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## Software Distribution, Remarketing and Publishing Agreements, 4 Computer L.J. 625 (1984)

C. Russel Hansen Jr.

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# SOFTWARE DISTRIBUTION, REMARKETING, AND PUBLISHING AGREEMENTS<sup>†</sup>

*by* C. RUSSEL HANSEN, JR.\*

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<sup>†</sup> © Copyright Hale and Dorr, 1983. Adapted from a speech delivered by Mr. Hansen on May 13, 1983 at the Fourth Annual University of Southern California Computer Law Institute.

\* Mr. Hansen is a Partner in the Boston law firm of Hale and Dorr. He has been a speaker at various institutes and seminars covering intellectual property law. He also is a member of the New England Office Systems Roundtable, an organization formed to establish user standards for office automation systems. Mr. Hansen received an A.B. degree from Harvard University and a J.D. degree from Harvard Law School.

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## I. THE ROLE OF WRITTEN AGREEMENTS IN THE BUSINESS OF SOFTWARE DISTRIBUTION

### A. THE “BEFORE” AND “AFTER” ROLES OF WRITTEN AGREEMENTS GENERALLY

Written agreements serve various purposes in business relationships, whether or not those dealings involve software or its distribution. Before the agreement is signed, the primary utility of negotiation is to make the parties *think* about what they are agreeing to and about the implications of consummating the transaction. The agreement smokes out facts and circumstances that the parties previously may not have investigated or considered relevant. After it is signed, the contract serves as a useful record of the terms of the transaction throughout the continuing relationship. Finally, the agreement may become a weapon in the event that litigation or arbitration is instituted. In the normal course of business dealings, legally binding documents generally play a small role, but that role can become crucial at times.

### B. WRITTEN AGREEMENTS IN THE SOFTWARE BUSINESS

Written agreements are significant in software distribution. The very heart of the business, the intellectual property rights, is at stake. The written agreement is one of the best means of protecting those rights. The role of these agreements is still small, however, because merely signing one is unequivocally insufficient to protect one's rights.

The party seeking to protect its intellectual property rights should make use of the “before” purposes of a contract (e.g., to make both parties think about the transaction and to smoke out certain facts and circumstances that may create problems later) and the “after” purposes (e.g., to provide a record of the transaction and the enforcement consequences) to emphasize the importance of protecting these rights. It is not enough to ask for and receive the advice of counsel. Mere technological impediments to software misuse will not suffice. Written policies and procedures regularly ignored will be equally ineffective. Awareness by the employees of a company of the need for secrecy is of little use when the working conditions or the challenge or pay levels impel the employees to find other work. Maximization of net revenues from software distribu-

tion cannot be fully achieved unless all of these factors receive careful attention.

This Article explores software distribution system agreements as a whole. "Software distribution system agreements" refers to any of the agreements among the various entities in the distribution system. These include publishing, original equipment manufacturer (OEM), distribution, dealer, independent sales organization, end user and other similar agreements. Occasional reference will be made to software protection as well.

### C. GOALS OF A CONTRACT IN LIGHT OF ITS ROLES

In view of the "before" and "after" purposes of a software distribution system agreement and its role in the larger business activity, the goals of a contract (in order of importance) should be (1) to be comprehensible to subsequent readers, (2) to evidence clearly the creation of a relationship of the utmost confidentiality, (3) to describe clearly and completely the business transaction, (4) to describe clearly and completely the legal aspects of the transaction, and (5) to interfere as little as possible with the marketing efforts of the parties. No agreement achieves all of these goals.

### D. THE ATTORNEY'S DILEMMA

Among the responsibilities of a lawyer is the duty to advise clients to enable them to weigh the business risks of the contract forms the lawyer produces. There are occasions when obfuscation in the contract is tactically preferred to clarification; when recognition of the opposing party's integrity is more important than the addition of numerous legal remedies; when the client's start-up status affords it little leverage in negotiating with Fortune 500 companies; or when the protection provided by a well-wrought contract form is worth neither the delay in closing sales nor the additional legal fees it entails.

## II. THE TEMPLATE APPROACH TO DRAFTING OR REVIEW OF SOFTWARE DISTRIBUTION SYSTEM AGREEMENTS

While there is no substitute for the exercise of one's own intellectual and intuitive capacities, checklists and templates prepared from prior drafting and negotiation experiences are useful because they represent the assembly of contractual concerns and negotiating experiences and techniques, as well as exemplify the application of legal principles. These templates are, of necessity, constantly evolving. Those set forth below represent one individual's current set.

A rough set of templates or checklists might cover: (1) the Software Distribution Marketplace, (2) the Business Transaction at Hand, (3) the General Areas of Applicable Law, (4) Analytical Considerations, (5) Contract Provisions, and (6) Sample Contracts. They are designed to be used together, but a detailed discussion of each is beyond the scope of this Article. Although brief note will be made of the other templates, those of immediate concern are (1) The Software Distribution Marketplace, (4) Analytical Considerations, and (5) Contract Provisions.

The thrust of the Contract Provisions Template is to serve as an outline for the organization and content of a given software distribution system agreement. It is a detailed, structured list of provisions. Sample provisions are not included because they are readily available elsewhere.

The Analytical Considerations Template serves a different purpose. Rather than providing a complete outline, it covers only the more significant points. Moreover, its provisions are not necessarily set forth in the order in which they might appear in any given agreement; different draftsmen will order the provisions of their contracts differently. Instead, the template's organization is designed to guide one's *analytical processes* rather than one's *drafting order*.

### III. TEMPLATE I—A LAYMAN'S SUMMARY OF CERTAIN ASPECTS OF THE SOFTWARE DISTRIBUTION MARKETPLACE WHICH AFFECT CONTRACTS AND THEIR NEGOTIATIONS

#### A. THE NEED FOR AN INDUSTRY TEMPLATE

Lawyers who know little of their client's business and its role in the marketplace generally will find it difficult to serve their clients well. Lawyers, however, are not businessmen and cannot be expected to have the same depth of understanding in business matters as their clients. Nonetheless, they must attempt, at least, to read periodicals of general circulation in the business field, and particularly those that relate to the computer field. This, along with discussions with clients and attendance at seminars and institutes should serve to improve their broad knowledge and their knowledge of the client's specific field of business. This Article does not attempt to explore the full software distribution marketplace; that has been covered elsewhere. Instead, it will focus on a few key characteristics of the marketplace that have major impact on contracts and their negotiations.

#### B. THE SCHIZOPHRENIC ROLE OF REMARKETERS IN VERTICAL DISTRIBUTION CHAINS

This Article considers third party remarketing systems rather than direct distribution systems. In these remarketing systems, every link in the distribution chain is dependent on every other link. The remarketing links, those between production and sale to the ultimate consumer, must deal with the links above and below them in the chain. They are "upper tiers" vis-a-vis lower members in the verticle chain, and they are "lower tiers" in relation to those above.

Because of the dual role played by remarketers, substantially all of the analytical considerations and contractual provisions used in one form of distribution system agreement (e.g., a publishing agreement) will be similar to those of another form of agreement (e.g., a distribution agreement). The entity which is a party to both a publishing agreement and a distribution agreement will have different (usually opposite) positions on the issues, depending upon which agreement he is negotiating. The issues and the provisions, however, are similar because both agreements involve remarketing. Although the author and the end user are not remarketers in a particular chain, experience with representing their interests has shown that similar issues and provisions are also involved in their agreements. In short, the Analytical Considerations Template and the Contract Provisions Template are omnibus checklists that will work reasonably well with any contract in the distribution system.

Because of the "universal" nature of the templates, this Article will use the terms "upper tier" and "lower tier" as a general description of the relationship between any two parties in the distribution chain.

#### C. EASE OF ENTRY INTO THE SOFTWARE MARKETPLACE

At present, the software marketplace is wide open. Although many experts expect the field of competition to narrow drastically, at present entry (as opposed to success) is relatively easy. The demand for new software is far outstripping the supply currently available. There is an enormous installed base on which to "piggyback", and the number of first-time end users is increasing exponentially. Many new entrants into the software market have successfully combined technical and marketing talents with venture capital, research and development, and public financing to develop basement operations into profitable, far flung enterprises.

This success is often a direct result of the extraordinary nature of the third party software distribution system. It is also made possible by a confluence of events including (1) increasing use of stan-

dard hardware components (e.g., Zilog Z-80, Z80A, Intel 8088 and Motorola MC68000 microprocessors, and Intel Multibus), (2) increasing use of standard operating systems (e.g., Digital Research's CP/M—, Bell Laboratories' UNIX—, and Tim Williams'/Phase One's OASIS—), (3) writing the programs in "C" and other high level languages, which have a large number of compilers written by third parties, enabling the new applications to run on the installed base of manufacturers' proprietary operating systems, and (4) creating the new programs in modular form so that the interface with different operating systems requires only a small percentage of code changes in the program.

**D. TECHNICAL EXPERTISE NOT CONCENTRATED AT THE TOP OF THE DISTRIBUTION SYSTEM**

One of the most interesting aspects of the software industry, and one that distinguishes it from many other fields of business enterprise, is that technical expertise is widely dispersed—not just among manufacturers/authors, but among the various members of the distribution system. In the automobile industry, for example, manufacturers generally have greater expertise in manufacturing and service than do distributors, dealers and consumers. Few consumers do their own maintenance or radically alter the performance or appearance of their automobiles. The opposite is true in the software industry. Many end users, such as multi-national companies, possess substantial, highly qualified in-house staffs of programmers and software analysts, many of whom are more proficient than the authors of the software packages being marketed. Similarly, most, if not all, dealers, distributors and publishers also maintain reasonably large supplies of software "mechanics."

