

LICENSING AGREEMENTS

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Licensing Agreements

I. INTRODUCTION

There are a number of issues and clauses common in all software licensing agreements. This article will address many of these issues and clauses and will provide a software user (“User”) with information and insight into what to look for and what to avoid in reviewing and drafting software licensing agreements.

II. SOFTWARE LICENSE

The right to use Software is typically given in the form of a license, rather than a sale. A sale would give the User all rights that are associated with ownership of the Software (e.g., sale or license of the Software to third parties, the right to copy and create derivative works). As Vendors desire to retain such rights in the Software, the Vendor conveys limited rights to the User in the form of a license.

Checklist:

- a. If a User desires to use the Software for an indefinite period of time and is paying one amount for such use rights, the User should obtain a paid-up and perpetual license to use the Software.
- b. A User should obtain the right to make copies of the Software (and documentation) should such be necessary for its intended use. At a minimum, the User should secure the right to make one copy of the Software for back-up and archival purposes.
- c. A User should be sure to allow all intended users to use the Software. Should the User want Affiliates and/or other persons and entities to use the Software, the User should be sure to clearly set forth such use rights in the Agreement. A User must also consider whether it wants to license the Software as a site license, or on a concurrent user basis, or simply on a single computer.
- d. Software upgrades, updates, modifications, releases, enhancements and versions (“Releases”) should be deemed part of the Software originally licensed. *See* Number 1 Sample Provisions.
- e. If the Software license is granted only for use on a specific identified computer or server, the User should obtain the right to transfer the Software to compatible, upgraded or successor computers or servers without paying a fee. *See* Number 2 Sample Provision.

III. IMPLEMENTATION PLAN

Prior to the installation and implementation of Software, the User and Vendor will

often complete an implementation plan setting forth respective responsibilities, milestones and timeframes. It is this implementation plan that will govern many (if not all) of the tasks necessary for a successful implementation. Consequently, special care should be given to the drafting and reviewing of such plan.

User Checklist:

- a. The implementation plan should clearly set forth the User's and Vendor's respective responsibilities and tasks. In addition, the implementation plan should include performance milestones and a corresponding timeline for the completion of such milestones.
- b. As any implementation may be delayed due to a Vendor's performance or non-performance if it's tasks, a User should consider "capping" implementation costs (e.g., implementation fees to be paid by the User for the Vendor's performance of the Vendor's implementation tasks shall not exceed \$XXX).

IV. DELIVERY

A User should specify the delivery date(s) within the Agreement. If delivery by a certain date is essential, be sure to include "time is of the essence" in referring to such delivery. In addition, should the User expect the Vendor to install the Software (or provide other pre-acceptance testing services), such obligation(s) should be expressly set forth in the Agreement, along with any payments due to the Vendor for such services. *See* Implementation Plan section. In the event the Vendor is to perform all or some of the services at no additional cost to the User, be sure to expressly identify which services are to be performed at no additional cost. Further, the Vendor may want User to bear the risk of loss of the Software while in transit. Delivery terms such as "FOB [shipping point]" and "FOB [origin]" would place the risk of loss on User.

V. ACCEPTANCE

The acceptance provision is one of the most important provisions in a software license agreement. First, even with standard "off the shelf" Software, User will never know until it actually tries the Software whether it lives up to User's expectations. Second, the need to develop sufficient and objective acceptance criteria will force User and the Vendor to come to a clear understanding of what the Software is supposed to do in User's business environment. Third, warranty provisions can be drafted to incorporate the acceptance criteria, thereby making them standards that the Vendor is committed to maintaining.

Checklist:

- a. If User has developed acceptance testing criteria (or other performance requirements), such criteria should be provided to the Vendor as soon as

possible. User should request that the Vendor submit a written response detailing the Software's capability to meet such performance criteria. Thereafter, the acceptance criteria and the Vendor's response should be attached to the Agreement.

