

# The Challenges of Protecting ‘Custom’ IP: Court Limits Injunctive Relief for Tailored Software Project

by Steve Kramarsky

Intellectual property, by its very nature, tends to pose challenges that traditional property does not. If I want to protect my valuable possessions, I can lock them up in a safe or install an alarm in my house. But the protection of intellectual property is not that simple. Of course, it is possible to protect the tangible forms intellectual property might take: a sound recording or customer list or source code implementation of a computer algorithm can be locked away in a physical or virtual vault. But the value of intellectual property typically comes from its use, not from the scarcity of any one physical copy of it. And since the entire concept of restricted use is a creation of law, it falls to the courts to figure out where that concept begins and ends. This determination often takes place in the context of a proceeding for an injunction.

Computer software is a good example of a product that has to be used if it is to have any value at all, but that loses its value if the owner cannot restrict that use to paying customers. If millions of people are using a company’s software, the company is happy—as long as it’s getting paid. But if the company loses control of the product, it must take steps to defend its rights. And the first step in that playbook is often to go to court and seek to restrain unlawful use of the intellectual property.

*CGI Technologies and Solutions v. New York State Office of Mental Health* is a recent New York Supreme Court case regarding exactly that situation; but it is worth examining, because it conducts the familiar preliminary injunction analysis in a somewhat unfamiliar way.

## Background Facts

CGI Technologies and Solutions (CGI) is an information technology consulting company that “work[s] side-by-side with clients to help maximize the technologies that transform their business[es].” In August 2013, CGI signed a contract with the New York State Office of Mental Health (OMH) under which CGI agreed to develop a new system to maintain and manage OMH’s medical records. In return, OMH agreed to pay \$51 million to CGI, to be paid in installments upon the completion by CGI of certain enumerated tasks.

Due to OMH’s particularized needs, CGI was required to develop “a highly-customized system tailored to OMH’s unique needs,” rather than utilizing an “off-the-shelf” product. Recognizing that CGI’s performance of its contractual duties would result in the creation of proprietary software, the parties’ agreement explicitly “addresse[d] the ownership and use of any ‘Custom Work’ developed by CGI

for the Project.” In particular, the contract stated that any “Custom Work” developed by CGI would “*belong exclusively to OMH ... upon payment in full for such Custom Work or portion thereof.*” *CGI Technologies and Solutions*, 66 Misc.3d 1204(A), at \*1.

CGI alleged that it completed the first phase of the project, development of software for OMH’s direct care facilities, in October 2017 and that OMH has been using that software ever since. Upon completion of the first phase, CGI informed OMH that it had “incurred extra costs ... in performing the contracted work” and required additional payment. CGI asked OMH to extend “the scope and cost of the Project.” As of that date, OMH had paid CGI for the work already performed but not for further work contemplated under the contract or for any of the “extra costs” identified by CGI.

On April 25, 2018, after attempting to reach a negotiated solution regarding its additional costs, CGI submitted a formal “Change Request.” Three weeks later, OMH suspended contractual activities, informing OMH that the suspension was intended only as a “pause” and that the Project would be resumed at a subsequent date. “Believing [that] representation, CGI allegedly complied with OMH’s requests, including OMH’s requests that CGI provide access to [its] critical intellectual property during [that] pause.” *Id.* at \*2 (internal quotation marks and citations omitted). The parties continued operating in that state of uncertainty until Aug. 6, 2018 when OMH terminated the contract. Following termination of the contract, OMH continued to use the system CGI had designed pursuant to the contract.

## The Litigation

On Jan. 31, 2019, CGI filed a claim in the New York State Court of Claims, asserting that OMH had taken “improper possession of CGI’s intellectual property and work product without having to pay for them as required under the contract.” CGI sought monetary damages, declaratory relief, and a preliminary injunction. On May 8, 2019, the Court of Claims determined that it lacked jurisdiction to issue a declaratory judgment. Two months later, the Court of Claims dismissed seven of CGI’s eight claims, leaving only CGI’s conversion claim, finding “CGI sufficiently alleges that it provided custom work to OMH, that OMH exercised dominion over CGI’s intellectual property by downloading and using it without having paid fully, and that OMH has cut off CGI’s access to its own intellectual property.” *Id.*

After the Court of Claims ruling that it lacked jurisdiction to issue declaratory relief, CGI filed a parallel action in the New York Supreme Court, Albany County. CGI sought “a declaration of rights to the Custom Work pursuant to CPLR 3001, together with an injunction restraining” OMH from continued use of those works. CGI also asserted two causes of action under CPLR Article 78 seeking similar relief. On Aug. 28, 2019, the court dismissed the causes of action under CPLR Article 78, but sustained the action for declaratory and injunctive relief, finding “CGI has stated a legitimate claim to ownership of the intellectual property at issue herein.” *Id.* at \*3.