**E. FINANCIAL STRENGTH AND BUSINESS ACUMEN NOT CONCENTRATED AT THE TOP OF THE SYSTEM**

Not only is technical expertise widely dispersed among the various links in the chain, but financial power is similarly distributed. The basement genius simply does not have the financial depth of the multi-national end user, and many publishers have distribution arrangements with OEM's, who have significantly greater financial strength than the publishers. Generally, greater financial strength is attributable to, and associated with, superior business acumen, marketing expertise and legal talent.

**F. THE SOFTWARE DISTRIBUTION SYSTEM AS MATRIX**

Although one may think of a distribution system as a chain,



with the author as the top link, the end user as the bottom link and the remarketers as the middle links, the software distribution system is more like a multi-dimensional matrix of relationships with chains moving in all directions. Independent publishers utilize distribution chains of other hardware and software vendors in addition to creating separate chains. A typical OEM has many authors and publishers above him, may be an author and a publisher himself, and will surely have many dealers and end users below him, who may also be authors, publishers, or distributors. That any such person will serve as different level links on multiple chains is one of the great strengths of the third party distribution system.

#### G. BUSINESS DEALINGS AND CONTRACT NEGOTIATIONS

Businesses must be prepared to deal with "genius" personalities represented by earnest but underqualified attorneys. Because of his uncertainty about the area of law, a lawyer may kill a deal, greatly delay it or substantially increase the cost of it. A program author may be incredibly brilliant in writing code, but he may also have an idiosyncratic personality and become paranoid or worse when he cannot control real world events beyond his keyboard and terminal. On the other hand, the lawyer representing the upper tiers must bear in mind that "upper" does not necessarily carry with it a stronger negotiating position.

#### H. A SAMPLE CONTRACTUAL IMPLICATION OF THE MARKETPLACE

If, for instance, a lawyer representing a publisher does not insist that the author grant modification rights for all lower tier members, including the end users, few large customers will be found for the new application product. If the only market is for home use, however, these end user modification rights may not be as important. The lawyer cannot simply cease his inquiry, because the publisher's distribution chain may include OEM's who need to modify the product.

### IV. TEMPLATE II—THE BUSINESS TRANSACTION AT HAND

The construction of this template is left to the reader. By using the other templates discussed herein and the information contained in other available sources, the practitioner should have little trouble creating a template for the particular transaction before him.

## V. TEMPLATE III—GENERAL AREAS OF LEGAL PRACTICE INVOLVED IN SOFTWARE DISTRIBUTION

Software distribution touches many areas of law. It is beyond the scope of this Article to discuss all of these areas. Suffice it to note that obvious fields are (1) taxation, (2) contracts, (3) patent, (4) copyright, (5) trademarks/names, (6) trade secrets, (7) anti-trust, (8) government contracts, and (8) charitable organizations, including higher education. Less obvious areas include (9) securities (under certain circumstances software distribution system agreements can constitute securities), (10) franchising, (11) consumer protection, and (12) other trade regulation. These legal areas are statutory, regulatory and decisional, and are international, national and local in origin.

## VI. TEMPLATE IV—ANALYTICAL CONSIDERATIONS

### A. FOUNDATION

For ease of recollection when one is drafting or reviewing a contract, the Analytical Considerations Template is organized into categories that are based on the ancient adage taught in grammar school English classes—describe who, what, where, when, why and how. These criteria generally serve as their own headings or sections (e.g., “when” normally is encompassed in the section of the agreement variously entitled “Term” or “Term and Termination”). More importantly, they must be considered in examining or drafting each provision under other main sections (e.g., “when” is important in drafting the duration of the program warranty).

### B. WHO—THE PARTIES TO, AFFECTING AND AFFECTED BY THE CONTRACT

#### 1. *The First Paragraph*

Do not overlook the first paragraph of the agreement. Quite often the notice provisions refer one back to this paragraph. Moreover, opposing counsel may, on occasion, try to bury something important (such as the grant of a one-year license when the business agreement was for a perpetual license) in this initial portion.

#### 2. *Other Parties, Not in the Distribution Chain, Affecting the Contract*

##### a. *Loan, Venture Capital and Other Material Contracts*

The attorney should determine whether or not the agreement will violate loan covenants, IRS capital expenditure limits, venture

capital agreements or any other material contracts. He should determine whether the agreement will be an asset if his client goes public. He should ask if his client's staff can administer it. He should inquire about problems the agreement might cause in marketing.

b. *Previous Employers or Independent Contractors—  
Noncompetition and Nondisclosure Covenants*

The software industry is characterized by high mobility. Clients are advised to require nondisclosure and, where appropriate, noncompetition agreements with their employees and independent contractors. It is therefore critical to inquire of an author, a publisher, or any other participant whether contracts containing noncompetition or nondisclosure covenants exist. More often than not, they will have been parties to such agreements, and the lawyer will be obliged to review them.

c. *Use of Representations and Warranties*

It would be appropriate to include in the agreement representations and warranties that there is no conflict with other agreements to which the party is bound, including loan agreements, nondisclosure agreements, and noncompetition agreements. It would also be prudent to request statements concerning the power and authority of the parties to carry out the agreement.

d. *Horizontal Parity and Most Favored*

While a lawyer generally considers a most favored nations clause automatically when representing the end user, he should consider seeking horizontal parity regardless of which link in the distribution chain he is representing. Competition is extremely keen, and if a competing dealer offers better terms than the dealer he represents, it will work to the competitor's advantage.

The upper tier, however, will be cautious in agreeing to grant such treatment. This clause, like so many other provisions, must be carefully negotiated and drafted. If, for example, the dealer is concerned about being competitively disadvantaged, then only the terms that address that concern should be embodied in the agreement. The upper tier should not grant a most favored nation provision more liberal than the circumstances require. In sum, the attorney must be specific.

### 3. *Parties in the Distribution Chain*

#### a. *Success, Reliability, and Strengths of Parties*

For both upper and lower tiers, the success, reliability, and technical and business strengths of the other tiers are important, and the lawyer ought to investigate this with his clients. An author anticipating high royalty income should be reasonably certain that his publisher will publish widely through an effective distribution network. A publisher, on the other hand, does not want to worry about the author's ability to correct defects on time and under pressure. The OEM wants his publisher's products promptly upon order and in adequate quantities. Although contractual provisions concerning these matters can be included in the agreement, it should be determined in advance that such expectations are realistic.

#### b. *OEM Representation and Warranty*

It is customary and reasonable to require this representation and warranty of a lower tier that is seeking a discount as an OEM. This is also necessary to demonstrate good faith compliance with the antitrust laws. Mere representations and warranties, however, are inadequate; some independent verification of OEM status is in order.

#### c. *Alternative Vertical Structures of Rights and Duties*

The simplest direct sales distribution system would consist of one author and many end users. The author would write the program and license it to the end users, who, in return, would pay the author a fee for the use of the program. Even in this simple arrangement, the relationship between the author and the various end users would be a continuing one. The author would have established a protection program for software and other proprietary information, perhaps combining copyright and trade secret protection methods. If an end user violated his rights, the author would be entitled to proceed directly against the end user by terminating the license, obtaining injunctive relief, or invoking other remedies. The end users would have continuing rights against the author, including rights under warranties, rights to software maintenance service with enhancements provided, rights to modify the programs and merge them with other programs, rights to proprietary information indemnification if the programs infringe third parties' proprietary rights, and some rights with respect to the source code. In the simple direct marketing hypothetical postulated above, the end user has direct rights against the author, and the author has direct rights against the end user.

In the complex software distribution matrix previously described, several intermediaries have been inserted between the author and the end user. Under these circumstances, the direct rights of action between the author and the end user will be altered. A number of combinations are possible. For example, the intermediaries can serve merely as quasi-sales representatives, and the direct rights of the author against the end user and the end user against the author can remain intact.

Another possibility is that each tier may be insulated from liability to the tier below the next lower tier. For example, the author might be obliged to furnish enhancements to the publisher but not to the end user. The publisher might then take on the obligation of furnishing the enhancements to the end user; the end user could then proceed only against the publisher if the enhancements were not furnished.

Still another possibility is a combination of the two methods. The author may use the insulated tier mode to pass on enhancements, so that he has no liability to the end user, but he may retain direct rights of enforcement against both the publisher and the end user. As more intermediaries are added to the list, the combinations increase accordingly.

Generally, the uppermost tier should consider in advance the appropriate combination of the various direct and indirect rights and duties. Normally, the protection program will maximize the rights of a given upper tier against lower tiers and minimize the rights of the lower tiers against that upper tier.

The paragraphs that follow describe the more significant rights that the parties receive from each other and discuss some of the considerations the parties should have in mind when creating those rights.

#### d. *Proprietary Information Protection*

The author and the publisher should consider the best method of protecting their respective intellectual property rights in the software. Whether the chosen method is copyright, trade secret or both, they must decide how enforcement measures and proceedings are to be undertaken. Further discussion of proprietary information protection (including the possible application of patent protection) is, however, beyond the scope of this Article.