- b. If acceptance criteria has not been developed, User should consider developing (either individually or jointly with the Vendor) such criteria as soon as possible. Further, if the Vendor proposes to use its own testing criteria, make sure to obtain a copy of such criteria to determine its adequacy.
- c. Make sure all agreed-upon acceptance testing criteria are attached to the Agreement and expressly incorporated into the Agreement.
- d. Acceptance testing should occur in User's own internal environment on User's own equipment.
- e. Acceptance testing should commence no earlier than upon successful installation of the Software at User's site.
- f. Provide for an adequate number of days to test the Software.
- g. Provide for the possibility that the Software will not pass acceptance testing (e.g., allow Vendor a certain number of days ("cure period") to correct the non-conformance *at no cost to User*).
- h. If a cure period is acceptable to User, User must have a period of time to re-test the Software after expiration of such period. Be sure to expressly state when User's re-testing period will commence and end.
- i. Provide User with the right to terminate the Agreement in the event the Software does not pass acceptance testing during the re-testing period.
- j. If User terminates the Agreement, Vendor should give User a full refund of all sums paid to Vendor.
- k. Vendor should also be responsible for all costs incurred in de-installing the Software, removing the Software from User's premises and in transporting the Software back to Vendor's site.
- l. See Number 3 Sample Provisions.

VI. SOFTWARE WARRANTIES

Vendors often attempt to cast software licenses in the form of a commercial transaction (e.g., the moment you drive it off the lot it is yours with all faults). However, Users pay for Software with the expectation that they will be able to use such Software

for many months, if not years, to come. Although no amount of warranty provisions will “guarantee” Software performance, such provisions should be carefully drafted and reviewed to protect the User’s interests and future expectations.

Checklist:

- a. Vendor *must* warrant that it owns the Software or, to the extent it does not own the Software, it has all rights necessary to grant to User the license under the Agreement. See Number 4(a) Sample Provisions.
- b. Vendor should warrant that the Software will not contain any disabling code. See Number 4(b) Sample Provisions.
- c. Vendor should warrant that it has used its best efforts to scan for viruses within the Software. A fall back position could be that the Vendor has scanned for viruses in accordance with standard industry practices. See Number 4(c) Sample Provisions.
- d. Vendor should warrant that the Software is Year 2000 Compliant.¹ See Number 4(d) Sample Provision.
- e. Vendor should warrant that the Software will not infringe on any patent, copyright, trade secret, trademark or any other third party proprietary rights. See Number 4(e) Sample Provision.
- f. Vendor should warrant that the Software will conform to all state and federal laws and regulations to enable the User to use the Software as set forth in the Agreement. See Number 4(f) Sample Provision.
- g. Vendor should warrant that the Software will conform to the descriptions, standards and performance criteria (including the acceptance testing criteria) contained in the Agreement. See Number 4(g) Sample Provisions.
- h. If applicable, Vendor should provide an adequate “response time” warranty. See Number 4(h) Sample Provision.

Commencement/Warranty Duration Checklist:

- a. All performance warranties (i.e., VI.h. above) should commence upon User’s acceptance of the Software.

¹ Although the new millenium arrived worldwide over 2 years ago, Users should still insist on including a Year 2000 warranty provision within software licensing agreements. Most (if not all) Vendors will assert that a User’s Y2K concerns should not exist as we are well past the year 2000. However, the passage of time will not, in and of itself, render a software application able to correctly and accurately calculate dates among and between different centuries.

- b. All non-performance warranties should commence upon execution of the Agreement and continue thereafter throughout the duration of the Agreement.
- c. Initially, attempt to have all performance warranties continue throughout the duration of the Agreement as long as User is receiving support from the Vendor. Should the Vendor fail to agree to such a provision, make sure to expressly set forth the number of days such performance warranty is in effect. See Number 4(g) Sample Provisions.

