Software Licensing Series:
The Compliance Gambit

Provided by

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You just received notice from one of your software suppliers saying they are considering an audit of your software licenses.

- What goes through your mind?
- Does it make you think you have a problem?
- Are you comfortable with your documentation?
- Do you have a solid plan for addressing this?

Read on, to learn more about what you can do in this situation.

Your Software Supplier Has Made a “Non-Compliance” Allegation

Software suppliers are in the business of selling their licensed, compiled software for as much money as they can make. Although mechanical reproduction or unlicensed installation may be possible, this software represents intellectual property that is legally restricted from reproduction. In order to preserve the collection of revenue from the sale and use of software, suppliers will enforce the terms of the licensing agreements. When a customer or non-customer of a supplier utilizes software without a valid license or violates a term in a licensing agreement this can be construed as a Non-Compliance event.

This enforcement of a licensing agreement by a supplier may result in a Non-Compliance allegation. Even if there is only a slight indication of a material weakness in complying with a licensing agreement, it has been reported by our clients that some suppliers will make an allegation or accusation of non-compliance apparently to strike fear into an existing customer. This initial fear can be further exacerbated due to software compliance requirements indicated or suggested in government regulations, such as Sarbanes-Oxley, and IT audit frameworks such as COBIT. This fear is then further leveraged by software vendors when they offer resolution to the non-compliance by extending expensive proposals for the purchase of software and maintenance.

The supplier’s intent is often financially-motivated: Preserving revenue from an aging product line or growing revenue based on financial objectives. However, personal objectives might also lead to a Non-Compliance allegation, including bad relationships and compensation. Unfortunately, these objectives are often disruptive to the relationship between the supplier and their customer.

IT managers and business decision-makers want to ensure software licensing compliance as part of their commitment to business ethics, contractual obligations, and audit and regulatory commitments. Software installation can proliferate if not carefully managed and can indeed result in licensing non-compliance. Non-compliance may result in financial penalties or the forced acquisition of licensing with non-favorable negotiating leverage and punitive contractual terms. Ultimately, non-compliance can lead to significant costs for a business as well as audit or regulatory compliance concerns and manager embarrassment. Managers should first seek to avoid non-compliance events from occurring by establishing mitigating controls. In the event that a software supplier alleges or accuses a company of non-compliance, IT managers should avoid responding fearfully and defensively and instead prepare themselves for a negotiation with the supplier pursuing a favorable outcome

What is Compliance?

When a company executes an agreement to purchase software, whether shrink-wrap or custom licensing agreement, that company is acquiring the right to use the software according to the terms of the software publisher’s license agreement. Licensing agreements are intended to protect the rights of the software developers and are enforceable under copyright law. By executing the agreement, the purchaser agrees to abide by the terms of the license.

These terms may include any number of specifics governing the use of the software. At a minimum, most agreements will specify the product and quantities that are licensed. Agreements will also contain language governing the authorized use and authorized users, possibly specifying the entities, subsidiaries and affiliates who are entitled to use the software. The duration of use will also be specified, such as a perpetual license or certain number of years. Warranties on the use and indemnities against business losses, claims, damages, etc. will also be stipulated.

Copyright law does apply to software licensing and, as a result, there are enforceable penalties for non-compliant use of that software. Computer software is protected by the U.S. Copyright Act that provides for damages, civil penalties and attorney fees for copyright infringement. An infringer is liable for either the copyright owner's actual damages or any profits of the infringer or statutory damages of $750 to $30,000 for each work infringed. If the infringement is proven willful, the court has discretion to increase the statutory damages to $150,000 per work. Further, a commercially-motivated infringement can bring up to a ten-year federal prison sentence and $250,000 in fines against the infringer and up to $500,000 against the company. It is important to keep copyright law in mind as penalties can fall within the realm of possible outcomes.

A violation of any of the terms in a licensing agreement may result in a non-compliance situation; the materiality of that non-compliance is often an area of contention. The resolution to this will likely come down to negotiating an outcome agreeable to both parties – a settlement. Whenever two parties debate the definition of material non-compliance, there is a risk that it will ultimately escalate to litigation and legal proceedings. Neither party prefers to pursue that route due to legal fees, negative publicity, etc, so a business negotiation will likely result. Prior to resorting to litigation and in advance of further negotiation towards a settlement, it is important to first define the outcome desired and outline the goals for the negotiation.

