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Software licences – is what you have the same as what you need?

- Software licence rights and restrictions must be considered in context of organisation's requirements
- Reviews of licences must be done regularly so as to ensure ongoing needs are being met as technology and practices change
- Essential to communication with providers so as to avoid extra licence charge or dispute

Every business uses many forms of technology to support its operations and every software system comes with its own unique licence agreement. These agreements range from large, complex and heavily negotiated terms to 'click and agree' terms embodied in the software.

In all cases, the rights and restrictions on use will vary with the licensing and pricing model available from each software supplier.

While day-to-day management of technology and purchasing may be delegated to the IT department or procurement managers, company officers and executive managers are not absolved of responsibility for compliance. They may be individually liable for copyright infringement even if they are not directly involved and the infringement is unintentional.

In this context, it is essential to understand the rights and restrictions in licence agreements, the software audit process and proof of licence requirements. When you consider acquiring or using other services, you need to ensure that what you have in mind is permitted under licence agreements as substantial costs may arise if it is not.

The recent case, *Software AG (Australia) Pty Ltd v Racing & Wagering Western Australia* [2009] FCAFC 36, illustrates how licence terms drafted in one context may not be appropriate to suit changes in technology and business use.

Licence terms

Racing & Wagering Western Australia (RWVA) entered into various licence agreements with Software AG (Australia) Pty Ltd (SAG) from 1980 for the provision of mainframe software, with another contract taking effect in January 2005.

RWWA had also entered into an agreement in September 2004 with KAZ Technology Services Pty Ltd (KAZ) under which KAZ provided disaster recovery services at its own site.

The software was licensed on the basis of a single processor at a single location, a common licensing structure for mainframe software.

The clauses in the agreement with SAG were especially relevant.

Clause 1.2 specifically prohibited use of the software on any other machine without SAG's consent. Clause 1.4 prohibited moving the software to, or installing it on, any location other than the designated site.

Clause 12.3 expressed limited rights for RWWA to maintain a copy of the software for archival or emergency restart purposes. None of these clauses would be considered unusual in a licence agreement where software is licensed on a single machine and location basis.

Disaster recovery

RWWA's mainframe disaster recovery and backup system kept a copy of the software on magnetic tapes stored off-site for downloading in the event of a disaster. Following improvements in disaster recovery, RWWA took the decision to move away from tape-based backup to 'mirroring' technology through its contract with KAZ.

Disk mirroring is a process where a mirror image of the mainframe, which in this instance included a copy of the software, is stored at the disaster recovery site. The mirror image is in a dormant form until activated in the event of a disaster or for the purposes of testing.

The disk mirroring process employed by KAZ for RWWA provided significant improvement to recovery time over tape backup which could take several hours. It is easy to understand why RWWA took the decision to modernise its mainframe backup recovery process utilising this technology.

The claims

Problems arose when SAG became aware of RWWA's new disaster recovery process. SAG sought additional licence fees from RWWA for the copy of the software stored at the data recovery site.

RWWA sought declarations and injunctions against SAG's demands for payment while SAG cross-claimed against RWWA for breach of the licence agreement to the tune of more than \$3 million in damages.

At the heart of the dispute lay the issue of interpretation of the rights granted under clause 12.3, which is the emergency restart clause, and the limitations on use and installation in clauses 1.2 and 1.4.

SAG did not dispute that clause 12.3 allowed RWWA to make a copy of the software but argued that the clause did not extend to use for testing purposes at the data recovery site. Similarly, SAG argued that such installation and use at the KAZ site was a breach of the licence restrictions in clauses 1.2 and 1.4.

RWWA was successful in the first instance and on appeal. The trial judge and appeal court considered the entitlement that clause 12.3 is designed to protect, being the right to maintain a copy of software for emergency restart purposes, must be given a construction that makes commercial sense. A right to keep a copy of the software for disaster recovery without a right to test that copy was 'unreasonable and inconvenient'.

In considering SAG's contention that installation for the purpose of conducting testing was in breach of clause 1.2 and 1.4, which provided that the system may only be installed and used on a designated location and machine, the court held that the interpretation of clauses must be construed so as 'to render them all harmonious one with another'. In essence, to achieve a commercially reasonable result, what was permitted under clause 12.3 could not be prohibited by clause 1.2 or 1.4.

No winners

During the proceedings, RWWA offered to pay SAG \$300,000 for use of the software on the data recovery site, which SAG rejected. In the court's view, the prudent course for SAG would have been for the vendor to have accepted the offer as an advance of a commercial compromise or to make a counter offer.