Warranty Breach Checklist:

- a. Provide Vendor with a set number of days to correct any warranty non-conformance *at no cost to User* (such period should commence upon Vendor receiving User's notice of non-conformance).
- b. In the event Vendor is unable to correct the non-conformance, User should receive a pro rata refund of all sums paid to Vendor under the Agreement based on a five (5) year straight-line depreciation calculated from the date of User's acceptance of the Software. [Please note: The above guideline suggests a five (5) year depreciated refund based on the assumption that the Software will have a five (5) year useful life. Should the Software have a shorter/longer estimated useful life, the provision should be accordingly modified].
- c. Consider obtaining a full refund of all sums paid under the Agreement in the event the Software fails to comply with applicable state and federal laws and regulations or fails to be Year 2000 Compliant. In addition, consider having the Vendor defend, indemnify and hold User harmless from any noncompliance with state and/or federal laws and regulations that results in harm to a third party or prompts any type of monetary penalty.
- d. Vendor should be responsible for all costs incurred in de-installing the Software, removing the Software from User's premises and in transporting the Software back to Vendor in the event Vendor fails to correct the non-conformance.
- e. See Number 4(i) Sample Provisions.

VII. HARDWARE WARRANTIES

A Vendor may also license an integrated "System" (consisting of Software and Hardware). In this event, the Software warranty provisions and checklist above should be used [by inserting the term "Hardware" in place of "Software"] in reviewing the

Vendor's Hardware warranty provisions. In addition, the following checklist should be consulted.

Checklist:

- a. Vendor should warrant that it will convey good and clear title to the Hardware being purchased under the Agreement, free and clear of all liens and encumbrances. See Number 5(a) Sample Provision.
- b. [If applicable] Vendor should warrant that it assigns all warranties it has received from the Hardware manufacturer. See Number 5(b) Sample Provision.
- c. Vendor should warrant that the Hardware is fully compatible with, and will operate successfully with, the Software. See Number 5(c) Sample Provision.
- d. Vendor should warrant that the Hardware shall be free from defects in material and workmanship. See Number 5(d) Sample Provision.
- e. [If applicable] Vendor should warrant that the Hardware will conform to the manufacturer's published specifications and user documentation in existence at the time of delivery of the Hardware.
- f. Whether the Vendor is providing Vendor owned Hardware or third party Hardware, the Vendor should warrant that the "System" will conform to the descriptions, standards and performance criteria (including the acceptance testing criteria) contained in the Agreement.

VIII. TERM AND TERMINATION

The term of an Agreement may vary from an initial one year term (with yearly renewals thereafter) to one perpetual in nature (e.g., as long as the Agreement is not terminated User continues to have the right to use the Software).

Term Checklist:

- a. In the event the Agreement contains an initial one year term, User should consider having the term automatically renew, unless User provides the Vendor with written notice of its intent not to renew within [a set number of] days prior to the expiration of the then current term. In addition, User should strongly resist a Vendor's request to have a similar termination right (as User may be reliant on the Software and such continued use should only be terminable in the event User breaches a material obligation).

- b. Make sure the Vendor may only terminate the Agreement upon a material breach by User which remains uncured for a set number of days (*see* Termination Checklist below).

Termination Checklist:

- a. Both User and Vendor should have the right to terminate the Agreement upon a breach of a material obligation by the other party which continues or fails to be remedied within a set number of days.
- b. User should also have the right to terminate any separate support agreement in the event User terminates the license Agreement.
- c. Specific “non-exclusive” remedy provisions should be included within any corresponding remedy provision. For example, in the event User terminates the Agreement prior to acceptance, User should receive a refund of all sums paid to Vendor. Further, in the event User terminates the Agreement after acceptance, User should receive a pro rata refund of any support payments paid to Vendor based on the then-remaining term for which such fees apply. Also, User should receive a pro rata refund of all other sums paid to Vendor based on an agreed-upon useful life calculated from the date of User’s acceptance.
- d. Lastly, in the event the Agreement is terminated, all confidential information should be returned to the disclosing party or otherwise destroyed, with written confirmation that such information has been either returned or destroyed.

IX. SOFTWARE SUPPORT

Often, Software support provisions are given less consideration than necessary. However, support provisions may provide a User with its only leverage to obtain post-warranty fixes.

Checklist:

- a. Support may commence upon either (i) the expiration of the performance warranty period, or (ii) upon acceptance of the Software. If support is to commence upon acceptance of the Software, such support should initially be provided at no cost to User [as User should not have to pay the Vendor to correct warranty non-conformances].
- b. Support should not be paid on a time and materials rate (as such costs could escalate). Rather, support should be provided for a fixed annual amount.