Define the Goals for the Negotiation Outcome

To define the goals for the negotiation with the supplier, the customer should assess the different areas of the relationship and prioritize the objectives in each area. It is not advantageous to openly convey these priorities to the supplier, but it is prudent to develop the plan internally to enable more effective negotiations leading to the best outcome. Further, it is important to avoid anchoring to any supplier proposals when establishing the customer's goals. The customer should develop its goals based on its needs not relative to anything offered or already in place with the supplier.

Factors to Consider in Defining Goals It is first important to understand the internal business drivers that have resulted in the purported non-compliance situation as well future business drivers that will impact usage and consumption of the software. In establishing a position with the supplier, a number of questions should be answered to understand the relationship with the supplier:

- To what extent has the supplier been involved or contributed to the current and future implementation and consumption of the software?
- What is the business plan; intended use and consumption of the software over the next several years (roadmap)?
- Has the supplier been slow to bring new functionality to their products?

- Has technical support been sufficient?
- Are there any replacement products already in use or planned?
- To what extent could an adverse outcome in the discussions with the supplier accelerate a transition to alternative software?
- Is there any opportunity/need to employ alternative supplier products?
- Can the supplier be considered to provide consulting services for the development of future capability?
- How is the relationship between parties, including individual relationships, with sales representatives?
- Have there been any past threats of litigation and what was the outcome?
- What is the materiality of the alleged non-compliance?

From these questions and others more germane to the business and compliance situation, managers must determine the relevant business objectives. Some examples of business objectives follow: If, for example, the non-compliance allegation is associated with usage by a subsidiary that is not covered under the licensing agreement, the customer may want to seek to secure expanded definitions around the authorized use and authorized users of the supplier's products. If desirable, the definition of "affiliate" should be broadly defined to include all legally-owned entities such as "an entity means any entity which, directly or indirectly, controls, is controlled by or is under common control with such entity". A service provider, integration partner or similar should be defined to include "direct or indirect third-party performing services on behalf of licenses or its affiliates on an outsourcing, hosting, consulting or similar basis". In addition, the license grant should allow for current and future affiliates and service providers.

Other objectives for an agreement might be based on the internally-developed roadmap for future use of licensed products. To accommodate unanticipated contingencies, the product or license use definition should possibly be expanded to include specified unit license pricing or discounts for additional uses. Past agreements may have secured pricing on incremental licenses for a restricted use, but there may have been no pricing secured for additional use, products, functionality, etc.

The value obtained from and the need for technical support must also be considered. Has the customer realized sufficient value from the supplier in the technical support received over the last several years? What is the support history? Has the supplier met service level expectations? What other support options are available? Can the product be supported in-house or through a third-party? The intent of these questions and the resulting answers is to determine whether the customer can opt to no longer continue technical support on their owned perpetual licenses. It should be determined if alternative technical support arrangements are available through a third-party organization or in-house expertise. Although this may not be a desired path, it is important to understand if forgoing a renewal is a viable alternative. Licensing and maintenance agreements should be reviewed to determine if the customer has the contractual right to forgo technical support services. There may also be other pricing options available for support from the supplier, e.g. time and materials rates, lower levels of support (9x5 vs 24x7).

Any renewal of technical support should include additional favorable terms such as an evergreen provision which enables renewal of support at consistent financial rates or minimal increases. Service level expectations and agreements should be established based upon historical data and service performance.

Technical alternatives should also be considered. If there are competing products in the marketplace or if the customer already has another technical solution that could provide similar functionality, an intention to migrate could be an actual plan or leverage in the negotiation.

As the preceding discussion highlights, while the financial goals for the negotiation are important, they are not the only focus of the negotiation that is required. It is important to establish the goals as well as level of flexibility for various options, including budgetary and financial. What length of term of a financial commitment is acceptable: 1 year, 3 year or 5 year? What incremental licensing growth in the future needs to be accounted for? What near-term budget constraints exist? What pricing leverage already exists? Once the business objectives have been established, they can be subsequently prioritized into goals for the negotiation.

Software Contract Negotiations Best Practices

People often approach a negotiation using rules of thumb or past experience or even speculation to approach a negotiation. The practice of applying past experience in a negotiation situation with potentially high stakes can limit the decision-making of the negotiator and result in a sub-optimized outcome. This leads to classic negotiation flaws, such as anchoring and adjustment, availability, framing, self-interest, status quo bias, and reactive devaluation, in their judgment and choices because it can be more efficient and in line with the past behavior of the parties. By understanding these common self-induced obstacles and their impact on a negotiation, a negotiator can reorient their behavior to make for stronger bargaining position. By thinking less emotionally about the information, examining background reasoning or causes, searching for additional information and establishing fact based attitudes and behaviors, a negotiator can advance the position by pursuing alternative means of persuasion. NET(net), Inc. has found that the best negotiations are won away from the bargaining table through well-defined goals, appropriate set-up and positioning, and non-emotional execution of a well-informed plan.