#### e. *Warranty and Maintenance Programs*

Regardless of which lower tier one occupies (publisher, OEM, other distributor, or dealer), one wants the programs and the docu-

mentation to work in accordance with some warranty standards. Corrective work is provided free for some specified period of time, usually referred to as "warranty work" during the "warranty period." Normally, the upper tier will include a number of provisions and restrictions in its warranty, such as a statement that all programs have bugs in them, a requirement that all bugs for which warranty work is requested be reported on specified "trouble report" forms, and a statement that there are no other warranties being made. There may be pitfalls in making these exclusions too broad.

Generally, end users are offered the opportunity to continue the corrective obligations after the free warranty period expires, usually on an annual basis. This arrangement may be called an "extended warranty period," a "software subscription service," or simply "maintenance." In addition, this service usually includes furnishing enhancements to the working product. Generally, these enhancements include changes that make the program run faster or add capabilities to it. If the applications that the program provides are drastically changed, the maintenance fee does not include the new applications, even where the old applications are bundled into the new product. This enhancement commitment is a key tool in minimizing bootlegging, because it is inconvenient to inconspicuously enhance a large number of pirated copies.

Whether the task is correcting defects or providing enhancements, someone must do it. In the simple distribution system, the author agrees with the publisher to correct the bugs and to continue, sometimes for a fee, to provide enhancements to the publisher. Depending on the software protection program, the publisher may simply mail out new media with the corrections/enhancements on it, or he may distribute patches to the lower links for redistribution, utilizing their "transcription serialization kits" or other devices. Each tier must consider the costs of these alterations in view of the software protection program. Most commonly, the upper tiers pass along a few copies to the lower tiers, who at their own expense pass along more copies, and so on. This, of course, depends upon whether the lower tier has direct access by way of contract to a tier above his next higher tier. The usual practice is to separate the tiers so that the lower tier only has access to the tier immediately above him for both warranty and maintenance work. Under these circumstances, each tier charges its own periodic maintenance fee to the lower one, recovering its costs of correction or enhancement and a healthy markup.

If the lower tier has the duty to pass along these enhancements and corrections, then, under most circumstances, it is going to need

transcription rights from the upper tier, as well as modification rights and the source code.

*f. Lower Tier Rights of Maintenance and Modification*

The publisher may want the right to contract with other authors, such as his in-house staff, to provide enhancements or corrections; the OEM's and other lower tier links may want similar rights from the publisher or other upper tiers. The author may wish to impose restrictions in order to increase his royalty flow, to protect his pride of authorship, or to maintain software protection. If the publisher and author cannot agree, one common solution is to give the author a right of first refusal that expires if not accepted and implemented promptly.

This compromise may not satisfy the OEM, who is closer to the needs of the marketplace and who may have a highly skilled technical staff of his own. He must also compete with other OEM's and distributors and may want to create significant product differentiation. Enhancements aside, the OEM may wish to modify the programs and documentation and merge them with other applications to create multiple packaged works. Such an arrangement may stimulate sales.

The author and the publisher must consider these possibilities in advance. Typically, the publisher will want the right to approve any changes and the right to market the modified product himself. Counsel will then be requested to prepare a cross licensing agreement. The OEM becomes the upper tier in the matrix with respect to these changes.

Ideally, to maintain control over the proliferation of the software, the author should make all of these changes and encourage the lower tiers to recommend enhancements. In reality, because technical expertise and financial strength are present throughout the distribution system, and because, in the usual situation, the OEM may have modification rights to the third party software with which he wishes to merge the author's software, the OEM will receive what he wants. If, however, the author or publisher is technically and financially powerful, this will not be the case.

*g. Lower Tier Rights to Source Code and Related Matters*

Without the source code, modification rights are of little use, and the lower tiers often cannot undertake the corrective and enhancement work required of them. The software protection implications are obvious and widely discussed. Even in the absence of

modification rights, it is often important for the lower tiers to have the right to obtain the source code on the occurrence of specified events, such as bankruptcy. The lower tier should consider asking for source code remarketing rights. Upper tiers should bear in mind that many end users are equally or more technically and financially sophisticated and will request such licenses for uses in addition to those discussed above. If, however, the end users are personal home users, source licenses so far down the chain will not be necessary.

#### *h. Transcription Rights*

In many cases, the upper tiers, such as publishers, will not want to maintain massive inventories of software, but will wish to spread the burden among the lower tiers. This can be accomplished if the publisher makes all of the copies and requires minimum inventory stocking; more commonly the publisher grants lower tiers limited transcription rights. In export sales, it may well be cheaper and faster to ship one copy of the software and allow the foreign licensees to make the copies.

In connection with their software enforcement programs, most mass marketing publishers provide "serialization kits," together with various end user unilateral or bilateral contracts, registration cards and enhanced support techniques, to maintain some control over the distribution. With respect to reproducing the computer program portion of the software, these kits seem to work well. With respect to the human readable documentation, a choice must be made. Normally, reproduction rights of the human readable documentation are withheld because the upper tiers have developed special packaging techniques to enhance the sales appeal of the product. The OEM which combines a series of computer programs to form an updated or even derivative work will not wish to give the end user or distributor ten user manuals relating to one program. The OEM needs to write his own manual, using the ten user manuals for reference and copying.

#### *i. Trademarks, Tradenames, and Private Branding*

A detailed discussion of trademarks and trade names is beyond the scope of this Article. In brief, trademarks and trade names must be protected by including limitations on their use, requiring faithful reproduction when they are used in a limited fashion, and maintaining rights of approval over even restricted use. If the author is not concerned about this, he must nevertheless take care in private branding.



Private branding is particularly common among hardware vendors. The vendor puts his own brand on other vendors' printers, monitors, and, to a lesser extent, disk drives. Most publishers also use their own brands on software which they do not own, but which is licensed to them by authors for remarketing. In theory, one is entitled to permit others to private brand one's copyrighted material so long as the appropriate copyright and other notices are affixed. Numerous copyright notices, warning legends and other proprietary notices conspicuously sprinkled throughout the documentation and programs may be warranted.

Private branding is widespread; the usual contractual treatment (in addition to requiring a plethora of notices, legends and labels) is to allow the private brander to put whatever names he wishes on the product, so long as he does nothing inconsistent with the proprietary rights of the licensor in and to the product.

j. *Lower Tier Indemnification*

Apart from the usual preconditions to indemnification and the ceilings which the indemnitors seek to put on these obligations, the distribution structure of the indemnification obligation must be considered. Generally, the market accepts the tier insulation structure found in other areas; the upper tier indemnifies the next lower tier, for such things as copyright infringement, to the extent of that tier's losses from the claims of the next lower tier. A middleman in this indemnification picture ought to agree to indemnify the lower tier only to the extent that he is indemnified by the upper tier.

This does not mean that this type of provision should necessarily be used, but only that many clients are developing the habit of using this structure.

k. *Upper Tier Indemnification*

In many contracts, the upper tier will convert the exclusions from its liability to the lower tier into events with respect to which the lower tier must indemnify the upper tier. For example, if the upper tier excludes indemnification for infringement of foreign patents, it may try to require the lower tier to indemnify it for such infringement. If the upper tier excludes liability for use of its programs with user data, it may seek indemnification therefore. After the unfairness of this is pointed out, the matter is usually resolved by providing that neither party has any liability to the other under such circumstances. The upper tier may well suffer damage from these liabilities, however, so it is not unreasonable to include some provision in the first draft.

1. *Upper Tier Rights*

As previously noted, in contrast to tier insulation which characterizes the liability of the upper tiers to the lower tiers, direct rights, via separate contract, assignment, or grant of powers of attorney, against *each* of the lower tiers, not only the one immediately below may be granted to the upper tier. The principal purpose of these direct rights is to protect the intellectual property of the upper tier, but the upper tier will not be averse to tacking on other direct rights where possible.

- m. *Classification of End Users*

In analyzing the parties who may be affected by the agreement, the particular market segments of end users must be considered. The complexity of the software distribution market is compounded by the various methods that publishers and distributors use to allocate market shares among the lower tiers. One method of allocation involves territorial restrictions. Another method limits the nature of the end users to whom the product may be marketed. For example, one dealer may be authorized to market to dentists and doctors but not to health care maintenance organizations or hospitals.

- n. *Summary*

Any software distribution system agreement affects many parties. The distribution chains and organizations within the system are complex and irregular. Counsel who has been asked to review or draft an agreement for a client in the software distribution system must learn from his client the nature of the parties who will be involved in the particular distribution structure and of those who may otherwise affect the agreement.

### C. WHY—THE REASONS FOR THE TRANSACTION AND FOR CERTAIN CONTRACT PROVISIONS

1. *"Whereas" Clauses, "Preliminary Statements," and "Factual Backgrounds"*

Many contracts that do not use introductory clauses are perfectly adequate. The careful draftsman, however, may decide that some early creation of "mood" is useful. The contract may be distributed to branch offices to ensure compliance; it may be read by salespeople to ensure compliance; it may be subject to later arbitration or litigation. Although both sides should be willing to agree that the whereas clauses don't form a part of the agreement, the introduction not only provides one an opportunity to set the tone for

future readers, but also forces one to look at the forest as a whole before plunging into the trees.