- c. Limit support payment increases to an annual increase of five percent (5%) or the percentage increase in the Consumer Price Index (CPI), as published by the Department of Labor, whichever is less.
- d. Vendor should warrant that all support services will be performed in a good and workmanlike manner consistent with acceptable industry practices. See Number 6(a) Sample Provision.
- e. Vendor should provide all support necessary to continue the warranties under the Agreement at no additional cost to User. See Number 6(b) Sample Provision.
- f. In addition, Vendor should provide all updates, upgrades, releases, enhancements, modifications and versions (“Releases”) of the Software at no additional cost to User. In the event the Vendor will not agree to provide User with subsequent Releases at no cost to User, User should obtain a price discount for such Releases.
- g. See Number 6(c) Sample Provision.

X. SUPPORT v. WARRANTIES

As Vendor’s often charge for support, Vendors want support obligations to commence as soon as possible. Although a User may desire support upon acceptance, a User should not have to pay the Vendor to correct warranty non-conformances. Therefore, if support is to be provided during the performance warranty period, be sure that all warranty non-conformances will be corrected by the Vendor at no additional cost to the User. In addition, Vendors often seek to separate its support obligations (and a User’s remedies) from those otherwise contained in the Agreement. This may be done, for example, by executing a separate support agreement. A Vendor may attempt to limit its support obligations to “repair or replacement” and correspondingly, limit a User’s remedies to “repair or replacement” and/or “to support fees paid.” From a User’s perspective, this could prove seriously inadequate, as a User could be left with non-functional Software and inadequate remedies. To protect against such a result, the User should insist that all performance warranties continue as long as the User is receiving support from the Vendor. If the Vendor refuses to extend such warranties, be sure to enable a User to obtain the source code to allow for internal support.

XI. PAYMENT TERMS

Although the amount of the payments to be made under an Agreement are often considered in selecting a Vendor, the times at which such payments are to be made are frequently given less consideration than necessary.

Checklist:

- a. User should tie payments to objective “progressive” milestones (e.g., 20% of the Software license fee payable upon successful installation of the Software, 30% of the Software license fee payable upon successful completion of test environment testing, etc.). User should also consider withholding payment of the Software license fee until User has accepted the Software. If the Vendor insists on “front loading payments”, User should resist paying more than fifty percent (50%) of the Software license fee prior to User’s acceptance. This will, amongst other things, provide the Vendor with an incentive to provide User with acceptable Software.
- b. User should NEVER tie payment dates to a set number of days after the occurrence of a “non-progressive” event (e.g., User shall pay 20% of the Software license fee within 90 days after execution of the Agreement; User shall pay 30% of the Software license fee within 120 days after execution of the Agreement). As a multitude of factors may affect a User’s implementation, the User should be careful not to be contractually obligated to make payments based on non-performance milestones.
- c. User should cap late interest fees at one percent (1%) per month. In addition, late interest fees should only apply to past due *undisputed* payments.
- d. User should also have the right to withhold payments based on a good faith dispute. In addition, Vendor should not have the right to terminate the Agreement or stop performing during such dispute. *See* Number 7 Sample Provision.

XII. INFRINGEMENT INDEMNIFICATION

Special care should be used in reviewing a Vendor’s proposed indemnification provision.

Infringement Checklist:

- a. Vendor should defend, indemnify and hold harmless User against third party claims of infringement.
- b. Indemnification coverage should include any claims that the Software infringes any patent, copyright, trade secret, trademark and any other proprietary right of a third party. User should strongly resist limiting coverage to patent and copyright infringement claims (as Software developers often seek to protect Software through trade secret protections).

