

FAST 'FLAG' Event: 'A Legal Eye on Licensing – Resold Software' – held at Lovells on 23rd June, 2009.

By Noel Unwin – Director at Discount-Licensing.com Ltd.

1.0 Introduction. Noel Unwin is a founder and Director of Discount-Licensing.com Ltd, formerly known as Discllc Ltd. For those of you whom have not heard of either, our company was formed over 5 years ago in order to investigate and create a secondary Microsoft software licensing market. Whilst being an authorised Microsoft reseller and registered partner, our main focus is to realise a residual value from disused Microsoft software licences from insolvent, as well as solvent companies, with a view to marketing and supplying legitimate software licence savings for small, medium and large businesses worldwide.

1.1 Synopsis. Today's FLAG event obviously relates to many software manufacturers, but the following refers specifically to Microsoft software 'Licence Contracts'.

1.1.1 To begin with, we will look at the mutual exclusivity of the 'Transfer of Ownership' and the 'Transfer of the Licence Agreement (LA) / Product User Rights (PUR)' as well as relevant changes to Microsoft's licence contracts.

1.1.2 We will then go on to explain how pre-owned software licensing has become a solution for non-compliant businesses and how the longevity of this relatively new niche market has grown following actions from Microsoft, with reference to how the ⁽¹⁾'Exhaustion Rule' plays an important role.

2.0 Mutual Exclusivity of the Transfer of 'Ownership' & Transfer of the 'Licence Contracts'.

When Discount-Licensing.com first came up with the idea of this secondary market, it was widely believed

that the transfer of 'Ownership' and the transfer of the software manufacturer's 'LA / PUR' were 'one-and-the-same' thing. This myth was created in part due to the actions of the software manufacturer, who desperately needed to convince its customers that its own contractual terms would over-ride the law of the land. Quite the contrary, case law surrounding the 100 year old 'Exhaustion Rule' realigns this myth by correctly advising both the customer and the software manufacturer of the mutual exclusivity of the transfer of 'ownership' and the transfer of the manufacturer's 'Licence Contracts and Terms'.

From time to time, we see this theory tested as Microsoft threatens companies with 'further action' should it decide or continue with a purchase of second hand licensing. The first instance occurred back in 2006, at which time Microsoft's intervention created a customer dispute with Discount-Licensing.com. A binding contract was in place following Discount-Licensing.com's offer, the customer's acceptance and our delivery of licence product. However, the customer attempted to subsequently cancel the order following threats of "further action" from Microsoft. As a result, the customer refused to pay Discount-Licensing on the grounds that it had not signed Microsoft's transfer forms – it was concerned as to what Microsoft would do. Discount-Licensing.com understood the importance of proactively marketing the differences between the transfer of 'ownership' and the manufacturer's 'Licence Contracts/terms' prior to sale. In the end, the customer agreed that it was contractually obligated to pay regardless of the post sale challenge from Microsoft. Payment was made without any further action from Microsoft and we

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continue to have an excellent relationship with that same customer to this day.

2.1 The 'Licence' is a separate asset to the 'Software'. One of the most important points that we highlight to our suppliers and customers is that the 'licence' is a separate asset to the copyrighted 'software', whereby Microsoft is not 'licensing' a software product when a 'new' or 'pre-owned' licence is sold. Indeed, when a perpetual pre-owned software licence is invoiced and paid for, a divestiture or sale of an asset has occurred. Again, the new end customer is contractually obligated to pay for the licences irrespective of whether it signs the Microsoft transfer forms, which is a post sale request to accept the transfer of the 'LA' / terms, and this has not been a pre-sale requirement to install and use the software.

2.2 Contractual terms imposed after sale. It is worth reiterating that Microsoft imposes its contractual terms upon the customer after the sale of the asset has taken place, whereas case law would suggest that any argumentation from Microsoft would be considered weak if it was to ever try to enforce legal restrictions on post sale software licence distribution.

