# Managing Software License Disputes: Cooperation or Litgation

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When company executives are approached by software publishers who claim that the companies are violating the terms of their software licenses, they often wonder whether they should cooperate or dig in and prepare for litigation. In my experience, the best strategy depends on a variety of legal and business factors. This article discusses common software dispute resolution frameworks and concludes that a combined approach of cooperation and preparation for litigation usually leads to the most favorable outcome for clients.

## I. Introduction:

In recent years the relationship between software publishers and businesses has become increasingly acrimonious. Software publishers are frequently approaching their customers making allegations that include violations of federal copyright laws and breach of software license contracts. Because software license disputes involve significant legal issues, lawyers can help their clients manage these matters through a combination of proven dispute resolution strategies that can be tailored to each client's particular objectives.

## II. Investigation – What information do you need to know to formulate a strategy?

Like any other dispute, the first step a company should take after receiving a threatening communication from a software publisher is to conduct an investigation of the facts before committing to a strategy or a resolution framework. In many instances, the lawyers must work closely with technology professionals to get a full picture of the facts relevant to the potential dispute. A proper investigation should include:

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- Inventory of software installed
- Review and analysis of license documentation
- Analysis of license agreement(s)
- Determination of platforms on which you have the right to install the software
- Review of customer-facing functionality
- Determination of license requirements for production, development, disaster recovery, testing, staging, and quality assurance machines
- Reconciliation of installations and licenses
- Prediction of how the publisher is likely to treat any licensing gaps in settlement discussions

After the investigation is concluded, developing the best strategy requires an understanding of the available resolution frameworks. Choosing the right framework is critical to helping the client achieve its objectives.

## III. Resolution Frameworks

Software publishers have an arsenal of resolution frameworks at their disposal when seeking to enforce their contractual and intellectual property rights. These frameworks vary in terms of cost and time and are generally relative to the seriousness of the allegations and the amount in controversy. They include:

- License True Ups
- Cease and Desist Letters
- Audits
  - Self Audits
  - Independent Audits
  - SAM Engagements
  - Publisher-Staffed Audits
- License Termination
- Mediation
- Arbitration
- Litigation

**a. License True Ups**

The least adversarial software dispute resolution mechanism is a license true up. Many software licenses contain provisions that require the end user to determine how many licenses it needs and "true up" by purchasing those licenses. For example, Microsoft Enterprise License Agreements frequently contain provisions requiring an annual license true up based on an honor system. Unlike software audits, the end user's conclusions regarding the need for additional licenses do not have to be supported by detailed installation information and are instead predicated on a representation by the end user that it is in compliance with the publisher's software licensing rules.

True ups can also be initiated in lieu of a self audit at the request of the publisher or a trade association. Under this scenario, the publisher or trade group will ask the target company to ensure it is compliant and execute a certification of compliance. True up mechanisms work best where there is an ongoing and positive relationship between the publisher and the end user and both sides have a vested interest in continuing the relationship.

**b. Cease and Desist Letters**

Many software disputes can be quickly and easily resolved with a cease and desist letter. Such letters are typically prepared by attorneys and outline the alleged infringement or violation of the software license. Typically the letter promises that the publisher will refrain from taking any additional legal action if the customer will immediately cease and desist from further infringement or violations.

If the recipient of a cease and desist letter agrees that its actions were wrongful and ceases the conduct, the matter is quickly and easily resolved. In many instances the recipient of the letter disagrees with the publisher's interpretation of the license agreement and believes it can continue its use of the software. In that case, a quick resolution based only on the cease and desist letter is unlikely and another resolution framework will likely be required.

**c. Audits**

A software audit is the most common software dispute resolution framework. A recent survey by industry analyst Gartner, Inc. indicated that 35% of companies responding to the survey have experienced an on–site, publisher–initiated audit. Alexa Bona and Jane B. Drisbow, *Gartner Survey Shows Increases in Software License Audits,* December 2006. Gartner expects that trend to continue. The types of audits initiated by software publishers and trade associations include self audits, independent audits, software asset management ("SAM") engagements, and publisher–staffed audits.

