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# Software license risk report 2017

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## New pressures on the largest software companies have resulted in their looking more intensively at existing customers for additional revenue.

Although these companies are always searching out new business, the easier call is to check that their existing customer base is fully licensed and, if not, to issue the demands for license fees and arrears of support and maintenance.

These checks — 'license reviews' or 'software audits' — have been very effective, yielding substantial income from customers that, even if they consider the demands unreasonable, have a continuing dependency on the technology: they cannot readily move to another provider.

The sums sought in such reviews are often very high: earlier this year, Anheuser-Busch disclosed in an SEC filing that it was in arbitration with SAP over a US$600m claim for license fees. Such claims are rarely publicised but the liabilities still exist and are often latent in many organisations.

Claims for license fees are common even in the most well-resourced business. And the values — often at list price and with overlays of back-support, penalties and support costs going forward — can be material in accounting terms. There are continuing risks here and boards, professional advisers and statutory auditors should consider what responsibilities exist to first identify these latent liabilities and then take steps to remediate, or mitigate against, the exposure.

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# Introduction

## Every corporate and public sector organisation is now seemingly a tech business, with few able to function without their underpinning database technology and software applications. Reliance therefore on the main software vendors has been inevitable and has created a dependency difficult to shake off.

This is uncontroversial apart from one element: the risks around being insufficiently licensed.

Although there has been an increasing appetite to move IT systems to the cloud, it is rare that any business of size can find it easy fully to migrate: legacy systems still need to be run and on-premise[1] software remains the norm for the operations of most company and public sector organisations, with some notable exceptions. These organisations have no realistic opportunity simply to switch off existing systems and move purely to hosted services. Customers, therefore, are held into a tight and dependent relationship with the software vendor; there is little opportunity to negotiate new pricing - and certainly no opportunity to alter what are inflexible (and often onerous) license terms. Many complain that the license agreements are opaque, ambiguous and unpredictable with the vendors often seeking to address technical change through white papers, guidance and policies; it is difficult to correctly understand what in fact the contract does say.

As businesses have sought to streamline their infrastructure and open up more fluid interfaces between the customer, the business and suppliers, many businesses have been caught out by the imposition of substantial additional license[2] fees and payments for back support and maintenance. Such imposition is usually triggered by a software audit or "license review"[3] initiated by the software vendor and permitted by specific inspection rights in the license terms. This takes the form of an exhaustive check of the actual deployment and usage of the relevant programs and compares this with the licenses in place to produce an "effective license position" (ELP).

When the ELP is presented, even the best-managed businesses, with absolute regard to compliance in their software licensing, are confronted with shortfalls resulting often in very high unbudgeted payments to the vendor. The principal vendors exercising such rights are Microsoft, Oracle, SAP, Adobe, IBM and Autodesk.

It is not unusual for even medium sized businesses (500 – 2,000 employees) to receive unbudgeted demands from these software companies for sums exceeding £1m. In many cases the demand can be reduced either by an immediate settlement offer for early payment or (increasingly) the forced purchase of new and additional products and services. However the alarming uncertainty regarding the prospect of these payments, the amounts involved and whether they are assessable create significant risks for any business.

What is the nature of those risks? And can they be identified and quantified early? This report examines the nature of these risks, why they are increasing, the responsibilities of the board and the related risk in relation to financial audits.

1 Namely running on the organisation's own servers either at their office locations or on servers physically located in third-party data centres but owned by the business.

2 We use the US spelling 'license' since this correlates to usage by Oracle, SAP, Adobe, IBM and Microsoft.

3 Although the software vendors and their license agreements use the term 'audit' to describe a license check exercised after contractual notice, we have chosen to refer in this report to 'license review' in order not to confuse with financial audits.

# The market environment

## The major software vendors have a singular dominance on business. Oracle has some 310,000 customers using its database technology[4] on premise (namely installed at the customer's location or on servers owned by the customer).

SAP SE has 345,000 customers[5] and advertises that 76% of the world's transaction revenue "touches an SAP system"[6].