2.3 'Exhaustion Rule' extinguishes distribution rights. Case law surrounding the 'Exhaustion Rule' extinguishes the distribution rights of the copyright holder upon transfer of ownership and one could say that Discount-Licensing.com is living proof that such case law carries some weight even though this secondary market is still a relatively small niche market. Although this relatively uncharted market is still in its growth phase, we suspect that we would not have been invited to present at this FLAG event if

members of FAST's legal counsel doubted the legitimacy of our business and the secondary market. Microsoft is not here today to discuss this subject on a public platform and given the 'zero tolerance' approach that it takes towards counterfeiters and non-compliant businesses, one would think that if Microsoft was confident that Discount-Licensing.com was operating outside of the law of the land or its own contractual terms, we should have seen evidence of "further action" by now.

3.0 Contractual changes to the Manufacturer's LA & Transfer Forms. With regards to the actual contractual changes that Microsoft has made to its 'LA' and 'Transfer Forms' in 2007 & 2008, first impressions appear to be that an attempt is being made to close this secondary market. However, on a second glance, the changes appear to have simply restricted the ability to transfer the LA terms / PUR and so we can only conclude that Microsoft was attempting to create a false impression so that businesses would believe that they would not be able to continue purchasing second hand licences. It is important to remember that Microsoft only requests that a new end customer (transferee) accepts the transfer the terms of the LA to the new end customer/company and that this request does not affect the customer's legal ownership or right to install/use the software. To those of you whom have not seen how the Microsoft Licence Contracts have evolved, the following highlights a couple of the key changes that have come into effect since Discount-Licensing.com created this secondary software licensing market.

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3.1 Transfers of LA are “Not for resale” + “Resale is expressly prohibited”. Two new inserts within the transfer section of the LA and transfer forms state that the customer is “not permitted to transfer licences for Resale” and that “Resale is expressly prohibited”. Discount-Licensing.com does not breach these new inserts as all LA transfers are intended to be on a permanent basis directly between the original customer and the new end customer, although the ‘transfer of ownership’ may travel through different parties. Discount-Licensing.com’s policy is to work within the software manufacturer’s terms and to therefore request that the new end customer abides by the software manufacturer’s request to accept the transfer of its LA terms (currently accepted by the original supplier). When divesting a software licence asset, we do not transfer/accept the LA terms to Discount-Licensing.com with the view to subsequently transferring the LA to the new end customer as this could be considered in breach of the software manufacturer’s transfer terms. However, neither action would affect the end customer’s contractual obligations with Discount-Licensing.com and the transfer of ownership rights.

3.2 “Transfers to an unaffiliated 3rd party in connection with a divestiture”. A second change has been the consolidation of the Open, Select and Enterprise ‘Licence Contracts’, in which the LA states that it is permitted to transfer the licences “to an unaffiliated 3rd party in connection with a divestiture”. A divestiture is defined as the sale of an asset and as all LAs have always been transferred directly to the new 3rd party customer for permanent use, we are clearly working within the parameters of Microsoft’s

transfer provisions, albeit it may not have been the originally intended use of this transfer provision.

Software manufacturers such as Microsoft have invariably chosen abstinence rather than offering a credible legal response to debates that sometimes erupt behind the scenes - why enter into a public debate, which appears to have only one plausible end? However, ‘dodging’ the inevitable has proven to be counter-productive for Microsoft as the secondary software licensing starts to gain momentum. When invited to present at FASTs FLAG event, we were keen to talk about our experiences and highlight the legalities of this market as well as suppress the myths on a more public forum alongside a software manufacturer such as Microsoft – unfortunately, it was a ‘no-show’.

Whilst contingencies are in place for contractual changes that Microsoft could make, we did not expect that the software giant would continue to make certain misleading statements, behind the scenes, to customers as to the legalities of this secondary market and Discount-Licensing.com. However, it is in part due to Microsoft’s tactics to suppress this market that has made Discount-Licensing.com home in on the importance of marketing the mutual exclusivity of the transfer of ‘ownership’ and the software manufacturer’s ‘Licence Contracts’. Clearly, the ‘Exhaustion Rule’ will play an increasingly significant role especially if Microsoft decides to make further changes to its transfer provisions, which may impact upon the process, by which Discount-Licensing.com currently divests and transfers pre-owned software licences.

