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# Software and Data Audits:

## Tips to Avoid the Traps

**Richard M. Assmus**

Partner, Chicago

+1 312 701 8623

rassmus@mayerbrown.com

**Valerie Vanryckeghem**

Lawyer, London

+44 203130 3074

vanryckeghem@mayerbrown.com

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# About Our Practices

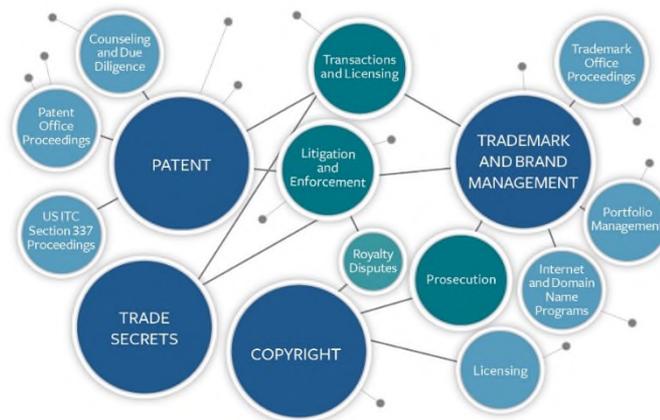
## Technology Transactions

- More than 50 lawyers around the world focused on helping clients develop and manage relationships with suppliers of critical services and technology
- Experience in 400 critical services sourcing deals with a total contract value exceeding \$200 billion, including data, digital, outsourcing and software



## Intellectual Property

- More than 100 IP professionals around the world protecting, preserving and enforcing the intellectual property rights and assets of the world's most innovative and inventive companies.
- The majority of our lawyers have technical degrees across a diverse set of disciplines, thus we not only know intellectual property law but its practical application to your business and industry—a distinguishing feature of our practice and a distinctive advantage.



# Our Geographies

Offices in the Americas, Europe, Asia and the Middle East



Our clients are the world's **largest companies**, including most of the Fortune 100, FTSE 100, Nikkei, DAX and Hang Seng Index companies and a majority of the largest banks. Our presence in the world's leading markets enables us to offer clients access to local market knowledge combined with global reach.

**26** GLOBAL OFFICES

**1500+**  
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# Speakers



**Richard Assmus** is a partner in our Chicago office. He has a balanced intellectual property litigation and transactional practice. He is also closely involved in intellectual property due diligence, patent and technology licensing, trademark prosecution and monitoring, copyright counseling, and advertising counseling. Richard utilizes his background in science and mathematics in connection with complex patent litigation, software, and technology matters.



**Valerie Vanryckeghem** is a foreign qualified lawyer practicing in the Intellectual Property practice in our London office. Valerie's practice focuses on information technology and intellectual property law. Typical projects include outsourcing, software development and implementation, intellectual property and technology licensing and data privacy matters.

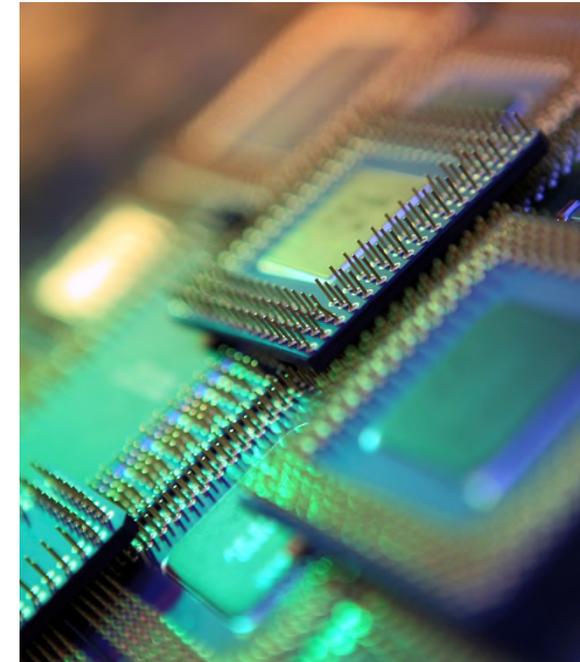
# Agenda

- What are software and data audits?
- Why are audits such a hot topic?
- Common issues in dealing with audits:
  - Identifying the governing agreement
  - Virtualization
  - Other usage metrics
  - Indirect use
- Parameters of post-audit settlement
- Audit clause negotiations



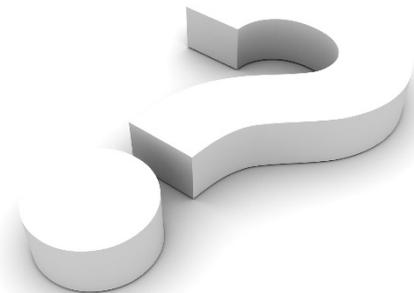
# What are software and data audits?

