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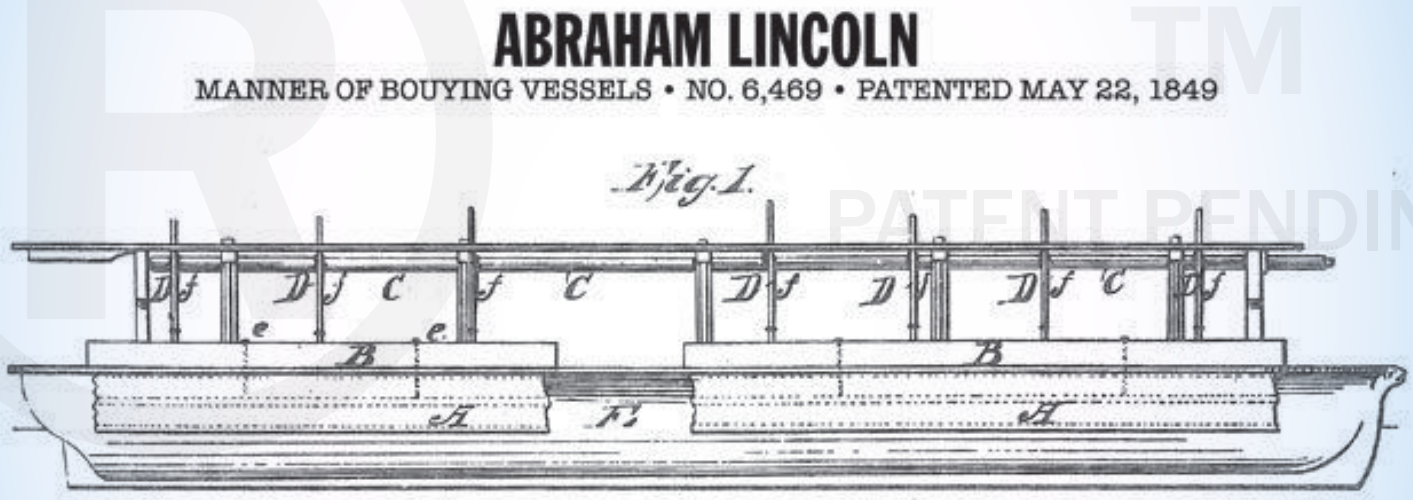

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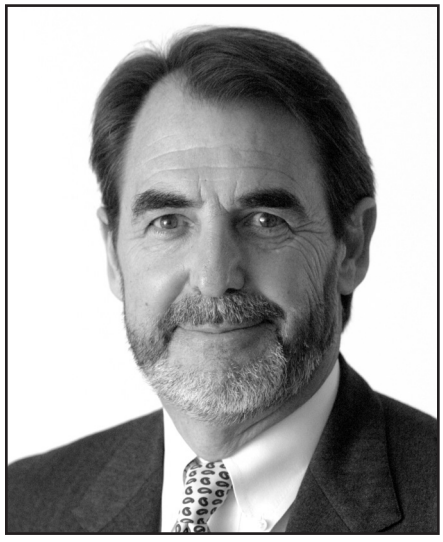

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POUNDING SQUARE PEGS INTO ROUND HOLES: NEGOTIATING SAAS AGREEMENTS

Contract forms eventually adapt to new technologies. When was the last time that you had to draft a definition of the Internet, the Worldwide Web or the acronyms URL, API or SaaS?

Sadly, agreement terms often remain behind the times. More precisely, substantive provisions often do not reflect the changes in the context and methods by which new technologies are disseminated under such agreements.

If you are a technology lawyer do either of the following scenarios seem familiar?

> Your VC-funded SaaS client tells you that the startup landed a major deal with a multinational corporation but their counsel wants a few "minor" changes to the Terms of Use (TOU) governing the subscription to the service. After reviewing the 35+ page agreement (excluding attachments) sent by counsel for the multinational you have to tell your client to reject the deal *or* that negotiating an acceptable version will cost about half of the expected deal revenue.
>
> Or, you are counsel for the multinational. Your internal business clients are wildly excited about the Software as a Service (SaaS) service. You have to tell them that they cannot use that service because counsel for the SaaS provider won't accept your "standard" vendor agreement.

