



Advisory Note: Product Substitution Restriction

Beware of a “Product Substitution Restriction” or “Re-use” Clause

If a software company tried to prevent you from buying a competing product after you stopped using their product, how would you feel about that? Well, this has actually happened to the Government. ESI is presenting this advisory note to help you identify and avoid this potential pitfall.

In certain license agreements, software sellers try to prohibit the government from buying a competing product after the license expires or terminates. The clause to look for is sometimes called “Substitution or Reuse”, “Product Substitution”, “Non-Substitution”, or just “Reuse”. Sometimes the language is inserted into an agreement with no title at all or it is placed somewhere in the option year clauses of multi-year agreements.

Be wary of clauses with those or similar sounding titles (or with no title) that might seem harmless on the surface. At first glance, you might think the clause sets forth the seller’s right to substitute or replace one of its products with another newer product – or that it might specify the Government’s right to reuse the seller’s product after the end of the agreement. That is not the case. The titles do not fully describe the intended purpose of the language in the clause – language that is designed to prohibit the purchase of any product that competes with the vendor’s product for a stated period of time. The paragraph below is an actual sample of a Non-Substitution/Re-use Clause.

“It is the intent of the Government by placing this Order to exercise each renewal option and to extend the lease until completion of the full Lease Term so long as the bona fide needs of the Government for the products or functionally similar products continue [sic] to exist. If (i) an Order expires prior to the expiration of the...full Lease Term... or (ii) the Government terminates the Order pursuant to a Termination for Convenience, ***the Government agrees not to replace the equipment and/or software leased under this Order with functionally similar equipment and/or software for a period of one (1) year succeeding such expiration or termination*** (emphasis added by author).

Below are links to an actual non-substitution case.

http://www.asbca.mil/Decisions/2009/54812_55362.pdf

<http://news.wolterskluwerlb.com/government-contracts/boards-interpretation-of-non-substitution-clause-was-faulty/>

At one time these clauses appeared only in software lease contracts with option years but they have begun showing up in non lease contracts that have a base year and options for two or



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more years. Often the clauses may not be titled so it's important to look for language that will prevent the government from buying a product similar to the vendor's product IF the government does not exercise the future year options. There currently is no known Federal law or Federal Acquisition Regulation (FAR) provision prohibiting such a clause. Therefore, you could find that a "Substitution and Reuse" clause in your agreement might be upheld by a court. That possibility should be avoided by striking the clause from any agreement for hardware or software.

One purported reason offered by sellers for including this clause is to "incentivize" the government to exercise the options so the seller does not lose money. For example, in an agreement with a base year and two option years, the seller may have had to pay the publisher in full for a three year usage period. If the government does not exercise the future year options, the seller will not be able to recoup its investment and will lose money. Sometimes sellers (Resellers) do not have the funds to pay the Publisher up front for the 3 year period so they finance their acquisition of the software through a lease agreement with the Publisher or a third party leasing company. Although the financing of the deal is slightly different for the seller (lease payments versus cash up front), the outcome is the same – a decision by the Government to not exercise future year options will result in the seller losing money. The seller's theory is that the Reuse clause will make it more likely that the Government will find a way to exercise the options if it still needs the functionality provided by the seller's software.

Although the seller's rationale for the clause might be understandable from their point of view, the Government's discretion to exercise or not exercise option years is a risk of doing business with the Government. A few sound business reasons for the Government not exercising an option might include: lack of funding for option years; poor performance of the seller in supporting the software; or finding alternative software that is more efficient or cheaper. Under no circumstances should the Government restrict its right to license the software it needs to fulfill its mission – even if that means terminating one agreement in favor of licensing similar software from another seller.

The best way to avoid that problem is to look carefully for any clause that attempts to restrict the Government's right to acquire similar software upon expiration of a base year or termination of the agreement – and to be aware that the clause might exist under an untitled or deceptively titled clause.

For additional support, please use the "Ask an Expert" feature on the ESI web site.