Such dominance has translated into high margins: comparing cost of delivery with sales revenue for software licensing and support, Oracle and SAP, for instance, have gross margins for their software support businesses of 94%[7] and 86%[8] respectively.

Though development costs are high, much of the technology used by businesses is well established, fully amortised and stable. Indeed many customers make little call on their support and maintenance agreements, often preferring to continue to use an existing tested system rather than jeopardise running with the implementation of patches and updates of little significance, even if available. In short, on-premise software licensing has been (and continues to be) highly profitable for the major vendors.

# Challenges from the cloud

## For flexibility, cost and ease of use, many businesses are moving as much of their operations as they can to hosted systems, software as a service, infrastructure as a service or simply moving their existing databases and current applications to the cloud.

At this point, a raft of new suppliers are available: both Amazon (through its Amazon Web Services - AWS) and Google have, in the space of ten years, overtaken all the major vendors in the offer of inexpensive and powerful cloud services. The traditional software vendors have been late in accelerating their moves to cloud services and have sought to catch up both by investing heavily in their own cloud offering and, in addition, making multiple acquisitions of innovative businesses in this space. In the last five years, Oracle has acquired over 20 businesses focussed on the cloud, spending over US $12 billion; IBM has acquired a similar number in that time investing in excess of US$7bn.

These substantial investments have however been into a new space where, because of the existing economies of scale of AWS and Google, profit margins have closed significantly. The result is that the revenues for many of the main software vendors have been falling[9] and their (traditionally high) margins have been cut.

A further challenge is that the software vendors' core offerings are also being sidestepped. Their flagship relational database products are increasingly being seen as too constraining for businesses that scale very fast. If businesses have very substantial and immediate requirements to both read and write big data, then there are alternative non-relational databases (NoSQL) – often open source - which displace the need for traditional proprietary offerings. Facebook (1.28bn active daily users[10] and 940,000 updates[11] every 60 seconds) for instance uses a Hadoop file structure – an open source solution for its massive database needs.

These overwhelming pressures on the principal software vendors have been pushed downstream in the form of pressure to the existing customer base. If there are fewer new customers to be had, surely existing customers can pay more? The legal device is the exercise of a notice requiring a forensic review of the customer's infrastructure, in accordance with license terms. The target is any organisation that has an investment in – and continuing dependence on - on-premise software. And the commercial intention is to secure additional revenue at little cost.

4 Oracle Fact sheet: 567070 | C20385 September 2016.
5 SAP Corporate Fact Sheet: 24 January 2017.
6 Oxford Economics/SAP analysis update 4/201.
7 Oracle Q3 2017 Fiscal Report: US$4,762m revenues / Related costs US$270m.
8 SAP Q1 2017 Quarterly Statement.
9 IBM's software revenue declined 9.8% in 2015. Source: IBM Annual Report 2015; Oracle's sales of new software licenses fell by 16% Q3-2016 to Q3-2017. Source: Oracle Q2 2017 Report.
10 Source: Facebook.
11 Source: The Social Skinny.

# The jeopardy for business

### Jeopardy for business is created by the following:

- a substantial and continuing reliance on technology and applications to run the business;
- the practical inability to replace such technology with another irrespective of price;
- the need, in many cases, to maintain legacy systems using existing software for many years;
- a parallel need to maintain support and maintenance contracts with the relevant vendor;
- complex and opaque licensing agreements often supplanted with white papers, guidelines and policies whose wording and reach often does not easily or understandably correlate with how the software deployment is described by IT managers and CIOs;
- changes in such documentation year by year, with software acquired over a number of years often being subject to differing licensing terms;
- changes in technology particularly in relation to virtualisation;
- software vendors seeking to impose new definitions of “use” of their technology covering, for instance, not just use by internal staff but any access by customers or suppliers, even indirectly, simply to information derived from the programs;
- a marked difference between software license costs acquired on a negotiated basis and those where there is a liability to pay when any shortfall is exposed;
- high support and maintenance charges (often 20 – 22% of purchase price per annum) imposed for arrears as “back support” and going forward where any shortfalls are identified;
- imposition of penalties where under-licensing is uncovered often at 1.5 times the annual support cost figure.

