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Audit? (Not) A Problem

The Truth About Software Audits – Customer Rights, Errors of Law & Unilateral Influence

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Andreas E. Thyen studied Economics, Law and Sociology as well as International Economic Relations and Socioeconomics in Hamburg. Thyen has consulted on numerous matters relating to planning, processes and management for over 20 years, including for an international consultancy firm, and has authored a number of publications in the course of this work. Nowadays, Thyen acts as Chairman of the Board at LizenzDirekt AG, a role to which he brings around 15 years of management experience on the pre-owned software market. Thyen has established himself as an industry representative and passionate advocate and visionary, helping both companies and public authorities to take advantage of this unique European possibility. In addition to imparting his knowledge about the legal underpinnings of this market, Thyen regularly shares his views on the implications of the associated economic and business aspects and interests with enthusiasm and foresight. Thyen has consequently become a highly sought-after interview partner by media outlets across Germany, Austria and Switzerland and regularly publishes articles on the sociopolitical and economic facets of digitalisation. Moreover, Thyen sponsors and is involved in various educational, social and sports projects for children.

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When it comes to software audits, there are two historically significant factors that coincide. On the one hand, Europe has become highly dependent on software providers in the US. On the other, as a result of the pervasive pressure to digitalise Europe appears to be prepared to make the situation even worse, despite the occasional announcement to the contrary. Read on to find out how this is related to the introduction of the software audit.

Reputable companies have always tried to ensure that the way they procure and use software is legally compliant, and they take extensive precautions to this end.

However, by introducing software audits developers and their service providers have managed to sow fear among their customers and have consequently been able to shape their behaviour for decades.

This is in spite of the fact that these customers have lawfully obtained the software and paid the company a not-inconsiderable sum of money for the privilege. Software audits are rarely a pleasant experience and often result in significant expenses for companies.

Yet this situation is a persistent paradox, and one that is all the more astounding when we look at the underlying legal basis.

Many conscientious companies are driven by a pervasive and paradoxical fear of software audits.

However, a closer look at the law shows they have nothing to fear.

The Law Has the Final Say

In the legal literature, most authors take a critical view on whether and to what extent such audits are permissible in purely legal terms. The right to information may serve as a legal basis for audits, although this does not grant the licensor the right to carry out its own audits. This leaves us with the right of access and inspection. Possible legal bases for this can be found in copyright law (Sections 101 and 101a of the German Copyright Act) and in general civil law (Sections 242 and 809 of the German Civil Code). Section 101 of the German Copyright Act and Section 242 of the German Civil Code deal with disclosure rights, whereas Section 101a of the German Copyright Act and Section 809 of the German Civil Code deal with access and inspection rights.

In order for software companies to invoke the right to perform an audit based on copyright law, there must at least be a sufficient degree of probability that the customer has committed an infringement of rights.

In order for Section 101, para. 1 of the German Copyright Act to apply, the rights of the claimants must have been infringed. The software company must therefore be able to present evidence to justify their request for information; they may not seek disclosure of facts vis-à-vis the allegedly infringing party to this end. However, the very purpose of a software audit is to verify without cause whether the software is being used in accordance with the licence. It is therefore necessary to start by determining whether software companies have a right to this information in the first place.

The developer must provide specific evidence of this infringement prior to performing the audit.

Although Section 101a of the Germany Copyright Act provides that the licensor may request access to documents and inspection of property, including software used by the customer, in order to assert this claim, the licensor must specify the license documents and software that are to be audited in advance and provide evidence that there is a sufficient degree of probability of an infringement of their rights. Moreover, the audit request must balance the conflicting interests—in particular the legitimate confidentiality interests of the licensee—and must be proportional. It is never permissible to access an IT system if that would impair its integrity, as the licensee cannot be expected to run a real risk of damage to their property without good reason.

They must also specify which documents or software they wish to audit and safeguard the interests of the customer.

In addition to these grounds for an audit request, legal bases may also be found in general civil law. For example, Section 242 of the German Civil Code provides for a general right to disclosure based on good faith whereas Section 809 of the German Civil Code governs the right to inspection.

