possibly, equitable claims may exist for obtaining code in the case of catastrophic failure or insolvency. Export regulations, taxes and the Convention on the International Sale of Goods may apply to international transactions.

In contrast, service subscription agreements frame the transaction either as access to software or the provision of software as a professional service. Terms are not limited to how property is used. Instead, restrictions, responsibilities, service levels, and liability terms can be made more elaborate and cover a wider range of issues. At the extreme, these agreements read like Web site terms of use, and often include a litany of

restrictions on the customer's online conduct that borders on the absurd. Whereas intellectual property rights in a license are well defined and can be enforced with a high degree of certainty, many of the terms in subscription agreements tend to sound vague, and the burden of actually proving them is in reality a difficult one. Because of or in spite of this, SaaS and Cloud providers reserve the right to change terms without the customer's mutual agreement and to suspend or terminate service without actually having to prove a violation occurred. None of this can sound very attractive to the average enterprise customer.

SaaS and Cloud Computing vendors and customers need to understand these distinct transaction models and develop strategies for employing them. Strategizing SaaS and Cloud Computing contract terms starts with asking questions like these:

- * What is the product (SaaS, PaaS, IaaS)? How does pricing jibe with projected transaction costs?
- * What is the value in creating property rights in the software for the provider? The customer?
- * What risks are treated or created by property rights?
- * What advantages are offered by using a subscription model? What are the tradeoffs?

For more, contact Eric Esperne, President at 703-850-7061 or email him at eesperne@jamesriverllc.com.

Company News

Eric Esperne Presents NCMA Seminar on the Topic of Risk Management in Complex Service Contracts Eric Esperne, President of James River, presented a one day seminar on the use of risk management tools and techniques in structuring and managing complex Government services contracts to a full ballroom of government and commercial sector lawyers and contracts professionals at the Hanscom Air Force Base Minuteman Club on January 13. Participants earned 7 continuing education credits. Eric evangelized the use of risk management as the "next big thing"

in the fields of contracts negotiation and management.

Eric Esperne to Present at ISM 95th Annual International Supply Management Conference

Eric Esperne, President of James River, will conduct a workshop on contractual and relational approaches to governance of outsourcing and services contracts at the ISM's 2010 international conference to be held April 25-28 at the San Diego Convention Center. Eric will resist all temptations to sneak off to Delmar Beach or Coronado Island.



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