On Dec. 31, 2019, the court denied CGI’s request for a preliminary injunction. The court performed the familiar preliminary injunction analysis, which requires the movant to demonstrate “a probability of s

uccess on the merits, danger of irreparable injury in the absence of an injunction and a balance of equities in its favor. *Id.* at \*3 (quoting *Nobu Next Door v. Fine Arts Hous.*, 4 N.Y.3d 839, 840 (2005)). The court found that CGI's application failed to establish any of those three predicates.

*First*, the court considered the likelihood of success on the merits. CGI asserted that CGI "has admitted to not fully paying for work that CGI performed under the Contract" and that, under the contract, "title to CGI's custom work only passes from CGI to OMH upon OMH's payment in full for the custom work." On that basis, CGI asserted that it retained ownership of the works and that OMH's continued use of them was in violation of OMH's contractual and property rights.

Once again, the court found that CGI had a "legitimate claim to ownership of the intellectual property at issue," but nonetheless determined that CGI had not demonstrated that it was "likely to succeed in establishing that it is the owner of all of the Software or even all of the Custom Work." *Id.* at 4. The court first noted that certain of the "source code" that OMH alleged belonged to it was in fact jointly owned by CGI and a non-party subcontractor hired by CGI and that CGI had failed to allege with particularity which portions of the source code over which it asserted exclusive ownership rights.

Further, the court found that OMH had obtained an ownership interest in certain portions of the source code for which it had already paid CGI. The court noted that "[u]nder the Contract, CGI was obliged to furnish OMH with 56 performance-based 'Deliverables' ... and OMH was obliged to pay CGI '[f]or each accepted deliverable.'" Consistent with that arrangement, the court found that OMH had paid "more than \$34 million to CGI pursuant to the Contract" upon acceptance of those "Deliverables." Pursuant to that contract, which provided that "custom source code developed for the Project by CGI 'shall be deemed to be a work made for hire ... and shall belong exclusively to OMH ... upon payment in full for such Custom Work or portion thereof,'" the court found that the paid-for "Deliverables" likely belonged to OMH and CGI had not adequately identified portions of the code to which it had exclusive rights. *Id.* at \*5.

*Second*, the court considered whether CGI would suffer irreparable harm in the absence of the requested injunction. CGI asserted that it would be because OMH might provide its intellectual property to third parties who are competitors of CGI. The court rejected that argument, finding that there was insufficient evidence that OMH would transfer CGI intellectual property to a CGI competitor and that, in any event, monetary damages could adequately compensate CGI for any alleged losses because under the contract, OMH obtained ownership rights to all Custom Works after payment in full. Thus, an award of monetary damages would place the parties in exactly the position they had contracted to be in. Somewhat atypically, the court went on to determine that injunctive relief would cause irreparable harm to OMH and its patients, by depriving those patients of critical medical data.

*Third*, the court found that the balance of the equities weighed against issuing a preliminary injunction. The court noted that OMH had paid over \$34 million for CGI's work and that it would be inequitable to deny OMH and its patients the use of all of the software on the basis that CGI asserted that some had not been paid for. Given that CGI had not identified any specific portion of the code for which OMH had

failed to pay and the difficulty of separating any such portion of the code from the remainder of the code, the court found it would be inequitable to restrain OMH from using any of the software.

## A Medical Impossibility

At first blush, CGI sounds like a textbook example of a proper preliminary injunction. It was virtually undisputed that OMH is in possession of, and actively using without permission, valuable intellectual property belonging to CGI and that OMH had not paid for that intellectual property. Yet, the court found against CGI on all three branches of the preliminary injunction analysis. Two main themes were central to that surprising result.

*First*, given the structure of the contract, OMH had paid a significant amount for the custom work CGI had done. While the court acknowledged that OMH likely did not own all of the software designed by CGI, it noted that OMH likely did own the majority of it and CGI had not provided any method to distinguish between the paid-for and unpaid-for segments of code. Off-the-shelf software is generally not sold; it is licensed. You may have a copy of Microsoft Word on your computer, but you don't own it. Microsoft owns it and you have a license to use it. Custom software is different: When a developer or company creates a custom software package for a client, it may retain ownership and give the client a license, or it may give ownership to the client as a "work made for hire". The rights, in such circumstances are entirely dictated by the contract between the parties and courts are required to enforce those contracts. Here the contract called for payment over time by the client and development and provision of services over time by the company. It also provided that the client would own the software outright upon full payment, but it did not segregate the payments and tasks into connected steps, so the court had no way to provide phased injunctive relief under the contract.

*Second*, the court devoted a lot of focus to the nature of OMH's work. In a somewhat unusual "irreparable harm" analysis, the court considered the harm to OMH, a New York state medical agency, and its patients should CGI receive the requested injunction. Indeed, following the court's reasoning, it is difficult to conceive a case where OMH would have been restrained from its continued use of CGI's software, given the court's view of the equities. Whatever the merits of that decision, developers (particularly those who work with state and federal agencies or in the health care field) should take note and draft their contracts with care.

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