IN THE MATTER OF
***THE COMMERCIAL ARBITRATION ACT*, R.S.B.C. 1996, c.55**
AND IN THE MATTER OF AN ARBITRATION

BETWEEN:

McHENRY SOFTWARE INC.

CLAIMANT/ RESPONDENT BY COUNTERCLAIM

AND:

ARAS 360 INCORPORATED aka ARAS 360 TECHNOLOGIES INC**.**

RESPONDENT/ CLAIMANT BY COUNTERCLAIM

HEARING: November 12-15, 18-19, 21- 22, 2013
and January 17, 2014 (Oral Submissions)

COUNSEL FOR THE CLAIMANT: David Wotherspoon, Tariq Ahmed and David Curtis

COUNSEL FOR THE RESPONDENT: David Lunny and David Cayley

ARBITRATION AWARD

Introduction

1. This Arbitration is pursuant to a Software Licensing and Development Agreement made as of February 5, 2010 (the "Agreement") between McHenry Software Inc. ("MS") and ARAS 360 Incorporated ("ARAS").

2. The Agreement sets out as its purpose that MS will modify some of its software products to permit seamless integration into ARAS' software products. The Agreement further states that MS would work with ARAS' programmers to incorporate the products and MS could make suggestions for incorporation but the final decisions were the sole responsibility of ARAS. The parties anticipated after the integration further enhanced products would be created. ARAS was to be the seller/retailer of the product.

3. MS had many years prior to this contract developed software that could simulate various kinds of motor vehicle accidents. With just the MS software

an accident could be reconstructed and reported as numerical reports. Over the years many such reports had been generated and used for various purposes, including accident reconstruction for court purposes. It also could display on a screen the accident but the vehicles moving over the background or terrain were not shown effectively unless the product was sent to an “artist”. The “artist” would fill in the background so the reconstruction of the terrain and vehicles could be easily seen when displayed. ARAS had software that could provide a “graphical environment”. In simple terms, it would do what the “artist” would otherwise do.

4. The idea was that when the MS and ARAS software were integrated the integrated software would do what had to be done previously by two separate processes. With the integrated software the accident simulation would be created and then immediately displayed on a screen. The display would show the appropriate vehicles moving over the correct terrain showing effectively exactly how the accident occurred. The completion of the integration was virtually achieved and a product was fully ready for market at the time of the dispute which came to a head in November/December of 2011.

History of these Proceedings

5. Paragraph 14 of the Agreement contains the dispute resolution provisions. The Agreement states in paragraph 14.4 that the final step in the dispute resolution process is that “….the parties agree to submit any and all disputes between them to final and binding arbitration before a single arbitrator under the BCICAC’s Domestic Arbitration Rules.”

6. I was appointed Arbitrator by the parties in this matter through the British Columbia International Arbitration Centre. Our first conference call was held January 23, 2013. Not including various conference calls, I made nine written Interim Orders between January 23, 2013 and November 12, 2013, the first day of the hearing. I made a further order on the second day of the hearing as a result of an application by MS.

Background

7. During 2009 the principals of MS and ARAS, Mr. McHenry on behalf of MS and Mr. Kennedy on behalf of ARAS, had discussions regarding the possible integration of some of the products produced by their two companies. The discussions led to the Agreement in early February, 2010. At that time the parties were confident the first part of the integration process would be completed and product ready for sale by July 15, 2010.

8. Under the Agreement, the first two products, ARAS MMIS and ARAS Collide, were scheduled to be ready for sale not later than July 15, 2010. This did not occur; instead the work went on until into the fall of 2011 when a different but

more comprehensive product was “released for sale”. There were some pre-sales and some sales which were subject to later provision of updates but the parties needed to get the completed product out. This delay of over one and a half years caused pressures that resulted in significant frustration for Mr. McHenry and Mr. Kennedy.

9. During 2010 and the first part of 2011, a major frustration arose because the parties had expected that the product sales by ARAS would start to generate profits at least by the summer of 2010. Mr. McHenry testified that he had advised Mr. Kennedy, both prior to the Agreement and after the Agreement was signed, that he needed to be assured his income would be protected during the process of integration. With these expectations the parties set the payments to MS from ARAS as set out in paragraph 10.2 of the Agreement.

10. The delays in the release of the product and the disagreements over payments were the two major factors causing the frustration between Mr. McHenry and Mr. Kennedy which grew and then erupted in November 2011. This eruption caused MS to send a letter in December of 2011 terminating the Agreement.

