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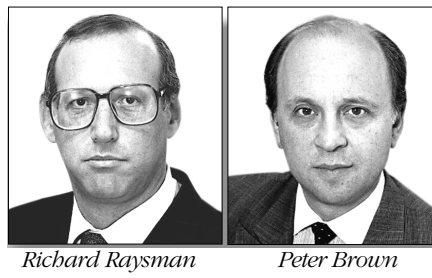
BY RICHARD RAYSMAN AND PETER BROWN

### *Patent Liabilities for Software Licensees*

**T**HE ABILITY to customize and build upon licensed software is often seen as a highly desirable feature, one that vendors may promote without the slightest hint that there may be limits on what can be built. The developers who acquire licenses for these products may never question whether or not a particular function they need to add or modification they need to make puts them squarely in the sights of a third party's intellectual property claim, such as a patent, especially if the licensor has represented that the software comes unencumbered by such third-party claims.

However, a recent judgment in a legal dispute between Microsoft Corp. and Timeline Inc., a developer of database technology, should put software licensees on notice of possible downstream liabilities that they otherwise might not have anticipated. At the same time, the case may encourage technology licensors to seek enforcement of their intellectual property rights against not only their own licensees, but also sublicensees with whom they did not directly contract. Ironically, it may be companies like Microsoft — the losing party in this dispute — that benefit most from the green light that the ruling gave its opponent to seek additional licensing revenues. Finally, the case should serve as notice to all licensing parties to consider the implications of downstream liabilities for their drafting of indemnity provisions and other contractual remedies.

The Superior Court of Kings County, Washington, handed down its decision in *Microsoft Corp. v. Timeline, Inc.*, No. 47888-5-



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I, 2002, on Feb. 19, 2003, implementing without published opinion an earlier decision by the Washington Court of Appeals (Wash. App. LEXIS 360 (Wash. Ct. App. March 4, 2002)). The case raised the possibility that a licensee of software — even from the most-established commercial licensor — who uses such software as the licensor intended it to be used and is in compliance with the applicable license agreement, may nonetheless face lawsuits or demands for license fees from third-party patent holders.

#### **The Decision**

The underlying dispute between Microsoft and Timeline began in early 1999, shortly after Microsoft released its SQL Server 7.0, a software product to manage large databases for businesses that is designed to be modified by users through additional programming. Within weeks, Timeline contacted Microsoft alleging that the reporting and analysis functions introduced in this new version of the SQL Server infringed patents held by Timeline. More specifically, Timeline alleged that the Data Transformation Services (DTS) and analyst services cube components of Microsoft's SQL Server 7.0 infringed U.S. patents numbered 5,802,511, 6,023,694 and 6,026,392 (collectively, the '511 Patents) — patents that set out a computer system that allows users to retrieve data that may be in different formats from disparate sources, providing key technologies for the automation

of the production of data warehouses and data marts.

In June 1999, Microsoft and Timeline negotiated and signed a license agreement that covered the '511 Patents, but their differing interpretations as to the scope of Microsoft's sublicensing rights under the agreement became apparent when Timeline contacted several of Microsoft's customers to negotiate separate licenses for the '511 Patents.

Microsoft claimed that its licensing agreement with Timeline meant that users who added code to the SQL Server 7.0 were permitted to do so if the code that they added did not in and of itself infringe the '511 Patents. Timeline's position was that users who added code that performed any step of Timeline's patented process were infringing the '511 Patents if the combination of that code and the SQL Server 7.0 resulted in a combined product that infringed the '511 Patents.

Microsoft decided to be proactive. Alleging that Timeline's interpretation of the license threatened its own customers' rights, Microsoft filed a declaratory action against Timeline on July 12, 1999. Timeline unsuccessfully moved for summary judgment, and the matter went to trial. The result was a finding by the trial court in favor of Microsoft: its ability to sublicense the '511 Patents was such that users who added code to its SQL Server 7.0 were permitted to do so if that code did not in and of itself infringe the '511 Patents.

Timeline appealed and, in March 2002, the U.S. Court of Appeals for the District of Columbia Circuit decided that the trial court had erred when it relied on extrinsic evidence to reach a conclusion not supported by the actual words of the license agreement between Microsoft and Timeline. Microsoft's ability to sublicense the '511 Patents was limited. If the code added by a user performed any step in Timeline's patented process and when combined with SQL Server 7.0 resulted in a software product that infringed the '511

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Patents, that user was infringing the '511 Patents and the license agreement did not offer any protection. The case was remanded to the Superior Court, which on Feb. 19, 2003 implemented the ruling of the Court of Appeals in favor of Timeline.

