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## Yours, Mine, Ours?

Wednesday, September 23, 2009  
by: [Ted Sabety](#)



The new owners of Skype face a daunting question:

Must they now create their own, new software code covering core functions of

their popular long distance telephony service to replace licensed code that was part of eBay's 2005 acquisition? And further, can they do so legally? If not, they may have to sign a new and costly licensing deal with the original owner, Joltid, or risk even more expensive IP infringement litigation.

Skype has 220 million users worldwide. The [new Skype owners](#), well regarded private equity investors, now hold approximately 65% of the company with a current valuation of \$2.7 billion. They hope that replacement software will be sufficient to insulate Skype from the Joltid license dispute, which predates the sale, and maintain momentum in the fast growing Skype business. It may not.

Currently, the core Skype software technology remains in the hands of Joltid, Ltd., controlled by the founders of Skype, Niklas Zennstrom of Sweden and Janus Friis of Denmark. The IP covers functions "including the technology underlying its peer-to-peer architecture and firewall traversal technology..." / result of the terms of sale of Skype to eBay in 2005, Skype's original owners [licensed the core to softw](#) [to Skype](#) rather than Skype having purchased it.

### Sorting out the rights

What is critical is how the structure of the license, which apparently encompasses copyright, patent and trade secret rights, impacts the investment made by Skype's new private equity investors.

Joltid owns copyright in its code, trade secrets in the proprietary aspects of the code and its operation and possibly patent rights not assigned to Skype. Joltid received a patent in January that may relate to the operation of the Skype service. (U.S. Pat. No. 7,480,658, issued Jan. 20, 2009). Negotiating an acquisition in these circumstances requires a multi-disciplinary approach to the intellectual property transaction. Patent, copyright, trade secret, and contract issues all are involved here. The acquirer's future business plans should be taken into account when negotiating the acquisition of intellectual property embodied in software technology. It is not clear that occurred here back in 2005.

Joltid claims that Skype breached the software license agreement by improperly obtaining source code

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(presumably by reverse compiling the object code Joltid had licensed to Skype), modifying the code (presumably to enhance the Skype business) and disclosing code in the conduct of pending patent prosecution cases (presumably because Skype was required to do so). As a result, Joltid terminated the license and Skype has sued Joltid in High Court, London for wrongful termination. In addition, Joltid has filed a copyright infringement lawsuit in the Northern District of California.

Skype has disclosed that it is relying on a legal theory of "the parties' mutual dealings since the execution of the license agreement" to establish that it has broader rights to "use" the software code than Joltid contends. This may indicate that the express language in the software license from Joltid does not fully provide for Skype's use of the code. With regard to the U.S. copyright case, the Ninth Circuit in *SOS v. Payday* narrowly held that in that case, the right to "use" software code did not include the right to reverse compile it, although they did leave the door open for that interpretation in the context of some kinds of transactions. Presumably, Skype's new investors are banking on that. As a backstop, Skype says that it is developing its own software to replace that licensed from Joltid.

## No Free Ride

Engineering its own code may not be enough to insulate Skype from the dispute. If Skype holds a license to the newly issued Joltid patent through the disputed software license, then Skype's attempt to replace Joltid's software with its own may require it to design around Joltid's patent claims. That is because those patent rights may be linked to the licensed code, which is typical. In addition, some of the processes executed by the software code modules Skype wants to replace may be trade secrets of Joltid, in which case "clean-rooming" these modules does not necessarily extinguish trade secret claims with regard to the new code—especially if the license prohibited reverse engineering and placed a duty of confidentiality on Skype.

There are several lessons to be learned here:

(1) **Plan for Future Needs.** Corporate due diligence in a technology transaction requires a careful reading of any technology licenses to determine whether the license permits the acquirer to do those things that it needs to do in order to develop the business. It is not typical for a large software acquisition to result in the acquirer not holding the right to have the core source code, as well as substantial rights to modify it to suit its strategic business needs. A buyer would preferably face field of use restrictions to ameliorate the seller's post-transaction competitive concerns rather than restrictions on the right to modify the code at all.

(2) **Obtain Carve-Outs.** A buyer that licenses in proprietary software under a duty of confidentiality from the same inventors who have sold the buyer the underlying pending patent applications must obtain appropriate carve-outs from the duty of confidentiality for disclosures made as required by law.

(3) **Separate IP Rights.** Any software business acquisition coming with licensed patent rights or trade secrets should preferably grant those rights separately from the rights in the copyright of the software code. That is because the lack of access to the original code, while sufficient to avoid copyright infringement liability does not shield the buyer from potential patent infringement liability or trade secret liability if the original processes are subject to the seller's patent claims or are properly maintained as the seller's trade secret and the secrets used to design the new code.

A multi-disciplinary approach to negotiating the original software agreement between Joltid and Skype considering possible future business scenarios, including a sale to strategic investors, may have prevented the current situation. Currently, the future is cloudy for Skype, its new owners and eBay, which remains a 35% owner of the fast growing company. For now, at least, it seems IP holders Joltid appear to be in the driver's seat. Perhaps the investors hedged their risk by obtaining an indemnity from eBay as a condition for the purchase?

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