11. In its termination letter MS only refers to one alleged default by ARAS. The letter states: “*In particular, ARAS 360 has failed to meet the minimum annual sales and to remit the minimum annual license fees required under section 10.2 of the agreement*.” In this arbitration MS claims there have been a number of breaches of the Agreement in that:

    a. ARAS failed to pay a minimum annual prepayment amount as contemplated during the second year of the Agreement.

    b. ARAS failed to pay royalty payments. Under paragraph 10 of the Agreement, the price of the product to the customer was fixed and MS was to receive a royalty of 20% on each sale of product. MS says it was not paid the royalty. Further MS says that the price was not to be changed except by written agreement of the parties. MS says the price was changed without written agreement thereby potentially reducing the royalty.

    c. ARAS failed to pay license fees and the fees required for the ongoing annual maintenance programs which it failed to charge and remit to MS as required in the Agreement.

    d. MS also claims breach of copyright and trademark infringement.

12. ARAS responds to these claims as follows:

  a. Annual "advance payments" were predicated upon the completion and delivery by MS of the software which MS failed to complete and deliver in a timely manner.

  b. MS acknowledged by its actions that ARAS was free to alter the price as it saw fit in the ongoing circumstances. Further MS waived any objections and received royalties for every license sold.

  c. ARAS was not obliged to pay these various sums, in light of the known product pricing and the fact that MMIS was not being sold as it had never been provided by MS. Further the amount being paid to MS was not deficient in any respect.

  d. ARAS at no time breached any copyright or trademark rights.

13. ARAS has counterclaimed for damages based on several allegations, including that:

  a. MS failed to deliver various products that it had contracted to provide;

  b. MS failed to deliver the necessary validation documentation and technical support;

  c. MS made false allegations and intentionally interfered with the relationships between ARAS and its suppliers and customers.

14. The reason for termination given by MS in the notice of termination, as well as the other reasons for termination given in the evidence and final argument, centered on the failure of ARAS to pay money to MS pursuant to Section 10.2 of the agreement. It reads as follows:

> **10.2** - Reseller shall initially purchase 100 licenses in advance of the ARAS MMIS product for the ARAS price of $1200 per license, and 100 Licenses of ARAS Collide for the ARAS price of $400 per license ($160,000.00 in total), when the ARAS MMIS product is delivered and adequate time is allowed for successful integration into the ARAS 360software products.
>
> Reseller will advance the amount of $40,000 when this Agreement is executed toward anticipated development cost by MS.
>
> During the approximately 6 month implementation stage (Feb through July 2010) MS will be available and provide priority response to inquiries from ARAS and designated ASAS agents and programmers to permit the rapid implementation of the software products.

An additional amount of $40,000 will be paid 30 days following the initial delivery of the alpha versions of ARAS MMIS and ARAS Collide which MS will deliver no later than March 31, 2010. Therefore the second $40,000 shall be paid on or before May 1, 2010.

The remaining $80,000 to be paid when ARAS MMIS and ARAS Collide are delivered in ‘ready for final version’ form to ARAS 360 and a reasonable time is allowed for integration and preparation for sale. The ‘reasonable time’ will be no more than 45 days after delivery of the final versions of the ARAS MMIS and ARAS Collide software to ARAS360. The expected delivery date is to be on or before June 1, 2010. ‘Ready for sale’ will be designated to be no later than 45 days after delivery of the ‘ready for final version’ of the software of July 15, 2010, whichever is sooner.

At end of the first year of this Agreement, the amount of sales actually made will be reconciled against the initial purchase, and the Reseller will either pay additional monies for sales in excess of 100 licenses or MS will provide a credit toward the next year if sales are less than 100 licenses sold.

At the end of the first year, and for the 4 years that follow to the end of the contract, the annual repayment for 100 licenses will increase by 20%.

Section 10.3 and 10.4 are also relevant to the timing of payments:

10.3 - Subject to the minimum annual license fees referred to in section 10.2 above, MS will be paid 20% of the license fee paid to Reseller by the Reseller’s end user customers for the Software. This fee shall not change unless otherwise agreed to in writing by both parties to this Agreement.

The license fees for the MSA-Software components are as follows:

ARAS 360 Product	Customer Price	MS fee	Delivery date of MSA-Software components
ARAS MMIS	$6000	20%	June 1, 2010
ARAS Collide	$2000	20%	June 1, 2010
ARAS Articulation	$1000	20%	Nov 1, 2010
ARAS TTM	$1000	20%	Mar 1, 2011
ARAS Collide 3D	$1000	20%	June 1, 2011
ARAS Advance	$2500	20%	Nov 1, 2011
ARAS Bio Motion	$1500	20%	Mar 1, 2012

10.4 - Reseller shall tabulate a list of licenses entered, including customer name, date of license, on a monthly basis and pay to MS the difference between any monthly advance and the royalty payment due on a monthly basis. Should the royalty due amount to less than the advance, MS will not be required to make any reimbursement to Reseller and any shortfall will carry over as an offset against future royalty payments. This list of licenses shall be provided to MS on the final day of each month over the life of this Agreement.