For new purchases, vendors can be highly flexible in offering perpetual licenses at very high discounts. Discounts of 50 – 60% are often obtained and, in exceptional situations, discounts of up to 98% have been secured. By contrast, in a license review situation, the vendor generally points to the list price for its demands, however implausible that may be to the typical business customer.

It follows, therefore, that any finding of under-licensing, even if seemingly trivial or inadvertent, can initiate a demand at a cost of what appears to be very far from the value of the perceived need by the client. It is correct that, with appropriate negotiations and a robust defence, disproportionately high initial demands from the software vendor can be reduced. But the result of any license review is often unpredictable, initiating what can be exceptional financial demands; these are often a matter of consternation within the IT function and of board-level concern.

Quite apart from the financial risk there is a reputational one: businesses and public sector organisations seek to demonstrate a business run with integrity and with fair dealing towards their suppliers and customers. It can be more than embarrassing then if a business were to be seen to be caught out with license shortfalls which, in some circumstances, can be intimated as an infringement of intellectual property rights.

Furthermore, the rights of the vendor often extend to terminating the use of the relevant software should there be a material breach of its licensing terms. In other words the alarming belief that critical systems could be ‘turned off’. In 2015, for instance, Mars had to apply for a declaratory judgment against Oracle[13] to prevent the termination of its licenses after a controversial and unaccepted license review — whose conclusions were not accepted by Mars.

## Oracle Audit example

A French case, Oracle v AFPA[12], is a rare instance of Oracle’s audit practices being examined in court.

In this case, Oracle pursued a French vocational training association, AFPA, for wrongful use of a component of its eBusiness suite.

The association had originally acquired the package in 2002 through an Oracle reseller and systems integrator, SOPRA. Some years later in 2009, AFPA called for tenders for a new purchasing solution. Allegedly in reaction to that, Oracle France called for a license review concluding in its review that there was unlicensed use of the ‘Purchasing’ module by 885 users at AFPA.

After unsuccessful negotiations, Oracle issued legal proceedings alleging infringement of copyright and called for €3.93m in license fees and €9.49m in back support and penalties.

Both the French Court of First Instance and the Court of Appeal rejected Oracle’s claims, finding that:

- ‘Purchasing’ was part of Oracle’s ‘Financials’ suite and accordingly already licensed to AFPA;
- Even if there was any under-licensing, Oracle’s claim should have been restricted to the license fees with the prevailing market discount – in AFPA’s case, 86%;
- Oracle’s claims were ‘mais mal fondée,’ – never well-founded – and should be rejected; and
- Oracle was to pay €200,000 in compensation to SOPRA and AFPA as well as their legal costs.

**Comment:** The case highlights the continuing jeopardy of even the most diligent of customers to high-value claims by software vendors even where, in the end, the claim is found to be highly inflated and ultimately unfounded.

12 Oracle France, Oracle Corporation, Oracle International Corporation / Afpa, Sopra Steria Group Cour d’Appel de Paris Pole 5 – Ch. 1, arrêt du 10 Mai 2016.
13 Court filings: Supreme Court of the State of California: Mars, Incorporated v Oracle Corporation and Oracle, America Inc, Oct 23 2015; case no: CGC-15-548606.

# The risks for the business

## Periodic license reviews by the software vendors to any major business or public sector organisation are now normal, even where there has been a long and trusted relationship between the customer and the software vendor.

Many larger businesses have desks and security passes for the software vendor's support staff, with their sales managers liaising on a weekly basis. Still, the (often predictable) result from such a license review is, seemingly, a credible and substantiated demand for very high sums from the customer; prior good relationships count for little. The risk may be latent but it is real and significant. What then are the responsibilities on the Board, the company's auditors and its other advisers?