- c. In the event the Vendor will not “defend” User, be sure the indemnification obligation is not limited to “costs and damages finally awarded.” Such a provision may prove seriously inadequate, in that User may incur substantial expenses in defending against actions which prove groundless. In addition, be sure to state that the Vendor will “hold User harmless”. Use of the term “hold harmless” is important, as such would require the Vendor to reimburse User for all damages, expenses, losses, claims and liabilities, including costs and reasonable attorney’s fees incurred by User.
- d. A Vendor may attempt to condition its indemnification obligations upon User giving the Vendor prompt notice of third party infringement claims, that User will not take any actions to prejudice the defense of the claim and that User will give the Vendor assistance and authority necessary to solely defend the claim. User should strongly resist any such conditions, as the Vendor could later use such provisions to avoid its indemnification obligations. *See* Number 8 Sample Infringement Provision.
- e. User should not limit or otherwise exclude the application of consequential, indirect, special or incidental damages arising from indemnification claims.
- f. *See also* Number 9 Sample “Non-Infringement” Indemnification Provisions.

XIII. REPLACEMENT OF SOFTWARE

Although the Vendor may be obligated to indemnify User against third party infringement claims, User’s use of the Software may be disrupted by such claims. This provision should be used to set forth specific Vendor obligations in the event a third party claim threatens User’s use of Software.

Checklist:

- a. Vendor should be required to perform the following (at no additional cost to User): (i) modify the Software so as to provide User with functionally-equivalent, compatible and non-infringing Software; or (ii) replace the Software so as to provide User with functionally-equivalent, compatible and non-infringing Software; or (iii) obtain a license for User’s continued use of the Software for the term of the Agreement; or (iv) if none of the foregoing are possible even after Vendor’s reasonable efforts, User should have the right to terminate the Agreement and the Vendor should promptly refund to User a pro rata portion of all sums paid to Vendor under the Agreement based on an agreed-upon useful life calculated from the date of User’s acceptance of the Software.

- b. The foregoing obligations should commence in the event a third party claim or threatened claim causes User's reasonable use of the Software to be disrupted or seriously endangered. [*Note*: Vendor's obligations should not commence in the event User is enjoined from using the Software; as User's use of the Software may be disrupted long before the issuance of an injunction].
- c. Vendor should acknowledge that time is of the essence in any interruption of User's use of the Software.
- d. Vendor should be responsible to pay all costs incurred in de-installing the Software, removing the Software from User's premises and in transporting the Software back to Vendor's site in the event Vendor is unable to continue User's use of the Software.
- e. See Number 10 Sample Provision.

XIV. SOURCE CODE

In the event a Vendor is unable to perform its obligations under the Agreement, User should be afforded the option to continue to use the Software. However, such continued use may require that User have the Software source code on site. Therefore, obligating the Vendor to deliver the source code to User upon the occurrence of certain events should be strongly considered.

Checklist:

- a. If User desires to receive the source code, User should clearly set forth the terms governing such delivery (e.g., source code release events, use rights, etc.).
- b. Release events: Delivery should occur in the event the Vendor or its successor corporation which assumes its obligations under the Agreement (i) ceases to transact business or (ii) maintain its computer software research, development, and support services at levels sufficient to meet its obligations and responsibilities under the Agreement on an ongoing basis.
- c. Upon the occurrence of a release event, delivery of the source code should occur within a set number of days after User's demand.
- d. User should secure the right to for it, or a third party, to use, copy, modify, maintain and enhance the source code, documents, and descriptions for User's [and, if applicable, User's Affiliates] internal use only.
- e. In the event the Vendor maintains such source code with an escrow agent, require the Vendor to notify User (upon initial delivery of the Software) of

the name of the escrow agent. In addition, User should require the Vendor to notify the escrow agent of the terms and conditions set forth in the source code section of the Agreement.

- f. See Number 11 Sample Provisions.

XV. LIMITATION OF LIABILITY

As a Vendor will likely attempt to limit its financial exposure with restrictive language, special care should be used in reviewing this section.

Checklist:

- a. The limitation of liability provision should *not* apply to indemnification obligations.
- b. If the Vendor insists on excluding consequential, indirect, special and incidental damages, such liability exclusion should apply mutually to both parties.
- c. The Vendor should remain open to direct damages.
- d. See Number 12 Sample Provision.

XVI. TAXES

Vendors will often initially require User to pay any taxes arising out of or related to the Agreement.

Checklist:

- a. User should not be required to pay any taxes for which User is exempt.
- b. If requested, User could provide a copy of its tax exempt certificate to the Vendor.

