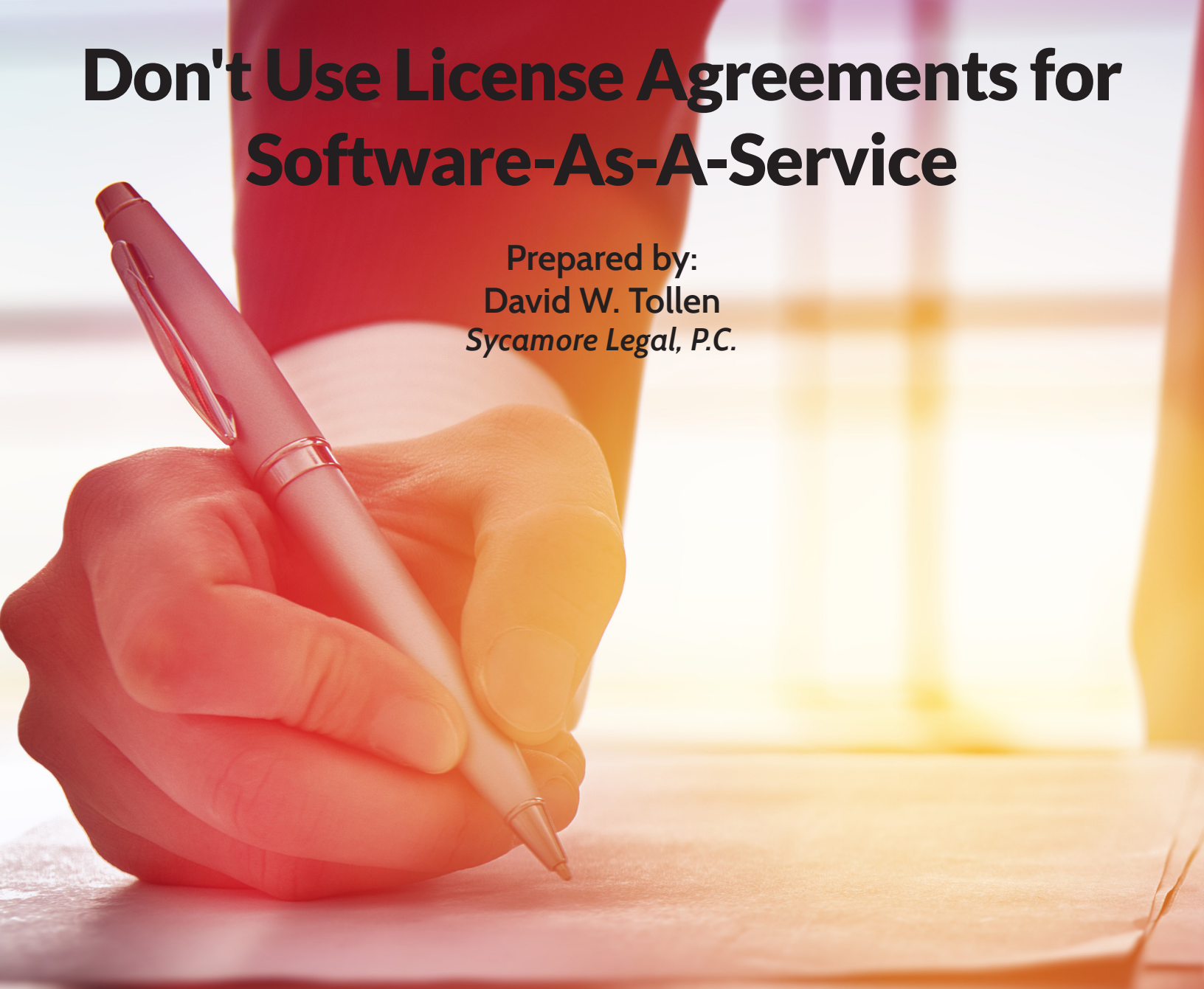
Don't Use License Agreements for Software-As-A-Service



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DON'T USE LICENSE AGREEMENTS FOR SOFTWARE-AS-A-SERVICE

Many software-as-a-service (SaaS) contracts grant a "license" to use the vendor's software. That's a mistake. Licenses are for on-premise software. SaaS is a *service*, as the name implies, and it doesn't need a license. And if you're the vendor, a license can hurt you.