# Accounting and audit issues

## There are impacts of not being fully compliant in terms of the number of actual users of software or processors compared to the quantity of licenses held.

A software review may well result in demand for unpaid licence and support fees but what are the other consequences and what are the factors that give rise to this issue other than just an honest mistake?

By its very nature, software usage is not necessarily easy to observe, particularly when some contracts seek to accommodate not simply direct running but also indirect usage and availability for running in virtualised environments.

It might be expected that smaller businesses might be more likely to be able to track their software usage and that, as businesses expand and become more complex, accurate tracking is more difficult. This may not always be the case, since in a smaller business the management team may well be focussed on a number of other strategic and tactical issues as they look to scale up.

Whilst larger groups may have thousands of staff, hundreds of subsidiaries in multiple jurisdictions, and numerous decentralised IT systems, each with different license terms, which collectively make monitoring inherently difficult, they are also more likely to have additional resource to apply to achieving compliance.

Mergers and takeovers can also increase the complexity of tracking software licence usage, terms and conditions and the resultant liabilities. Furthermore, key expertise related to legacy systems may be lost in the years following any acquisition.

# Tax implications

## Software licensing for applications used for business is an allowable expense.[14]

Such costs can be offset against taxable profits leading to a lower tax bill. Often these costs are eligible for R&D tax credits, where appropriate investment is taking place.

Additional costs arising from any successful investigation by the vendor should also be allowable for corporation tax relief but this would only be generally available in the year they are incurred (subject to prior year adjustments).

However, corporates need to bear in mind that HMRC is increasingly vigilant in its monitoring of taxpayers. If it sees examples of errors being made in the completion of tax computations then this could affect the way in which it considers the risk factors for a business, potentially leading to enquiries.

The public airing of license reviews is rare, with many audits conducted in confidence. Accordingly settlement figures - and indeed details of who is being audited - are rare. Some examples from engagements carried out by Cerno however illustrate the typical position:

**£21.4m**
High Street bank (Microsoft)

**£6.39m**
NHS Trust (Oracle)

**£420,000**
London-based hedge fund (40 employees) (Oracle)

**€12m**
European NGO (Oracle)

**£39.2m**
Fashion retailer (SAP)

**£8m**
Insurance company (IBM)

**£5.7m**
Restaurant group (Oracle)

Note: Descriptions changed to protect confidentiality

[14] Part 3 Chapter 3 (Trade Profits: Basic Rules) of the Corporation Tax Act 2009.

# Keeping proper books and records

## Directors have a fiduciary responsibility to keep books and records in such a manner that the financial position of the company can be determined at any point in time.[15]

If a business is not keeping complete and up-to-date financial records, which would including contractual obligations such as software liabilities then it and, in particular, its directors may be in breach of the Companies Act 2006.[16]

A consequence of significantly under-recording liabilities (and thereby overstating financial performance) is that the management team will not make informed decisions and may well face solvency and liquidity problems. A number of stakeholders, such as shareholders, bankers, employees and suppliers rely on the financial information that businesses produce in their day to day dealings. If errors occur and are made public then this would impact on reputation and could lead to adjustments to credit ratings, supplier terms and, for public companies, their share price.

To put this into context, if a company has profits of £1 million and profits are understated by £10,000, then there would probably be less concern. However, if the same company has understated its profits by hundreds of thousands of pounds, then clearly there is greater cause for alarm.

Companies should properly understand, and record on a timely basis, the total cost of using any software. The business should also understand its obligation to determine the number of software users and expect that vendors will seek remedies for late/non-payment.

Under the Companies Act, directors could face sanctions for not keeping proper books and records.[17]

While seemingly slim, the risk of successful legal action or criminal prosecution of company directors due to underpayment of a liability cannot be ignored. At a minimum, where uncovered, the under-reporting of liabilities could certainly raise questions about the general governance of a company. In the most extreme case, shareholders could call for a director to resign, particularly for a poorly-performing business, or where the liability is significant.