I have experience over the last few years with agreements between SaaS providers—typically VC-funded startups—and large enterprises.[1] What we often find is a mismatch of expectations and therefore agreement terms. Negotiations become something akin to trying to pound a square peg in a round hole because one party sees legal expenses in trying to compromise and the other sees unacceptable risks without provisions covering them.[2]

Conflicting Business Models

The conflict reflects in part differing business models and in part over-reliance on "old" forms. For their part, startups want to "scale," which is another way of saying rapidly expand their business without a concomitant increase in labor-intensive activities. They prefer a "self-provisioning" model that, in theory, eliminates the need for customer service to open accounts and receive payment and providing a "one-size-fits-all" TOU to establish the legal basis of the relationship.

Enterprises typically seek standardization in their technology vendor agreements, which accomplishes at least three goals as it: (i) provides organizational efficiency (easier to manage contracts with the same terms); (ii) enables the internal IT systems to be run with greater efficiency; and (iii) systematically reduces exposure to damaging liability. So their counsel typically use agreements developed over the years with lengthy provisions that cover a broad range of contingencies. Not surprisingly, risks inherent in those contingencies are then shifted to the vendors.

Equally unsurprising, many of the lengthy provisions do not apply to the SaaS services. If the SaaS vendor is monitoring website uptime, does the agreement need to include two pages on "personally identifiable information"? Conversely, should an enterprise that is about to spend, say, $20,000 per month for a service have to pay, in advance, and by credit card, for that service, as the SaaS vendor expects?

And so the pounding on the square peg into the round hole begins. How do we craft legal terms so that the round hole and the square peg can be re-shaped to fit? First, let's create a hypothetical, then look at some of the differences in provisions and then propose a few solutions.

A SaaS Hypothetical: Sassax and Enterproco

The SaaS Vendor

We'll call our SaaS vendor *Saasax*. Saasax's service enables users to collect and analyze data from the web. It's not mission-critical data. Let's say that the service can track the use of a word, phrase or photo across the web and provide an analysis of the context in which it is used. This kind of service is often called "business intelligence" or "business analytics," providing directional guidance for strategic decisions.

Saasax's software is based in the Cloud so the user does not get a copy of the software—only *access* to its features and functionality.[3] The user goes online and, using a credit card, opens an account, usually a monthly, quarterly or annual subscription. Through a browser, the user utilizes a "dashboard" to enter the relevant parameters and then can view and manipulate the results. The user can create reports, graphs and so forth and store online and/or download (*i.e.,* copy) the information.

The Enterprise

Enterproco is a global corporation with 50+ subsidiaries that develops and implements online strategies, so its services include website and app building and management, systems integration and strategic marketing services to several hundred companies.[4]

Enterproco wants to use Saasax to monitor the brands of its clients. Enterproco wants to enable its subsidiary (sub) and clients of both parent and sub(s) to use the same service. So, potentially, this could be well over a hundred corporate accounts with multiple users on each such "account" and thousands of terms to be searched. For example, its Italian sub would like to monitor use of the name of a famous soccer team, Juventus, on Twitter and Facebook; its UK sub wants to enable its client to understand who is posting comments about its show, *Top Gear*, on blogs; and so on and so forth.

You represent Saasax. You create a matrix of the differences, the most important of which are:

TOPIC	SAASAX POSITION	ENTERPROCO POSITION
Business/IP		
Users	*Per seat per company*[5]	*Unlimited users per entity*
Payment & Accountability	*Enterproco pays for all users at all levels; responsible for all users complying with TOU*	*Invoiced in arrears to each sub; 90-day payment; Saasax must go after subs and clients for violations, including non-payment.*
IP Ownership	*Saasax owns software and anonymized aggregate data; Enterpoco owns its results*	*Enterproco has right to source code or in escrow; all data owned, no rights to Saasax; right of re-publication of all data, including individuals and screen-names for use in ads.*[6]
Liability	*Enterproco indemnifies for user TOU violations*	*Saasax indemnifies Enterproco for all risks*
Technical		
Bug fixes, upgrades	*Immediate and whenever appropriate*	*"Dev environment" with 60-day notice, 45-day implementation*
Availability	*97.5 – 99.5 Uptime with 4 hours/week scheduled downtime*	*99.99 Uptime, 4 hours/month scheduled downtime*
Service response	*Normal business hours PDT*	*3 – 12 hours depending on severity, irrespective of time zone*
Inapplicable		
Advertising buys	*Inapplicable; Saasax does not do ad buys—it provides data*	*Only through Enterproco*
PII	*Must report on policies*	*Enterproco can audit*

So What?

