

(Cite as: 1998 WL 966825 (D.Vt.))

In re COMMERCIAL LOGIC, INC., Debtor.

No. 97-11704-FGC.

United States District Court, D. Vermont.

Dec. 31, 1998.

J. Emens-Butler, and R. Obuchowski, of Obuchowski Law Office, Bethel, VT, for Debtor Commercial Logic, Inc. (CLI).

J.J. Kennelly, Pratt Vreeland Kennelly & Zonay, Rutland, VT, and W.P. Kealey, Stuart & Branigin, Lafayette, IN, for Creditor Micro Data Base Systems, Inc. (MDBS).

MEMORANDUM OF DECISION GRANTING CLI'S MOTION TO MODIFY THE CLAIM OF MDBS

CONRAD, Bankruptcy J.

***1** Before us [FN1] is a Motion by Debtor Objecting to a Proof of Claim filed by MDBS and requesting that we disallow or significantly reduce the claim ("motion"). MDBS's proof of claim, as amended, seeks in excess of \$9 million dollars, which represents damages due to CLI's years of alleged copyright infringement and misappropriation of MDBS's trade secrets, as well as breach of contract, conversion and attorneys' fees. MDBS responds, asking that the claim, including a request for trebled damages, be allowed in full, or in the alternative that the claim be temporarily allowed under Fed.R.Bankr.P. 3018(a). [FN2]

FN1. Our subject matter jurisdiction over this controversy arises under 28 U.S.C. § 1334 (b) and the General Reference to this Court under Part V of the Local District Court Rules for the District of Vermont. This is a core matter under 28 U.S.C. §§ 157(b)(2) (A), (B), (C), (K), and (O). This Memorandum of Decision constitutes findings of fact and conclusions of law under Fed.R.Civ.P. 52, as made applicable by Fed.R.Bkrcty.P. 7052. The objection motion was consolidated with an adversary proceeding. This Memorandum decides only the issues before us in the Motion.

FN2. All citations are to the Bankruptcy Code, Title 11, United States Code, unless otherwise noted.

CLI's Motion is granted insofar as MDBS's claim is reduced to \$48,600.00. MDBS's request for

attorneys fees and trebled damages is denied. MDBS's request to have its claim temporarily estimated is moot.

BACKGROUND

On May 9, 1985, CLI executed an O.E.M. Software License Agreement (OEM) with MDBS. The OEM allowed CLI to utilize and distribute certain MDBS software to CLI's customers. The OEM provides:

2) LICENSE FEES

O.E.M. shall pay M.D.B.S. the fee indicated on the attached Royalty Schedule B under the terms and conditions set forth in the attached Schedule A for each run-time authorization, prior to the distribution of each Application Product Software license which O.E.M. sells, licenses, or otherwise conveys to a CUSTOMER ...

4) AUDIT RIGHTS AND ROYALTY PAYMENTS

C. O.E.M. shall pay royalties due M.D.B.S. for each such sale or transfer in accordance with Schedule A, as amended from time to time.

D. O.E.M. shall obtain run time authorizations and tokens from MDBS for each Application Product Software license prior to its conveyance ...

9) COPYING AND MODIFICATION

B. OEM shall affix to the original production of each CUSTOMER'S copy of the Application Product Software a token in the form designated and supplied by MDBS. The tokens affixed shall correspond to the components of the Software which are included in the Application Product Software.

Exhibit R-2, O.E.M. SOFTWARE LICENSE AGREEMENT [FN3]

FN3. An example of the inconsistency in the business records of MDBS is the spelling variations of run-time. It is spelled throughout the pleadings and exhibits as run-time, run time and runtime. Unless the pleadings are quoted verbatim, we will use the runtime variation throughout this Memorandum.

MDBS and CLI for past due royalties in 1992, in Indiana. The dispute was settled. Any claim for monies owed for any reason prior to the 1992 settlement date are disallowed. At issue now is the amount of royalties owed after the 1992 settlement. MDBS claims that CLI,

without appropriate remuneration, used, duplicated and distributed MDBS computer codes as part of its software. [FN4] MDBS alleges that CLI has not purchased or affixed a token to any of the updated or demonstration copies of MDBS's computer code since 1992. CLI has, however, purchased runtime tokens for some software.

