

October 1, 2009

Software Licenses: Permission vs. Forgiveness and the Law of Unintended Consequences

In a case that may prove to be as serendipitous for struggling software companies as anything else, the United States Court of Appeals for the Sixth Circuit wrote another chapter in the law of unintended consequences with its ruling in *Cincom Systems, Inc. v. Novelis Corp.* (published September 25, 2009 pursuant to Sixth Circuit Rule 206: File Name: 09a0346p.06).

Cincom Systems and a predecessor of Novelis Corp. were parties to a license agreement. After an otherwise routine series of transactions resulted in internal restructuring among affiliates, Novelis Corp. (the surviving entity) continued to use Cincom's software without obtaining its written consent. Cincom subsequently filed a lawsuit, alleging that the continued use of such software by Novelis constituted infringement and violated the original license agreement. The *Cincom* case stands for the proposition that, in the absence of written consent, software licenses do not vest with the surviving entity formed as part of a corporate restructuring, despite statutory language suggesting otherwise.

This decision was rendered, despite the fact that Ohio's statutory merger law automatically vested assets with the surviving entity. The court in *Cincom* ruled that federal law prohibited the transfer of the software licenses, even though, before and after the merger, the software may have sat on the same computer, doing the same thing, and at the same location. The surviving entity was found to be in violation of the software license as a result of the merger, and damages of nearly \$500,000 were awarded to Cincom.

An important thing to remember about the *Cincom* case is that it did not involve a merger with a third party entity in an ordinary arm's-length transaction. This case stemmed from a parent company's consolidation of some wholly-owned subsidiaries. And although the case raises issues purely within the context of an internal corporate restructuring through a series of mergers, the issues and potential liability are equally applicable to arm's-length transactions. The *Cincom* case also raises questions, such as:

- How will the scope and nature of routine IP due diligence change as a result of this case?
- Will *Cincom* impact internal and ordinary arm's-length business combinations by creating operational and financial hurdles, such as a recast of valuation to reset a sales price net of licenses?
- Will plaintiff lawyers start lining up target software companies to file cases similar to *Cincom*?
- Will some software companies view this case as a pathway to recapturing or increasing revenue?
- Should companies involved with recent mergers (internal or arm's-length) during the applicable statutes of limitation consider being proactive in examining their exposure to potential *Cincom* claims, and make an effort to obtain post-merger consents?

- In arm's-length mergers, what is the most effective way of addressing *Cincom*-type damages, especially if the claim upon which such damages may be predicated is based on the essential act of infringement more than anything else?
- Are the potential damages which could result from a *Cincom* claim the type that could be covered by existing insurance policies, and if not, is there any type of insurance coverage that could be obtained to help mitigate the exposure?

Despite the fact that most arm's-length mergers will include IP due diligence that identifies issues such as those raised by *Cincom*, the reality is that many arm's-length mergers take place without complete and proper consents being obtained prior to a closing, especially where smaller or less vital software is concerned. Notwithstanding the *Cincom* ruling, the vulnerability of merger survivors could be minimal with software companies that have continuing relationships to protect and preserve. But where software companies with software that has been phased out as a result of a merger or reorganization are concerned, the vulnerability to a *Cincom* claim will be increased.

There is nothing to suggest that the damages in *Cincom* had anything to do with the length of time the software was used following the merger, and the potential damages are disproportionate to the benefit of waiting to address the issue until after the closing of a merger. Where software licenses are concerned, *Cincom* illustrates the danger of waiting to see if forgiveness is cheaper or easier than permission.

For more information, please contact any of the following members of [Mergers and Acquisitions](#) or [Intellectual Property](#) practice groups:

[Gregory R. Samuel](#)

214.651.5645

greg.samuel@haynesboone.com

[Randall C. Brown](#)

214.651.5242

randall.brown@haynesboone.com

[Mark A. Tidwell](#)

713.547.2551

mark.tidwell@haynesboone.com

[Andrew S. Ehmke](#)

214.651.5116

andy.ehmke@haynesboone.com

[Clark S. Stone](#)

408.660.4159

clark.stone@haynesboone.com

[Nick Gikkas](#)

408.660.4163

nick.gikkas@haynesboone.com

[Ken Bezozo](#)

212.659.4999

kenneth.bezozo@haynesboone.com

[Arthur A. Howard](#)

713.547.2287

arthur.howard@haynesboone.com

[Rick A. Werner](#)

212.659.4974

rick.werner@haynesboone.com

[Brian C. Daughney](#)

212.659.4964

brian.daughney@haynesboone.com