Space limitations make it impossible to examine each one of the divergent positions in detail. Briefly then, let's cover "Business & IP Issues" and "Technical Issues:"

Business & IP Issues		
Users	*Per seat per company*	*Unlimited users per entity*

Given that the revenue from the deal could be substantial, Saasax might want to re-consider its revenue model. One approach is to have a high base subscription rate with discounts applied to increments of additional users. Another approach is to charge by search/brand term rather than users.

Payment	*Enterproco pays for all users at all levels*	*Invoiced in arrears to each sub and client; 90-day payment; Saasax must go after subs and clients for violations, including non-payment*

If Saasax were to invoice every subsidiary and client, Saasax would spend most of its hard-earned revenue generating invoices and tracking payment. The same would hold true of collections: How could Saasax be expected to chase anyone for, say, $500 of unpaid subscriptions, let alone subsidiaries or clients of those subs in non-US jurisdictions?

Someone has to step up to cover the monthly payments. If Enterproco is offering access to this service, then it should provide a minimum guarantee of monthly revenue or an account from which Saasax could deduct what is due Saasax. Saasax will look *only* to Enterproco for payment. Otherwise, Saasax should insist that every sub sign up on the site. Alternatively, Saasax could offer to invoice any sub that owed a minimum of, say, $10,000 per month for the service.

IP Ownership	*Saasax owns software and anonymized aggregate data; Enterpoco owns its results*	*Enterproco has right to source code or in escrow; all data owned no rights to Saasax*

IP ownership is pretty tricky. There are at several bundles of IP rights. Typically, there is no dispute over the Saasax technology such as the underlying software and User Experience (U/X), as well as Saasax's know-how on the effective date. Likewise, there is no dispute that what Enterproco provides to use the service Enterproco owns.[7]

Where it gets sticky is what is developed from the use of the SaaS service. Saasax has granted Enterproco rights in the output—*i.e.,* whatever results from Entreproco users entering data into the service. They include new know-how. This strikes me as akin to telling a plumber that new techniques for plumbing repair he or she develops while fixing your toilet would be owned by you.

Saasax should reject this requirement. Not only should it have the right to its own "new" know-how, it should be able to retain data as to the results, which it can use for its own reports, provided that it is anonymized, *i.e.,* the names of Enterproco, its clients and the brands would be stripped out.

Technical

Some of the biggest disconnects arise from technical requirements. From what I can tell, these problems occur because the enterprise agreement includes "standard" provisions that often do not apply. The agreements often include what is typically called an "SLA" (for service level agreement) or a variant thereof. These terms usually mandate uptimes and permitted exceptions (*e.g.,* scheduled maintenance), as well as levels or priorities of issues, response times and service credits for failure. Let's take uptime. If the SaaS service is not mission-critical, then a 99.9% uptime serves no purpose, other than to increase the burden on the SaaS vendor. Mission-critical services might require an even *higher* level but not, for example, business analytics. This is also true for response times. Eight-hour response windows just raise costs.

In our hypothetical, Enterproco's "standard" agreement requires that Saasax create a "development environment" for changes to the software plus an evaluation period, together lasting up to ninety days. During that time, Enterproco's IT team can evaluate the changes. In this case, they can also require approval before a change is deployed. These obligations may make sense for on-premise software installation or in mission-critical services, but they obviate one of the main advantages of SaaS, namely, that any software changes are immediately propagated in the software running the SaaS service. It is one thing if the service were integrated into the IT systems of Enterproco, but not if the service merely generates results. Once again, the provisions should not apply.

So What?

One approach is another scenario with which you might be familiar: Counsel on the other side says to just ignore provisions that do not apply. Right. Putting aside the obvious objections, very often such provisions include reporting requirements and audit rights. In other words, even if, say, Saasax does not collect PII, the agreement might require monthly reports on PII policy. Enterproco might also have an audit right for PII collection procedures.

