

Wednesday, Jan. 31, 2007
Vol. 23, No. 02

Soft•letter

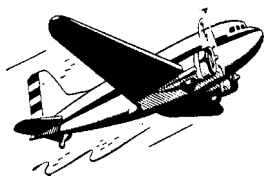
BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS

What to Do When the Customer Says “Take This EULA and Shove It”

by Jeff Gordon, author, *The Software Licensing Handbook*

Have you (or your sales team) ever gotten this call?

“Hi! I’m Jeff from the contract management group at yournextcustomer. I’m calling about the End User License Agreement that your distributor would like us to agree to before purchasing your product. I just have a few issues with it and want to know where to send a redline.”



*Both median services margins and contributions to revenue continue to fly high and steady
See pages 4-5.*

Do you know what is happening or about to happen? The call above is not fabricated, as it is a conversation I have personally started hundreds of times with a variety of software vendors over the last several years. The companies I’ve worked for believe they are large enough to not have to agree to a one-sided contract and I was hired for the express purpose of negotiating a more favorable license agreement with each of our vendors. Invariably, I start with the sales contact, get passed to management, and I usually end up with a contract more favorable to my company than it is to yours.

When I initiate the call, I am usually confident about two key things. The first is that you want our business. As a large buyer in a particular industry, you may want to leverage experience in that industry into more lucrative deals. I count on the fact that you realize that an initial purchase is almost never the final purchase, and that getting your foot in the door with a negotiated agreement is better than no deal at all. Secondly, and perhaps more importantly, I know that I can use that “want” of business to leverage you into using my template license agreement. The important next detail, then, is an awareness of the various options available when a customer refuses to agree to your EULA.

Initially, you have three possible options, depending on your comfort level and pre-planning: a) offer the customer a negotiable Software License Agreement, b) negotiate the terms of the EULA itself, or c) use the customer’s template Software License Agreement. Obviously, if possible, you would want to use option (a) first. It’s probably longer than your EULA, but it also has probably been written in a way that would allow for some concessions to various terms and conditions.

Options (b) and (c), however, pose more difficult challenges. EULAs are now distributed to the customer *(continued on page three)*

Publisher & Managing Editor
Merrill R. Chapman
rickchapman@softletter.com
860/663-0552

Editor
Donald K. Rosenberg
don@softletter.com
919/687-4172

Editor Emeritus
Jeffrey Tarter
jtarter@softletter.com
617/668-0028

Editorial office
Soft•letter
34 Sugar Hill Rd.
Killingworth, Conn.
06419
Voice: 860/663-0552

Subscription office
Aegis Resources
34 Sugar Hill Rd.
Killingworth, Conn.
06419
Voice: 860/663-0552
Fax: 860/663-0553
info@softletter.com

www.softletter.com

Identifying Good Product Managers

by Alyssa Dver, author, *Software Product Management Essentials*

The biggest complaint about product managers from their executive bosses is that they don't come prepared for their role. The multi-tasking challenges of product management requires people who are **not** at their best when focused towards delivering a completely definable, measurable job. Product managers can never be perfectionists nor can they be flustered by constant interruptions.

So how do you identify potentially effective product managers? Here is a list of interview questions I've used to help me identify someone with PM potential:

- **Why did you select the education path you did?** An ideal answer illustrates someone's interest in learning beyond a single focus. They may have a business or engineering degree, for example, but did they take other, non-related, electives? Are they open minded to learning new things or do they prefer to apply straightforward rules to problems that have absolute answers? PMs rarely obtain truly "correct" answers to the challenges they face and often can't apply rote decision making methods.
- **What TV shows do you watch?** Despite what educators tell you, watching some TV can actually relax your mind and open it creatively. Being tuned into popular culture, no matter what product you support, is important. Not only does it help you to participate in relationship-building small talk, but it also clues you into ideas that clearly have already won mass acceptance. For example, your company may not make iPods but knowing how they work might give your PM some good installation or interface ideas for your company's product.
- **What newsletters, magazines, etc. do you subscribe to (online and hardcopy)?** This questions elicits a person's interest in knowing what's going on beyond the obvious internal and industry news. There is no right answer here, but a collection of different and thought provoking media is ideal. (Understanding new media also helps a PM evaluate whether it's an appropriate channel for his/her audiences.)
- **What do you do to remain innovative?** This is a tough question and relates to the above interest in staying abreast of news, innovation and a diversity of topics. An ideal PM candidate will indicate that they are interested in a variety of things and make sure that they ingest all types of information to ensure their brains stay fit and flexible.
- **How well do you communicate?** A person who communicates well will know it from specific feedback and experience they've had. A great communicator works hard to constantly improve their craft by writing, presenting, and conscientiously interacting with people and seeking qualitative and quantitative feedback.
- **Do you like interacting with people? Why?** Many technical people will say that they are uncomfortable interacting with people. This is a red flag for PMs! To cull the well-rehearsed interview pitch from the genuinely interested PM, the answer to "Why" should include the ability to learn from other people, gain new ideas, and challenge their own communication skills—especially listening.

