

Information Technology - Switzerland

Supreme Court rules on unilateral modification of source code

Contributed by [Wenger Plattner](#)

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Facts
Supreme Court decision
Comment

The Federal Supreme Court⁽¹⁾ recently considered whether the conclusion of contracts on the delivery of standard software and the development of client-specific applications and maintenance allows for unilateral source code modification by the licensee. It also considered how a licensee may compensate the software provider after having unilaterally modified the software source code.

Facts

Software provider V developed a generic enterprise resource planning (ERP) application that it sold to different clients. The application could be adapted to their specific needs.

Companies A, B, C and D belong to Group Z, which is active in the evaluation of laboratory analysis and scientific and medical research.

In 1999 V and A concluded a project agreement for the development - or rather, delivery - of V's ERP application for approximately Sfr30,000.

At the same time, the parties concluded a support agreement of unlimited duration for the maintenance of such software, which provided for remuneration based on hourly rates, depending on the services provided. Under the support agreement, a multi-user system licence was granted for the modules belonging to the standard application. The agreement further stated that no licence was necessary for the modules specifically developed for A, as long as they were used by multiple users within the user's company. It was also agreed that ownership would at all times remain with V, and that A was not allowed to resell or assign the software to third parties or to have it modified by third parties.

An annex to the support agreement stated that in the event of a third-party laboratory being interested in acquiring identical software to that developed for A, the parties would negotiate the commercial conditions of such eventual resale.

Between 1999 and 2007 V made various developments for A. The software was, in principle, based on the original 1999 version and subsequently enhanced and maintained. The software was developed for A, but was also used by B, C and D in several Swiss cities. V was aware of such use and had, in particular, participated in translation services concerning the use of the software in D's laboratories and provided a certificate about the software's value before it was brought into newly established company B as a contribution in kind.

Also between 1999 and 2007, V invoiced for Sfr393,693 based on the support agreement. The various invoices were paid by A, B, C or D.

In mid-2007 V encountered serious financial difficulties. One of V's owners decided to leave the company and to join A in August 2007. Since V had at all times used a single password for all its developments and had never changed it, the former owner of V (now an employee of A) was in a position to modify the software source code autonomously on A's behalf. Consequently, A no longer required V's services.

In June 2007 a dispute arose concerning A's rights to use the software. In particular, V and A were unable to agree whether A was entitled to make the software available to B, C and D and to modify the software source code autonomously.

Also in June 2007, V cancelled the 1999 support agreement, including the annex.

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A performed minor modifications to the software source code with regard to the core and specific modules of the software.

On March 31 2008 V sued A, B, C and D and claimed Sfr749,000. On May 5 2011 the first instance court rejected this claim. The court argued that A was entitled to make the software available to B, C and D and to modify the software source code autonomously after termination of the contractual relationship with V.

V appealed. At second instance, V reduced its claim and requested:

- Sfr125,000 for alleged illegitimate appropriation of the core modules;
- Sfr83,333 for alleged unlawful assignment of the specific modules to B; and
- Sfr167,210.95 as lost profit.

On January 3 2012 the second instance court rejected these claims.

V appealed to the Supreme Court.

Supreme Court decision

The Supreme Court held that whether A was entitled to make the software available to B, C and D was a question of interpretation of the contract. According to Swiss Law, the true and common will of the parties is decisive. It must be assessed by taking into account not only the parties' declarations of intent, but also all relevant circumstances before and after the conclusion of the contract. If a true and common will cannot be established, the parties' declarations must be interpreted by application of the principle of good faith.

The court considered the support agreement stating that the licensee was not entitled to resell or assign the software to third parties. However, the court held that the annex stating that the parties could discuss the commercial conditions of an eventual resale of identical software to a third party revealed that V was not itself entitled to resell to third parties the software specifically developed for A either. The court held that V was fully aware of the software use by B, C and D over several years and had never objected, and thereby had accepted such use.

With regard to whether A was entitled to modify the software source code autonomously, the court initially held that the software source code is the key element allowing maintenance, enhancement and development of software. The court further held that software providers do not ordinarily grant clients modification rights with regard to the source code, in order to protect their exclusivity to maintain the software. According to the court, the relevant question was also one of contractual interpretation.

The court deduced from the contract and the correspondence exchanged that V had not waived its exclusive right regarding the source code free of charge, but had intended to protect its exclusivity for maintenance and development of the software instead. The court held that A, B, C and D were not allowed to modify the software source code autonomously, but should have entered into negotiations with V instead. According to the court the following three alternatives were open to A, B, C and D:

- purchasing the right to modify the software source code;
- purchasing maintenance services; or
- leaving the 2007 version of the software unmodified.

As the autonomous and illegitimate modifications to the software source code had already taken place, the court contemplated two alternatives of compensation:

- Purchase of right to modify the software source code - the court pointed out that whenever a purchase price for an adaption right for source code needs to be assessed, consideration must be given to the fact that the software provider waives its exclusivity to modify the software and, in consequence, loses the opportunity to acquire mandates for maintenance and development services. The court stated that it might be necessary to ask an expert to calculate such purchase price. The court further held that the manufacturing costs of software are not also relevant when it comes to this calculation. In the case at hand, however, such a calculation was obsolete: V had made no proper allegations in that regard, therefore its claim was dismissed.
- Lost profits - alternatively, the software provider can argue that it has lost profits due to the autonomous and illegitimate undertaking of modifications to the software source code by the licensee. However, since V had made no substantiated allegations in that regard, its claim was dismissed.

V had based its claim for Sfr167,210 on provisions in the Code of Obligations about the premature withdrawal from the contract and the client's fault for the impossibility of performance of the contract. However, the court held that no contract was in place from

August 2007 to which these provisions applied.

Comment

Commercial software users frequently make considerable investments in highly specific and essential business software, but forget to include a provision about the software source code in the contract. The reason is simple: the software user does not need access to the software source code as long as the software provider properly performs maintenance services. However, if the business relationship cools and the performance of maintenance services is no longer safeguarded, the software user will soon become aware of its high level of dependence on its software provider.

It is widely accepted that the software user, as a rule, acquires no adaptation rights to the software source code if the relevant contracts do not explicitly grant such rights. This applies even if, as in the present case, the software user has paid for all developments and if these developments are more valuable than the standard applications initially bought.

This could be avoided, or at least alleviated, either by purchasing the software source code right at the beginning of the business relationship, or by having the software source code deposited in escrow. It all depends on careful contractual drafting.

The court has reconfirmed that the surrender of the software source code is to be qualified as concession of an adaptation right for which a software user must pay separately. It has identified two alternatives for the compensation of a software provider when an autonomous and illegitimate modification to the software source code has taken place.

However, how should such compensation be calculated in practice?

The purchase price for the right to modify the software source code is a matter of negotiation. Practical guidelines are difficult to find. It might seem reasonable to search for guidance in the relevant maintenance contracts. However, services provided under maintenance contracts are not necessarily identical to the right to modify the software source code. For that reason, a different method of calculation might be appropriate.

Lost profits that have arisen due to the non-conclusion of further maintenance contracts can easily be calculated if the respective contract provides for flat rates. However, if the contract - as in the case at hand - provides for remuneration based on hourly rates, it is important to ask how much time and effort was required to perform the modifications that were in fact performed. An expert in the field should be able to make a realistic estimation in that regard.

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Endnotes

(1) Federal Supreme Court, July 3 2012, 4A_98/2012 (www.bger.ch (in French)).

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