## License fees payable even if license category and price is not known

A February 2017 High Court judgment[18] gives a rare insight into the uncomfortable relationship between major corporates and their software suppliers and the financial jeopardy of under-licensing claims.

SAP had pursued the world's biggest spirits producer, Diageo, for license fees for those of its customers who were indirectly accessing Diageo's systems. The case turned on SAP's rights to charge license fees on any business in respect of any individual – even if not working for that business - who interacted with the business' SAP software indirectly through other platforms (e.g. to place or amend orders or check prices).

Diageo's relationship with SAP was long-standing dating back to 2004 and, in recent years, Diageo had been paying SAP UK over £11m in support and new licenses annually. Despite this lengthy relationship, SAP maintained that Diageo's customer platforms based on Salesforce technology connected back into mySAP ERP software and accordingly all Diageo's ultimate customers (5,800 individuals) thereby all needed to be licensed as 'Named Users'. In October 2015, SAP (UK) Ltd brought its claim against Diageo Great Britain Ltd asserting £54,503,578 for license fees, £3,955,954 in interest, fees for back-support/ maintenance and an injunction.

The case arose after Diageo deployed two new third party systems in 2012. The first, Diageo Connect, allowed Diageo's customers to place orders online (rather than through a call-centre) via a Salesforce.com system which utilised data held in an Oracle database but was associated with SAP XI. The second, Diageo Gen2 allowed Diageo's sales staff to use an iPad to access, via a Salesforce.com application, relevant customer data in an Oracle database associated with the mySAP ERM software.

The court declared that Diageo's external customers and suppliers did need to have SAP licenses even though there was no clear user category, or pricing allied to that, in SAP's pricelists. The final figure to be paid is to be determined later this year at another hearing unless the two parties can, in the meantime, agree the additional license costs.

15 Section 386 (1) (c) of the Companies Act 2006 (Duty to keep accounting records) and Section 393 of the Companies Act 2006 (Accounts to give true and fair view).
16 Section 414 (4) and (5) (Approval and signing of accounts), Section 415 (Duty to prepare directors' report) (4) and (5) and Section 419 (Approval and signing of directors' report) (3) and (4).
17 Section 387 (Duty to keep accounting records: offence).
18 SAP (UK) Limited v Diageo Great Britain Limited [2017] EWHC 189 (TCC), 16 February 2017.

# Audit

## One of the fundamental principles of accounting standards is that liabilities and obligations are accounted for appropriately.[19]