Alyssa Dver, author, *Software Product Management Essentials*, 23 Nancy Drive, Ashland, Mass. 01721; 508/881.5664. E-mail: alysadver@comcast.net.

by one of two main conduits, either as a click-through agreement or as a PDF, sent prior to the sale or attached to the ordering document. As a negotiator, I prefer to use an electronic form of the agreement, so having a word-processing document format would be advisable. Using e-mail to send the document to your customer subtly tells the customer that you have a document from which you want to start and it opens the door for negotiation without agreeing to use the customer's template.

Regardless of which document you end up negotiating, there are key license and other terms that you need to consider with respect to margin, liability and feasibility issues. In essence, you need to evaluate the language with an eye to profitability, exposure and whether you can actually live up to the agreement. Your answers to these issues, of course, are unique to your business, but the following sections are usually considered the most crucial to any software license and should be paid special attention.

Warranty

It was once common to see a one-year warranty; more common now, however, is a short-term warranty of anywhere from 30 to 90 days. The reduction in length is a function of the real purpose of a warranty, namely, to show to the customer that your product works as advertised. It is imperative that a warranty describe those things that you guaranty will never happen, and those things that will be fixed at no charge (for some limited period of time). Among this list would be warranties that protect the customer against problems resulting from ownership issues, documentation conformance, processing four-digit years and a warranty protecting the customer from the introduction of malicious code.

Indemnification

When a customer licenses software, one of the last things they want to have to worry about is a situation where the software vendor does not have the right to license or is not the owner of the product licensed; this creates financial liability that customers believe the vendor should assume. As a result, the concept of indemnification is used by vendors to promise to customers that they will be receiving an unencumbered license (based on the license grant as discussed above). Indemnification obligations are most often a) limited to only cover the most recent version of a particular product, but b) offer unlimited financial protection to the customer (the cost of the product, attorney's fees and any damages awarded to a true owner). A EULA may offer little or no indemnification, but a customer's desire to include an indemnification section should not be a surprise to a software vendor.

Confidentiality

Another common, but often overlooked provision is one detailing the confidential information of each party and the obligations the recipient of confidential information will have to

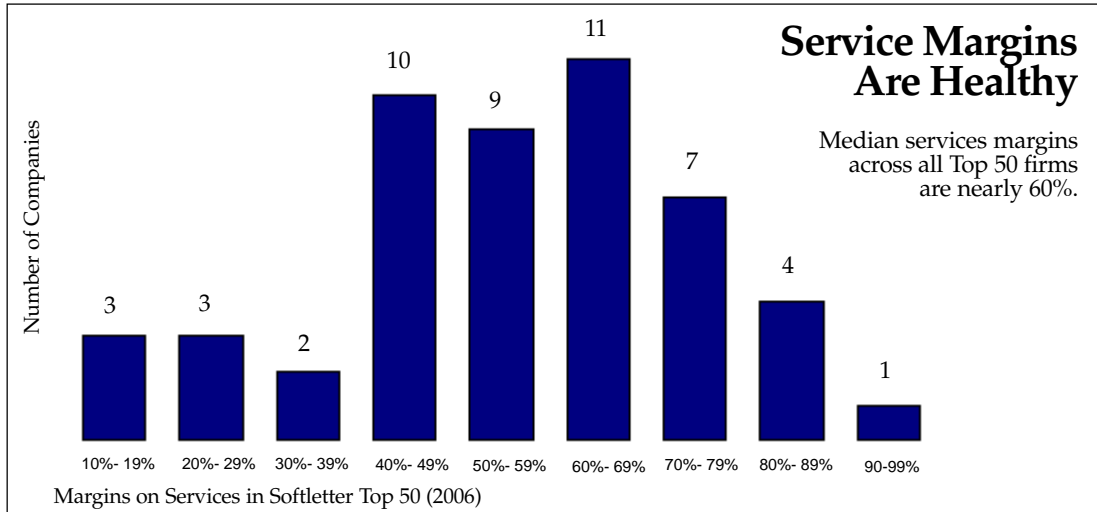
(continued on page six)

“Customers also have a tendency to believe that warranties are the free version of maintenance or support services. To their credit, this was a functionally accurate description until the late 1980s, when many software vendors started offering maintenance programs designed to provide long-term support and product updates.”