At *best*, I would concede to a sentence at the start of each inapplicable provision that the parties agree and acknowledge that this Section X does not apply in this situation and it is of no force and effect. I would do that only under extreme duress. We lawyers are better than that: The other side should understand and accept that "standard" provisions apply only in relationships that fit within the definition of "standard." It is always better to have an agreement with *only* the terms that are applicable.

There are two "overarching" approaches that can help. The easiest approach would be to match provision against feature and risk. In this hypothetical, the SaaS output is not mission-critical. If Enterproco's technical people are concerned about, for example, integrating report downloads into their content management system should the Saasax platform be altered, then the technical people can figure out upper bounds for changes to the platform. In other words, have the right people in each party work out the core issue, which then enables the lawyers to craft *applicable* language. Usually these sorts of discussions can (and should) occur in a conference call with the business and technical people while the lawyers *listen*.

Another approach is for Saasax to have two-tier pricing: If Enterproco wants comprehensive changes to the basic terms in the TOU then there needs to be meaningful (read: substantial) revenue to Saasax, which can be achieved by a higher seat license fee, a minimum guarantee and/or a long-term commitment with onerous termination opportunities. If not, then Enterproco and its subs and clients can simply sign on to the TOU and move forward at the lower price.

Eventually, management for enough enterprises will realize that the business side is losing out on services that its competitors are using to great effect. And, with the same eventuality, the "standard" agreements will be revised to eliminate terms that have no reason for being in the agreement. Of course, by that time, we technology lawyers will be pounding our heads with square pegs over the latest technology and the agreement wrinkles it causes.

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Endnotes

1. In this column "SaaS" (Software as a Service) refers to providing access to *use* technology without necessarily having a copy of that technology (*e.g.*, software or hardware) operating on the premises for the client. Well-known acronyms include "IaaS" (Infrastructure as a Service), "PaaS" (Platform as a Service) and "DaaS" (Data as a Service) but it also covers, for example, contact center technology for inbound/outbound calls, online surveys, etc.
2. I could not resist: If you want to know the origin of the saying about square pegs, see https://en.wikipedia.org/wiki/Square_peg_in_a_round_hole.
3. As the software is not being copied, the agreement should not include a license to the service but, rather, a right of access and use. There should be license grants where one party copies the data of the other party or one party creates data.
4. As with Saasax, Enterproco is a somewhat arbitrary construct. It could just as easily be a global hardware company such as Cisco or Intel, a large advertising agency or a global brand such as Armani or Coca-Cola.
5. The models vary but they are based on use. One approach is to charge per term searched or per network on the web searched (*e.g.*, blogs, Twitter, AdWords, etc.) or *both*.
6. Suppose, for example, that the Saasax service would dig up a social media post with a user's screenname and photo saying nice things about a relevant brand. Under this provision, Enterproco would have a right to use that likeness in ads. This is not far-fetched: Cases regularly pop up. I understand that one ad agency explicitly required a SaaS provider to grant a license in such likenesses unless state law prohibited it. A familiar case arose with Virgin Mobile (Australia) creating an ad from a photo of a 15-year old posted by a photographer on Flickr.com. The case was dismissed for jurisdictional problems but can be found by searching "*Chang v. Virgin Mobile USA.*" *See* http://www.nytimes.com/2007/10/01/technology/01link.html.
7. The agreement should have Enterproco grant a limited license for Saasax to use the information to provide the service.

DESIGN PATENTS
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45. 776 F.2d 1007, 1014 n.4, 227 U.S.P.Q. (BNA) 497, 502 n.4 (Fed. Cir. 1985)
46. 17 U.S.C. § 102(a); *Johnson Controls, Inc. v. Phoenix Control Systems, Inc.*, 886 F.2d 1173, 1175 (9th Cir. 1989); *AtPac, Inc. v. Aptitude Solutions, Inc.*, 787 F. Supp. 2d 1108 (E.D. Cal. 2011).
47. http://techterms.com/definition/gui.
48. *Apple Inc. v. Samsung Elecs. Co.*, 2015 U.S. App. LEXIS 8096, *24–27 (Fed. Cir. 2015).
49. *Apple, Inc. v. Samsung Electronics, Co., Ltd.*, 2014 U.S. Dist. LEXIS 17204 (N.D. Cal. Feb. 7, 2014).