**1. Self Audits**

Self audits are a mechanism often employed by trade associations acting on behalf of software publishers. These trade associations acting under power of attorney from the publishers, investigate and resolve allegations of copyright infringement.

The trade associations, and in some instances, the publisher itself, requests that the target company conduct a self audit and report the results of the audit to the trade association or publisher. Companies that agree to conduct a self audit must inventory the applicable software on the computers within the scope of the audit and report the number of installations, the number of licenses, and the number of license deficiencies. The target company must ultimately certify that the results of the self audit are accurate in order to reach an out–of–court resolution of the matter.

When evaluating whether you should cooperate or litigate after a request for a self audit, you should consider the benefits of a self audit compared to the other types of audits. For instance, in publisher and third–party audits, you usually have a contractual obligation to participate in the audit and provide information to the auditors. When conducting a self audit, you have some control over the timing of the audit and the allocation of resources. That flexibility is not always present in other types of audits.

Additionally, if you are conducting a self audit, you can ensure that all the materials are complete and accurate before submission. Outside auditors are not always required to be impartial and may submit incomplete or inaccurate results. For these reasons, regardless

of the type of audit requested by the software publisher, companies faced with an audit should request the opportunity to provide a self audit rather than an independent audit, a publisher–staffed audit, or (usually) a SAM engagement.

**2. Independent Audits**

An independent software audit involves the use of a third–party auditor to gather the facts relevant to the dispute. Unlike a self audit, independent audits require detailed discussions regarding confidentiality and non–disclosure agreements as well as a definition of the audit scope. Independent audits are preferred over SAM engagements and publisher–staffed audits because the auditor is usually ethically obligated to remain independent.

Many software licenses incorporate audit provisions allowing software publishers to request an independent audit to determine whether its customers are in compliance with the license agreement. Audit provisions, like the one below, must be carefully analyzed to determine the potential business impact of the audit and liability that may result from the audit.

> As mentioned above, Distributor and its Affiliates shall keep accurate books and records reflecting the installation of the Product and all authorized uses thereof. Not more than once in any calendar year, Jabber may retain an independent certified public accountant ("Accountant") who may, upon one week's written notice and during normal business hours and with minimal disruption to Distributor's and/or its Affiliates' operations, inspect and audit the records of Distributor and/or its Affiliates with respect to installation and use of the Products and compliance with the terms of the Agreement. (See http://contracts.onecle.com/webb/france–telecom.lic1.2002.10.17.shtml)

An independent audit based on the audit clause above could be very costly and time consuming. The audit target has no input into the selection of the auditor, how long the audit will last, or the scope of the materials the auditors may review. The target company has also agreed to bear the costs of the audit if the auditor finds a licensing discrepancy of more than 5%. A three–day audit by one of the big four accounting firms can cost tens of thousands of dollars. If the auditors conclude there is a discrepancy, the publisher has the contractual authority to unilaterally determine the license price for the software necessary to become compliant. Independent audits have significant business impacts and should be avoided if possible.

**3. SAM Engagements**

SAM engagements are also conducted by third–party auditors or consultants, but there is no obligation that the auditor in a SAM engagement be independent. The software publisher requests that the target allow a third party to audit its software installations and report the results directly to the publisher. In these engagements, the publisher pays the auditor, and the target is required to purchase licenses to cover any deficiencies in its software licenses. Microsoft's SAM engagement has been extensively used in lieu of traditional software audits with mixed reviews from the end user's perspective.

Participation in a properly managed SAM engagement may be in the client's best interest because such engagements typically provide some flexibility and a lower total cost of resolution than self audits and independent audits. In many instances, the publisher seeks no compensation for alleged past infringements in exchange for an agreement to come into compliance on a go forward basis.

**4. Publisher–Staffed Audits**

Publisher–staffed audits are the most intrusive and least impartial of all software audits. In these audits, the publisher's employees collect information relevant to the dispute. In many instances, publishers request a company's confidential information or access to a company's network to meaningfully conduct the audit and analyze the audit information. Although a publisher may arguably have a contractual right to request that it be allowed to examine its customers' computer network

to determine whether it is compliant with its software licenses, it is never advisable to agree to a publisher–staffed audit without examining all of the alternatives first.