Jeff Gordon, The Software Licensing Handbook

“The complex nature of customer environments discourages software vendors from offering a longer term warranty, as the risk of issues increases the longer the product is installed. On the other hand, most customers believe a warranty to act in the form of an insurance plan—a way to guaranty that the product continues to work over a longer period.”

—Jeff Gordon, The Software Licensing Handbook



Benchmarks: Services Margins and Contributions

Because of consolidation in the software industry we cannot track the very same companies we have been able to follow in the past, but there is great overlap in the current Top 50 with the old Top 50 listing and our current listing does contain its own three-year history.

Our current results show that both median services margins and services contributions to revenue are holding steady:

Median Services Contributions:

2004	2005	2006	3-Yr Av.
49%	48%	49%	49%

Median Services Margins:

2004	2005	2006	3-Yr Av.
58%	59%	57%	58%

Companies typically divide revenue into licenses (for software products); this category can also include subscriptions to keep licenses current. Services, on the other hand, may cover software maintenance, updates, training, and customization/integration.

From a profit perspective, licenses/subscriptions are an opportunity for higher profit owing to the low marginal cost of supplying product once development is done. In its simplest form, SaaS is a means of extending this profit model by simplifying the relationship with the customer: fewer services are supposedly required, and higher profit should therefore result, because the software itself has a low marginal cost, while services have a higher marginal cost because actual work must be performed in order to receive revenue.

But the tables show services margins to be generally high, and services have the added advantage, particularly in a SaaS world, of binding the customer to vendor. The creation of this ongoing relationship is worth the investment and effort, and is the reason we do not see SaaS companies neglecting the service side of their businesses, generally expressed as an integration of the customer's IT department with server-side SaaS software.

The Top 50: Services Margins and Contributions

Total Revenue (\$000)				
	Small <\$150M	Medium \$150-\$299M	Large \$300M-\$999M	Very Large >\$1B
Total Revenue 2004	\$852,054	\$2,735,777	\$3,431,758	\$25,577,332
Total Revenue 2005	\$943,232	\$3,303,945	\$3,939,137	\$28,256,505
Total Revenue 2006	\$1,040,734	\$3,744,429	\$4,353,728	\$32,387,253
Cumulative Annual Growth Rate	10.5%	17.0%	12.6%	12.5%

Service Revenue (\$000)				
	Small <\$150M	Medium \$150-\$299M	Large \$300M-\$999M	Very Large >\$1B
Service Revenue 2004	\$410,728	\$1,192,527	\$1,781,116	\$7,496,549
Service Revenue 2005	\$465,084	\$1,430,441	\$2,023,495	\$7,917,318
Service Revenue 2006	\$516,944	\$1,685,691	\$2,289,409	\$9,030,274
Cumulative Annual Growth Rate	12.2%	18.9%	13.4%	9.8%

Service Cost (\$000)				
	Small <\$150M	Medium \$150-\$299M	Large \$300M-\$999M	Very Large >\$1B
Service Cost 2004	\$182,267	\$540,359	\$621,698	\$4,809,992
Service Cost 2005	\$200,671	\$601,469	\$687,142	\$4,917,611
Service Cost 2006	\$232,473	\$706,118	\$762,174	\$5,479,945
Cumulative Annual Growth Rate	12.9%	14.3%	10.7%	6.7%

Median Service Margin				
	Small <\$150M	Medium \$150-\$299M	Large \$300M-\$999M	Very Large >\$1B
Service Margin 2004	56.2%	52.9%	67.6%	55.7%
Service Margin 2005	54.6%	54.3%	68.1%	56.9%
Service Margin 2006	52.5%	53.0%	68.4%	57.1%
Cumulative Annual Growth Rate	-3.3%	0.1%	0.6%	1.2%