Persuasion plays a crucial role in resolving the conflict between the customer and the supplier. For a negotiated settlement to be reached, both parties have to be persuaded that the settlement is in some sense optimal. An unbiased, systemic approach is more conducive to persuasion and creative problem-solving, likely a necessity as non-compliance allegations often result in conflicting perspectives of contractual language and previous agreements.

There are two suggested approaches to change to a more systemic approach. The first is to increase both parties' motivation by focusing on interests rather than positions. A second approach is to shift toward more open, information-seeking questions rather than stating positions or making assertions. By seeking information and answering questions, the negotiating parties' will shift towards thinking more systematically about their own interests and goals.

It is also important to consider how to capitalize knowing that the supplier will also rely on their and the customer's past behavior and tendencies in the decision-making processes. To exploit this, the customer will need to develop creative solutions which deliberately break from its prior history. While breaking from previous supplier proposals, the customer can fortify its base by offering what it can substantiate in its existing contract rights, e.g. countering with proposals with longer or shorter maintenance term lengths or changing the level of technical support. Illustrating a willingness to litigate by providing the perspective of two or more lawyers can also speak to the credibility or trustworthiness of the customer's contractual position or its resolve in its position; however, this should be deferred as a last resort to dislodge the supplier from its compliance allegations and aspirations of success in a resulting law suit.

To develop a systemic approach, all of the available information to the negotiation should be reviewed from an unbiased perspective. This information includes recent negotiation discussions, positioning statements and all (or as much as possible) communication to the supplier in addition to contractual information and technical support experience. After objectively defining the goals for the negotiation, they should be prioritized from a business perspective. The goals of the opposing party based on past understanding and communication should also be written-down. Alternative paths or outcomes, including walk-away positions, should be explored to understand the Best Alternative to a Negotiated Agreement (BATNA) opportunities. The Zone of Possible Agreement (ZOPA) should also be defined to understand where the possible outcomes lie that would benefit both parties. Understanding these negotiating parameters will then help to establish framework for the discussions and the subsequent execution strategy, sometimes referred to as a Supplier Negotiation Platform (SNP)™. Ultimately, the execution of the SNP is designed to lead the negotiating parties to an intersection in the ZOPA where the outcome is most optimal to the customer – known as Pareto Optimal.

Every step of every negotiation comes down to two choices: cooperate or defect. Customers typically approach long standing relationships with the intent to cooperate. In the case of a supplier alleging Non-Compliance, the supplier is often banking on this notion. Cooperation can be appropriately used to create value. However, when the value is not there, customers can elect to defect in order to claim value. Defection often sets boundaries and brings about clarity to help guide the discussion and for this reason, can often be used to re-align suppliers to new borders in the discussion.

Common Pitfalls

In the early stages of the negotiation, both parties may tend towards defensive motives and value claiming – the supplier may anticipate limited growth or even a decline in their revenue stream from the customer. The customer may staunchly defend its compliance in the face of allegations to the contrary reinforced by a high cost "remediation" proposal. At this time, neither party is likely to persuade the other of its position. Instead, the customer should abandon its defensive posturing and assemble a more systemic approach designed to achieve its objectives.

The customer should also consider the information that has been shared with the supplier in re-establishing its position. The customer may have communicated to the supplier that the licensed products will be decommissioned in the future in favor of a competing or alternative solution. Or they may know that there is future growth opportunity for the product or other supplier solutions. The supplier may know the internal costs or hurdles in implementing these solutions. There may have also been previous proposals or discussions regarding a settlement of the non-compliance situation offering additional insight on motivations by either party.

Developing the Negotiation Strategy

In order for the customer to determine the appropriate negotiation strategy with the supplier, all of the elements have to be pulled together including the current situation and historical positioning, the goals of both parties and the requisite market intelligence, industry best practices and execution excellence.

To effectively develop the negotiation strategy given past positioning, NET(net) recommends a 3 phase approach. The customer should first regroup by disengaging from the current communication with the supplier and define the negotiating strategy. The supplier should then be re-engaged in a non-confrontational way. Based on the supplier's response (conciliatory or not), the execution strategy will take one of two alternate paths each with multiple options.