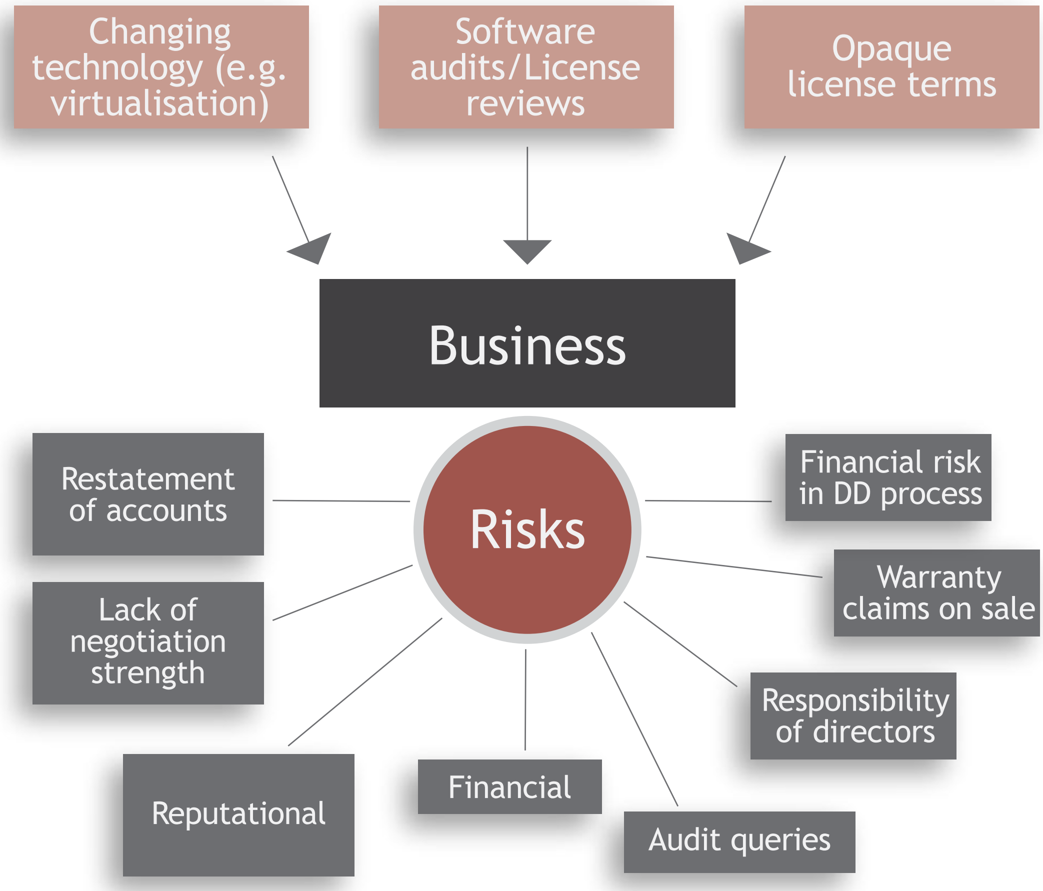
When there is a contractual, or a constructive obligation (i.e., you sign a software contract with a supplier), there should be an accounting for that liability in line with the contract.

From an audit perspective, if a company has published incorrect figures for any matter, including software licensing costs, an auditor may insist on an adjustment to the financial statements.

Materiality is another foundation of financial reporting. It is a threshold for when missing or inaccurate information in a company's financial statement is considered so serious that it could influence the decisions of the users of those accounts.[20]

For more serious errors, for example where the auditor considers there is a fundamental error, the company's prior year accounts may need to be restated.[21]

As part of a financial audit, the auditor will ask those charged with governance for written representations on matters subject to verbal assurances, which will include, inter alia, confirmation that all known provisions for liabilities (including software licensing costs) have been accounted for. The Board will be relying on the robustness of their financial procedures and controls in making this assessment but should consider periodically whether the risk profile in this regard has changed or whether the information has been subject to verification.




19 IFRS SOURCE - Paragraph 15 (General Features - Fair presentation and compliance with IFRS) of IAS 1 (Presentation of Financial Statements) and Article 9 of IAS Regulation No 1606/2002 on the application of international accounting standards.

20 IFRS SOURCE - Paragraph 29 (Materiality and Aggregation) of IAS 1 (Presentation of Financial Statements.

21 IFRS SOURCE - Paragraphs 42-48 of IAS 8 (Accounting Policies, Changes in Accounting Estimates and Errors).

# Other accounting impacts

## In the event that a business is either looking to acquire or sell, then understanding whether there is an impact on the underlying quality of reported earnings is important for accurately assessing the valuation of the business.

If a business has been under-paying material software costs for several years, then a higher level of earnings will have been reported than would have otherwise occurred. A purchaser may, therefore, overpay and on discovery seek compensation.

### Internal software audits

The issue of mapping software liabilities is not insurmountable. Financial and enterprise resource planning software can help companies track software licensing costs.

The Software Alliance, a group representing software suppliers including Microsoft, Oracle and IBM has stated that the decline in the use of unlicensed software in the UK is partly due to the increase in cloud computing subscriptions and growing use of software asset management.

SAM tools can help but often do not accommodate contentious contractual interpretations of the software license agreements nor mistakes in scripts run or other outputs from vendor tools.