Median Service Contribution				
	Small <\$150M	Medium \$150-\$299M	Large \$300M-\$999M	Very Large >\$1B
Service Contribution 2004	51.7%	37.1%	59.8%	31.4%
Service Contribution 2005	53.2%	36.6%	59.2%	32.9%
Service Contribution 2006	50.4%	44.9%	61.1%	34.0%
Cumulative Annual Growth Rate	-1.3%	10.0%	1.1%	4.1%

Note: Dollar amounts are totals within each size segment and year.
 "Services Contribution" is the percentage of revenue from Services.
 "Services" are primarily maintenance and professional services.

the discloser. Confidentiality terms should almost always be mutual, with each side having an identical obligation to the other with respect to how they are going to treat information they receive. Software would be included within the definition of confidential information for the vendor, whereas specifications, drawings and other work product might be information special to the customer.

There are five standard exclusions from protection: 1) information already known by the recipient, 2) information later received from someone not under a confidentiality agreement, 3) information put into the public domain, 4) information you're later told by the discloser is no longer confidential, and 5) information required to be disclosed by a court of law (so long as the recipient gives the discloser reasonable notice that they're being compelled to provide confidential information).

Term and Termination

Software license agreements are usually found to be either perpetual (license the software once and there are no additional license fees) or term-based (license the software for a set period of time and renew the license afterwards if still needed). A third variety, the so-called "subscription model", is essentially a term-based license for a set number of years and the license includes maintenance, support and upgrades. There is a faction of attorneys and negotiators that are concerned about the perpetual model, and thus resort to a 99-year term license. This is not a subscription, but a way to license the software well beyond its useful life. When negotiating, watch for the conversion of a term-based license to a perpetual license and for the inclusion of maintenance, support and upgrades.

Termination is also a consideration, as most EULAs will have broad termination rights for the vendor. It is not uncommon to have almost identical termination capabilities for both parties and to limit termination for cause to the breach of a party's obligations. Customers sometimes desire the ability to unilaterally terminate the agreement without cause (you can't force a customer to use the product). Vendors can usually accept this provision with the caveat that the licensee and/or maintenance fees for the current term still be paid as due under the agreement.

Maintenance

Perpetual and term-based licenses are designed to allow continued use of a product over a long period of time. In the meantime, the software vendor continues to develop their product line as well as provide support for the current products. Customers are usually offered the ability to purchase maintenance as a way to obtain those newly-developed products without paying the entire licensing fee all over again, as well as to enable the vendor to offer help in the event of a problem. Confusion sometimes happens when maintenance and/or support are separated into their component parts or when service capabilities are redefined to mesh with the customer's needs.

Avoid converting an EULA into a fully-negotiated contract because the level of risk can increase proportionately to the changes in language. If you do not have a full software license agreement and are selling a product for more than \$15,000-\$20,000 (either a single product or an average sale), it is advisable that you have one developed, as buyers of that quantity of product expect the ability to negotiate. As starting the negotiation process from your preferred language is one goal of the EULA, maintain that advantage by developing a negotiable license as well.

Jeff Gordon, author, the Software Licensing Handbook, 9304 Cub Trail, Raleigh, N.C., 27615; 408/954-3977. E-mail: jgordon@avaya.com. Website: www.licensinghandbook.com.

Recasting Your Financials for an M&A Event

By Dang Nguyen, Corum Group

One of the most important components of a successful M&A process is the way in which sellers present their financial information to potential buyers. The typical financial statements or tax returns of privately held companies are generally not suitable for a promising M&A strategy. Owners of private companies tend to focus more on minimizing tax liabilities rather than maximizing business valuation. In order to properly depict the true financial capability of the business, owners must consider recasting their financial statements.

The intent of recasting is to make adjustments to the financial statements to demonstrate the operating potential of the firm in “normal conditions” to a potential buyer. Some of the adjustments may benefit the seller, while others may benefit the buyer. There are many items that qualify for recasting that apply to the Income Statement or the Balance Sheet. Below is a list of some potential items that should be considered:

- Owner’s compensation is discretionary; if exceeding high or low, it should be recast to reflect the rate at which another individual would be paid to perform the same task.
- Executive “perks”, which may include luxury cars, club membership, or first-class travel should be recast to align with customary standards for fringe benefits. Travel and entertainment is a necessary expense in operating a business, however, family vacations to Hawaii do not qualify even when a little business is mixed in while relaxing with relatives.
- Any extraordinary expense such as legal/advisory fees, should be considered because it is a one-time expense. Undervalued or overvalued investments in securities, real estate, or the like should reflect its market value.