In order to assert the right provided for in Section 242 of the German Civil Code—and indeed that provided for in Section 809 of the German Civil Code—the claimant must at least have reasonable suspicion of infringement of an obligation. In the case of an existing contractual relationship such as a license agreement, the standard of proof for justifying reasonable suspicion is the balance of probabilities, which goes further than the standard of a sufficient degree of probability as specified in Section 101a of the German Copyright Act. Otherwise, any request for disclosure is not permissible.

When a claim is made under the German Civil Code, a predominant degree of probability of infringement is necessary. Requests for disclosure are not permissible.

But that's not all: the uncertainty around whether or not the customer is under-licensed may not be of the licensor's own making, which is often the case given the well-known and oft-discussed vagaries of license agreements. Finally, the audit must be reasonable from the perspective of the licensee.

The software company may not be responsible for the audit being needed as a result of any lack of clarity.

As has been demonstrated, licensors do not have the right by law to audit customers unless they have valid grounds to do so. In fact, there are major hurdles for them to overcome even when the standards of a sufficient or predominant degree of probability have been met.

It is not possible to enforce an audit without valid grounds to do so.

Are Audit Clauses Even Valid?

In many cases, software companies include an audit clause in their pre-formulated licence agreements. However, that does not mean that these contractual provisions are actually valid.

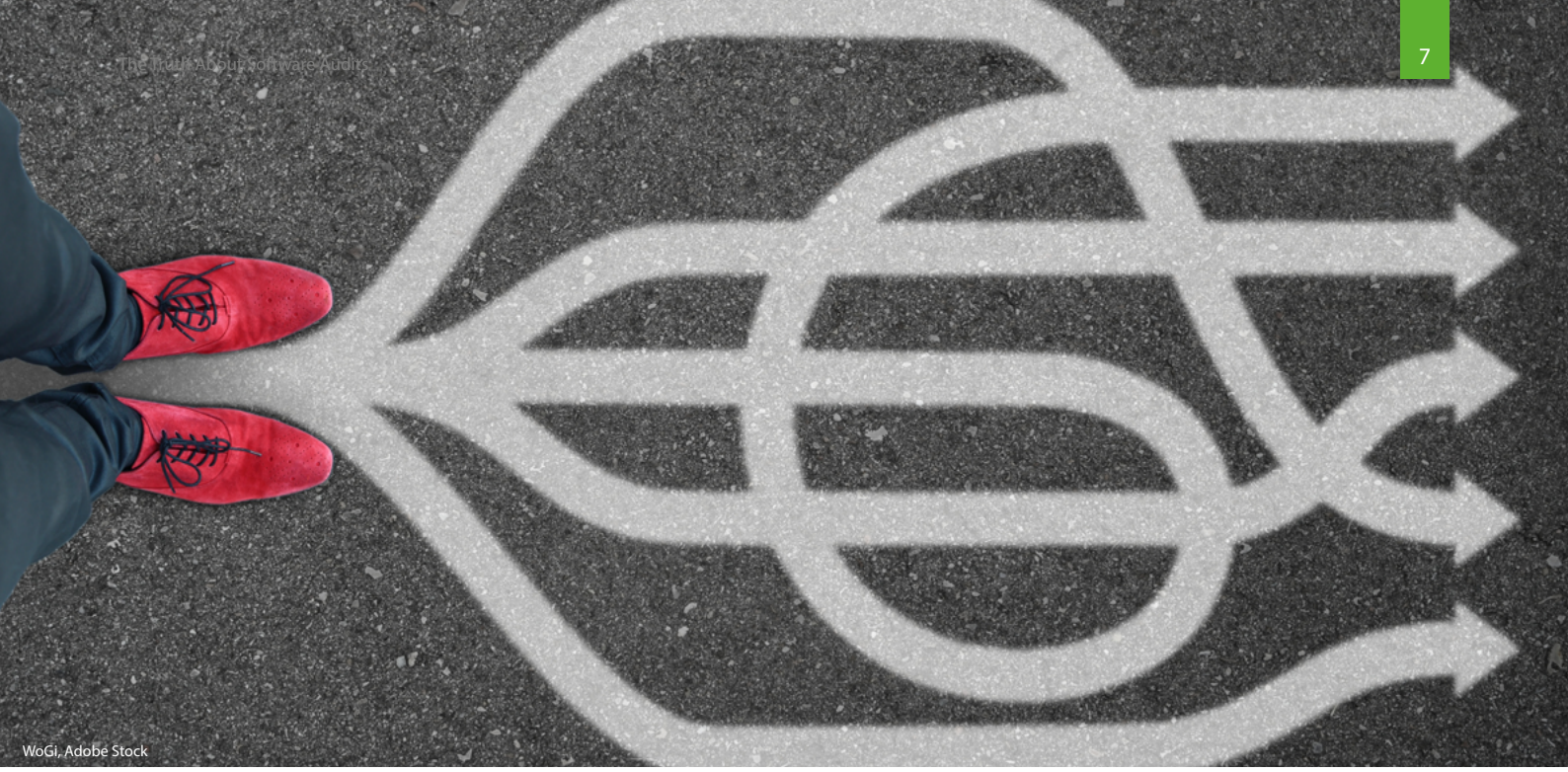
The validity of audit clauses is questionable.