FN4. PowerPM, TrakTime, TrakDate and the Database Servers are some of the software products CLI distributed. An "Overview of Products," introduced as Exhibit R-7, provides a description of each of these programs.

On April 24, 1998, MDBS filed an adversary proceeding seeking a preliminary injunction against CLI's use, duplication and distribution of its computer code. Evidence was presented and the preliminary injunction was granted. We made certain observations and entered findings [FN5] relevant to this motion.

FN5. In a Memorandum of Decision dated December 4, 1998, our Order Granting Preliminary Injunction was Affirmed by the District Court. An appeal to the Second Circuit Court of Appeals has been filed. A stay of the injunction while the appeal is pending has been denied by the District Court. A motion has been filed requesting that the injunction be enforced. A hearing on the alleged violations of the Injunction Order is set for January, 1999.

***2 THE COURT:** ... But essentially by my granting this injunction, I essentially put the debtor out of business ... [A]nd it still defies common sense to me why they would want to put someone they have been doing business with, even though it's been aggravating, because there's a lot of aggravations in the copyright world....

But in any event, it's clear that CLI has breached the licensing agreements by licensing the time management system to end users without paying the royalties due MDBS under the terms of its OEM agreements, and by also failing to provide MDBS with required reports, and by conveying or signing its rights without the prior written consent of MDBS. Now the evidence here shows it's pretty inconclusive to me as to how many end users it was sold to without paying any royalties. I also- it appears to me that there may be a conflict in the reports, ... This is more than a weather report. This is a tornado. Okay. It's clear that your claim is overstated, MDBS's claim is overstated. It's clear. By quite a bit. And you can't go back and raise your prices in '97 and make everything retroactive back to the past ...

Transcript (Tr.) of May 13, 1998 at pp. 277-278, 280-281.

Our granting MDBS's request for a preliminary injunction has the potential to sound the proverbial death knell for Debtor. In fact, the May 28, 1998 order encompassing our ruling authorized an immediate appeal "because its issuance effectively terminates the operations of the Debtor." Having put a halt to the use and distribution, we now must parse through the

various reports and affidavits submitted by both sides in order to reconcile the records to determine the amount owed to MDBS. The parties' inability to specifically track CLI's use of MDBS code makes the calculation of damages tedious, but doable. After parsing through the records, we question MDBS's truculent pursuit of this inflated claim. Indeed, enhancing revenues does not appear to be the motive driving MDBS in this Chapter 11.

DISCUSSION

CLI filed under Chapter 11 on November 19, 1997. MDBS is listed as a Schedule F creditor for \$45,000.00 evidencing a debt incurred from the post settlement date. The consideration listed is license fees. MDBS filed a proof of claim for an unsecured debt in excess of \$ 9 million dollars. MDBS claims that the monies owed it have accumulated over the years from CLI's copyright infringement, misappropriation of MDBS's trade secrets, breach of contract [FN6] and conversion. CLI argues that the claim as filed is based on figures derived from nonexistent agreements.

FN6. Counterclaims for breach of contract, breach of the implied covenant of good faith and fair dealing and other breaches of good faith and misrepresentation, have been asserted by Debtor in a related adversary proceeding. We make no findings with respect to the claims and counterclaims asserted in the adversary proceeding.

The documents that MDBS prepared and that were received into evidence confirm that MDBS filed an exaggerated proof of claim that includes fees for services and products never agreed to by CLI. The charges for tokens are egregiously inflated.

At the October 15, 1998 hearing (Hearing) on the Motion, Steven R. McGlothlin, Director of Global Affairs at MDBS, testified about the various types of tokens. This testimony is of particular importance as "token" is not a defined term in the OEM.

***3** Steven McGlothlin: ... The runtime token is used the first time a distribution occurs to a customer. An update token is used for subsequent distributions to somebody who has received a properly licensed token for that same module previously. Demo tokens are used in situations where the MDBS module is distributed where it is protected by time and technology for use on a limited time frame, limited technology capability for sales and marketing purpose only."

Tr., October 15, 1998, pp. 110-111.

