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Software Patents

Ariba versus ePlus: A Software Patent Lawsuit in The USA

Llorenç Pagés-Casas

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In the summer of 2002 the journal “Purchasing Magazine Online” published a list of the most important companies (more than 50, most of them American) in the area of supply chain management software. Barely a year later, a note appeared in the same journal announcing that the company ePlus had taken out a software patent on supply chain management software. The announcement was remarkable for two reasons: firstly because ePlus was not on the list of major companies in that area published the previous year, and secondly because the patent referred to functionalities such as the electronic verification of inventory availability or the transfer of information from ERP (Enterprise Resource Planning) or other systems to purchase orders, functionalities which the supply chain management software industry had already been providing for several years. This is how software patents work in the USA. In this article we will be taking a closer look at the subject by studying the specific case of a lawsuit which went to court and was finally settled a few weeks ago.

Keywords: Ariba, ePlus, Lawsuit, Software Patents.

1 Introduction

In a recent article in the Financial Times [1], Patti Waldmeir made mention of the proliferation of a new breed of professionals, known as patent trolls, or as Waldmeir herself calls them: "... dark and hairy lawyers who use cheap and often useless patents to blackmail powerful corporations with patent infringement lawsuits". Defending against their lawsuits has come to be a part of the "cost of doing business in America". Intel, for example, has five full time staff on its payroll just to defend patent lawsuits filed against it (almost all of them by patent trolls) at a rate of one a week. The author of the article also points out that since patent trolling is considered to be no more than an "unorthodox business model", many legitimate businesses now troll part-time. And she closes by saying that "...In their better moments, trolls help test the validity of patents granted by an overworked and underfunded Patent Office. The rest of the time, though, they indulge in a legalised form of extortion".

Is the software business suffering the consequences of this phenomenon? Read about the case set out below and judge for yourselves.

2 The Lawsuit of ePlus against Ariba

As announced in the journal Purchase Online Magazine [2], having filed a software patent for supply chain management software, ePlus planned to force other companies of the sector and, by extension, their customers to pay royalties on the technologies they had patented.

And so it was that in May 2004 ePlus sued Ariba for a total of 79 infringements of three of its patents in Virginia, USA., did not appear on the list of the most important companies (more than 50, most of them American) in the area of supply chain management software compiled the previous year [3].

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three Ariba products (Ariba Buyer, Ariba Marketplace, and Ariba Category Procurement), claiming between 76 and 98 million dollars in damages. The target could not have been better chosen. Ariba, one of the B2B (Business to Business) giants that were cut down to size when the techno-bubble burst, had survived (unlike Commerce One which went to the wall) to become a leader of sector now known by the more generic term of Spend Management Software. Ariba’s secret was to deliver better than anyone else one of B2B’s greatest promises: the sale of software licences to major corporations to allow them to interact electronically with their suppliers (e-Procurement). Ariba holds a press conference to explain their presentation focused on two aspects: a) The circumstances that forced them to reach an agreement: - Once the jury found Ariba guilty of infringing ePlus’s patents, the company estimated that the appeal process would take at least two years. In the meantime, the plaintiffs’ core business was focused on the sale and leasing of IT equipment, a business which is dominated by other much more powerful corporations, it would be fair to say that the conflict was between a bit player and a leading actor to be fought out on the latter’s home ground.

3 The Settlement of The Case
The deliberations of the Virginia jury charged with hearing the case in first instance focused on the 8 of the 79 alleged infringements. Finally, on February 7, 2005 the jury issued a verdict whereby it declared invalid the 3 patents at issue and found Ariba guilty of all 8 infringements before moving on to the damages assessment phase of the trial.

According to applicable law, Ariba could be held liable to pay up to three times the maximum amount claimed (i.e. 98 million dollars x 3) if it was found to have infringed the patents wilfully.

That same day, Ariba issued a statement reaffirming its position and regretting the error that the company believed the jury had made. It also announced that it was preparing new versions of its products that avoided ePlus’s patents and would be distributed free of charge to its customers so they would not be affected by the decision.

As things turned out, this would not happen. On February 14, the two companies announced that they had reached a settlement whereby ePlus agreed to the release of all claims, including any future royalty claims, in return for a cash payment of 37 million dollars to be paid in three cash instalments. The settlement, announced as a cross-licensing agreement, begs a number of questions, not least of which is: have the two companies, by aggregating ePlus’s patents to Ariba products, entered into an alliance to set up an almost insuperable barrier to their competitors in the sector?

That was what Ariba shareholders were excitedly discussing on Internet forums. But the answer to their, and my, doubts was to come via that same medium, as we were able to listen in to the webcast press conferences held by the two companies on that subject.