Under German law, pre-formulated audit clauses in contracts are subject to the law on general terms and conditions of business, which means in particular that they must be transparent and appropriate. If it is unclear how they should be interpreted, it is the customer who will be given the benefit of the doubt, not the software company. When determining whether or not a provision is clear, it is to be viewed from the perspective of an average customer, not an astute licensing expert.

When assessing whether a clause is valid, the primary yardstick is deviation from legal provisions.

As for the assessment of whether or not such audit clauses are appropriate, the point of reference is the relevant legal provisions, which, as mentioned previously, do not provide for assertion of rights without reason and provide comprehensive protection of the interests of the customer. These interests include in particular continuation of business as well as protection of trade and company secrets. Moreover, the provisions of labour and data protection law must also be observed. A breach of privacy regulations can also lead to an audit clause being classed as 'inappropriate' within the meaning of the law on general terms and conditions of business. Furthermore, provisions on how the costs of the audit will be shared between the parties must also be included. If the audit clause does not meet these requirements, it is considered null and void. There is no occasion for a validity-preserving interpretation.

Audit clauses must meet stringent requirements, e.g. regarding data protection, costs and liability.



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Why the Divergence between the Legal Base and its Application in Practice?

Despite the legal provisions in place, dependence on software solutions and a pervasive fear of non-compliance have meant that customers have not only failed to challenge software companies' auditing rights but have also endeavoured to avoid any dispute in the first place.

However, this has resulted in a bizarre situation where software companies need only reach out to obtain detailed information and successfully enforce their demands, leaving customers resigned to their fate.

Consequently, software companies started being seen as pseudo-legislators. This can only be described as irrational, not only in principle, but also in light of the legal background outlined above.

The correct course of action would have been to at least seek to negotiate audit conditions on an equal footing and come to agreements on the significant expenses for customers as well as the data protection rules to be observed.

It is clear to see why these developments came about from a psychological perspective; they are at least in part the result of customers attempting to smother even the slightest suggestion of non-compliance.

This is a questionable approach, as fear of conflict should not cause companies to submit to a right that does not even exist instead of acting in accordance with law and safeguarding their own interests.

Intimidatory effect of audit clauses

Software companies acting like legislators

Decades of suppression

The Nature of an Audit

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The details of audits are rarely made available. In many cases an agreement is reached regarding a certain reduced volume or follow-up contracts are concluded in return for the allegations being dropped. However, many customers fail to negotiate the terms of an audit in advance or to precisely define what may be audited and how. In particular, there is a need for precautions with respect to data protection and labour law provisions.

Audits must be negotiated in advance on an equal footing to ensure that each party's interests are safeguarded and any obligations are met.

Software companies often assign external auditors the task of verifying conformity of use. As a result, customers often take the outcome of such audits at face value. Yet it should not be forgotten that even if an external auditor carries out a perfectly diligent inspection, this does not alter the fact that it is the software company who sets the parameters of that inspection.

The role of external auditors

This is in spite of the fact that, according to the legal standards set out above, software companies do not have the right to interpret contractual provisions in a manner that suits them and assess usage on that basis.