Being well prepared and prudently recasting your financial statements to provide acquirers with a cleaner, clearer picture of the financial situation going into negotiations will help lead to a successful M&A transaction.

Dang Nguyen, financial analyst, Corum Group, 10500 NE Eighth St., Bellevue, Wash. 98004; 425/455-8281. E-mail: dangn@corumgroup.com.

Company/Description	Acquired by	Price/Terms	Revenues	Multiple
Carreker (CANI) • Financial services software	CheckFree (CKFR)	\$206,000,000 <i>Terms: Cash and debt</i>	\$114,400,000	1.80
WhereNet • RFID asset management solutions	Zebra Technologies (ZBRA)	\$126,000,000 <i>Terms: Cash</i>	\$36,000,000	3.50
Digica • European IT services company	Computacenter (CUUCFPK)	\$54,800,000 <i>Terms: Cash and debt</i>	\$38,000,000	1.44
StubHub • Online ticket reseller	Ebay (EBAY)	\$310,000,000 <i>Terms: Cash</i>	\$100,000,000	3.10



Book Review: *The Software Licensing Handbook* by Jeff Gordon

The just introduced *Software Licensing Handbook* is an invaluable guide to one of the software's industry's most maddening and, at times, controversial topics, software licensing. Since the introduction of the end user legal agreement (EULA) in the late 1970s, software companies have struggled to negotiate successfully the web of various rules and regulations that govern copyright, trademark, patent, and trade secrets. At 216 pages, this handbook is a compact and succinct guide to when you'll haggle over software license terms and conditions and how to do it well.

Of particular interest is the book's scenario-driven approach. In most the chapters, a common point of contention between the software licensor and licensee is described, followed by an outline of the issues that underlie the topic and suggested negotiating points for both sides. This is the type of book any software senior executive should keep close to his/her desktop for immediate reference when needed. Highly recommended (and in some cases, critical). Available online at: www.licensinghandbook.com.

SUN MICROSYSTEMS CEO JONATHAN SCHWARTZ ON HIS ADVERTISING STRATEGY:

"Here's how our business works. You decide you need an operating system because you're a new start-up in India. And where do you go to get an operating system? You go to the Internet, right? Because you're not going to go to the corner store. And from there, we now have an opportunity — independent of whatever hardware they're running on — to serve that customer, because over time if you have an OS, if you have a computer, you need storage; if you have storage and a computer and you have software, you need network connection, and all of a sudden you need infrastructure requirements. I'm not going to advertise during the Super Bowl. What a waste of money. Where am I going to advertise? I'm going to buy land in Second Life." (Quoted in the *New York Times*, 01/13/2007)

FOG CREEK CEO JOEL SPOLSKY ON THE CHANDLER PROJECT:

"The Chandler team also overestimated how much help they would get from volunteers. Open source doesn't quite work like that. It's really good at implementing copycat features, because there's a spec to work from: the implementation you're copying. It's really good at Itch Scratching features. I need a command line argument for EBCDIC, so I'll add it and send in the code. But when you have an app that doesn't do anything yet, nobody finds it itchy. They're not using it. So you don't get volunteers. Almost everyone on the Chandler dev team got paid." (Quoted on <http://www.joelonsoftware.com/items/2007/01/21.html> 01/22/2007, 01/22/2007)

FORRESTER RESEARCH ANALYST MICHAEL GOULDE ON THE MERGER OF THE OSDL AND FSG OPEN SOURCE CONSORTIUMS:

"If Linux is really to be a long-term product for customers, the system needs to allow application developers to develop once for Linux so their software can run on any distribution." (Quoted in *Computerworld*, 02/22/2007)

Colleagues made off with your last issue? Go to www.softletter.com. Click Subscriber Login in the upper right of the home page. To view the current issue and to search archives of hundreds of articles by keyword, topic, or issue date, log in and enjoy!

Soft•letter is published 24 times per year; entire contents copyright © 2006 by Soft•letter. All rights reserved. Reproduction by any means, without permission of the publisher, is prohibited. ISSN: 0882-3499.

Subscription rates: \$395 worldwide. Subscription office: Aegis Resources 34 Sugar Hill Rd. Killingworth, Conn. 06419 Voice: 860/663-0552 Fax: 860/663-0553 info@softletter.com