XVII. MEDIATION AND ARBITRATION

Mediation and arbitration provisions can assist in reducing the costs and scope of potential litigation. If a mediation and arbitration provision is used, be sure to have the mediation and arbitration occur in the county in which User is located.

XVIII. GOVERNING LAW/JURISDICTION

Checklist:

- a. The laws of User's State should govern the Agreement.
- b. In addition, be sure to exclude the application of conflicts-of-law and choice-of-law provisions.
- c. User should obtain exclusive jurisdiction in User's State and exclusive venue in the county in which User is located.

XIX. FORCE MAJEURE

This provision is intended to address non-performance due to events the risk of which should be borne by both parties. Although rarely invoked, care should be given to this clause.

Checklist:

- a. Limit events to natural disasters and other events the risk of which should rightfully be borne by both parties (e.g., war, civil disturbance, actions or decrees of governmental bodies, acts of God).
- b. Strongly resist insertion of the phrase "events beyond the reasonable control of either party" as such phrase could be used by the Vendor as an escape clause for events which are part of the daily risk of doing business (e.g., strikes, transportation delays).
- c. Limit period of non-performance to a set number of days.
- d. Provide for termination rights in event the non-performing party is unable to perform after a certain number of days after the force majeure event.
- e. See Number 13 Sample Provision.

XX. ENTIRE AGREEMENT

The entire agreement clause is one of the most important sleeper provisions in computer contracting, for it addresses what the Vendor is willing to stand behind if anything goes wrong in the performance of the Software.

Checklist:

- a. Make sure all exhibits and other documents which are part of the Agreement are incorporated into and made a part of the Agreement.

- b. Be sure to exclude any shrinkwrap, click wrap terms, etc. from the Agreement. See Number 14 Sample Provision.

XXI. MODIFICATION

The Agreement between the parties should be as written and care should be given not to allow either party to orally modify the Agreement.

Checklist:

- a. Make sure to insert a provision stating that the Agreement may be amended or modified only in a writing signed by duly authorized officers of both User and Vendor.

XXII. ASSIGNMENT

The Vendor may want the ability to assign its obligations and rights under the Agreement to third parties. However, User should attempt to limit the Vendor's assignment rights.

Checklist:

- a. Provide that both parties shall not assign or subcontract all or any part of the Agreement without the written consent on the other party. If pressed by the Vendor, User could provide that such written consent will not be unreasonably withheld.
- b. If the Vendor insists on having the ability to assign its obligations to third parties, limit such assignment to cases of merger or acquisition, provided such successor entity expressly assumes all of the Vendor's obligations and rights under the Agreement.
- c. See Number 15 Sample Provisions.

XXIII. Health Insurance Portability and Accountability Act of 1996 ("HIPAA")

A User should determine whether the Vendor's applications and/or the performance of services by the Vendor or User will be subject to the requirements of HIPAA. Failure to comply with such requirements may lead to both civil and criminal penalties.

- a. Privacy Standards: With a few notable exceptions, if the User is a "covered entity" under HIPAA and will be disclosing "protected health information" ("PHI") to a third party, the User should have a business

associate agreement in place with the third party. See Sample (Draft) Business Associate Agreement in Appendix B.

- b. Security and Transaction Standards: Whether a User must comply with HIPAA's Security and Transaction standards depends on a number of factors. For example, but without limitation, if the User is a "covered entity" under HIPAA and will be conducting certain electronic transactions with or through a third party, the User may require a business associate, trading partner, and/or chain of trust agreement with the third party. In addition, but without limitation, in the event the User is a "covered entity" under HIPAA and will not be submitting electronic insurance claims or related transactions with or through a third party, but will otherwise be electronically transmitting PHI to a third party, the User may require a business associate and chain of trust agreement with the third party. See Sample Business Associate, Trading Partner, and Chain of Trust Agreement in Appendix C.

XIV. CONCLUSION

Although the issues and provisions addressed in this article are not intended to be exhaustive, such should provide a User with guidance and information necessary to avoid a number of common "pitfalls" in software licensing agreements.

Appendix A

**SAMPLE PROVISIONS
[OMITTED]**