

Lawyer Insights

Adventures in Audits, Part Two: How Business Context Affects the Bottom Line

By Douglas Garrou and John Gary Maynard III
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In a typical software piracy case, a software [vendor](#) identifies and then pursues a nefarious stranger who has unlawfully copied and used the vendor's product. Software [audit](#) disputes, on the other hand, [occur in a very different world](#). Because a vendor's audit rights can flow only from a contract or license agreement with the software user, in essentially all cases the vendor and the user (or perhaps their corporate predecessors) have already done business together. Indeed, in many cases, a software audit dispute arises in the midst of an ongoing, substantial and valued business relationship. Litigators know that when disputes arise between existing business partners, the parties' business goals, their existing and potential economic leverage over each other and their personal relationships all drive the resolution at least as much as the relevant legal principles and contract terms. So it's worth reviewing some business scenarios, common in our experience, to see how they might affect the bottom line in a software audit dispute.

Scenario One: The Divorce

One recurring situation involves a user who has decided to discontinue using the vendor's software—perhaps because the user simply has different software needs or because the user has made a better deal with one of the vendor's competitors.

A vendor who sniffs out an impending 'divorce' may decide to conduct a software audit. By doing so, the vendor, at essentially no cost to itself, could conceivably build sufficient leverage to prevent the divorce entirely. More commonly, when the loss of the customer proves to be inevitable, the vendor will be in a position to extract the last bit of value from the customer before parting ways.

Not surprisingly, software divorces tend to be bare-knuckled affairs. The jilted or soon-to-be jilted vendor has little incentive to rein in its claim for audit compensation or to forgive inadvertent or technical noncompliance that may have caused little real damage. Relationships built over time between the vendor's and the user's business personnel are unlikely to smooth the waters—on the contrary, vendor sales and technical personnel who have long labored (and perhaps repeatedly compromised) to support the user may be driven by a sense of betrayal. The same personnel may also hold grudges against the competitor that has "stolen" the vendor's business.

Because many vendors will view the divorce scenario largely as a zero-sum game and are motivated personally and financially to extract maximum value, software divorces are the scenario least likely to be settled for nuisance value, and most likely to generate formal dispute-resolution proceedings. From the very beginning, both sides will want to take careful stock of their rights and obligations and tread carefully to ensure their legal interests are fully protected.

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Scenario Two: The Squeeze

In an ideal world, software audits would occur only when a vendor has reason to believe that there has been truly material noncompliance and where the vendor has a good-faith basis to seek justified compensation. Unfortunately, however, it is hardly unheard of for vendors to initiate software audits simply because the vendor senses that the user is at a point of maximum vulnerability. Perhaps the vendor discovers that the user faces an important deadline for generating a product or a bid, or perhaps the vendor knows that there has been turmoil and turnover among the user's business personnel. Whatever the source of the pressure on the user may be, a cagey and opportunistic vendor will know that it can profitably add to that burden with a well-timed software audit.

Generally, the crux of the vendor's leverage in such a squeeze play will be that the harried user simply lacks the man-hours to engage robustly with the audit process and defend the user's position in associated negotiations. After all, there are only so many hours in a day and executive and IT personnel time spent dealing with a software audit isn't available to deal with the user's crisis, whatever that might be.

Accordingly, the key to the settlement value of an audit squeeze play is the extent to which the user has prepared in advance for an audit. Are company personnel well-versed in the audit procedures that will be employed? Have any required reports to the vendor been timely prepared, and are they kept readily at hand? Is there a clear identification, ahead of time, of the company personnel who will be responsible for handling the audit, and what their roles will be? Does the company already have in-house and/or outside legal counsel who understands the ins and outs of audits? For every "no" answer, the vendor's leverage, and the cost of resolving the audit, increase accordingly.

Scenario Three: The Maintenance Trap

When is the last time you read the remedy provisions of your various software license agreements—the contractual terms that specify the actions that the vendor may take if it finds noncompliance as the result of an audit? If those terms enable the vendor to suspend maintenance services until any audit issues are resolved, beware. The vendor's power to do so means that any noncompliance can quickly snowball into a huge user headache, creating powerful settlement leverage for the vendor.

As with the other scenarios, the extent to which a vendor can extract value from maintenance-cessation clauses depends entirely upon the business scenario. For some software users, maintenance amounts to nothing more than occasional updates delivered by the vendor, an activity that many users barely notice, and that they can forgo for some time with little problem. For other users, however, software maintenance may consist of a continuing, even daily, give and take between the user's employees and the vendor's specialists—work that is absolutely necessary to ensure that the software is capable of performing mission-critical tasks every day.

Users in this latter category, who depend on extensive maintenance, should keep in mind that the vendor may be able to wield the no-maintenance hammer in response to truly minor non-compliance. Moreover, where the vendor has licensed multiple products to the user, the license terms may even enable the vendor to cease maintenance for all the products where noncompliance has been found with respect to only one. In the final article in this series, we will look at what the law has to say about software audit disputes and investigate the key distinction between viewing resolutions as transactions or as settlements.

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