4 The Ariba Press Conference
The same day of the settlement, Ariba held a press conference to explain it. To sum up, its presentation focused on two aspects:

Ariba was still convinced that the jury’s findings were erroneous and that an appeal would demonstrate that fact. But any plan to prolong litigation meant coming up with a workaround to provide customers with the necessary software patches to prevent them from being affected by the conflict, something which they considered to be overly risky.

Ariba has an important patent portfolio in the field in which it operates (e-Procurement). Normally, whenever there is a patent dispute between companies in the same sector, the sued company tends to use its own patent portfolio to try to launch a counterattack, seeking out its rival’s weak points to sue it in turn, until a standoff is reached and a fair settlement found. But in this case it was not possible: in spite of all the patents that ePlus has in this area, e-Procurement accounts for a mere 1% of its total business. In the light of this situation, and in order to focus on its business and not hinder the company’s innovation process and the imminent acquisition of new customers (a few days later the company announced the capture of two new major customers: ABN AMRO and PSA Peugeot-Citroen), Ariba decided to reach this settlement in order to “put this case behind” them.

4 The Ariba Press Conference
The same day of the settlement, Ariba held a press conference to explain it. To sum up, its presentation focused on two aspects:

a) The consequences of the settlement. Apart from the financial implications that we will not go into here, other no less interesting matters came to light:

■ The settlement was made via a cross-licensing agreement because this is the legal way of avoiding future mutual royalty claims on their current companies. This was in now way a cross-selling agreement and therefore any idea that the two companies were planning to develop anything in common was out of the question from the outset.

■ Ariba was of the opinion that in accounting terms the settlement added nothing to the company’s value. It was merely an expense. Under normal circumstances, whenever Ariba licenses a software product it is recorded as an investment, and therefore an asset, but in this case the value of being able to develop and exploit its software avoiding ePlus patents was zero. For Ariba, ePlus’s patents are still worth 0.

■ Although Ariba has an important patent portfolio in its field, up until now it had not paid much attention to it. From now on it will. In other words, it has the will and determination to ensure that what has happened will never happen again. Which will ultimately mean more work for the lawyers.

5 The ePlus Press Conference
The following day, ePlus also held a press conference, not expressly to comment on the settlement but rather to present the company’s earnings up to December 2004.

The previous day, precisely the day when the settlement with Ariba was announced, it became known that the company had recognised an error in one of its revenue items which would mean a drop of around 20% in the profits declared in September 2004. This classic accounting error was the same one that gave American investors so
many unpleasant surprises; it cost ePlus a 15% share price drop in spite of the major injection of funds that the settlement provided.

Aside from these issues of a more internal nature, it became apparent that ePlus’s sudden appearance on the e-Procurement scene was the result of a new strategy implemented by the company, of which patent lawsuits was to be just the beginning.

Most of ePlus’s revenues come from the leasing and sale of IT equipment, especially to US federal agencies and their contractors and subcontractors. This business seems to have stagnated or even gone into recession, and as 2004 was an election year and therefore a bad one for its core business, the idea was to obtain new revenue sources by selling products and services in various areas, e-Procurement software among them.

In this particular area ePlus had been working on the filing of patents since 1992. The patents allegedly infringed by Ariba included the following functionalities:

- Conducting electronic searches.
- Selection and comparison of records.
- Processing of catalogues from multiple vendors.
- Identification of equivalent products and appropriate replacements.
- Generation of purchase orders for multiple vendors.
- Electronic inventory verification.

It was from this position of strength that ePlus negotiated the settlement with Ariba and was hoping that, as a result of the publicity given to the verdict and the subsequent agreement, the market would recognise it as a major player in this area. However, ePlus’s management were to face a stormy question and answer session.

If the company’s position was strong, why had it ceded more than half of the requested damages? Did the company not know that those damages could have been up to tripled according to the jury’s final damages assessment? Why did the company not sue other competitors in the sector who were providing similar products to Ariba’s?

The answer to all these questions was always the same: the need to concentrate on its core business from which it was doubtless being distracted by the litigation.

### 6 Conclusions

Up to now, what you have been reading is a faithful account of what I have heard and read on the matter. Personally, I am always reluctant to pass judgement on matters or situations from afar. But on this occasion I think there are special circumstances which tempt me to make an exception:

1. Once again we have seen the long reach of the Internet in action. The fact that we have been able to hear both companies’ press conferences, including the Q&A sessions, is vital when it comes to giving an opinion.
2. Any conclusions that may be drawn are of great interest. In these times in which legislative processes (as is the case of the Directive on Software Patents in the European Parliament) are becoming bogged down in rambling theoretical discussions and obscure conflicts of interests much to the disconcertion of both those concerned and the general public at large, the study of practical cases is likely to be a very valuable exercise.