During the regrouping stage, the customer will define the goals and develop the plan. The objectives or goals for both the execution and outcome should be established. The customer should clarify its position(s) and assemble supporting arguments both on current licensing and future use of the supplier technology and support. BATNA opportunities should be explored and defined as well as any near and long term options to minimize exposure to financial and legal risk. Acceptable outcomes should be determined; likewise, acceptable escalation levels within the customer and the supplier and tolerance for escalation to achieve the outcomes should also be determined. The supplier players that are involved and could potentially be involved should be assessed to identify their respective individual and business agendas. The team to represent the customer for re-engagement should be identified – new negotiators might be introduced to perform exploratory discussions with the supplier, set up the new position and execute the strategy.

The next phase to reengage in discussions should be accomplished after well-defined goals and a plan have been established. The approach with the supplier can be either formal or informal and should seek to clarify their position. One approach might be to request a formal statement with clarifications of the supplier's position. The goals of the supplier should be further identified based on their response. The supplier's response will indicate the next steps in the execution of the negotiating strategy. If they are cooperative, then the customer should consider either, a) offering to acquire the required licensing at negotiated rates, or b) negotiating a long-term agreement with additional product licensing through a systemic approach utilizing protracted optimization and negotiations work effort. In addition, the customer should seek the supplier's collaboration on charting a sustainable relationship for the future consumption of currently-deployed and other supplier products.

If the supplier is instead confrontational, the customer may pursue a defection strategy. Possible strategies could include indicating to the supplier that technical support and product upgrade rights are no longer required as the customer is locking down the production environment from future upgrades. An RFP to help the customer migrate from the supplier technology to a competing technology should be released immediately following this notification. A third strategy that might be coupled with a defection strategy is to outline how the Supplier's position is flawed. The customer's position should be outlined and delivered with vigor indicating how defensible the position can be maintained. Once the position is delivered, the customer should highlight the business case to collaborate to come to a mutually-agreeable outcome or face an immediate defection.

What Do You Do Next?

If a customer is actively engaged in a software compliance negotiation with its supplier and the needle is not moving, it is recommended that the customer "go dark" on its communications with the supplier. If the customer can avoid submitting technical support requests for a few weeks to develop a new position and execute a negotiating strategy, it would improve the customer's leverage; particularly if a BATNA to forgo technical support from the supplier is viable. Regardless of this viability, the customer should avoid any meaningful responses to the supplier for an extended period of time depending on the frequency of past communications. This may very well prompt the supplier to dislodge their defensive position and begin collaborating on ways to arrive at a more sustainable outcome.

During this time, the customer should develop its own negotiating strategy to be a more unbiased, systemic approach. The strategy should be documented in a Supplier Negotiation Platform or similar to define an objective plan that outlines the customer's goals, an understanding of the supplier's goals, new position, negotiating strategy options and steps to execute. This document serves an important purpose in putting the strategy on paper, shifting the psychology of the negotiator to be less emotional and more methodical, and also allowing objective feedback from peers. It might be a preferred option to actually have a peer or uninvolved, unbiased third party execute the strategy as it will remove past biases and anchoring tendencies. The customer should consider engaging professional assistance in the negotiations to advance the current stalemate and avoid litigation.

Maintaining compliance with your software licensing contracts is certainly a best practice and contractual obligation. However, many software suppliers notoriously and consciously avoid mechanically obstructing installing non-licensed software. As a result, companies may find themselves with installed, non-licensed software potentially resulting in a non-compliance situation. Proactively addressing the situation to establish contractual compliance is highly recommended. However, in the event that the software supplier identifies, alleges, and\or accuses their customer of non-compliance, the customer should avoid immediate defensive posturing, establish its goals for the outcome, assemble its negotiating strategy and execute the negotiation, pursuing a favorable outcome.

For more information on negotiating with your suppliers in light of potential software licensing non-compliance situation, allegation or accusation, call +1 866.2.NET.net or email info@netnetweb.com. NET(net) provides assistance in constructing a defined negotiation strategy and executing in the form of a formal optimization and negotiations engagement. NET(net) has extensive experience representing clients in complex IT negotiations with compliance allegations. Systemic negotiations conducted by NET(net) assist clients in identifying BATNA opportunities and negotiation ZOPA to achieve Pareto Optimal outcomes in IT agreements. NET(net), Inc. specializes in IT Investment Optimization Services and is recognized as the global leader. NET(net) helps its clients enhance the economic and strategic value of their key technology investments by 33% on average and has helped clients capture more than $30B of incremental market value since 2002. NET(net) can help you lower costs, mitigate risks, improve quality, maximize agility, govern compliance, improve relationships, strengthen contractual agreements and build sustainable business partnerships.

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