Instead, customers are free to interpret the relevant license conditions in their favour in light of the legal context and to cast doubt on the validity of those conditions in the event of ambiguities. Here, there continues to be a misguided acceptance of the role of software companies, meaning they are able to act as both judiciary and executive.

The legal situation is to be interpreted in favour of the customer.

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Audits and the Dilemma of On-Premises Versus Cloud

So how is the trend towards subscription and cloud-based services affecting the relevance of audits?

It could be suggested that audit pressure has at least paved the way for subscription models on the customer side. Given the previously illustrated discrepancy between customer perception and the actual legal situation, this is likely to have led to key decisions being made based on false legal assumptions. The consequence? Companies are acting in a highly economically inefficient way.

This strengthens the case even further for on-premises perpetual licences where these are able to cover the technical requirements of the company to the same extent. Ultimately, the frequently integrated cloud elements of subscription licences present a significant data protection risk given the fact that the EU-US Privacy Shield has now been declared invalid. What's more, customer often do not know that their legal position is fundamentally different in the case of perpetual licences compared to subscription licences. In the case of perpetual licences, the customer is to be regarded as the owner of the software according to the European Court of Justice and is thus entitled to sell the relevant licences on, for example.

The subscription model, on the other hand, makes it possible for the software company to change the conditions unilaterally at any time, for instance by raising prices or changing usage rights. Moreover, once customers have transferred their own data to the supplier's cloud, they are usually unable to change providers, meaning that they are even more likely to remain stuck with the same software company.

In many cases software companies include a provision in their terms and conditions requiring the customer to continually monitor usage in light of any changes in circumstances, even in the case of subscription models, and to buy additional licences in the event of over-usage.

Audit pressure boosts cloud-based and subscription license sales.

The cloud is associated with data protection risks.

Perpetual licences are protected as property.

Cloud and subscription licences increase dependencies even more. It's time for a change.

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Reducing Dependencies

The fear of audits and the resulting behaviour on the part of customers over the years are a clear manifestation of existing dependencies. It is about much more than customers being afraid of their business having to make further payments down the line;

if we look at the current state of affairs, we can see that there are a number of new pertinent issues. Even at infrastructure level, businesses are now hugely dependent on their cloud provider,

which makes it particularly bizarre that the US software giants are currently embroiled in a dispute over their share of the EU market (over all our heads of course) and are accusing each other of unfair market practices.

This makes it all the more tragic that it is these very same providers that are taking a lead role in Gaia-X, the EU's project to increase digital sovereignty.

However, there are ways for customers to at least spread the risks, for example by choosing hybrid cloud models and by using different providers for licensing the applications and for licensing their environments.

Bring-your-own-licence models for risk mitigation

Summary

By way of conclusion, it can be said that a clear divide has become apparent between the legal basis with regard to audits and their implementation in practice.

There is but one explanation for this: software companies have clearly succeeded in influencing customers and controlling their behaviour for decades. Moreover, this demonstrates that people are increasingly forgetting what legal provisions actually apply, and as a result these provisions are losing significance.

This is a very worrying development, especially since it is such an important issue these days. A particularly important aspect of the law in question is its provisions on the European freedoms that have allowed, for example, the purchase and sale of pre-owned software despite numerous objections from software companies.

Andreas E. Thyen, pioneer on this market and trained economist, never tires of reminding others of this fact. He wishes to call for vigilance: 'Europe and its companies must not only recognise their interests, but also assert them. The Data Act and other initiatives demonstrate the importance of this.