- **Contractual audit vs court ordered**
  - Audit clauses vary in scope
- **Audit by a software or data vendor to check if the licensee is using the software and/or data within the boundaries of the license, e.g.:**
  - Permitted CPUs
  - Permitted Named Users
  - Permitted location(s)
  - Permitted uses
    - E.g. for one type of customer or for information but not for trading
  - Use of derived data / indirect use



# What are software and data audits? (cont.)

- **Often presented as an optimization project**
  - Sent not to legal department, but contact of sales associate
    - Presented, for example, as opportunity for savings
  - Often tied to quarter-end
- **Varying methods:**
  - Q&A (written, plus interview)
  - Running scripts remotely (sometimes requiring new installation)
  - On site
  - All of the above, including multiple rounds
- **Varying timelines**
  - Some take years





# Why do they occur?

- **Bad luck**
  - Vendor may have selected you at random
- **Expected return on vendor side**
  - Vendor has experience with compliance issues under certain contracts/usage metrics
  - Audits have become a regular revenue driver for vendors
- **Suspicion of bad behavior**
  - Past compliance issues
  - Knowledge of asset management deficiencies
- **Independent auditor tips?**



# Why such a “hot topic”?



- **Technology changes**

- As licensees migrate to SaaS delivery, last chance for vendors to monetize older investments
- “Big data” processing tools allow auditors to crawl all over IT systems in new ways
- Ways companies use data has outpaced the data usage rights
- Data providers are noticing the new value that licensees are deriving from that data

- **And wider changes impacting software and data use**

- M&A – consolidating and splitting software and data usage
- Outsourcing – especially asking vendors to drive cost savings
- Cloud hosting – clarity of use/misuse

# Why such a “hot topic”? (cont.)



- **Some strained relationships between software/data vendors and licensees**
  - Different frames of mind brought to process.
- **Lack of software/data asset management**
  - Poor licensee practices are both a risk and an embarrassment
- **Can be immensely disruptive to a business**
  - Financially
    - Extremely high initial claims that can swamp an annual budget
  - From a business continuity perspective
    - Risk of abrupt loss of rights/functionality

# Why such a “hot topic”? (cont.)

- **Some interesting claims making it to court:**
  - Highest profile case is against AB InBev (US \$600M)
  - SAP vs DIAGEO case opened the “indirect use” box
  - 118 v IDS – convoluted audit invocation clause ruled to mean no audit right



# How to deal with audits



- **General**

- Manage it as a project
- Appoint SPOC and establish lines of communication (vs everybody talks to the other side)
- Involve legal function in a way that preserves privilege over investigation
  - Take care to document process in a thoughtful manner
  - Train audit team on communications protocols
- Avoid finger-pointing (no need to break ranks)
  - Root cause analysis can be saved for an audit post-mortem after settlement

# How to deal with audits (cont.)

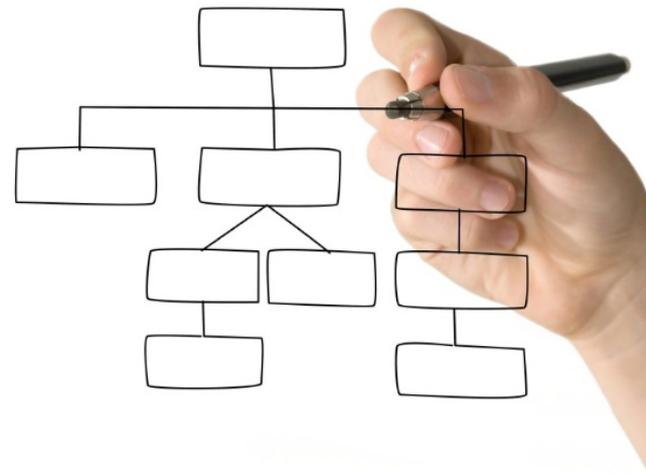
- **Internally**

- Collect all relevant documents (including contracts, POs, invoices, earlier audit reports, settlements, pricing lists, and correspondence)
- Review key clauses
  - Audit clause
  - License grant
  - Under-licensing obligations
  - Liability regime
- Assess tools for tracking compliance
  - Particularly with respect to data, infrastructure may not exist to track use
- Make sure data and documents are preserved



