

The Oracle Audit: Lessons From The Only Licensee Suit

By **Arthur Beeman, Joel Muchmore and Belinda Liu** (November 15, 2017)

Software licensing audits are most often viewed by businesses as mundane: a matter involving little in the way of time and resources, and hardly an experience that requires the licensee to “lawyer up.” Oracle Corp. has changed that perception in the world of licensing.

Today, 97 percent of Fortune 500 companies license at least some Oracle-branded software.[1] And, as licensees are discovering, Oracle may not hesitate to subject its customers to an expansive auditing process that culminates in allegations of licensing shortfalls that many customers believe are inflated. If a licensee fails to resolve the alleged shortfall within Oracle’s compressed time frame, Oracle may threaten to abruptly terminate the license agreements. Oracle’s typical audit process, which we loosely refer to in this article as Oracle’s “audit script,” may leave licensees stuck between the overarching threat of losing their right to use integrated Oracle software or acceding to demands they believe to be unfair.

For those familiar with Oracle’s reputation as an assertive litigant, the nature of Oracle’s audit script may be unsurprising. But, despite Oracle’s reputation, there has only been a single publicly filed complaint identifying Oracle’s licensing tactics — Mars Inc. v. Oracle Corp., which was brought by the licensee, not by Oracle, and was quickly resolved before any material ruling by the court.[2]

Bearing in mind that even a single adverse ruling could unravel Oracle’s licensing strategy, it doesn’t take a legal scholar to speculate that Oracle does not wish to test the viability of its audit script in court. The savvy licensee should appreciate and exploit this negotiating advantage. Given the manifold pitfalls and traps potentially written into the audit script, early retention of counsel provides a licensee’s best shot at resolving the audit process quickly and efficiently, while protecting the licensee from the expensive and restrictive quick fixes that Oracle might propose.

Oracle’s Audit Script

Oracle is fully aware that its enterprise software products are integrated deep into licensees’ business operations. Conversely, most licensees accept that the terms of the controlling license agreements allow Oracle to audit a licensee’s use of its software in order to ensure compliance with licensing terms. Accordingly, Oracle’s licensees typically enter into license audits with a desire to assist and cooperate.

However, that cooperative spirit can soon dissipate as Oracle’s audit requests become increasingly demanding. For example, a portion of Oracle’s audit script can involve a licensee’s use of virtualization, and unfolds as follows: Most licenses are on a “processor” metric, which is defined as all processors on which Oracle products are “installed and/or running.” Defining “installed” as “available for use,” Oracle argues that the capacity for live migration (the process of moving a running virtual machine or application between different physical machines) means that the programs are installed (aka “available for use”) on all



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processors across virtual environments.

Accordingly, if it discovers that a licensee runs virtualization software (e.g., VMware), Oracle may demand system and processor information for all virtual machines, whether they run Oracle programs or not. And, as seen in the Mars v. Oracle matter (discussed below), if a licensee declines to accede to the demands for more information, Oracle may argue breach of the license agreement for failure to cooperate. On the other hand, when Oracle finishes its investigation into virtualized environments, it may allege a precipitous licensing shortfall that could price into the tens of millions of dollars. Once the licensee is properly alarmed, Oracle may proceed to offer steep “discounts” for additional licenses and past due fees and/or push replacement license agreements that promise relief from the pressures of the audit, albeit at the cost of further restricting the licensee going forward.

And the virtualization inquiry isn’t the only Oracle strategy a customer should be prepared for.

No Stranger to Litigation

Anyone with a cursory knowledge of current events in Silicon Valley knows that Oracle is not shy when it comes to large-scale, contentious litigation. The tech giant’s protracted copyright battle against Google Inc. has made headlines for seven years and counting, and has cost both sides millions of dollars in legal costs alone.[3] From 2014 to 2016, Oracle was simultaneously fighting six separate lawsuits by or against the state of Oregon in litigation that was variously described as “bitter” and “nasty,” before the cluster of lawsuits eventually settled for \$100 million.[4] Oracle has even fought to keep employee wage-and-hour claims out of arbitration, and in court.[5]

But, as seen below, when given the opportunity to have its interpretation of “installed and/or running” vindicated by a court, the matter just ... disappeared.

