HOW TO

Improve Your Company's Form Software License Agreement

PART 2: ASSIGNMENT

KOLEY JESSEN

ATTORNEYS

PART 2: ASSIGNMENT

KEY TAKEAWAYS

A form software license agreement should:

1. prohibit the customer from assigning the contract to any third party without the licensor's prior written consent;
2. expressly state that all assignments in violation of the assignment clause are null and void; and
3. address the licensor's rights if the customer undergoes a change of control.

Assignment provisions govern a party's ability to transfer some or all of its rights, obligations, and liabilities under a contract to a third party. As a general rule, if the contract does not include an assignment provision or otherwise address a party's right to assign the contract, default law permits a party to assign the contract to a third party without the consent of the other contracting party. This general rule is not always true for intellectual property licenses, but licensors should take the safe approach and work under the assumption that default law (absent contract terms to the contrary) will permit the customer to assign the contract without the licensor's consent. As a good starting point in their form software license agreement, licensors should prohibit the customer from assigning the contract to any third party without the licensor's consent.

The simple example we will use to illustrate the importance of addressing assignment rights in a software license agreement is a licensor granting an enterprise software license to a small company ("SmallCo"), and SmallCo subsequently being acquired by a large multi-national company ("BigCo"). In one version of the example, SmallCo is acquired by BigCo via an asset sale. In another version of the example, SmallCo is acquired by BigCo via a stock sale. In the last version of the example, SmallCo is acquired by BigCo via a merger.

There are many different reasons why the licensor may want to prohibit SmallCo from assigning the software license agreement to BigCo and having BigCo using the software as the new counterparty to the agreement. BigCo may be a competitor or potential competitor of the licensor. Also, the licensor may miss out on additional revenue because BigCo would now have an enterprise license in exchange for SmallCo's presumably lower enterprise license fees. Furthermore, the licensor may have difficulty complying with its other obligations in the software license agreement (ex. maintenance and support) if the other party is BigCo and not SmallCo.

If the licensor has a standard assignment provision in its form software license agreement with the

"null and void" language referenced above, the licensor has largely protected itself from SmallCo assigning the software license agreement to BigCo in an asset sale scenario. An asset sale would require BigCo to become the other party to the software license agreement by SmallCo assigning the agreement to BigCo, but the software license agreement expressly says that SmallCo does not have the right to do that. Moreover, the "null and void" language says that SmallCo does not have the legal power to do that. So, if SmallCo purported to assign the software license agreement in violation of the assignment provision, the purported assignment would not be effective – BigCo would not be a party to the software license agreement and would not have new rights under the software license agreement. Also, many software license agreements would provide a termination right to the licensor if the customer purports to assign the software license agreement in violation of its terms.

In the stock sale example, it is unlikely that SmallCo would need to assign or transfer the software license agreement in any way. Rather, the ownership of SmallCo changes. The parties to the software license agreement remain unchanged in the stock sale example, meaning the parties to the agreement remain licensor and SmallCo. As a result, the standard assignment provision would likely not protect the licensor from a situation where SmallCo is acquired by BigCo in a stock sale. That language says SmallCo has no right or power to transfer the software license agreement to another party, and SmallCo has not done that in this stock sale example.

The stock sale scenario may be less concerning for the licensor because the other party to the software license agreement is still SmallCo (not BigCo). So, depending on how the enterprise license is precisely worded, expanded software usage rights to all of BigCo may, or may not, be a concern. However, whether or not the acquisition was an asset sale or stock sale, the licensor may be uncomfortable with a competitor or potential competitor owning SmallCo.

If the licensor wants to protect itself from the stock sale example where SmallCo remains the contracting party but is now owned by BigCo, the licensor should expressly state in its form software license agreement that changes of control are deemed assignments under the assignment clause, insert a "change of control" provision, or both. Change of control provisions, in essence, say that the licensor has a right to terminate the software license agreement if a certain percentage of ownership of the customer changes hands. Then, in our example, the licensor would have the option to terminate the software license agreement if SmallCo was acquired by BigCo via a stock sale.

Finally, in the merger example, SmallCo may or may not need to assign the software license agreement to BigCo or another entity. Mergers can take many different forms, and various different statutes set forth different rules on whether or not a merger involves an assignment of a contract "by operation of law." If drafted properly, the "change of control" provision set forth in the preceding sentence that provides the licensor a termination right would likely protect the licensor in the merger example. Also, the licensor should ensure that its assignment provision specifically says that SmallCo may not assign the agreement "whether voluntarily or involuntarily, directly or indirectly, or by operation of law, merger, consolidation or otherwise." This language would likely be interpreted by a court to prohibit the assignment or transfer of the software license agreement to BigCo (or any other entity) in connection with a merger of BigCo and SmallCo.

This article is one part of a ten-part article published by Koley Jessen to help software licensors improve their form software license agreements.

Please contact Koley Jessen's Commercial and Technology Contracts Practice Group for further assistance.