The introduction should contain the key points, or at least the key factual circumstances, of the transaction, upon which the contract will elaborate. These may include (1) a description of what the upper tier is contributing to the transaction, (2) a description of what the lower tier is offering, (3) a statement that a bundle of rights and remedies generally constituting either a license or a sale arrangement is involved, as well as the provision of support services, and (4) a statement of the significance of confidentiality in the relationship.

*2. Other Provisions of the Agreement in Which "Why" Should be Included*

Like the other broad categories of the template, the "Why" is not limited to one portion of the agreement. It may be helpful to explain the purpose of a specific clause, particularly when the explanation bolsters the rights granted in the provision. The classic example is the injunctive relief clause, which typically explains that the reason injunctive relief is granted under the agreement is that delay may cause injury for which the remedy at law is inadequate.

**D. WHEN—CUT-OFF PERIODS FOR THE AGREEMENT AND VARIOUS PROVISIONS**

*1. Term of the Agreement*

Most contracts have a separate provision setting forth the term of the agreement. It may be for a specified period of years or in perpetuity, or it may expire when a certain number of sublicenses are granted.

It is easy to be lulled into granting a perpetual license, and in most cases it is appropriate, if the license is subject to termination. The perpetual term ought not to be accepted without prior consideration of its appropriateness, however. For example, the newest waves of microcomputers employ sixteen bit microprocessors either separately, as coprocessors, or in tandem, as in the so-called perpetual processors or "fault tolerant" systems. All of these chips are assemblers, and the probability that different parties will write the same code for similar operations or applications is not small. With the possibility of claims for infringement increasing, it may be useful to limit one's liability by limiting the term of the license. The limited term serves as a practical limit on exposure. Exposure is of concern not because the client in fact may have copied another author's works or may have used someone else's trade secrets, but be-

cause the programming may give the *appearance* of infringement or misappropriation. The expense and aggravation of defending a lawsuit in which the client will be proven innocent must be avoided. In effect, by limiting the duration of the license, the time period for claims and the amount of damage caused to a particular customer are being limited. This technique is not yet widespread.

## *2. Time Implications of Other Provisions*

It may be more satisfactory to limit not only the term of the agreement, but also the duration of the various provisions. The best example of this is the 90-day, 120-day, or one-year performance/manufacturing warranty that is often provided. It illustrates again how one of the large categories, "When," applies not only to the agreement as a whole but also to individual provisions. Most perpetual licenses, for example, do not contain a time limitation on intellectual property rights indemnification.

In addition to limiting the time period of the provisions covering (1) the contract as a whole, (2) the product performance and manufacturing warranties, and (3) the indemnification for infringement or misappropriation of intellectual property rights, one might consider the effect of time limitations on provisions concerning (4) confidentiality, including supplementary non-disclosure agreements that may be required of employees, (5) noncompetition, (6) source code licensing, (7) software subscription/maintenance service, (8) private labeling, (9) training, (10) sales support, (11) lower tier business standards, (12) other types of representations and warranties, and (13) standard and miscellaneous terms and conditions, such as the passing of risk of loss, occurrence of delivery, acceptance, and order and delivery periods.

## E. WHAT

### *1. Matters Covered*

The bulk of any agreement is the "What" portion. This section of the Article will consider the organization of concepts by use of definitions and schedules, the key appropriate considerations for confidentiality, the issues of exclusivity and noncompetition, the grant of principal rights, payment alternatives among authors, publishers, and other tiers in the distribution chain, provisions which might be added to confirm what the parties have discussed, such as representations and warranties, a collection of supplementary rights and duties that are useful in implementing and rounding out the fundamental rights, and possible problems and remedies.

## 2. *Definitions*

Definitions are useful tools for making a document easier or more difficult to read, and for trapping the unwary reviewer or draftsman. Terms may be defined throughout the document as the need arises, or a list of definitions may be inserted at the beginning or end of the document. In drafting computer related contracts, a list at the beginning of the document is the most effective method. It gives the reader a sense of the quality of the draftsman and sets up immediately the distinctions that are being made in the document. It is simpler to draft the definition separately than to insert it awkwardly into the middle of a sentence; it is also easier for the reader to comprehend the meaning when this method is used. Finally, since most of the defined terms will be used immediately after the section, they are readily accessible to the reader.

Lengthy negotiation can be avoided by including a controversial principle in a definition. One has a tendency to think of definitions as mere mechanical conveniences, and may therefore overlook their substantive impact. The confidentiality provisions, for example, have far different ramifications if one defines "proprietary information" as all information furnished by one party to the other, rather than as all of such information which is marked as proprietary information. When the term is then used in the confidentiality section, it sounds reasonable and may not be questioned. This is not to say that one ought to include unreasonable provisions in the contract whenever possible. Relegating tough problems to the definitions section, however, may reduce argument, or at least isolate the area of disagreement. Where subtle drafting may be required, and nuance may be of some benefit, the definitions section is an excellent place to make use of them.

A tight set of definitions can make the document eminently readable. Aptly choosing the expressions to be defined will reduce a cumbersome document to a meaningful one. The client will be irritated if he is handed several pounds of poorly written paper; he will not enjoy asking the lawyer to explain the meaning of particular clauses. If the document is to be widely distributed, to mass marketed software licensees or among the branches to assure compliance with its provisions, it must be clearly written to be understood. Definitions can help accomplish this. It should also be remembered that, in the event of litigation, courts in most jurisdictions will interpret ambiguities against the draftsman of the document.

Some terms may not warrant a lengthy definition. Terms of art and jargon may be dealt with by providing that they shall have the meaning ascribed to them by a specified computer dictionary, such

as Sippl and Sippl, and if not defined therein, shall have the meaning generally given them in the industry.

### 3. *Schedules*

At times, salting away the restrictions in the definitions section simply will not do. For example, if one attempted to define use as possession, demonstration, copying, transcription, modification and so forth, and then attempted to limit the scope of those various processes, the definition would be unworkable, and possibly unenforceable. The normal tendency to describe what may be done, and then to describe everything that may not be done, out of fear that the former may be misinterpreted, must be avoided in the definitions section of the agreement.

When the concepts are too large to be treated in the definitional section, it is appropriate to put them in schedule form or in the contract's main body. The advantage of schedule form is that it is a modular structure that allows the parties to discuss the concept as a separate matter, without interfering with their thoughts on the agreement as a whole. If left in the main body of the agreement, negotiated changes will have to be made throughout the agreement because of the ripple effect of making changes. If the concepts are set forth on schedules, however, the ripple effect is less likely to occur.

### 4. *Confidentiality*

#### a. *Location of Principal Confidentiality Section*

The portions of the agreement dealing with confidentiality are familiar. Because of their importance, confidentiality provisions should be placed at the beginning of the contract, either after the definitions or with legends at the top of simpler agreements. If the contract does not read smoothly with this placement, perhaps because the matters to be kept confidential have not been discussed in the agreement yet, the confidentiality provisions should still be placed as close to the beginning as possible.

#### b. *Other Locations*

Confidentiality, like the "time period" concept, ought to be liberally sprinkled throughout the agreement. Not only should one discuss it in the agreement's sections for the "preliminary statement" and "confidentiality," but one should also take the opportunity to include it in (3) "relationship of the parties" (where one typically sets forth the independent contractor status of the parties), (4) "definitions" (under such defined terms as "programs," "object code," or "source code"), (5) "grant of license," (6) "ownership of the

software," (7) "transcription rights," (8) "modification rights," (9) "representations and warranties of upper tier," (10) "intellectual property indemnification," and (11) "remedies".

c. *The Risks of In Terrorem Provisions*

A contract may provide that a breach of the confidentiality obligation, however trivial, constitutes a material breach under the default provisions; but the lawyer must beware of the paper tiger. If he constructs a beautiful contract with all of the provisions favoring his client, the client must be prepared to enforce its rights in the event of such a breach. If he sits on his rights, his conduct will undermine the confidentiality provisions so carefully woven into the agreement. Issues of unconscionability aside, an upper tier may lose the whole secrecy issue by pushing too hard on a detailed provision it had no intention of enforcing—notwithstanding the language providing that waivers on one occasion do not constitute waivers on subsequent occasions.

5. *Exclusivity and Noncompetition*

Much has been said about whether license agreements should be exclusive or nonexclusive, whether or not it is appropriate to include a noncompetition provision in any particular agreement, and whether or not a noncompetition clause is enforceable. This Article will not address these topics in detail, but a few points are worth noting.

In many arrangements, exclusivity and noncompetition go hand in hand. If an author grants a publisher the exclusive right to do all the things appropriate in the publishing arrangement, then the author ought not compete with the publisher. Farther down the line, however, many OEM's grant exclusive licenses in particular territories, while reserving the right to sell directly in those territories.

As complex as the software distribution system is, it still has not developed the sophisticated devices that are prevalent in the distribution systems for other goods and services produced and sold in the United States. For example, the issue of creating exclusive territories and dealing with transshipping from one exclusive territory to another is seldom confronted. As the industry continues its process of growth and maturation, however, antitrust issues will present themselves for resolution.