Mars v. Oracle

Oracle’s dispute with Mars began with a letter from Oracle’s license management services (LMS) group in September 2014, notifying Mars that the licensee had been selected for a “license review.”[6] For the next several months, Mars met with LMS representatives repeatedly in an effort to come to an agreement on how to structure the audit in a manner consistent with the terms of Mars’ agreement with Oracle and generally accepted audit principles.[7] But LMS ultimately informed Mars that Oracle would not agree to a “letter of understanding” to govern the audit process and, in April 2015, Oracle accused Mars of material breach of the agreement by unreasonably delaying and refusing to permit Oracle’s license review.[8]

The most significant point of contention was Oracle’s demand that Mars provide a listing of all clusters and servers included in Mars’ virtual environments.[9] In support of its demand, Oracle argued the following:

- “Installed and/or Running.” Mars must purchase licenses for “all processors where the Oracle programs are installed and/or running”;
- “Available for Use.” Oracle defined “installed” as “available for use.”

- “Live Migration.” Because virtualization technology, like the VMware technology used by Mars, “specifically is designed for the purpose of allowing live migration of programs to all processors across the entire environment,” Oracle programs are available for use in every processor across the entire environment. [10]

Mars provided more than 230,000 pages of documents in response to Oracle’s requests.[11] But Mars declined to produce extensive documentation of its virtual environments, arguing that:

- Actual “use” is the proper metric. Mars is only required to purchase licenses for servers that actually use Oracle software, not for processors where Oracle programs are merely “available for use”;
- Live migration is not enabled. As configured, each of Mars’ virtual servers and clusters has a specific and independent purpose. That means that processing in one cluster cannot be moved to another, and dedicated storage cannot be accessed by different clusters. Mars corroborated these claims with video evidence.
- Mars has complied. Mars has complied with the audit requests by sending screenshots of all virtual clusters that “use” Oracle software.[12]

Oracle ultimately responded by issuing successive notices of termination to Mars beginning in May 2015, with the termination date eventually extended, in metes and bounds, until Oct. 26, 2015.[13]

On Oct. 23, 2015, just days before Oracle’s threatened license termination date, Mars filed suit seeking a judicial declaration affirming that, by refusing to provide additional information regarding its virtual environments, Mars is not in breach of its agreement with Oracle, and Oracle was not permitted to terminate the agreement or use of licenses provided pursuant to the agreement.[14] Mars simultaneously moved for a preliminary injunction to bar Oracle from following through on its threat to terminate Mars’ license.[15]

Two weeks later, Mars and Oracle stipulated to a withdrawal of Mars’ motion for preliminary injunction because “the issues presented by Mars’s Motion ... are hereby rendered moot.”[16] And three weeks after the stipulated withdrawal was entered, Mars requested dismissal of its case, with prejudice, enabling Oracle to circumvent a resolution on the merits.[17]

In sum, what the parties had spent over a year warring over in private was hastened to a dismissal of the matter after less than two months on a court docket.

Explore Options With Outside Counsel From the Outset

Oracle may attempt to leverage audits to enhance Oracle's licensing revenue (though the purchase of additional licenses), compromise the contractual posture of its licensees (through replacement licensee agreements) and, in the long run, improve Oracle's position vis-à-vis its competitors as the provider of emerging services (perhaps most significantly, cloud-based services and virtualization technology).

Retention of an experienced attorney can help ensure that Oracle's audit is appropriately circumscribed to the licensee's contractual obligations. Retention of counsel can also accelerate the audit resolution process and send a strong signal to Oracle that the licensee is willing to challenge Oracle's modus operandi.