**d. License Termination**

**Publishers often have a contractual right to terminate the license and require customers to immediately stop using the software.**

In some instances, publishers who suspect their intellectual property rights are being infringed will not request an audit at all. Instead, the publishers will send a legal notice to its customer attempting to terminate their license agreement. Publishers often have a contractual right to terminate the license and require customers to immediately stop using the software. A sample termination provision is below.

> This Software License Agreement may be terminated (a) by your giving Altova written notice of termination; or (b) by Altova, at its option, giving you written notice of termination if you commit a breach of this Software License Agreement and fail to cure such breach within ten (10) days after notice from Altova or (c) at the request of an authorized Altova reseller in the event that you fail to make your license payment or other monies due and payable. In addition the Software License Agreement governing your use of a previous version that you have upgraded or updated of the Software is terminated upon your acceptance of the terms and conditions of the Software License Agreement accompanying such upgrade or update. Upon any termination of the Software License Agreement, you must cease all use of the Software that it governs, destroy all copies then in your possession or control and take such other actions as Altova may reasonably request to ensure that no copies of the Software remain in your possession or control. The terms and conditions set forth in Sections 1(g), (h), (i), 2, 5(b), (c), 9, 10 and 11 survive termination as applicable. See http://www.altova.com/order_license4.html.

If the software product at issue is an enterprise–wide product that cost millions of dollars, an unexpected termination notice can interrupt the business and will almost certainly escalate the dispute.

**e. Mediation**

Software publishers usually want to avoid costly litigation as much as end users do. Accordingly, a publisher may try to persuade the target to participate in mediation prior to commencing formal legal proceedings. Mediation can be valuable when there is an ongoing relationship between the parties, and the parties are interested in continuing the relationship.

One of the many advantages of mediation is that it can, relatively quickly, bring parties interested in resolution together. Mediations are typically shorter, more informal, and less costly. Parties with settlement authority attend the mediation with the goal of reaching a resolution and avoiding more formal, more costly arbitration or litigation.

**f. Arbitration**

In some instances, arbitration can be more favorable than litigation when resolving a software dispute. In theory, the procedure is less formal, and in many instances, proceeds more quickly than litigation. Either a single arbitrator or an arbitration panel considers the issues of the matter and makes a decision that is binding on the parties. Arbitrators with considerable software licensing experience and a general understanding of IT should be selected for software disputes. In complex cases, the arbitrator selection process can be time consuming and expensive.

There are also some significant disadvantages to arbitration. Initially, arbitrators are not required to follow the law when making their decisions.

It is therefore sometimes difficult to accurately evaluate the probability of success on the merits. Additionally, whether and to what extent factual discovery will be permitted is almost always left to the arbitrator's discretion. In reality, parties can spend years and hundreds of thousands of dollars arbitrating a software dispute.

Because the results in arbitration can be unpredictable, it is vital for a company to be in a position to accurately evaluate what is at risk in a software dispute to be arbitrated. The consequences for guessing incorrectly could result in an adverse award with catastrophic consequences.

## IV. Litigation Considerations

There are some software licensing disputes that do not lend themselves to amicable resolutions. When there are millions of dollars in controversy and each party believes that it has acted within its legal rights, litigation may be unavoidable. Many times, even when litigation seems certain, the parties evaluate the various litigation considerations and conclude that they should try pre–litigation resolution strategies to see if they can, at the very least, narrow the issues.

### a. Amount in Controversy

Until a client understands its potential exposure in a software dispute, choosing a strategy is almost impossible. The difficulty in software disputes is that a tremendous of amount of work and analysis is required to estimate the amount in controversy.

In trade association audits conducted by the BSA and the SIIA, the amount in controversy may be relatively easy to estimate because agencies typically employ mature alternative dispute resolution processes that permit accurate estimates of not only the amount in controversy but also the probable settlement range.

The amount in controversy is much more difficult to determine in other types of audits because the contractual audit provisions contained in software licenses frequently do not specify a formula for resolving any license compliance gaps following an audit. Regardless of the nature of the dispute, helping the client determine the amount in controversy is an important role for in–house and outside counsel.