One of the themes of this paper is that attorneys must act with some degree of due diligence. This requires asking a line of questions of the client so that the lawyer fully understands the transaction. This questioning is also beneficial in assisting the client in his

thought processes. For example, a client may be comfortable in granting nonexclusive licenses without territorial restrictions to various OEM's and distributors. He may be even more comfortable in granting exclusive territorially restricted licenses to OEM's in other countries. It is not enough, though, to hear from the client that he is comfortable with granting these exclusive licenses. The lawyer must also inquire whether the client himself ever intends to open branches or establish subsidiaries there. Quite often a client will reply with a quizzical expression and then realize that he does intend to establish such offices and that the grant of an exclusive license would preclude that. In any case, exclusive licenses restrict the future flexibility of the grantor and generally should be avoided whenever possible.

Noncompetition also can serve as an enforcement right supplementary to the nondisclosure obligations that another party has agreed to assume. The primary use of noncompetition clauses is in employee nondisclosure agreements. This coupling, however, should be used whenever appropriate, not only with employees.

Exclusivity and noncompetition are exceedingly sensitive issues, in terms of their enforceability and the likelihood that the parties will in fact abide by the terms. They can create, at the beginning of a transaction, ill will that later sours further. Courteous negotiations and accurate draftsmanship are required.

## 6. *The Principal Grant of Rights*

### a. *The Fundamental Rights*

Whether or not it is evident, the contract always contains a grant of some fundamental rights, such as the right to use internally, the right to reproduce, or the right to demonstrate. Elsewhere in the agreement there will be supplemental provisions restricting, explicating, or even reducing some of these fundamental provisions. The first task, before becoming immersed in the detailed provisions, is to identify the fundamental rights to be included. Under a variety of circumstances, these may encompass (1) furnishing of services to write the programs and documentation, (2) outright sale of all rights in the programs and documentation, (3) copying for internal use (4) demonstration, (5) reproduction, (6) modification, (7) marketing, distributing and sublicensing, (8) maintenance, (9) rights to future products, (10) developmental programming, (11) modification for remarketing, (12) technical assistance, (13) possession, (14) testing, (15) training, and (16) private branding.



b. *Internal Use or Remarketing*

One must consider whether these fundamental rights are to be licensed for internal use only, or whether the lower tier should have the right to pass them along, and, if so, how far down the chain. For example, is the grant of the right to demonstrate the system limited to demonstration to one's employees, or does one have the right to demonstrate the system to customers?

c. *The Tangible Property*

One should assure that the rights apply to specific tangible things, such as (1) media, (2) object code, (3) source code, (4) programs, (5) test aids, (6) tutorials, (7) machine readable documentation, (8) user manuals, and (9) technical manuals.

d. *The Intangibles*

In addition to this tangible items, there are rights in intangibles: ideas, concepts, and know how. Consider them also in the drafting or review.

e. *Specific and Complete Analysis*

The upper tier should be conveying different rights in each of these items of property, each with some pricing, bundled or otherwise, and with various termination dates and other consequences. Be specific and complete.

7. *Payment*

In this section, the Article temporarily departs from the upper tier/lower tier approach. Because there are usually more custom tailored arrangements between authors and publishers than among other remarketers, the discussion will concern authors and publishers. Note, however, that all of the thoughts presented can apply to the other remarketers. Also note that the discussion does not cover more routine payments, such as annual maintenance fees.

a. *Minimum and Maximum Aggregate Payments*

An infinite number of payment arrangements are available, many of them bearing little resemblance to one another. Most, however, involve minimum and maximum payments and a time period over which the royalties are paid. The publisher, of course, seeks to establish a ceiling on the payments, while the author wishes to create a floor.

b. *Up Front Payments*

The author has expended time and cash out-of-pocket, and has foregone other job opportunities in order to write the programs or the documentation. Normally, he expects some form of up front payment, based on his expected hourly rate, to cover the cash disbursements and lost opportunities. If the publisher must make a "down payment," he would prefer to characterize this as an advance against future royalties, rather than as a nonrefundable payment. Naturally, the author would prefer the opposite approach.

c. *Timing of Periodic Payments*

The publisher does not know if the programs will really work after beta testing, and, although he thinks there is an unlimited market, he ought not to delude himself about how fast he can penetrate it. The publisher's inclination ought to be to pay as the product is sold or when he has received payment from the lower tiers. If the author is amenable to this unpredictable payment flow, he at least ought to request payment when the product is remarketed rather than when the publisher is paid.

d. *Minimum and Maximum Periodic Royalty Payments*

Although the author and publisher may have agreed to minimum and maximum aggregate payments, it is often useful when representing the author to insist upon a regular flow of minimum payments, or periodic advance royalties, regardless of when the "sales" are booked or paid. If the publisher accedes to this demand, he ought to require a maximum as well. In each case, the author and the publisher are attempting to deal with the vagaries of the marketplace.

e. *Fixed Rate Installment Payments*

If the author doubts that the maximum aggregate price will ever be reached, he might wish to separate the royalty stream from the publisher's sales by requiring an installment payment plan for something less than the maximum amount. Although this might also be accomplished by minimum periodic royalty payments, each minimum payment is likely to be less than each periodic installment payment of the "purchase price."

f. *Optional Buy Out Price*

The publisher should consider requesting a "buy out fee," a price he can pay at any time during the contract, before the maxi-

mum aggregate payment is reached, to obtain a fully paid up license. If the author is willing to accept this term, he should establish different buy out prices at various points during the term of the contract to motivate the publisher to elect or not to elect the option. For example, the buyout price could be relatively low initially and increase as time passes.

*g. Security for Payment*

The author might also concern himself with the publisher's ability to pay. Security for the payment of some portion of the maximum aggregate royalties may be in order. The simplest form of security for the author is a letter of credit. When the issuer, via the letter of credit, has a security interest in the property of the debtor (publisher), however, problems beyond the scope of this Article arise. In brief, the solution to these problems is to have the author "equally and ratably secured" with the issuer in the collateral of the publisher.

*8. Confirmations*

*a. Role of Representations and Warranties*

In many contracts, the detailed description of the programs and related documentation is contained in the principal grant of rights. While this is often appropriate, there are occasions when the description ought to be set forth elsewhere, because a significant amount of detail is needed for a clear and complete description of the products being sold or licensed or the services being rendered. It may be useful to set forth the specifications in separate schedules instead of interfering with the flow of the agreement by including them in its main body.

There are, however, several types of brief statements that the lower tier should request the upper tier to make and vice versa. Those statements, which are often referred to as representations and warranties, may relate not only to the products and services, but also to the general ability of the parties to the contract to enter into it, to be bound by it and to implement and observe their obligations under it.

*b. Confirming Ownership or Remarketing Rights*

The lower tier ought to be concerned about the ownership of or rights to use the subject matter of the agreement—principally the computer programs, the documentation, and the intellectual property rights. Accordingly, it would be appropriate for the upper tier

to make statements about its ownership of or its right to use and to sublicense these items of tangible and ingangible property.

c. *Compliance with Specifications and Other "Product Warranties"*

It is also reasonable for the lower tier to request statements about the quality and performance of the products: that the products comply with detailed and functional specifications, that there are no defects in material or workmanship, and that the products otherwise perform in accordance with agreed upon standards.

d. *Marketing of Proprietary Information*

When a party to contract is required to maintain the confidentiality of information which the other party marks as proprietary, the party with the burden of secrecy is entitled to a statement that the material so marked is in fact proprietary. This statement ought to reduce the amount of material unthinkingly classified as proprietary.

e. *Other Confirmation of Remarketing Rights*

The upper tier should be concerned with the power, authority, rights and impediments relating to the performance by the lower tier of its obligations under the agreement (i.e., the general representations and warranties). It is also entitled to assurances that the lower tier is an OEM, if the pricing has been determined on that basis. If the lower tier intends to remarket the products of the upper tier in conjunction with products of other suppliers, by modification, or simple bundling, the upper tier is entitled to statements relating to the ownership of and rights to use and remarket the products, as well as statements relating to the intellectual property rights which are intended to be remarketed.

f. *Crispness*

The utility and advisability of thinking clearly and writing crisply in order to implement the expectations and agreement of the parties must be stressed. The particular problems that may arise in light of the niche the parties occupy in the software distribution system must be anticipated.

9. *Supplementary Rights and Duties*

a. *Role of Covenants and Agreements*

Intellectual property contracts contain provisions covering the

secondary and tertiary duties and commitments of the parties to the contract. In most contracts, these obligations are scattered without apparent order. Both the Analytical Template and the Contract Provisions Template consider these duties and organize provisions into two sections: the additional duties of the upper tier (concerns of the lower tier), and the additional duties of the lower tier (concerns of the upper tier).

b. *Concerns of the Lower Tier*

In general, the upper tier furnishes more than products. It also furnishes training in the use of the products, maintenance, enhancement, and other support services, and correction of programs or documentation that does not work or otherwise fails to meet the standards set forth in the representations and warranties section.

