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Puzzles and Solutions to Software License Disputes

By Chen Jingjing, Ma Li

To many people, computer software is a quite familiar topic, but the same cannot be said with regards to software licensing. We are living in an Internet Era where software has become so prevalent in almost everything that we use through electronic means. Software are used in computers, mobile phones and many other electronic devices which provide us with services that we can no longer live without; things such as online chatting, e-reading, shopping, music, and etc. The reason why we get to enjoy and benefit from these features is because licensees have obtained permission from the software's rights holders- the licensors. Consequently, software licensing disputes will invariably come with software licenses. With the rapid development of the software industry, the number of software disputes has risen dramatically in recent years. According to a rough estimate by industry experts, about half of all disputes in the IT field derive from software licensing, especially in commercial software licensing areas. This phenomenon can be attributed on the one hand to licensees using software beyond the scope of its original license, and on the other hand from software enterprises' growing awareness to limit their licensees' software use in compliance with their original licensing agreements.

Software license agreement disputes is a relatively new type of contract dispute, due to the fact that software is still considered to be a new form of technology, traditional contract laws, regulations and their related practices do not adequately apply to resolving software licensing disputes. Many software licensing disputers are considered to be unprecedented "first cases", which not only increase the uncertainty of the risks of software licenses, but also challenge both the dispute resolution systems and the people who are appointed to resolve these disputes. Tang Gongyuan, Senior Legal Advisor in an international IT company, and part-time arbitrator for the Beijing Arbitration Commission and China International Trade Arbitration Commission, believes that commercial arbitrations can be utilized to better address and resolve current software licensing disputes because they are more practical as compared to other forms of litigation. But an even better way to address these disputes is to have binding and efficient licensing terms and agreements when contracts are first reached so that such issues will not even occur.

Software Licensing Disputes Frequently Occur

With Tang's long tenure and work experience at a global IT company, he is often selected by the parties to arbitrate over software disputes. Tang told reporters that most of his arbitration cases involve IT, with the majority of them relating to software licensing disputes.

Generally speaking, there are three types of software license agreements. The first is ordinary licensing agreements, which are entered into between licensors and licensees by mutual agreement; the second is shrink-wrap licensing agreements, in which licensors place their licensing terms and agreements inside of their software packing, and licensees implicitly accept these terms when they open the package; the third is click-accept licensing agreements, in which licensees are subjected to the terms of the licensing agreement once they install the software, then click and agree to the terms that appear on the screen.

Tang pointed out that all three types apply to commercial software licenses, but the second and third types apply mainly to standardized commercial software. The licensing terms of standardized commercial software are relatively simple- licensees are composed of mainly individual consumers and some commercial users who have accepted the terms by their behavior and thus very few disputes arise between licensors and licensees. Software licensing disputes that need to be arbitrated the most relate to commercial computer software licensing agreements, e.g. ordinary licensing agreements.

The most common disputes arising from ordinary licensing agreements are disputes concerning licensing fees. Amongst such disputes, the most common issues stem from the use of software by more than the allowed number of licensed users. For example, a licensing agreement with a licensing fee of one million RMB may provide that the licensor only allow one million users to use the licensed software, but the actual number of users sometimes

Thomas Tang

Thomas Tang is working as a Counsel for a world famous IT company.As a general commercial lawyer, Thomas is supporting the company's business transactions, which includes hardware sales, software licensing, technology services and business consulting services. As a manager, Thomas leads a team of lawyers and Contract Professionals supporting the company's customer engagement and business development across the country, in which he has generated very rich experiences in commercial contract negotiations. Prior to joining the company, Thomas was an Attorney at Law, he advised on Build Operate Transfer projects and foreign investments in various industries, setting up joint ventures and handling M&A matters. Before that, Thomas spent 10 years studying and working in the USA. As an in-house counsel in the US, Thomas advised Chinese and US investors on China foreign investment law, technology transfer, IP protection and Import/Export contracts between Chinese and US companies. Thomas also has teaching and research experiences in China.