SaaS Customers Don't Copy Software

The confusion stems from the role of "software" in software-as-a-service. You can cut through that confusion by asking what the customer will *do* with the software. If the customer puts a copy on a computer — if it's on-premise software — the contract needs a *license*. Copyright law gives the software's owner a monopoly on the right to copy it, so the customer needs a copyright license to make copies. The rule is the same whether the customer owns the computer receiving the copy or uses computers provided by its data center vendor. (Actually, copyright law has some confusing rules about whether the user actually needs a license to put a single copy on a single computer, but that's not important here.)

In a SaaS deal, on the other hand, the customer *does not* put software on a computer — or copy it at all. The software sits on the vendor's computers, and the customer just *accesses* it. With no copies, copyright plays no role in the promise of services, so the customer doesn't need a copyright license. Rather, it needs a simple permission: "During the term of this Agreement, Customer may access and use the System." (For more sample language, see *The Tech Contracts Handbook* Chap. I.E.1, as well as the examples in our clauses archive.)

In other words, the customer gets a *service* in a SaaS deal, not software. The vendor just uses software to *provide* the service. I often call the transaction a "subscription" — just to give it a handy name — instead of a "license."

Trouble for SaaS Vendors

Some pundits argue that a "license to use" SaaS just means *permission* to use it and does not grant a copyright license. But why take the risk, since a SaaS contract using the word "license" could hurt the vendor in at least four ways?

1. ***Patent License:*** Lawyers use "license" to grant patent rights. So a customer could argue that its SaaS "license" gives it rights under the vendor's patents — rights to build and sell its own software similar to the SaaS system.
2. ***Right to a Copy:*** In a dispute, a customer with "license" could demand a copy of the software running the SaaS. Maybe an ex-customer claims wrongful termination of its contract, for instance, and argues that it now needs a copy of the vendor's software to manage its business and minimize losses. Licensing language, with its implied right to copy, could support that argument.
3. ***Copyleft Open Source Distribution:*** Many SaaS systems include "copyleft" open source software (a.k.a. "viral" open source software, though the nickname is misleading). This copyleft code is provided to software companies with certain conditions, particularly a requirement that, if the company distributes its own product, it must distribute it *as open source software*. Generally, these copyleft rules don't apply to SaaS vendors because they *don't* distribute: they don't give customers copies of their software. But any suggestion that customers do get copies, or that they have a right to copies, could support an argument that copyleft applies. Using the word "license" creates such a suggestion. (For more on copyleft, click here.)
4. ***Bankruptcy:*** Intellectual property licenses generally continue even after the vendor files bankruptcy. So if the vendor goes through reorganization, customers with "license" in their contracts could argue that they keep their rights to the SaaS.

Other Differences between SaaS Contracts and On-Premise Licenses

If you're granting licenses for SaaS, you may be confused about its other key differences from on-premise software. For instance, SaaS contracts don't need maintenance clauses, which call on the vendor to fix the customer's copy of the software. Rather, SaaS contracts need service level agreements (SLA's), which recognize that the vendor hosts the software and calls on it to keep the system running. SaaS contracts also don't need updates and upgrades clauses. Again, the vendor hosts the software, so it provides any revisions as a matter of course.

SaaS contracts also call for much more focus on data management and security than on-premise software contracts. The customer's data sits on the vendor's computers, rather than on the customer's, as with on-premise software. (For more on data clauses, see *The Tech Contracts Handbook*, Chap. II.H, as well as the sample terms in II-H of our clauses archive.)

Combination Deals

Of course, your deal may involve *both* SaaS and on-premise software. A SaaS vendor may provide its main offering online but also provide an application for customers' computers — something that helps those machines talk to the online service. Don't let that confuse you. What you need there is a software license covering that one installed app, wrapped in the larger SaaS subscription contract. The license addresses the installed app only, not the SaaS system on the vendor's computers.

David Tollen is the author of The Tech Contracts Handbook, the American Bar Association's bestselling manual on IT agreements. He is an attorney, expert witness, and the founder of Sycamore Legal, P.C., a boutique IT, IP, and privacy law firm in San Francisco. His practice focuses on software licenses, cloud computing agreements, and other IT transactions. David also serves as a lecturer at U.C. Berkeley Law School. Finally, he is the founder of Tech Contracts Academy and our primary trainer.