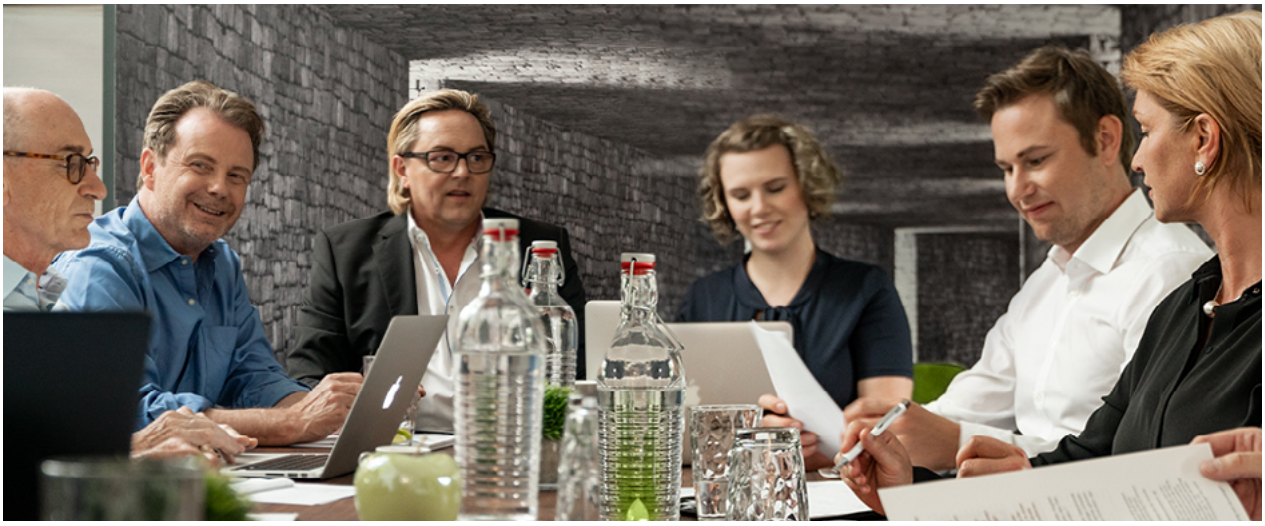
However, this needs to become common knowledge so that people can stand up to the software giants, for example when they demand information. This is easiest when the software belongs to the customer.'

Major contradiction between the legal situation and the customer perception of companies' audit rights

Moving away from perpetual licences means abandoning important protection provisions and customer rights.

Customers should assert and defend their interests in a more enlightened and autonomous manner.

About LizenzDirekt



The LizenzDirekt Group is one of Europe's leading dealers in pre-owned software licences. The company has numerous offices in Switzerland, Austria and Germany and buys and sells usage rights (volume licences) for business software and operating systems used by business customers and public agencies.

LizenzDirekt is a **Microsoft Partner, Cloud Solution Reseller** and **Authorized Education Reseller** and is included in the official register of **pre-qualified companies for public tenders** as a 'competent, highly capable and reliable company for public tenders'.

The group's customers are primarily corporations, larger mid-size enterprises and ministries, but it also works with a host of small and medium-sized companies as well as district and city administrations.

Together, the management team boast several decades of experience in the area of pre-owned software. Many of the group's employees are also certified by software companies and have acquired a vast amount of knowledge about licences and the SAM process. This means they are well-placed to help customers tackle the issue of audits without compromising security and without any stress.

LizenzDirekt deals in tailored software solutions, whether you're looking to buy, sell or lease new or pre-owned licences or are in the market for cloud-based Software as a Service.

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[1] For a detailed review of the subject: Kotthoff/Wieczorek: 'Rechtsrahmen von Softwarelizenzaudits - Zulässigkeit und Grenzen' ('Legal framework of software licence audits – permissibility and limitations'), in: *MMR*, 2014, pp. 3 et seq. (only available in German).

[2] According to Bundestag document 16/5048, p. 49; also p. 38 on Section 101, para. 2 of the German Copyright Act.

[3] See Bundestag document 16/5048, p. 49, p. 40.

[4] As expressly provided for in Section 101a, para. 1, third sentence of the German Copyright Act.

[5] Federal Supreme Court Gazette 150, 377, 388 et seq.

[6] According to the previous case law of the Federal Supreme Court, the principle of good faith requires that a claimant's request for disclosure be granted if the existing legal relationships between the parties are such that the claimant is excusably unaware of the existence or scope of their rights and the obligated party can easily provide the information needed to remove this uncertainty; BGH NJW 2007, 1806, 1807.

[7] See Sections 305 et seq. of the German Civil Code.

[8] See Section 305c, para. 2 of the German Civil Code.

[9] ECJ Judgment of 16 July 2020 in Case C-311/18 ('Schrems II').

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