That is not enough, however. In addition, the products ought to have some good will or reputation in the marketplace; the lower tier should expect the upper tier to undertake advertising, promotion and other marketing activities, including continuing enhancements, to keep the product active. The upper tier ought to be obliged to supply sales literature, advertising mats, and materials on a prompt and adequate basis. If the policies of the upper tier require the lower tier to affix labels, obtain registration cards, or obtain end user license agreements or other materials, the upper tier should furnish these materials to the lower tier. If the lower tier is not permitted to copy the programs and documentation, the upper tier ought to be obliged to ship them promptly and in quantities adequate to meet the best needs of the lower tier. If the lower tier has transcription rights, it ought to have the right to maintain an adequate inventory of copies of the software, and not be restricted by the typical single use/archive copy limitations.

c. *Concerns of the Upper Tier*

The lower tier has duties as well. Presumably it has been selected for its past or potential marketing and sales abilities. The upper tier may have passed over other potential remarketers in favor of the one selected. Therefore, it is not unreasonable to require the lower tier to maintain a well qualified technical and marketing staff, adequate storage, sales and other facilities, and adequate amounts of inventory and promotional brochures. The lower tier also ought to agree to actively promote distribution by advertising or otherwise.

If the policies of the upper tier require labels, warning sheets, registration cards, executed and user agreements, or other procedures, the lower tier ought to agree to observe these requirements.

d. *Reporting and Policing Concerns of Both Parties*

It is quite common to require the lower tier to keep the upper tier informed by providing monthly reports of sales, by immediately reporting violations of the confidentiality provisions, and sometimes by furnishing customer lists. Although the lower tier ought to resist furnishing customer lists to the upper tier, if its negotiating posture does not permit it to resist this requirement, the upper tier at least ought to agree to maintain the lists in confidence, and not to use them for any purpose other than trade secret enforcement. As part of the reporting requirement, the lower tier should be required to police the intellectual property rights of the upper tier and to assist in enforcement thereof. There must obviously be some discussion about who should bear the cost of the assistance of the lower tier in this regard. Finally, any provisions that are to be "passed through", directly or indirectly, to still lower tiers should be set forth in the agreement as duties of the lower tier.

e. *Supplementary Concerns of Both Tiers Beyond the Capabilities of the Agreement*

Any link in the distribution system builds its reputation and business on the reputation of the other links in the chain. Consequently, it should also give and receive a commitment that goes beyond the dry terms of the contract—a commitment based on an understanding that the contract can not cover everything despite the best efforts of all concerned. The contract itself can sometimes help create and sometimes undermine this emotional or psychological commitment.

The lawyer must contribute to the spirit of mutual support, or discover why it is not being achieved. If the other party is simply naive, the lawyer must encourage him and his attorney to learn. This situation should be distinguished from one in which the other party is far from naive, and merely wishes to generate sales, without making himself available when problems arise. The lawyer should give his client the benefit of his instincts and observations, both legal and nonlegal. The client can then weigh for himself the merits of his lawyer's nonlegal judgments.

10. *Problems*

The next set of fundamentals concerns what happens if the parties' expectations, as evidenced by the contract, are not fulfilled. These concepts are normally embodied in a section called "events of default," but may also be sprinkled in other provisions of the agreement. The events of default, such as nonpayment, nonperformance,

breach and bankruptcy are well known and will not be reviewed in detail.

They must be well drafted, however. If the event of default arises out of nonpayment, there ought to be a provision for notice and a cure period. If the default is for failing to keep liens off the property, the lien ought to be permitted if it is being contested in good faith and by appropriate legal proceedings. Voluntary filings in bankruptcy and involuntary petitions ought to be distinguished, and, in the case of involuntary petitions, a time period to cure ought to be allowed. Although ipso facto bankruptcy default clauses are not enforceable in bankruptcy court, they are still worth including. A good reason for declaring an event of default is the violation of other covenants, such as those for prompt payment and maintenance of appropriate levels of qualified technical, support and sales staff. A party who must rely on bankruptcy events of default has not been monitoring the other party's business, which would show deterioration well before bankruptcy occurred.

## 11. *Remedies*

### a. *Termination*

Generally, an entire section of the agreement is devoted to termination provisions. The lawyer also ought to consider termination ramifications on a section by section basis, as well as on the contract as a whole. Often, it is glibly provided that the entire agreement terminates if the distributor fails to remit his royalty fees on a timely basis. While many contracts also provide that, even if the agreement terminates, the licenses to existing end users will continue, the effect of termination on other provisions may not have been fully considered. For example, the other party's obligations to maintain confidentiality should not terminate. The typical OEM who pays a fee for the internal use of a copy of the software should question such a broad termination provision. The fully paid-up licensee should also question it when the licensor would like to terminate the license because he believes the licensee has disclosed confidential information. Termination does not appear to be fair where the full monetary consideration has been paid. If there has been a disclosure, the licensor is entitled to monetary damages and possibly to injunctive relief, but it is not clear that he should always have the right to terminate the OEM. Each party to the agreement should also beware of agreeing to stringent provisions that would give the other party a colorable excuse to terminate for other reasons (e.g., for violating the antitrust laws), couched in the garb of these overly strict "technical" provisions.

In short, each violation or purported violation of a covenant or breach of a representation or warranty should have its own remedies; although it may be appropriate to include termination as one remedy for some breaches, it is certainly not appropriate to automatically provide this remedy in all cases.

b. *Indemnification*

Few contracts do not contain some form of indemnification by the upper tier for losses sustained by the lower tier as a result of upper tier infringement or misappropriation of the intellectual property rights of third parties. These indemnification obligations are typically conditioned upon prompt notice, the right to sole control of the defense and settlement of the claim, and the cooperation of the lower tier seeking indemnification. It is also common to exclude from the matters giving rise to indemnification: use of anything other than the latest release of the product, use of modified versions of the product, use of the product in combination with data not supplied by the upper tier, and use of the product in the practice of a process. From the perspective of the lower tier, these exclusions are reasonable if the qualification that infringement would otherwise have been avoided is added.

This indemnification provision of most contracts ends with intellectual property indemnification. There are, however, other matters for which each party ought to seek indemnification. Although a party may, as a matter of law, be entitled to indemnification beyond what is specifically provided for in the contract, the availability of that indemnification will be assured by expressly including it in the agreement. In particular, each party ought to be indemnified by the other for breach of the other's representations and warranties. The typical exclusion of liability for lost profits and incidental or consequential damages might have the effect of precluding any recovery. Accordingly, those limitations of liability ought to be restricted to the performance of the programs, and not extended to all of the contractual obligations.

Similarly, provisions for indemnification for nonperformance of the other covenants and agreements ought to be included. It avails the remarketer little to acquire fine products if the upper tier fails to adequately support and maintain them.

c. *Craftsmanship*

Termination and indemnification are common remedies. Other remedies include those provided under the Uniform Commercial Code, injunctive relief, and damages. Remedies for any particular



disappointment in the transaction must be reasonable and properly tailored to the wrong suffered. Boilerplate limitations on remedies may be held to be unconscionable. Provisions properly negotiated by the parties are more likely to be enforceable, and will generally be viewed by the parties as regrettably necessary rather than forced upon them.

#### F. HOW AND WHERE

##### 1. *Terms and Conditions of Sale and Miscellaneous Provisions*

The general terms and conditions of sale and the miscellaneous provisions of the contract are the primary sections in which "How" and "Where" are treated. Such things as the manner of shipment and the place of delivery may be conveniently expressed in mechanical provisions. This is not to suggest that such considerations are without significance; rather, the contract is more easily understood with mechanical and procedural details organized together after the main body of the arrangement has been set forth.

##### 2. *Other Places in the Agreement*

###### a. *Method Considerations*

"How" and "Where" should be expressed throughout the agreement. For example, in negotiating transcription rights, the question of how distribution is to be effectuated must be addressed. If transcription rights are to be granted, one must determine how the copying is to be accomplished—by reproduction kits, serialization, other means.

###### b. *Territorial Restrictions*

A key provision involving "Where" is the territorial limitation on the grant of rights. The contract should specify the territory, whether it is worldwide or citywide. The antitrust implications of these territorial restrictions are beyond the scope of this paper.

###### c. *Limiting Liability*

"Where" is also important in limiting intellectual property indemnification, which is commonly restricted to claims arising under the laws of the United States.

###### d. *Single/Multiple CPU and Site Licensing*

Most end user licenses ought to be limited to single CPUs at a single site; the usual provision for archive copies, back up CPUs, and redesignation requests should be included as well. The single

CPU license is rapidly eroding, however. Business users are developing significant networking among their CPUs, and even between home and office. Any computer may have many processors, and care must be taken to include such computers in the definition of a CPU. Where central processors are networked, the license normally designates one CPU as the primary, or "source," CPU, and each additional CPU added to the network becomes a secondary, or "object," CPU for licensing purposes. Usually a high front end fee is paid for the use of software in connection with the primary CPU, and smaller fees are paid for each secondary CPU.

*e. Other Limits to Liability*

"How" and "Where" also help to narrow other obligations by establishing procedures, such as prompt notice and the right to defend and contest, for bringing claims against another party. The contract might also provide that local law governs, and that both venue and jurisdiction are in one party's locality. This latter provision will be resisted by the other party.

## VII. SOFTWARE DISTRIBUTION SYSTEM AGREEMENTS

Template V—Contract Provisions is attached as the Appendix. Its contents are in no special order. Since it is an omnibus template, all of the provisions will not apply in any one situation.

Template VI—Sample Contracts is not included because these documents are so readily available elsewhere.

Among the ideas this paper has presented, there are several of special note. The lawyer should attempt to develop at least an amateur's understanding of the business as a whole. He should also attempt to acquire a detailed comprehension of the proposed transaction and its ramifications. He should analyze carefully and make use of the templates if they will be of assistance. He should be crisp, orderly, and clear in drafting the agreement, and not be unthinkingly bound by customary boilerplate provisions. Finally, he should make the agreement readable; it ought to tell a story.