Tips for mapping software licensing liabilities correctly

1. If software licences are a significant cost to your business, ensure you fully understand the area of licensing.
2. Undertake regular audits of your software licenses. Annually should be sufficient, unless there's a major change in your business, e.g. via M&A activity
3. In the case of M&A activity, ensure that IT assets and licences – and any latent software license risks - are included in pre-deal due diligence;
4. A company board should always keep oversight of software licensing liabilities as part of its corporate governance and risk management role. It should also ensure that finance, IT and risk departments co-operate on data sharing and analysis regarding licence agreements and usage.

## SAP seeks US$600m from Anheuser-Busch

US-based Anheuser-Busch InBev acknowledged in its 2017 SEC filings* that it had entered into arbitration, February 21, with SAP America Inc. According to AB, the claim asserts multiple breaches of a 30 September 2010 Software License Agreement based on allegations that AB employees used SAP systems and data—directly and indirectly—without appropriate licenses, and that the company underpaid license fees due.

The statement of claim lodged by SAP against AB seeks both new license terms and damages 'potentially in excess of USD 600 million'. AB says it will defend the 'asserted claims vigorously'.

*Reference: 2017 SEC filings (http://bit.ly/2p1Rs0M)

# Criminal and civil infringement

## Computer software is protected under the Copyright, Designs and Patents Act 1988 (CDPA) as well as under equivalent legislation worldwide.

As such, any use of that software (including its storage or running) requires the license of the copyright owner – the software vendor. Without adequate license the use is an infringement of copyright and the company is liable to civil proceedings.

Criminal offences are also incurred where any person, without the licence of the copyright owner, possesses in the course of a business with a view to committing any act infringing the copyright any article which is known to be (or there is reason to believe that it is) an infringing copy of a copyright work. Although this might be thought just to cover pirate CDs, this also covers situations where a business knowingly downloads and uses unlicensed software, with the servers or hard drives being classified as the relevant 'articles'.

Because of the lack of clarity and certainty as to exactly what comprises the agreement with the software vendor there is some legal uncertainty as to whether under-licensing equates, necessarily, to infringement of copyright. Many license agreements have "true-up" provisions whereby any shortfall in licensing can, under the contract wording, be remedied by notifying the vendor at the end of each year.

Furthermore, many of the audit/license review provisions of the license agreements tacitly permit remedial payments to be made within 30 days of the conclusion of the review and the finding of any under-licensing.

Nevertheless, the position is often asserted that any under-licensing is a form of infringement of copyright. Accordingly, whatever the nuances may be of the interpretation of the license agreements, there is reputational risk should organisations such as FAST and The Software Alliance announce findings of under-licensing against a particular business or organisation. Understandably, statements that an organisation is 'under-licensed' can be chilling.

The likelihood of this has been accelerated by the introduction, in 2016, of an "Incentive Payment Agreement" by FAST in order to reward individual whistle blowers if reporting the unlawful use of software. The payment is calculated as a percentage of the historic use amount, once costs have been deducted. The Software Alliance, too, has a scheme with rewards on a sliding scale from US$5,000 up US$1m if reports as to inadequate licensing by a business result in recoveries.

# M&A scenarios

## Although the date when a license review may be triggered may not be predictable, the financial liabilities on the corporate are still both present and real and may be quantified in advance of such review.

In any M&A situation, early and astute recognition of the software risk issue may be of considerable negotiation value. Equally, if overlooked, hidden software license liabilities that later become known can cause warranty or indemnity claims, with little (or no) opportunity for the paying party to remediate.

Within any share purchase agreement, there are extensive warranties generally given by the selling shareholders in favour of the acquirer. These would inevitably require the sellers to pay the company for any shortfalls in license and support costs that may be uncovered post-completion.

Typical warranties are as follows:

- The Company has no liabilities (including contingent liabilities) other than as disclosed in the Accounts.
- The Accounts do not understate any liabilities (whether actual or contingent).
- Save as disclosed, the activities and operations of the Company have not given and do not give rise to any obligation to pay any royalty, license fee, compensation or any other sum whatsoever.
- The Company has obtained all necessary rights and licenses from third parties to enable it to make use of its Software and IT Systems for the purposes of the Business as constituted as at the Completion Date.