Specifically, experienced counsel can help answer some or all of the following questions:

- What information is Oracle entitled to in an audit?
- What are a licensee's obligations with regard to accidental use or inadvertent activation of Oracle programs?
- What are a licensee's obligations with regard to changes in system architecture (addition of servers, etc.) that potentially increase the licensee company's processor count?
- How does a licensee's use of virtualization software (e.g., VMware) affect its licensing obligations?
- What are the parameters of Oracle's contractual right to terminate the license agreement?
- What is the long-term impact of certain replacement license agreements, such as unlimited license agreements?

Oracle's auditors might have licensees believe that capitulation is the only way to resolve the pressures of an audit. However, resolute licensees may see opportunity for relief in Oracle's reluctance to test its overreaching interpretations in court. Given that Oracle may demand the purchase of additional licenses and payment of past-due fees and support with shelf-prices of tens, if not hundreds, of millions of dollars, early investment in experienced counsel may be prudent and best protect the licensee's bottom line.

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DISCLOSURE: Beeman and Muchmore were lead counsel for Mars in the Mars v. Oracle matter.

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[1] See https://education.oracle.com/pls/web_prod-plq-dad/db_pages.getpage?page_id=932&p_org_id=27&lang=US (accessed Oct. 18, 2017).

[2] See docket in Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606 (S.F. Super. Ct. Oct. 23, 2015).

[3] Liam Tung, "Oracle vs Google: Just as you thought Java-Android row was over, it all kicks off again," ZDNet (Feb. 13, 2017 3:47 PST), available at <http://www.zdnet.com/article/oracle-vs-google-just-as-you-thought-java-android-row-was-over-it-all-kicks-off-again/>; see also Rachel King, "Google wants \$4 million from Oracle for legal costs," ZDNet (July 6, 2012 16:33 PST), available at <http://www.zdnet.com/article/google-wants-4-million-from-oracle-for-legal-costs/>.

[4] See Jeff Manning, "Oregon Settles Bitter Legal Fight with Oracle for \$100 Million," OregonLive.com (Sep. 15, 2016) available at http://www.oregonlive.com/politics/index.ssf/2016/09/post_183.html; Barb Darrow, "Oracle and Oregon Settle Nasty Lawsuit for \$100 Million," Fortune.com (Sep. 15, 2016), available at <http://fortune.com/2016/09/15/oracle-oregon-law-suit-settlement/>.

[5] Melissa Daniels, "Oracle Refuses To Arbitrate Wage Fight, Ex-Worker Says," Law360 (Sep. 6, 2017, 6:32 PM EDT) available at <https://www.law360.com/articles/961203/oracle-refuses-to-arbitrate-wage-fight-ex-worker-says>.

[6] Complaint at 5, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606 (S.F. Super. Ct. Oct. 23, 2015).

[7] Complaint at 6, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606 (S.F. Super. Ct. Oct. 23, 2015).

[8] Complaint at 6, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606 (S.F. Super. Ct. Oct. 23, 2015).

[9] Complaint at 8, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606 (S.F. Super. Ct. Oct. 23, 2015).

[10] Complaint at 10, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606 (S.F. Super. Ct. Oct. 23, 2015).

[11] Complaint at 8, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606 (S.F. Super. Ct. Oct. 23, 2015).

[12] Complaint at 12-13, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606 (S.F. Super. Ct. Oct. 23, 2015).

[13] Oracle Letter to Mars dated Sep. 25, 2015, Exh. 11 to Declaration of Eloise Backer ISO Plaintiffs' Motion for a Preliminary Injunction, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606 (S.F. Super. Ct. Oct. 26, 2015).

[14] Complaint at 17-18, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606 (S.F. Super. Ct. Oct. 23, 2015).

[15] Plaintiff's Notice of Motion and Motion for a Preliminary Injunction, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606, (S.F. Super. Ct. Oct. 26, 2015).

[16] Stipulation and Order for Withdrawal of Motion for Preliminary Injunction, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606, (S.F. Super. Ct. Nov. 24, 2015).

[17] Request for Dismissal with Prejudice, Mars, Inc. v. Oracle Corp., et al., Case No. CGC-15-548606, (S.F. Super. Ct. Dec. 16, 2015).