## APPENDIX

## TEMPLATE V—CONTRACT PROVISIONS

- I. OMNIBUS SOFTWARE DISTRIBUTION SYSTEM  
CONTRACT TEMPLATE
  - A. HEADING
  - B. PRELIMINARY STATEMENT/PRECONDITIONS TO USE
  - C. DEFINITIONS
  - D. CONFIDENTIAL RELATIONSHIP
  - E. SCOPE OF LICENSE
  - F. OTHER DUTIES OF UPPER TIER
  - G. OTHER DUTIES OF LOWER TIER
  - H. REPRESENTATIONS AND WARRANTIES OF UPPER TIER
    - I. REPRESENTATIONS AND WARRANTIES OF LOWER TIER
  - J. EVENTS OF DEFAULT BY LOWER TIER
  - K. REMEDIES OF UPPER TIER
  - L. EVENTS OF DEFAULT BY UPPER TIER
  - M. REMEDIES OF LOWER TIER
  - N. NONCOMPETITION
  - O. LIMITATION OF LIABILITY AND EXCLUDED MATTERS
  - P. ARBITRATION
  - Q. SOURCE CODE ESCROW
  - R. GENERAL TERMS AND CONDITIONS
  - S. MISCELLANEOUS TERMS AND CONDITIONS
  - T. CLOSING
  - U. SCHEDULES
- II. HEADING
  - A. NAMES AND ADDRESSES AND STATES OF ORGANIZATION
  - B. DATE
- III. PRELIMINARY STATEMENT
  - A. BUSINESS AND CONTRIBUTIONS TO ARRANGEMENT OF UPPER TIER
  - B. BUSINESS AND CONTRIBUTIONS TO ARRANGEMENT OF LOWER TIER
  - C. CONFIDENTIAL RELATIONSHIP
  - D. PRECONDITIONS TO USE
- IV. DEFINITIONS
  - A. THIS AGREEMENT
  - B. AREA, TERRITORY, COUNTRY
  - C. CPU/COMPUTER
  - D. CPU MAKER/COMPUTER MANUFACTURER

- E. DEALER
- F. DEALER AGREEMENT
- G. DEALER UNIT
- H. DEFINED/ELIGIBLE CPU'S/COMPUTERS
- I. DELIVERY PERIOD
- J. DISTRIBUTOR AGREEMENT
- K. DISTRIBUTOR UNIT
- L. DOCUMENTATION
- M. EFFECTIVE DATE
- N. END USER
- O. END USER LICENSE AGREEMENT
- P. FREE SUBSCRIPTION PERIOD
- Q. LICENSED PROGRAMS
- R. LICENSED PROGRAM MATERIALS/SOFTWARE
- S. LICENSED PROGRAM REGISTER
- T. MEDIA
- U. NEW RELEASE
- V. NEW VERSION
- W. OBJECT CODE
- X. OBJECT CPU
- Y. OBJECT SOFTWARE
- Z. OEM/ORIGINAL EQUIPMENT MANUFACTURER
- AA. ORDERING PERIOD
- BB. OTHER SOFTWARE/PROGRAMS
- CC. PRODUCT
- DD. PROGRAMS
- EE. PROPRIETARY INFORMATION
- FF. REGISTRATION CARD
- GG. REPRODUCTION
- HH. SERVICES
- II. SOFTWARE DELIVERABLES
- JJ. SOFTWARE PRODUCTS
- KK. SOURCE CODE
- LL. SOURCE CPU
- MM. SPECIFIED PRODUCTS
- NN. SUBLICENSE
- OO. SUBSIDIARY
- PP. SUPPORT
- QQ. SYSTEM
- RR. SYSTEM QUANTITY LEVEL
- SS. TEST AIDS
- TT. USE
- V. CONFIDENTIAL RELATIONSHIP
  - A. RELATIONSHIP OF UTMOST CONFIDENTIALITY

- B. BOTH PARTIES HAVE PROPRIETARY INFORMATION
- C. DESCRIPTION OF INFORMATION TO BE KEPT SECRET
  - 1. *Must It Be Marked as Such*
  - 2. *Sample List*
    - a. *Licensed Program Materials*
    - b. *Source Code*
    - c. *File Layouts*
    - d. *Flow Charts*
    - e. *Logic Diagrams*
    - f. *Source Listings*
    - g. *Ideas*
    - h. *Concepts*
    - i. *Know How*
    - j. *Systems Design*
    - k. *Modular Program Structure*
    - l. *System Logic Flow*
    - m. *File Content*
    - n. *Data*
    - o. *Video Display*
    - p. *Data Entry*
    - q. *Report Generation*
    - r. *File Handling Techniques*
    - s. *Routines*
- D. TO WHOM DISCLOSURE PERMITTED
  - 1. *Need to Know Employees*
  - 2. *Sign in Log*
- E. PROHIBITED USES
  - 1. *Disclosure Outside of Permitted Parties*
  - 2. *Copying*
  - 3. *Display*
  - 4. *Loan*
  - 5. *Transfer of Possession*
  - 6. *Assignment*
  - 7. *Licensing*
  - 8. *Transfer*
  - 9. *Gift*
  - 10. *Exchange*
  - 11. *Security Interest*
- F. NO REMOVAL OF COPYRIGHT NOTICES
- G. REPORTS OF VIOLATIONS
- H. MAINTENANCE OF RECORDS RE LOCATION
- I. DESTRUCTION OF PROGRAMS PRIOR TO DISPOSING OF MEDIA
- J. INSPECTION, AUDITING, REASONABLE INQUIRY STEPS

- K. LIMIT NUMBER OF COPIES
- L. SINGLE/NETWORKED CPU LICENSE
- M. SITE LICENSE
- N. SERIALIZATION
- O. BACK UP CPU
- P. REDESIGNATION
- Q. ARCHIVE COPIES
- R. CUSTOMER LISTS
- S. FINANCIAL INFORMATION
- T. FINANCIAL CONDITION
- U. BUSINESS PLAN
- V. EMPLOYEE MEASURES (E.G., NONDISCLOSURE AGREEMENTS)
- W. VISITOR/PROSPECT MEASURES
- VI. SCOPE OF LICENSE
  - A. INTERNAL USE
  - B. SITE AND CPU DESIGNATIONS
  - C. ARCHIVE COPY
  - D. BACK-UP CPU
  - E. REDESIGNATION
  - F. DEMONSTRATION
    - 1. *Same Limitations*
    - 2. *Load into Customer's System*
    - 3. *Remote Loading*
  - G. SUBLICENSE
  - H. TRAINING
  - I. REPRODUCTION
  - J. USE THE LICENSED PROGRAMS
  - K. READ THE DOCUMENTATION IN CONNECTION THEREWITH
  - L. POSSESS THE MEDIA
  - M. MODIFICATION
  - N. SUBLICENSE AS MODIFIED
  - O. MAINTAIN AND TECHNICALLY SUPPORT
  - P. DERIVATIVES
  - Q. PROGRAM DEVELOPMENT
  - R. MAINTAIN INVENTORY
  - S. TESTING
  - T. PRIVATE LABELING
- VII. OTHER DUTIES OF UPPER TIER
  - A. TRAINING
  - B. SUPPORT AND TECHNICAL ASSISTANCE
  - C. MAINTENANCE
  - D. BUG FIXES, PATCHES

- E. GOODWILL (E.G., ADVERTISING)
- F. CORRECT DOCUMENTATION
- G. FURNISH STANDARD POLICIES
- H. FURNISH SALES LITERATURE
- I. FURNISH COPIES OF PROGRAMS
- J. FURNISH COPIES OF DOCUMENTATION
- K. FURNISH LOWER TIER LICENSE AGREEMENTS
- L. FURNISH REGISTRATION CARDS
- M. FURNISH WARNING SHEETS AND LABELS
- N. FURNISH TRANSCRIPTION KITS
- O. FURNISH SALES AIDES, BROCHURES, ETC.
- P. FURNISH ADVERTISING
- Q. PROVIDE ADVERTISING ALLOWANCE
- R. PROVIDE ADVERTISING MATS AND MATERIALS
- S. FURNISH SOFTWARE AND OTHER MATERIALS PROMPTLY  
AND IN ADEQUATE QUANTITIES

VIII. OTHER DUTIES OF LOWER TIER

- A. COMPLY WITH UPPER TIER POLICIES
- B. MAINTAIN WELL QUALIFIED TECHNICAL STAFF
- C. MAINTAIN WELL QUALIFIED MARKETING STAFF
- D. MAINTAIN GOOD FACILITIES
- E. ACTIVELY PROMOTE THE DISTRIBUTION
- F. ADVERTISING
- G. MAINTAIN ADEQUATE INVENTORY
- H. NOTIFY UPPER TIER OF PROBLEMS
- I. FURNISH UPPER TIER WITH REPORTS
- J. FURNISH UPPER TIER WITH CUSTOMER LISTS
- K. APPLY EXTERNAL LABELS
- L. OBTAIN REGISTRATION CARDS
- M. OBTAIN LOWER TIER LICENSE AGREEMENTS
- N. MAINTAIN SHIPMENT RECORDS
- O. PAY TAXES, ETC.
- P. PERMIT UPPER TIER ACCESS
- Q. POLICE AND ASSIST
- R. REQUIRE LOWER TIER COMPLIANCE WITH SAME  
PROVISIONS
- S. COMPLIANCE WITH LAW