What is clear from the O.E.M., is that CLI owes MDBS a runtime token royalty for each "original production of each customer's copy" of a CLI Application Product Software. Exhibit R-2, ¶ 9(B). The O.E.M. is silent about a fee for a demo token and is also silent about what an "update" entails. [FN7] Peter Coburn, president and majority stockholder of CLI, testified at

the hearing that no royalties are owed for demo or update tokens because royalties for these tokens were not contemplated by the parties in 1985 or 1992.

FN7. The evidence establishes that MDBS drafted the contract at issue. Accordingly, any ambiguity is construed against MDBS.

Peter Coburn: ... It was a concept that didn't exist until I guess I first heard of it in early '94, after we'd been customers of MDBS for over ten years. There was no talk of updates when we signed our original distribution license. There was no talk of updates when we settled our first dispute with MDBS in 1992. There was no talk of updates when MDBS persuaded us to reinvest more development money and time in MDBS to go from MDBS

3 and MDBS 4. There was no talk of updates when they persuaded us to license the NLM system, to pay more money for that.

Once all that got done, then there began to be this buzz around update tokens. And sometime in late '94 and early '95 they began sending us draft contracts purporting to be a new O.E.M. licensing contract. The main purpose of which as far as we could see was to get us to sign off on the idea that we needed to pay for updates.

Now, in that contract they defined an update as whenever we distributed to our end users an enhancement of their DMS runtime times.

Tr., October 15, 1998, pp. 14-15.

It appears that MDBS changed the rules midcyberspace without notifying CLI. There was no written agreement between the parties obligating CLI to pay for updates and demos. Accordingly, we strike that portion of the claim that includes a charge for 1215 units of single user DMS updates. (Tr., October 15, 1998, pp. 13-15; Exhibit R-1) MDBS's claim for 285 TrakDate updates is also disallowed. Discussions between the parties and circulated drafts were never reduced to a signed document. We find Mr. Coburn to be the more credible witness. [FN8] Based upon the lack of credible evidence to establish otherwise, there are no royalties owed for demos and updates.

FN8. We do not mean to impugn the integrity of Mr. McGlothlin by this finding.

Testimony with respect to MDBS's pecuniary loss on runtime royalties was elicited from Mr. Coburn. MDBS included in its proof of claim payment for 88 runtime royalties of TrakDate or TrakRite. Evidence confirms that no copies were distributed to any CLI customers who were not already licensed users. This finding makes the issuance analogous to an update rather than an original sale. Thus, no payment is owing for updates.

***4** The charts and customer lists supplied by MDBS and admitted into evidence are not credible from our point of view. They contain duplicate and in some instances triplicate listings of customers, and make claims for certain tokens listed as credit memos. CLI was being charged royalties for certain PowerPM distributions that customers had actually returned. There were also charges attributed to sales of PowerPM manuals, seminars or telephone transactions; charges not indicative of an original transaction. (Tr., October 15, 1998, p. 12.) CLI will pay, however, for 20 PowerPM original single user sales priced at \$400.00 each. The price is derived from the 1995 price sheet for purchase of 11-50 runtime tokens.

MDBS's Exhibit R-1, a supplement to its proof of claim complete with charts, lists 57 distributions of the NLM Database Servers. CLI does not dispute this number and in fact, told us that there was one additional distribution not included in MDBS's claim. The sticking point here is the price MDBS ascribes to the database server. MDBS wants \$14,000.00 for each distribution. CLI priced the distributions at \$700.00, the price quoted in the 1994 price sheet. (Exhibit D-5) The \$14,000.00 value is not applicable as that number includes a fee for a new development system. CLI did not make any distributions that contained the new development portions of MDBS software.

Trying to reconstruct business records to justify a bottom line is never easy. This arduous task is further compounded when the adjusted pricing can't be attributed to a written agreement and is in fact based on agreements to agree. Based upon the many inconsistencies found in the exhibits prepared by MDBS and the credible testimony of Peter Coburn, the claim of MDBS is reduced from more than \$9 million to \$48,600.00. Finally, we do not include an award for trebled damages or attorneys' fees. Such an award is not appropriate at this time.

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