

## BEA Customers Should Seek Contractual Protections Before Acquisition by Oracle

Peter Wesche, Jane B. Disbrow

Oracle has announced an agreement to purchase BEA Systems. The deal is expected to close in the second quarter of 2008.

Including negotiated terms and conditions that address software vendor acquisition issues is a best practice for any software acquisition. Because this acquisition has been announced, customers negotiating deals with BEA should also include such provisions before signing their contracts.

### Key Findings

- Oracle has a history of renaming, re-bundling and changing license models. These changes can result in customers having to convert older licenses to newer licenses when additional licenses are required, sometimes at unfavorable conversion ratios. Include provisions that provide long-term protections for current BEA licenses, including the right to purchase additional licenses under current license models.
- Unless additional licenses are being purchased, BEA is not likely to agree to contract changes for current customers.
- Key provisions to negotiate with BEA include an assumption of contract right obligations, and the right to purchase additional licenses at negotiated prices, license models, and current terms and conditions.

### Recommendations

- If purchasing BEA software products for the first time or adding new licenses, this is an excellent time to ensure that you have terms and conditions in place that provide long-term contract protections.
- Without contract protection, there is always some risk of unexpected cost due to changes in ownership.

## ANALYSIS

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Any software company's announcement that it is being acquired can create concern among customers as to what might happen to their investments once the acquisition is completed. Unless new software is being purchased, BEA is unlikely to agree to amend any prior contracts; however, we recommend considering the following provisions for any negotiations that are in progress with BEA, and that all customers recognize and plan for the specific areas of risk we highlight. These issues are general in nature, but are put into the context of Oracle's acquisition of BEA. As a best practice, we recommend that enterprises include such provisions in any strategic software agreements.

Furthermore, because of BEA's software focus, user organizations need to understand how Oracle will pursue the integration of BEA's products into the Oracle portfolio of middleware components, especially Oracle Fusion Middleware (see "Oracle Seeks to Consolidate the Middleware Market With BEA Deal"). At this point, Oracle has not stated any intentions regarding the BEA product set and is not expected to do so until after the acquisition is closed, which is common in such acquisitions.

### **1. Assumption of contract obligations.**

It is important to include in the BEA contracts a clause that states that BEA or its successors should be required to honor all the terms negotiated in the license agreement. Because most BEA licenses are perpetual, BEA customers will retain the license use rights, and they will have no obligation to convert to Oracle license agreements unless there are provisions in the contract that enable BEA to cancel the agreement. For established licenses, organizations should have the right to remain with the current BEA license metrics and should not be obliged to move to new Oracle license metrics. Where possible, include in the contract the right to purchase additional licenses under current BEA license metrics for some period of time — for example, two years. Although Oracle has honored contractual commitments for prior acquisitions, including this right in the agreement will provide protections that additional licenses can be purchased under BEA negotiated price protections and license models. Even if product names are changed or license models are changed, you will continue to be able to add more licenses as per the agreed price for the original entitlement.

### **2. Lock in license pricing and discounts.**

Contractually freeze license prices and discounts based on current BEA pricing. This stipulation will enable predictable pricing for any additional licenses that are required. Discounts for additional licenses should be clearly articulated in the contract, particularly if different discount levels have been offered on different product sets. Customers who assume that their discounts will be valid for multiple years should ensure that this is evident in the contract. If BEA does not allow a price list to be added to the contract at this stage, customers should ensure that, on the order documents, pricing for each module or product is listed separately, making it clear what was paid for each component.

For products not under price protection, ask BEA to provide current list pricing on BEA letterhead for any products that might be purchased in the next year or two — if you do not have such pricing already — because this may provide negotiating leverage when purchasing additional licenses in the future.

### **3. Guarantee product support for a specified period, and lock in maintenance and support entitlements and long-term caps on increases.**

BEA support is covered under BEA's "then current" technical support policies. Oracle also states that maintenance and support will be provided under "then current" technical support policies. This type of terminology provides a vendor with a great deal of control in changing maintenance and support entitlements. Lock in long-term basic entitlements, with long-term caps on maintenance and support increases (for example, not to exceed 3% to 5% per year or some metric, such as the Consumer Price Increase) to provide long-term price protection.

BEA offers multiple levels of support (developer, production and mission-critical) at different rates, depending on the level of support. Oracle primarily offers one level — premium support at 22% of the discounted price. Without contract protections to purchase support at current rates, customers may find they have to pay more for the same support. BEA has charged support at full list price in some cases, where Oracle charges support based on the discounted price of the software. BEA customers that are paying at full list price are unlikely to get a reduction in support prices from Oracle.