### b. Switching Costs

Perhaps the most overlooked issue when developing a strategy for a software dispute is the costs to discontinue use of a publisher's software and switch to a competitor's product. High switching costs for enterprise products places the software publisher in a position of strength from a practical perspective. By contrast, low switching costs or changing business requirements places the negotiating strength in the hands of the client. For this reason, publishers who have a dominant market share, such as Autodesk, are generally more aggressive in their approach to audits and litigation than those publishers operating in highly competitive markets.

Switching costs are also critically important because most software licenses contain a termination provision that will almost certainly be invoked when litigation is commenced or just prior. Termination provisions give the publisher a great deal of leverage in litigation and, if the publisher is able to demonstrate that it properly terminated a software license, can bolster the publisher's copyright infringement claims in the litigation.

Before choosing a strategy, audit targets should work with experienced counsel to conduct a careful analysis of the licenses in question and a disciplined assessment of the alternatives to using the auditing publisher's products.

### c. Probability of Success on the Merits

The next step in the strategy development process is evaluating the strength of the claims on the merits. While software license disputes are generally pled as copyright infringement claims, the license agreements define the nature of the copyright holder's grant of authority to use its products. Most matters that proceed to litigation arise because of ambiguous language in the license agreements defining the scope of the license. When the terms of a contract are subject to more than one reasonable interpretation, the terms are ambiguous. Because millions of dollars can rest on the interpretation of a single ambiguous sentence,

the assessment of the merits frequently turns on the probable interpretation of an ambiguous software license.

Without a contractual provision to the contrary, ambiguous terms in a software license will be construed against the software publisher. Provided that there are no other business factors that would make litigation unwise, an ambiguous license agreement is the situation most likely to lead to litigation.

### 1. Construction against the Drafter

When dealing with ambiguities, it is important to determine whether the license in question contains a provision indicating that ambiguities will not be construed against the drafter. If there is no such provision, the general rule in most jurisdictions is that ambiguities in software license agreements will be construed against the publisher. If the license agreement is silent on construction against the drafter, it is important to review any choice of law provision and determine if the specified jurisdiction follows the general rule.

### 2. Parol Evidence

The Parol Evidence Rule, which is applicable in most states, provides that when a court determines that a contractual provision is ambiguous, the parties may introduce extrinsic evidence to prove that their interpretations of the contract are consistent with the parties' intent when entering into the contract.

In a software dispute, parol evidence will include testimony from both the software publisher and the end user regarding pre-contract discussions and negotiations as well as pre-contract writings including e-mails, faxes, purchase orders, and draft license agreements. All of this evidence would be precluded in a contract dispute where there was no ambiguity in the contract. In such instances, the court would be confined to what is called the "four corners" of the software license agreement when conducting its interpretation.

Software licenses often discuss technical matters and are therefore frequently ambiguous. These ambiguities require the parties to develop and present extrinsic evidence in court. Typically, the evidence is developed through pre-trial discovery mechanisms such as requests for production of documents and depositions, which can be very expensive.

### 3. Triable Issues of Fact

Contract disputes, including those involving software licenses, are frequently resolved before the trial begins through motions for summary judgment. The interpretation of a non-ambiguous software license is decided as a matter of law by the court. In addition, because the parol evidence rule precludes the introduction of evidence in contravention of the plain meaning of an unambiguous contract, litigation costs are reduced because the extrinsic evidence regarding the parties' pre-contract intent is not considered by the court.

On the other hand, a dispute over an ambiguous contract is usually not amenable to resolution by a pre-trial motion for summary judgment. The existence of the ambiguity makes evidence of the parties' intent relevant and therefore involves a fact issue that must be tried to a jury or other fact finder.

The requirement to try a software license dispute involving an ambiguous provision in the license is a significant factor favoring the end user and disfavoring the publisher's assessment as to the advisability of litigation.

## V. Combining the Best of Both Strategies

**Most disputes between software publishers and their customers evolve over a period of several months or years.**

Most disputes between software publishers and their customers evolve over a period of several months or years. As a result, clients must evaluate the prospects of an out-of-court resolution, while at the same time preparing an analysis of the various factors outlined above. The key is to cooperate through appropriate non-litigation resolution frameworks without jeopardizing the client's legal position in the event that a favorable out-of-court settlement is not possible.

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