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4.0 Pre-owned Licensing continues as the most economical solution for non-compliant businesses. With regards to the use of pre-owned licensing as a means to rectifying a non-compliant position, we believe case law surrounding copyright distribution puts rest to the Microsoft argument: “Discount-Licensing.com / second-hand licensing is not an appropriate way to resolve a non-compliant position”. It was not the originally intended purpose of Microsoft’s transfer provision to create a secondary market, but like it or not, the co-operation from Microsoft that Discount-Licensing.com received throughout 2004 and 2005, coupled with its transfer provision, has paved the way to creating this secondary market. When faced with such arguments from Microsoft, Discount-Licensing.com sets out the non-disputable facts to any non-compliant business:

(i) Whilst Microsoft may prefer a non-compliant customer to purchase new licences and receive a royalty, any company has the legal right to purchase the ownership of either ‘pre-owned’ and/or ‘new’ Microsoft licensing in order to correct its non compliant position ongoing. It is clear that Microsoft does not receive a second royalty fee if pre-owned licensing is purchased, but of course this is not a legally justifiable reason for not purchasing ‘second-hand’ licences.

(ii) Both ‘pre-owned’ as well as ‘new’ licence purchases can only address the question of future use.

(iii) Microsoft cannot legally force a company to purchase the ownership of ‘new’ licences from a reseller of its own choosing.

Since 2006, approximately 65% of our customers could be defined as ‘non-compliant’ to a certain degree. A number of those transactions were discussed on a public platform between Discount-Licensing.com, the customer and a Microsoft representative prior to completion. Contrary to statements / challenges from Microsoft, not one pre-owned licence purchase made through Discount-Licensing.com has been subsequently retracted, made void or challenged post sale/transfer by Microsoft.

We must remember that whilst we work with Microsoft, it is our competitor. Like any competitor, we expect Microsoft to try to ‘deter’ customers away from purchasing second hand licences through Discount-Licensing, although its tactics have been somewhat dubious in so far that it ‘warns’ the customer that our company “may not be a credible source” or that “second hand licensing may not be accepted as an appropriate solution”. The more Microsoft tries to ‘persuade’ customers as to what it considers the vices of this secondary licensing market, the more non-compliant customers that we see coming through our doors; and so it is in part due to Microsoft’s struggle to suppress this secondary market that it has in fact made it a more attractive to businesses whom are simply looking to become legally compliant as cheaply as possible.

5.0 Summary. To this day, Microsoft has not legally challenged, retracted or void any transfer of ‘Ownership’ or ‘Licence Contract’ orchestrated through Discount-Licensing.com and this includes transfers of LA’s containing the new restrictive changes that Microsoft made in 2007 and 2008.

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Unlike certain 'me-too' competitors that have come and gone, Discount-Licensing.com policy is to work both within the terms of the software manufacturer as well as the local corporate laws.

Sometimes, businesses are unfortunately manipulated and persuaded against the use of pre-owned licensing, but in the end, pre-owned licensing users are the ones that can distinguish between the transfer of 'ownership' and the manufacturer's LA / terms. Whilst we will try to work within the transfer provisions set out by the software manufacturer, we will do so until such time that Microsoft may attempt to make it unworkable. If preventative rather than restrictive changes are ever made to its LA, case law supporting the 'exhaustion rule' becomes invaluable and provides the longevity that this secondary licensing market needs to continue realising a value for suppliers and legitimate savings for businesses worldwide. The pre-owned software licence market is now moving out of its foetus stage and into the growth phase of its life cycle and as mentioned before, the approach that Microsoft has adopted so far has played a major part in its development.

It is difficult to foresee how Microsoft could make further changes to its transfer provisions, which would definitively (and legally) close the 'transfer window'. In any case, a sufficient number of customers now accept the strength of the law of the land over Microsoft's contractual terms and place their trust in Discount-Licensing.com when sometimes confronted by intimidation from a software giant.

This paper was presented by Noel Unwin (Director at Discount-Licensing.com) at the FAST's Legal Advisory Group' event: "A Legal Eye on Licensing - Resold Software": 23rd June, 2009.

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