## Licensees of Microsoft's SQL Server

For licensees of SQL Server 7.0, several steps should be considered in light of the ruling. Faced with the possibility of owing Timeline either ongoing license fees or a one-time license fee ranging from \$250,000 to \$5 million, such licensees may want to:

1. Identify any functionality in the programs that it uses in conjunction with SQL Server 7.0 that touches on the retrieval of data from disparate sources.
2. If any such functionality is identified, have the underlying code reviewed to determine if there is a risk of infringing the '511 Patents.

## Stepping Back

Taking one step back from the actual finding in *Microsoft v. Timeline*, SQL Server 7.0 may only be the start. The full scope of the '511 Patents has not been determined. Other data management products from Microsoft and other vendors may also be infringing. Taking another step back, there looms on the horizon for every software licensee the possibility of a third-party patentee demanding licensing fees, and it raises the question, "How much protection do my company's license agreements really provide from these types of claims and other instances of downstream liability?"

## Where to Look First

Although many clauses should be reviewed in light of *Microsoft v. Timeline*, intellectual property indemnity provisions are of primary concern. Once each indemnity provision has been checked to determine whether or not patent claims are covered and the extent of any temporal or geographic restrictions on that coverage, they should be reviewed in light of the intended uses for the licensed software. Software that was designed to be used "as is" and on its own presents different risks from software meant to be used in combination with other commercially available products or built upon by its users.

Indemnity provisions typical of those found in the standard forms of software vendors offer very little protection to licensees when the software to which they apply is meant to be

used in combination with other commercially available products or built upon by users. In most instances, such indemnities do not apply to an infringement resulting from the combination of the licensed software with any software, hardware or technology not licensed by the same vendor. Instances of infringement arising from any modification of the licensed software by any person other than the licensor also tend to be excluded.

In instances where the use of a commercially available software product is dependent on another commercially available software product, a licensee may be able to use that dependency to its advantage. First, the licensee should attempt to obtain from the licensor of the dependent software a broader indemnity that includes the combination of

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the licensor's software with software that the licensor has "approved," a change that licensors sometimes make. Next, the licensee would obtain the licensor's approval of the combination of the licensor's software with the software upon which it is dependent.

## Approach to Indemnities

No software vendor will be willing to expand its intellectual property indemnity to include infringement claims arising because of the combination of the licensed software with absolutely anything that its licensees might develop. The exclusion of all instances of infringement that arise from the combination of the licensed software with code developed by the user, using the tools provided by the software vendor in a manner promoted by the software vendor, is not a prudent choice for any licensee.

Finding a middle ground means answering the question of how to allocate the risks relating to infringement claims by patent holders in a reasonable manner. Is the value of the licensed software in its ability to be built upon? Does the licensed software have uses without being built upon? To what extent are

the processes that any user is going to build foreseeable? To what extent is user-developed code, when combined with the licensed software, likely to infringe any patent? Who is in a better position to manage such risks the user who decides what to develop or the licensor who should be aware of the patents applicable to the type of software that it is licensing?

## Where Do We Go From Here?

The prospect of additional and non-trivial license fees and the costs that a licensee would incur to defend a claim of infringement are an incentive to do something. Negotiating a more comprehensive indemnity for intellectual property infringement when licensing software that is meant to be built upon is a start, but it may prove challenging since it involves changing common practices.

In addition to rethinking indemnities, it is advisable to take other precautions. First, ask the licensor about the patents that apply to the type of software that is subject to the license. Ask if the licensor or any other licensees have been approached by any patent holders alleging infringement. If the software vendor states that there are no applicable patents or that it has not been approached by any patent holder, or that there is nothing to worry about, try to obtain representations or warranties to that effect in the license agreement. The licensee may also want to make sure that any limitation of liability set out in the license agreement does not apply to the intellectual property indemnity.

## Lessons for Licensors

Although it may be SQL Server licensees that pay a monetary price following the court's decision, the *Microsoft v. Timeline* dispute has undoubtedly put Microsoft in a tough public relations posture with respect to some of its customers. Thus, software vendors who are themselves licensors of patented technology should take steps to ensure that their licensees are protected to the extent possible against liability to third parties. This means careful drafting of sublicensing rights agreements that explicitly carve out the rights of a licensee's customers, and may entail higher fees for a broader grant of rights.

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