# How to deal with audits (cont.)

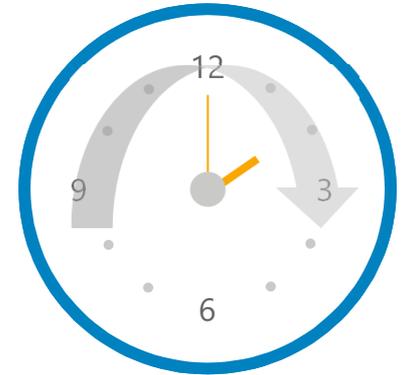
- Assess your legal/financial risks up front
- Assess options for/perform clean up
- Assess your further product dependency (need for extra products or run off)
- Look for other points of leverage with vendor
- Plot a strategy
  - Vendor typically seeks “good cop-bad cop”
  - Licensee typically better off when single track



# How to deal with audits (cont.)

- **Vis-à-vis Vendor**

- Do not be rushed – buy time
- NDA + coverage for risk related to use of audit tool
- Involve other relevant parties who have responsibility for license management (e.g., integrator, re-seller)
- Demand transparency on tools used
- Reserve rights when cooperating



# How to deal with audits (cont.)



- **Vis-à-vis Vendor (cont.)**

- Challenge the vendor on identifying relevant contract documents (often they can't)
- Challenge every assumption, ask for proof (vendor has the burden)
- Evaluate the credibility of threats (e.g., to discontinue support, to file suit)
  - Check litigation history
  - Check background of your contacts
  - Check press reports, user group resources

# Common issues – identifying the agreement



- **Contractual framework often consists of multiple layers of contracts and incorporated terms**
- **Complexity of pricing models and their separation from the license itself can lead to this problem**
  - Signed contract vs communicated T&Cs, price lists, etc.
- **Question of enforceability with respect to new terms communicated to licensee but not part of signed agreement**
  - Accepted (explicit or tacit)?



# Common issues – virtualization

- **Most well-known example: VMware**
- **A VMware Server is a virtualization product that makes it possible to partition a single physical server into multiple virtual machines.**
- **Relevance for software licenses:**
  - VMware enables several operating systems and software applications to run on just one physical server or “host.”
  - Software allocates computing resources to each virtual machine as needed.

# Common issues – virtualization (cont.)



- **Example Belgian case (Oracle):**

- **Oracle's reasoning:**

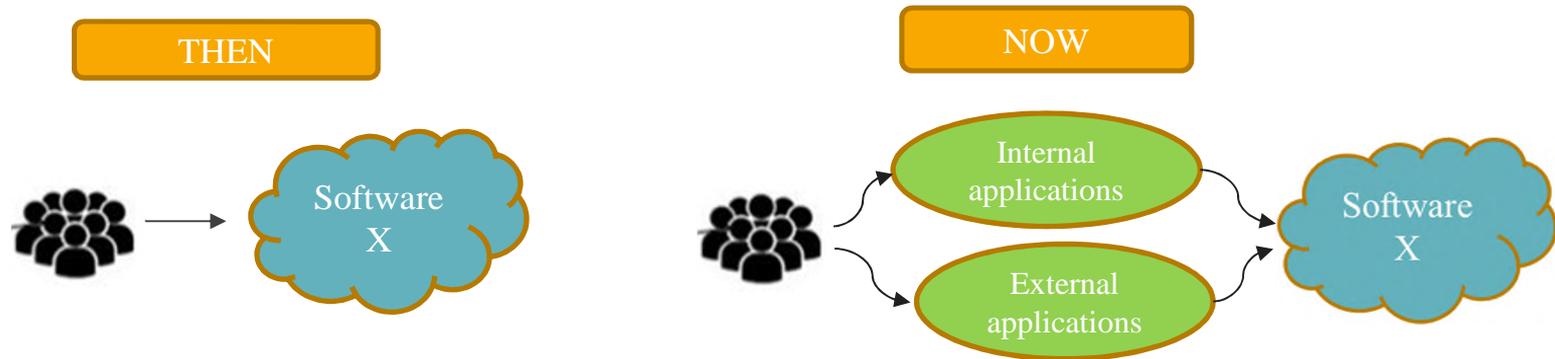
- CPU/processor-based metric
    - "Processor" is defined as any processor on which the ORACLE programs **are installed and/or running**.
    - ORACLE's Partitioning Policy (soft vs hard):
      - Each virtual server can also potentially run the ORACLE software.
      - "Processor" thus includes all processors upon which the ORACLE programs potentially may be installed or run.