Some BEA customers have signed up for premium maintenance that provides guarantees of response and restoration times. If the system problem is not solved within the target period, then the customers receive a refund of a portion of their maintenance and support fees. Oracle does not have a comparable support offering. We expect Oracle to address this need within its Advanced Customer Service offerings.

In addition, Oracle has been known to refuse support to customers until they have agreed to sign the Oracle license agreement. This has happened primarily to customers of the smaller vendors that it has acquired, to get as many customers as possible on to the Oracle agreement. It should not be necessary to sign Oracle's agreement just to continue maintenance and support, especially because Oracle technical support is covered under "Technical Support Policies," rather than the Oracle license agreement. Include in the BEA agreement the obligation that the vendor will provide support for some period of time from general availability of a version (for example, at least three years) and that the vendor will not single out a customer to drop support, unless all customers with that product will no longer be offered support. It has been a general practice of Oracle to provide de-support notices 18 months or more in advance. In some cases, Oracle has extended support beyond the period originally set by the acquired vendors.

### **4. Allow license agreement terms and conditions to be changed only via an addendum that has been signed by both parties.**

Ensure that clauses in the original BEA software license agreement state that contract terms and conditions cannot be changed without an addendum signed by two authorized signatories that clearly lists the changes to the original terms. Oracle's Order Form is signed by both parties and, therefore, can be used to amend a master agreement, if appropriate. As they generally take precedence over the license terms and conditions, any new Order Forms should be reviewed to ensure that originally negotiated clauses are not removed as a consequence of signing any new Order Forms.

### **5. Negotiate a functionality replacement clause.**

Oracle Fusion Middleware and BEA's product families have significant overlap in technology and functional capabilities. Protect your investments if Oracle no longer supports the licensed BEA product, but supports the same or substantially similar variety of functionality in a follow-on

version or replacement product of its own. The clause should state that, if a software vendor reduces or replaces the functionality contained in licensed products, and provides this functionality in a future, separate or renamed product, even if that product contains additional functionality, then you would be entitled to license such a software product at no additional license or maintenance fee. To be clear about whether products are substantially similar or not, we recommend that, rather than just licensing BEA product names (for example, BEA Tuxedo or BEA WebLogic Server), generically define the broad functional blocks that have been purchased (for example, message conversion, supported protocols, escalation, monitoring and scheduling, or Web server middleware capabilities). Also, keep any documentation from your initial BEA presentations, white papers, requests for proposal and request for information responses, and so on, that can be used to clarify any vague areas of the original offering. Note that most software vendors, including Oracle, warrant to the functionality in the product documentation and often disclaim any warranty for any other information outside the agreement itself.

## **6. Negotiate contract protections to enable you to convert effectively to an Oracle contract and alternative license metrics.**

We anticipate that, in the course of migrating the BEA middleware technology into the Oracle stack, Oracle may work to migrate BEA customers to the Oracle Fusion Middleware products. This may entail converting BEA licenses to Oracle licenses that are priced by different metrics. Even in the shorter term, as Oracle rationalizes the pricing of the BEA and Oracle portfolios, conversions may be required when BEA customers want to add new licenses if the Oracle pricing metrics are different. In a recent press release, Oracle stated that "Oracle Fusion middleware has an open 'hot-pluggable' architecture that allows customers the option of coupling BEA's WebLogic Java Server to virtually all the components of the Fusion software suite." However, no detail on the mechanics of the license metric conversions has been divulged.

We believe that, over time, Oracle will offer inducements to make the conversions. To date, the clearest and most equitable license fee conversion mechanism we have seen Oracle offer is net-to-net price conversions. In this model, you would take the net license price paid and then credit that to the new net price based on the same discount off initial list price. Ensure that the discount offered on the new offering is in line with the discounts Oracle is offering new customers. If converting, be aware that Oracle's current maintenance fees are charged at 22% of net license fees, as opposed to some of BEA's levels, which are lower and offer fewer entitlements for the lower levels.

## **7. Multicore and CPU-based licensing.**

Oracle and BEA offer some products by CPU-based licensing. Oracle charges for enterprise edition, multicore products based on a formula that depends on the type server, generally a multiple of .5 for each core of AMD and Intel servers and a multiple of .75 for each core of all other servers, except the Sun UltraSPARC T1, which is .25 per core. BEA generally charges a 25% uplift per core. This may cause some changes in BEA licensing requirements, unless licensing requirements are locked into current contracts.