IX. REPRESENTATIONS AND WARRANTIES OF UPPER  
TIER

- A. DULY ORGANIZED AND IN GOOD STANDING
- B. POWER TO EXECUTE AGREEMENT
- C. AGREEMENT DULY AUTHORIZED, EXECUTED
- D. NO CONFLICTS WITH OR DEFAULTS UNDER LAW OR  
CONTRACT

- E. NO LIENS
- F. ALL TAXES PAID
- G. NO LITIGATION OR OTHER PENDING OR THREATENED CLAIMS AFFECTING AGREEMENT
- H. TITLE TO PROPERTIES/LANDLORD WAIVERS
- I. SOLE OWNERSHIP OF PROGRAMS AND/OR RIGHTS TO SUBLICENSE
- J. SOLE OWNERSHIP OF COPYRIGHTS IN DOCUMENTATION OR RIGHTS OF COPYING SAME
- K. SOLE OWNERSHIP OF TRADEMARKS AND/OR RIGHT OF USE
- L. SOLE OWNERSHIP OF TRADE SECRETS AND/OR RIGHT OF USE
- M. SOLE OWNERSHIP OF PATENTS AND/OR RIGHT OF USE
- N. DEFECTS IN MATERIALS/WORKMANSHIP WARRANTY
- O. PERFORMANCE WARRANTY
- P. COMPLIANCE WITH SPECIFICATIONS
- Q. ALL MATERIAL MARKED AS PROPRIETARY IS IN FACT
- X. REPRESENTATIONS AND WARRANTIES OF LOWER TIER
  - A. SAME AS ABOVE
  - B. OEM WARRANTY
- XI. EVENTS OF DEFAULT BY LOWER TIER
  - A. NONPAYMENT
  - B. BREACH OF REPRESENTATIONS AND WARRANTIES
  - C. NONFULFILLMENT OF COVENANTS AND AGREEMENTS
  - D. OTHER
  - E. BANKRUPTCY
  - F. INELIGIBILITY FOR EXPORT LICENSES
- XII. REMEDIES OF UPPER TIER
  - A. TERMINATE AGREEMENT IN WHOLE
  - B. TERMINATE IN PART
  - C. SPECIFIC PERFORMANCE
  - D. INJUNCTIVE RELIEF
  - E. REPURCHASE OF INVENTORIED PRODUCTS
  - F. ENTRY AND REPOSSESSION
  - G. NOTIFICATION TO LOWER TIERS OF EXERCISE OF REMEDIES
  - H. LIQUIDATED DAMAGES
  - I. OTHER REMEDIES AT LAW OR IN EQUITY/CUMULATIVE
  - J. RECOVER UNPAID AMOUNTS
  - K. ACCELERATE PAYMENTS
  - L. REQUIRE RETURN OF PRODUCTS
  - M. REQUIRE DESTRUCTION AND CERTIFICATION



## N. INDEMNIFICATION

## XIII. EVENTS OF DEFAULT BY UPPER TIER

## XIV. REMEDIES OF LOWER TIER

- A. OBTAIN HELP ELSEWHERE WITH NO AFFECT ON WARRANTIES
- B. OBTAIN HELP ELSEWHERE WITH COST DIFFERENTIAL PAID BY UPPER TIER
- C. ACCELERATE DELIVERY OF PRODUCTS
- D. SAME AS UPPER TIER WITH APPROPRIATE MODIFICATION

## XV. NONCOMPETITION

## XVI. LIMITATION OF LIABILITY AND EXCLUDED MATTERS

- A. MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE
- B. NEVER BUG FREE
- C. NO INCIDENTAL, SPECIAL OR CONSEQUENTIAL DAMAGES
- D. LOST PROFITS, PROPERTY OR PERSONAL DAMAGE
- E. REPAIR, REPLACE OR SUBSTITUTE
- F. CEILING ON MONETARY LIABILITY
- G. FLOOR BEFORE BRINGING CLAIM
- H. CUT OFF PERIOD FOR BRINGING CLAIMS
- I. NO OTHER REPRESENTATIONS OR WARRANTIES
- J. SOLE AND EXCLUSIVE REMEDIES
- K. TO THE EXTENT INDEMNIFIED FROM UPPER TIER
- L. LATEST UNALTERED RELEASE
- M. USE WITH OTHER PROGRAMS OR DATA
- N. PRACTICE OF A PROCESS
- O. NOTIFICATION AND COOPERATION

## XVII. ARBITRATION

## XVIII. SOURCE CODE ESCROW

## XIX. GENERAL TERMS AND CONDITIONS

- A. DELIVERY
  - 1. *Place*
  - 2. *Time*
  - 3. *Specified Date or Period*
- B. RISK OF LOSS (BUT NOT TITLE)
- C. SHIPMENT
  - 1. *Freight Costs and Arrangements*
  - 2. *Insurance Costs and Arrangements*
  - 3. *Storage*
  - 4. *Manner and Cost of Packing*
- D. INSTALLATION

1. *Who Performs It*
2. *Who Pays For It*
3. *What Constitutes*
- E. ACCEPTANCE
  1. *What Constitutes*
  2. *Rights of Inspection and Testing*
  3. *Substitutes/Modifications*
- F. QUANTITIES AND PRICING
- G. ORDERING
  1. *Method*
  2. *Time Period*
  3. *Reference Master Agreement*
  4. *Information Required*
- H. RESCHEDULING
  1. *When Permitted*
  2. *Rescheduling Charges*
  3. *When Constitutes Cancellation*
- I. CANCELLATION
  1. *What Constitutes*
  2. *Cancellation Charges*
- J. PAYMENT
  1. *Due*
  2. *Currency*
- K. PRICES
  1. *Price Protection Period*
  2. *Determined as of What Dates*
  3. *Currency*
- XX. MISCELLANEOUS
  - A. AMENDMENTS
  - B. ARBITRATION
  - C. ASSIGNMENT, SUBCONTRACTING, ETC.
  - D. ATTORNEYS FEE
    1. *Each Bears*
    2. *Loser Pays Winner's*
  - E. BEST EFFORTS
    1. *Parties Will Use*
    2. *Spell It Out*
  - F. CAPTIONS AND HEADINGS NOT CONTROLLING
  - G. COMPLIANCE WITH LAW
  - H. COUNTERPARTS
  - I. ENGLISH LANGUAGE/TRANSLATIONS NOT CONTROLLING
  - J. ENTIRE AGREEMENT/MASTER AGREEMENT
  - K. EXPORT CONTROL
  - L. FORCE MAJEURE

- M. FURTHER ASSURANCES
- N. GOVERNING LAW
  - 1. *Applicable Law*
  - 2. *Jurisdiction*
  - 3. *Venue*
- O. MALE GENDER PRONOUNS INCLUDES FEMALE
- P. MOST FAVORED NATIONS
  - 1. *For What Matters—Pricing, Service, etc.*
  - 2. *For What Class—Similarly Situated, U.S.*
  - 3. *Government, Specify*
- Q. NOTICES
- R. PERSON INCLUDES CORPORATIONS, ETC.
- S. PLURAL INCLUDES SINGULAR AND VICE VERSA
- T. RELATIONSHIP OF THE PARTIES
- U. REMEDIES CUMULATIVE
- V. SEVERABILITY
- W. TERM
- X. TAXES AND FEES
- Y. WAIVERS

## XXI. CLOSING

- A. BOTH PARTIES
- B. HEREUNTO DULY AUTHORIZED
- C. CORPORATE SEAL REQUIREMENT
- D. INSTRUMENT EXECUTED UNDER SEAL
- E. ACKNOWLEDGMENT BY NOTARY PUBLIC REQUIRED

## XXII. SCHEDULES

- A. COMPOSITION OF PROGRAMS (OFTEN BY MEDIA ON WHICH RECORDED)
- B. DEALER LICENSE FORM OR SUBSTANTIVE PROVISIONS
- C. DESIGNATED CPUS
- D. DISTRIBUTOR LICENSE FORM OR SUBSTANTIVE PROVISIONS
- E. DOCUMENTATION DELIVERABLES
- F. END USER LICENSE FORM OR SUBSTANTIVE PROVISIONS
- G. EXTENDED MAINTENANCE
- H. FORM OF REGISTRATION CARD
- I. FORM OF SALES REPORTS
- J. FORM OF SYSTEM ERROR REPORT
- K. FORM OF WARNING SHEET/PACKAGE LABEL
- L. LIST OF COPYRIGHTS
- M. LIST OF PATENTS
- N. LIST OF PROGRAMS
- O. LIST OF TECHNICAL MANUALS

- P. LIST OF TRADEMARKS
- Q. MODIFICATION RIGHTS
- R. NAMES OF SOURCE LISTINGS
- S. PRICING AND DISCOUNTS FOR PRODUCTS AND SERVICES
- T. PRIVATE BRANDING
- U. SALES LITERATURE PUFFING
- V. SITE REQUIREMENTS
- W. SOFTWARE DELIVERABLES
- X. SOURCE CODE LICENSE
- Y. SOURCE CODE SECURITY MEASURES
- Z. SPECIFICATIONS
- AA. USER MANUALS