- **Counterarguments**

- Partitioning Policy was not enforceable
    - Oracle's duties as a professional IT services provider
      - Previous audit
      - Regularization of VMware constellation

# Common issues – indirect use

- Use of “Software” via 3<sup>rd</sup>-party SaaS, applications, bots or other products
- Question of whether the 3<sup>rd</sup>-party product is the “user” of “Software” or whether the person using the 3<sup>rd</sup>-party product is using “Software” indirectly



- Notable recent case: SAP vs. Diageo
- License terms matter: mere access of data vs. use of software functionality

# Common issues – derived data



- **Data vendors want to manage how their data is used**
  - Step 1: Who has access to the data?
    - Very similar to software audit
  - Step 2: Who has access to the work product created from that data?
    - For example, financial market data from which other reports are generated
- **Some data vendors try to police use of derived data**
  - Plain language of agreement purports to govern any use of data from which the data itself can be gleaned
  - For example, pricing data used to create a report on value

# What are the parameters for settlement after an audit?



- **Settlement**

- 80% reduction of claim is not out of bounds
- Full release for claims based on past events
- Grace period for future audits
- No admission of liability

- **License grant – adjust licensing regime**

- Number / type of units (users/CPU => site/enterprise/partners)
  - E.g., “corporate wide licence” up to a maximum number of employees
- Clarify terms that are subject to dispute or potential confusion

- **Revise audit clause**



# What are the parameters for settlement after an audit? (cont.)



- **Typical negotiating factors:**

- Audit findings and technical basis for allegations
- Strength of vendor contractual claims
- Strength of evidence of over-use
- Other applicable evidence, such as communications/admissions
- Strength/future of relationship

- **Negotiating approaches:**

- Creating a reputation for standing on principle
- Treat negotiation like any other litigation-type claim
- Somewhere in between



# Audit clauses

- **Points of contention:**

- Audit process (e.g., Q&A vs on-site, prior notice, office hours, etc.)
- Deadlines for completion
- Right of rectification for simple mistakes (i.e., without bad faith)
- Damages that may be claimed in event of non-compliance (e.g., 200% vs the discounted price of purchase)

# Audit clauses (cont.)

Example licensor-favorable audit clause:

*Upon 10 days' written notice, Licensor may audit your use of the programs. You agree to cooperate with Licensor's audit and provide reasonable assistance and access to information. You agree to pay within 30 days of written notification any fees applicable to your use of the programs in excess of your license rights. If you do not pay, Licensor can end your technical support, licenses and/or this agreement.*

- Short notice
- Wide in scope
- Duty to cooperate
- Short payment deadline
- Unclear what rates apply
- Several hammers for licensor

# Audit clauses (cont.)



- **Other provisions to consider**

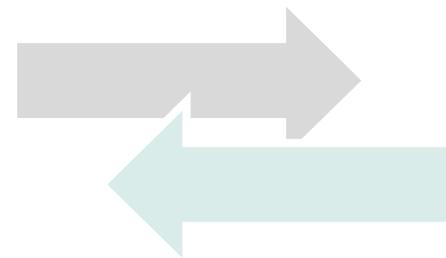
- Staged approach: first Q&A - request for on-site audit needs to be justified.
- Strict confidentiality agreement directly with independent auditor.
- Audit results shall be first discussed in good faith between the parties with a view to resolving any issues in a way that strikes a fair balance between the interest of the vendor and licensee
- Licensee is allowed to remedy bona fide transgressions of the license parameters which are not intended to circumvent license terms and conditions.

# Other contact considerations



## Right to:

- Maintain discount for additional purchases
- Swap between licenses
- Compensate under-licensing with over-licensed products
  - In our experience, many products are over-licensed due to change in technology or business





# Upcoming Programs

- **May 14, 2019:** 13th Annual Technology and Innovation Conference: Doing Business in a Connected World
- **June 13, 2019:** Software as a Service: What You Need to Know –Webinar

*Further information about these events is available on the Resource List widget.*



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