These warranties are absolute. A belief that they are of little consequence is naive and could expose the warrantor(s) to paying out on heavy unexpected claims when any internal or external license review is conducted post-completion.

Additionally, if software licensing has been identified as an issue, there could also be indemnities (as opposed to simply warranties) required from the sellers. This can be a very dangerous area for sellers since if the business elects to settle any license review without significant challenge then the costs can be many times what might have been negotiated earlier.

When given time and choice as to product and supplier, new license purchases might, for some technology, be obtainable at a 50-60% discount, with support and maintenance going forward based on those purchase costs. But in a difficult license review, urgent and remedial purchases might be imposed at a limited 10% discount, a requirement to pay back-support, penalties required at 1.5 times that figure, audit costs and a requirement for support and maintenance going forward at 22% of the (unfairly high) license purchase costs. The difference is substantial.

Where under-licensing is uncovered, the licensee's bargaining power is weak; with tacit intimations of intellectual property infringement and switching-off support, a corporate often has little opportunity but to accept a poor commercial deal.

For sellers, by far the better position is in the six months pre-sale, for the business to commission and address its own license review, crystallize the exposure and negotiate a contained commercial deal.

For buyers of a company, there is significant benefit to commissioning the company's own license review so ensuring that all costs and claims are fully laid off to the warrantors within the warranty period.

# Recommendations

1. Never assume that a software estate is fully licensed: the interplay of new technical environments and opaque license terms mean that surprising licensing liabilities may open up;
2. If you have not undergone a software audit or license review in the last three years, then expect one;
3. Prepare by commissioning your own internal license review(s) with specialists who are expert in the licensing practices and interpretations of the particular software vendor;
4. If contemplating a trade sale or listing, initiate such reviews at least six months in advance and remedy any shortfalls;
5. If acquiring a business, consider whether an early internal license review, post-acquisition, can usefully be carried out to crystallize any warranty/indemnity claims;
6. Maintain all documentation including all historic orders and license terms: these may differ from current terms;
7. Do not assume that trust or length of relationship with a particular software supplier carries any weight in displacing or reducing demands if under-licensing is identified;
8. Never sign-off any new technical deployment unless the licensing impact has been assessed;
9. Be especially alert if using virtualisation/VMware either on your own servers or hosted elsewhere;
10. If migrating to the cloud, consider the inevitable need for dual-running and consequent additional licenses required;
11. When opening up portals to suppliers or customers, assess potential licensing costs of ‘indirect access’;
12. If under-licensing is alleged, be prepared for substantial claims - in the AFPA case (see box) Oracle’s claim for use of just one module within the eBusiness suite was for over €16,000 per individual;
13. Maintain intense control over what areas of your IT estate the vendor can access and review - their audit entitlements are generally limited only to your ‘use of the programs’ - not your whole estate.

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Smith & Williamson is a financial and professional services firm with 12 offices and over 1,700 people located across the UK, Ireland and Jersey. Our firm works with a range of businesses and, through our transaction services team, we can provide security over the past and projected performance of a business, identify unrecorded liabilities, highlight areas of risk and inform potential mitigating action.

We are a key member of Nexia International, a global network of independent accounting firms. With 600 offices in over 120 countries, Nexia International links us with major cities around the world.

By working alongside Cerno we help you to manage your licensing risks.

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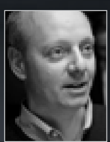
# About Cerno

Cerno offers an unusual combination of technical, contractual and commercial expertise in negotiations or disputes with the major software vendors.

With specialist expertise, Cerno works with corporates in their licensing issues – particularly software audits initiated by Oracle, Microsoft, Adobe, SAP, IBM and SAS. Its mission in every case is to reduce cost.

Cerno is fully independent. It is not a reseller nor does it have any partner relationship or other informal arrangement with any of the software vendors or their distributors.



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