Thomas also has a strong legal educational background. He received his LLM degrees from both the University of California at Davis, School of Law and Beijing University, School of Law, respectively. He was also conferred by San Francisco State University a Certificate for completion of the Program for International Business Relations, a Bachelor of Law degree by Beijing University, School of Law and a Certificate for completion of Program for Lawyers by the School of Law at Harvard University.

may reach 1.2 million. The licensor may incur significant losses this way because he had charged this fee based on a previously agreed upon number of users. In consideration of such potential losses, more and more licensors are now adding audit clauses into their licensing agreements, giving licensors the right to audit financial information of the licensees in order to verify that the actual number of uses by the licensees do not surpass the number of users previously agreed upon.

On the contrary, in practice, there is another kind of dispute that arise from software use: when the less than previously agreed upon number of users actually use the licensed software. According to Tang, some licensing agreements may sometimes provide a minimum licensing fee. In terms of such minimum licensing fees, licensees use the licensed software at a relatively favorable price, but are required to pay licensors a minimum licensing fee annually. In the event that the number of actual uses is less than the previously agreed upon quantity which is used as the basis of calculation for the minimum of license fees, it's possible that the licensees refuse to pay the fees.

Tang pointed out that, in addition to disputes arising from license fees, there are two other noticeable kinds of disputes: one relating to the title to the intellectual property rights of the software developed in accordance with the specific demands of licensees; and the other relating to the assumption of infringement and compensation liabilities in the event of lawsuits made on the licensed software by a third party.

How to Resolve Software Licensing Disputes?

As a newer form of technology, software is constantly going through changes and innovations; law, on the other land, is known to be more stable and adapts slower to changes. To a certain extent, the main problem with software licensing is a lack of precise guidelines from existing laws to help resolve these types of disputes.

Many of such disputes arbitrated by Tang are resolved by mediations. "The disputes themselves are not easy to be resolved by arbitrations. The problem is not that such cases are unable to be handled by arbitration awards, but that such awards will create 'precedents', which will considerably affect subsequent similar cases." Therefore, Tang stressed the importance that arbitrators need to be highly cautious when handling such cases.

For example, there is an arbitration case regarding a dispute on software licensing fees. Under the licensing agreement, the licensee was a mobile phone manufacturer who was liable to pay a sum of licensing fees in the form of loyalty for every time the software was installed onto a mobile phone made by the manufacturer. But the licensed software soon became open source software, and the licensee therefore no longer paid the licensing fees. This poses the question as to how to deal with the licensing contract under these circumstances. Tang believed that, in accordance with the agreement, the licensee had undoubtedly defaulted, but the licensee insisted that it would be unfair if it had to continue to pay the license fees, because anyone can download the software for use after it became open source software. But the licensor insisted that it would not only go against the licensing agreement, but also results in unfairness to the licensor if the licensee was ruled not to continue to pay the license fees, because the software was not made to become open source software by the licensor.

The case was eventually resolved by mediation, where the licensor agreed to continue to pay the licensing fees during the license period, but the licensor agreed to reduce the licensing fees provided by the agreement. Tang introduced that, during the handling of this case, the licensee had once insisted that the legal principle of "changed circumstances" provided by The Supreme People's Court's Interpretations of Certain Issues Concerning the Application of The Contract Law of the People's Republic of China (Part III) should be applied in this case. But the issues remains as to whether the

situation that licensed software which has become open source software shall necessarily fall into the scope of "changed circumstances". Any arbitration award supporting or denying such a viewpoint will affect not just a single enterprise or a single case.

"In the face of the rapidly updating technological innovations, the instability of the changes of business models resulted from such innovations, and the non-specific provision of the laws, the "discretion" of the persons appointed to solve the disputes will play an important role. When turning to their "discretion", the persons appointed to resolve the disputes, if qualified, shall determine an appropriate ruling acceptable to both sides." Tang particularly pointed out that when solving disputes arising from such newborn carriers of technology transfer, the persons appointed to solve the disputes shall also know how to innovate, and shall flexibly resolve the disputes in accordance with the changes in business models.