My conclusions are as follows:

1) A company’s tradition or its leadership position in a sector does not a priori give it any advantage in a dispute over software patents. In its conference ePlus alleged that it had been working on its patents since 1992. How then is it possible that in 2005 it had a merely token presence in the e-Procurement market? Is it plausible to think that ePlus’s contribution to the development of e-Procurement has been greater than Ariba’s? It would seem that, as well as taking into account who was first to file in the Patents Office, other considerations which were totally ignored in the case of Ariba vs ePlus, should also be given their due importance.

2) (Corollary of the above point)

There would be less chance of successfully fighting a patent infringement lawsuit if the litigant were not operating in the market in question. Ariba alleged that ePlus’s lack of presence in the market prevented it from countering, based on the principle that, in the software world where patents are concerned, the adage: “Let he who is without sin cast the first stone” would appear to hold true.

In other words, if the end purpose of patent system is to reward the developers and promoters of the different areas of technology, the end result would seem to be the opposite and it is the players operating outside the market who are most likely to win their lawsuits.

3) A claim against one of the companies of a sector would stymie all the other companies in the market. It is well known that software products concerning the same area tend to have many similar functionalities and differ from one another only very subtly (in interface, performance, ergonomics, etc.).

The economic and moral advantage enjoyed by a plaintiff in a patent lawsuit when the other side “throws in the towel” in the first round would encourage its managers and shareholders to dig deeper in the search for new potential actions. And knowing the software world as I do, such actions would not be hard to find.

This has not happened in the case of ePlus, but the barrage of questions that the management had to face is symptomatic of the fact that, in a world which is ever more prone to taking the short-term view, the idea of initiating a lawsuit against another company may be a temptation too great to resist.

4) The relentless trend towards building software in layers makes the industry especially vulnerable to patent infringement litigation.

Ariba’s customers who were building solutions on Ariba Buyer or Ariba Marketplace were under threat of having to go to court too, which at this point in time would do enormous damage to future sales of these platforms.

Can a software company, even when faced with a manifestly unjust lawsuit, afford to paralyse its sales and developments related to those sales for months or even years in order to seek justice?

5) (Corollary of the above point)

The level of uncertainty surrounding new developments would grow exponentially as new layers were developed.

What would have happened if Ariba’s customers had also been sued? Most likely some would have preferred to pay up before going to court and...
others would not. And what about the customers’ customers? It could have led to a legal tangle of monumental proportions.

And the worst thing is that experience tells us that nowadays the judiciary is deciding cases at an ever slower rate while the software industry is growing at an ever faster rate.

7 Economic Effects of Software Patents

If any of the above conclusions smack of subjectivity, here is another conclusion which merits a section of its own due to both its importance and its irrefutability: patents substantially change the economies of the software industry, as attested to by one of the latest CEPIS (Council of European Professional Informatics Societies) discussion papers on Software Patentability [4].

Under the European model whereby software is protected as intellectual property, software building is encouraged because the sale of licences and the subscription of software services on demand are more profitable activities.

However, under the patent protection model (adopted in the USA), a cross-analysis of all patents involved must be conducted before any development project is undertaken, not only with regard to the developer’s own products but also to those software products on which their software is being built. And even that would not be enough: a developer needs to include provisions for unforeseen contingencies for an amount which, as things stand now, is impossible to put an exact figure to. Let us look at our case in point:

In its quarterly earnings report for the period ending 31/12/04 Ariba reported the following margins per business activity:

- Software licences: 90%
- Subscriptions and maintenance: 75-80%
- Projects and services (labour intensive: 15-30%)

Now the company has to pay 37 million dollars in cash, plus legal costs; in other words, more than twice its quarterly income from licences, approximately 17 million, in addition to having run the risk of losing the customers which provide that revenue. In the light of this, can Ariba justifiably claim those margins for its licensing business?

Furthermore, if they intend to provision for future contingencies of that nature, exactly what contingencies should they consider? Could they in all honesty, after so many years in the business, have foreseen that someone would come along and do them financial damage with a patent from the year 2003? Will all this not have a discouraging effect on initiative and innovation, exactly the opposite of what a patent system is supposed to do?

8 Epilogue

When, as a result of a discussion in the e-forum of the Spanish CEPIS society ATI, the editor of Novática suggested that I write this article, I had some less radical conclusions in mind in which perhaps I gave more of the benefit of the doubt to the software patent system.

But as I delved deeper into the subject, my convictions became stronger. Most likely Ariba will have learned its lesson and from now on its team of lawyers will have an important role to play in the company’s decisions when new developments are to be undertaken. As an IT professional, I would not be at all happy if one day our companies had to learn the same lesson in the same way.

Translation by Steve Turpin

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