## **8. Attempt to gain rights to the source code.**

Software escrow is usually requested in case the vendor declares bankruptcy or the customer fears that it might. However, it should also be a required clause if there are concerns about the long-term availability of maintenance. If Oracle becomes unwilling to support older versions of some of the BEA products, or if those customers do not want to move to future Oracle middleware products, a source code arrangement can be helpful as a short-term contingency plan, while alternatives are evaluated (see Note 1). Clients should note that source code,

however, requires access to sophisticated development resources. Oracle has a proven history of providing support for a longer period on particular versions than the acquired entity planned.

Third-party support offerings (see "Long-Term Trends That Will Radically Alter Licensing in the Software Market") are emerging to offer support for enterprises that want to remain with the current application, as long as they are compliant with legal and regulatory requirements and are not interested in future upgrades. These offerings will require that the customer has rights to the source code under the BEA license agreement. This will be difficult to obtain, because BEA does not typically offer customers the right to the source code in standard license agreements.

Because the service providers are also not given source code rights, the viability of this model is uncertain, unless source code access is pre-negotiated. Also, a BEA customer that does obtain source code rights will still be obligated to pay for additional license use, unless a clause has been included that states that, once the source code is obtained, there will no additional costs paid to the software vendor, even if use is expanded. Again, this will be difficult to obtain.

At this point, there are no established third-party vendors providing BEA support, so any such rights would depend on future offerings by third parties for such support. The risk of such support offerings should be rated from two angles: the quality of external support and the premium customers have to pay for back support in case the customer needs to move back to obtain upgrade or migration rights.

**Disclaimer:** This research is not intended to give legal advice. Use legal counsel, specialized in software license contracting, to ensure that you have the necessary terms and conditions.

## Bottom Line

BEA customers and prospects should immediately do a legal review of their contracts and seek specialized legal advice to ensure that they have sufficient protection. Contract changes will have to be made prior to the acquisition to be effective. If you have a need to purchase additional BEA licenses, use this opportunity to add protections to your license agreement. BEA may be more amenable to negotiations while it is under its existing regime. BEA customers with these protections, perpetual licenses and support provisions should remember that they will not be obligated to convert to Oracle licensing agreements. All license agreements must be written to take into consideration the possibility that the software vendor may be acquired.

## RECOMMENDED READING

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"Oracle Seeks to Consolidate the Middleware Market With BEA Deal"

"Long-Term Trends That Will Radically Alter Licensing in the Software Market"

"IT Spending on Software Maintenance Is Expensive, So Improve the Value Being Received"

### Note 1 Escrow

Enterprises should also understand that escrow is not usually a permanent solution. An escrow agreement should:

- Cover the material to be held in escrow, such as the source code, any customized code and documentation for the current and prior versions. Rights to prior versions are important, because most enterprises are not running the most-current version of the software.

- Detail special requirements, such as updates to the material and the process, to ensure that the vendor regularly provides updates to the escrow agent.
- Specify conditions under which the material will be released to the licensee (include non-support of the licensed software) and the time frame (fewer than five business days) required for the release of the material, after the conditions for release have been met.
- Specify the enterprise's rights to the source code after its release and that there will be no additional cost to the enterprise once the source code has been obtained and is being internally maintained.

## **REGIONAL HEADQUARTERS**

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### **Corporate Headquarters**

56 Top Gallant Road  
Stamford, CT 06902-7700  
U.S.A.  
+1 203 964 0096

### **European Headquarters**

Tamesis  
The Glanty  
Egham  
Surrey, TW20 9AW  
UNITED KINGDOM  
+44 1784 431611

### **Asia/Pacific Headquarters**

Gartner Australasia Pty. Ltd.  
Level 9, 141 Walker Street  
North Sydney  
New South Wales 2060  
AUSTRALIA  
+61 2 9459 4600

### **Japan Headquarters**

Gartner Japan Ltd.  
Aobadai Hills, 6F  
7-7, Aobadai, 4-chome  
Meguro-ku, Tokyo 153-0042  
JAPAN  
+81 3 3481 3670

### **Latin America Headquarters**

Gartner do Brazil  
Av. das Nações Unidas, 12551  
9º andar—World Trade Center  
04578-903—São Paulo SP  
BRAZIL  
+55 11 3443 1509