As a type of commercial contract disputes, software licensing disputes can be resolved by either litigations or arbitrations. But, in consideration of the unique features of software licensing disputes mentioned above, Tang believes that software licensing disputes are more suitable to be resolved by arbitrations. First, software license agreements are of a special niche in this particular field of law, so, if the disputes are submitted to be resolved by arbitrations, the parties to the agreements will have the opportunity to choose arbitrators with the corresponding professional background, but, if the disputes are filed to be resolved by judicial courts, the parties to the agreements will have no similar opportunity to choose judges with the corresponding professional background; second, even if the arbitrators lacks the professional understanding about the disputed technologies, the parties to the arbitrations can "train" them to understand by making use of the flexibility of the arbitrations, whereas it will be unthinkable to "train" judges in litigations; third, under many circumstances, subsequent to the resolution of their disputes, opposing parties to the dispute will still want to continue their business relationship in the future, which makes arbitration a more acceptable mean when it comes to maintaining confidentiality as opposed to taking the case to the courts.

In fact, in the United States and many other European countries, parties to software licensing agreements generally choose arbitrations to resolve their disputes. Domestic enterprises, when entering into software license agreements with foreign companies, also include arbitration clauses into their agreements.

Preventing Disputes by Carefully Designing Contract Terms

It's better to prevent disputes by carefully drafting terms of contracts than to resolve the disputes afterwards. Tang said: "In practice, both licensors and licensees are increasingly aware of compliance and the strong desire to regulate their licensing agreements."

As far as beyond-the-licensed use of the software, a common kind of dispute, it's wise to include a clause of "record-keeping and auditing" into the agreements. If it was common practice a few years ago for licensors to turn a blind eye to beyond-the-license use of software, they are now paying particular attention to auditing the licensees. Such a term is important to the licensees, because they will avoid litigations arising from no provision on beyond-the-scope use in the future, therefore leaving the normal operations of their enterprises unaffected. Tang recommended that a contract clause of "record-keeping and auditing" should include the following content: the licensee must allow the authorized representatives of the licensor within licensee's normal business hours to exam the use of the licensed software in order to: (1) determine that the provisions under the licensing agreement are faithfully performed; and, (2) to ensure that there's no use of the software exceeding the permissible scope under the agreement.

As far as the disputes are related to the title to the intellectual property rights of the software developed in accordance with the specific demands of licensees are concerned, Tang suggests that the title to such software can be provided by reference to the methods as follows: first, if the software is uniquely developed for a certain enterprise, it's more proper to ascribe the title to the software to the licensee, otherwise, the licensor. Second, if the software is developed on the basis of the original technologies of the licensor, it's suggested that the title to the software be subscribed to the licensor, and if it's completely newly developed, it's suggested that the title to the software be subscribed to the licensee. Lastly, to modularize the software and determine the importance of the specific modules to each of the two parties. If they are more important to the licensee, the title to the software shall be subscribed to the licensee, and if they are more important to the licensor, the title to the software shall be subscribed to the licensor. "Regardless of the ascription of the title, in consideration of avoiding disputes and of further necessity to use, the party without title to the software shall retain its licensing right in the agreement to internally and externally use the software." Tang said.

As far as software on which a third party's claim right is concerned, Tang recommended to include a term of "licensor's compensation liabilities to the licensee for IPR infringement" in the agreements. Tang suggest this to be drafted as follows: "In the event of any and all IPR claims from any third party, the licensor shall have the right to defend, and shall compensate the third party in accordance with court judgments. In the event that such claims have been made or have possibility to be made relating to the software, the licensee shall take the following remedial measures: (1) obtain and ensure the right of the licensee to continue to use the software in consistence with the agreement; (2) modify the licensed software to constitute no infringement on any right of any third party in the subsequent use but remain in consistence with the agreement; (3) substitute the software with non-infringing software in consistence with the agreement; (4) or retake the software and refund any and all amount paid for the software by the licensee to the licensor."

Tang stressed: "For the purposes of avoiding controversies, the terms of the licensing agreements shall be as precise as possible by taking any detail which might cause any future disputes into consideration. This brings challenges to the related practitioners, but they shall understand IPR, have the ability to manage commercial transactions and negotiate contracts, and have forward-looking insight to foresee the existence of disputes and take preventative measures in advance."

Both licensors and licensees want to win the most advantageous position in contract negotiations. But Tang pointed out that commercial transactions never benefit or damage a single party, and a mutually beneficial contract can only be reached on a win-win basis. This is the essence to reducing software licensing disputes.