In light of evidence that SAG's anticipated licence fee recoverable from RWWA was in the vicinity of \$400,000, the court took the view that the cross-claim of over \$3 million in damages was exaggerated. The combination of the exaggerated claim and failure to consider RWWA's offer ultimately resulted in SAG bearing RWWA's costs of the litigation.

While RWWA succeeded at trial and on appeal, the overall cost to both parties in terms of management time, attention to the dispute and the impact on a longstanding business relationship cannot be underestimated.

It is not an optimal result for any customer or supplier of software to arrive at a position of needing to resort to two and a half years of litigation to obtain an interpretation of the terms of a licence agreement.

Lessons learned

While the case is about a large mainframe system, every organisation must ensure that its licence terms suit its needs and plans.

The case highlights that while software agreements contain terms that are - on the face of it - 'standard', the rights and restrictions must be considered in the context of the actual requirements of the business to ensure that the licensing permissions are consistent with those requirements.

The case also emphasises the need for regular reviews of software licence arrangements, in particular those that have been in place for many years. A permission suitable for a standard backup procedure to tape was inadequate and open to interpretation once that standard changed.

This situation is not unusual. Businesses are constantly reviewing and considering new technologies particularly in the current climate, seeking out more efficient ways of managing the business and its systems. Options such as off-shore outsourcing, utilising contractors, transfer of assets within the organisation and through divestitures are being considered and implemented.

With technology constantly changing, a proactive approach and open communication with software suppliers about any business case that changes the way in which technology is used will help to reduce the risk of an unexpected additional licence charge or a long-running and costly dispute.

One size doesn't fit all

It is not uncommon for businesses to assume that software is licensed on the basis of having sufficient numbers of copies of software for the number of desktops, laptops or processors in the organisation without considering other restrictions that may apply.

However, licensing models such as those in the RWWA case can contain further limitations such as use on a particular machine, location, territory, named user or job type. Larger software vendors

may also include product-specific rights in their agreements and it cannot be assumed that the rights granted for one program are the same across all products.

Questions such as these should be considered.

- Will the software be used by related entities?
- What are the effects of changes in control of the company?
- What are the limitations on user numbers, user type, system location and use by contractors?
- Are there prohibitions or strict requirements on transfer of licences internally and externally?

Licence transfer

One area where transferring licences can cause compliance problems is where the business goes through an internal structural change or is part of a divestiture or acquisition. It is common for software licences to be 'non-transferable'. This term prohibits transfer to any party and may include related bodies corporate.

If a software program is installed on a particular desktop which is transferred to another part of the business or as part of an asset sale to a third entity, the transfer is likely to be subject to certain strict requirements such as transfer of original discs, notification to the vendor and documentation as proof of licence.

A failure to comply with these requirements can result in the acquirer of those licences discovering during a vendor's software audit that there is a lack of documentation supporting compliance. The result may be additional licence fees.

Software audits

Software licence compliance and asset management is not a new concept and clauses in software agreements that provide the vendor with a right to audit at relatively short notice are common, particularly in widely deployed desktop applications.

Sophisticated tools for software asset management have been developed over the last decade and suppliers of these tools are noticing a marked increase in software audits by suppliers. While some software suppliers have a longstanding reputation for working actively with customers to promote ongoing compliance and regularly utilise the right to audit as part of that process, less active suppliers are starting to utilise software audit rights as standard practice.

Whether or not this increased activity is being driven by software suppliers exploring ways to increase revenues in a difficult market, the fact that audit activity has increased suggests it is an appropriate time for business to implement good compliance processes.

Aspects that management needs to be aware of about each supplier are:

- how frequently can the supplier conduct an audit and what notice must they give
- the additional licence and audit fees if the supplier identifies non-compliance
- the 'proof-of-licence' requirements such as keeping original media and manuals.

Different suppliers will have different rights and proof-of-licence obligations. A lack of awareness of these differences can result in a failure by the customer to comply with them.

Software audits and compliance programs should not be viewed as merely weapons for suppliers. Most sophisticated suppliers approach audits in a proactive and customer-orientated manner.

There are many potential benefits to businesses in conducting regular audits. For example, where software is made available through multiple licensing models, a regular audit will highlight where the business has changed and determine whether the current licensing program used is the optimal for the business needs. Proper software asset management will also reveal over-licensing where technology has become redundant.

The fluidity and constant changes in information technology requirements mean that software licences are not a 'set and forget' acquisition. Management needs to ensure an appropriate process for reviewing and managing compliance is in place, whatever the size of the business or the extent of information technology systems utilised.