15. The parties expected the timing of the implementation phase to be approximately 6 months from February to July 2010. The payment schedule was tied to when ARAS MMIS and ARAS Collide were delivered in ‘ready for final version’ form to ARAS, with a reasonable time allowed for integration and preparation for sale. The expected delivery date was on or before June 1, 2010. ‘Ready for sale’ was designated to be no later than 45 days after delivery of the ready for final version of the software or July 15, 2010, whichever is sooner.

16. The parties agree the actual integration did not get fully under way until January of 2011, a year after the agreement was signed. The evidence shows the reason for this approximately one year delay in the start was because the ARAS product, which was to provide the “graphical environment”, was not available until January of 2011. This meant that the integration did not start until 6 months after the integration was expected to be completed for the first two products.

17. In January 2011 the integration phase started. In order to conduct the integration the parties set up a process that included three primary programmers located in three different locations: Mr. McHenry who was located in North Carolina, Mr. Paul Hetherington (PH) who worked for ARAS and was located in Kamloops British Columbia, and Mr. Varatharaj Ponnuchamy (Chamy) who worked for ARAS and was located in India. Communication between the three programmers was primarily by email and Skype.

18. In October of 2011, after 10 months working on integration, there was a product release. In the fall of 2011 there were disagreements between the parties which lead to the MS termination letter on December 9, 2011. As stated earlier there had been a one year delay while the ARAS product was made ready. This additional 10 month time frame is about 4 months longer than the parties expected for integration and a product release. The total timeframe for the integration was almost two years rather than the expected six months.

19. The parties disagree about the cause of this extended time for integration. Mr. McHenry is adamant that any delays are the fault of ARAS. ARAS says delays in this kind of project are not unusual and that Mr. McHenry is not free from blame. Basically, ARAS says it is a team effort and therefore, as far as the speed the project moves, all the participants will inevitably be part of the success and part of the failures.

20. It is clear in the oral evidence at the hearing and in the emails exchanged that Mr. McHenry complained to Mr. Kennedy and Chamy about PH. Mr. McHenry believed that PH was not carrying his share of the load and that was causing

unnecessary delay. In an email dated March 17, 2011 Mr. Kennedy agreed with Mr. McHenry that PH was not working effectively. During his testimony Mr. Kennedy stated he did not agree with Mr. McHenry's complaints, he only made the comments regarding PH to keep Mr. McHenry happy so the project would keep moving. Mr. McHenry also had an email exchange with Chamy where Chamy seemed to agree with Mr. McHenry.

21. Mr. McHenry also had a heated email exchange with PH in early June 2011, setting out his concerns. PH complained back. During his testimony at the hearing Mr. Kennedy was asked about Mr McHenry's email and he responded in part:

> "….In that email you'll notice that he is blaming my programmers and saying that the delay issue is not due to his product. We don't respond to that and blame him. Because I still thought in the end, if all got done, there's not going to be any point in pointing any blame. But I don't want anyone to think that I wasn't thinking a lot of this was due to him not having his ducks in a row. And that had consequences on the project as well."

22. I note that the Agreement has no provision for what happens if the time lines expressed in the Agreement are exceeded except that in paragraph 17 it states, in part, that "The Agreement may be amended only by a written instrument executed by both parties." The above emails regarding complaints about delay took place in June, 2011, a year and a half after the contract was signed. The parties kept working, albeit with some frustration, even when programming delays were occurring more than a year after the expected completion set out in the Agreement. Further, they kept working without amending the time lines in the Agreement.

23. In addition to the frustration expressed by Mr. McHenry regarding delays caused by PH, Mr. McHenry believed that Mr. Kennedy was causing further delay by wanting to add features to the first product that the Agreement said would be sold. There are emails, particularly in the late spring of 2011, where Mr. McHenry and Mr. Kennedy discuss changes to the first release to add features which were really intended for later releases. The idea was to enhance the first release since they were behind schedule. Mr. McHenry testified that this "feature creep" was Mr. Kennedy's doing. Mr. Kennedy testified he saw it as something Mr. McHenry was suggesting. In emails in May and June 2011 there are various discussions, in which both Mr. Kennedy and Mr. McHenry were cooperatively speaking about the possibility of getting out a product that had additional features including 3D.

24. Mr. McHenry's complaints of delay caused by programing and the delay caused by the "feature creep" were characterized by counsel for ARAS as "the blame game". The complaints about delay and "feature creep" were not resolved. The parties continued on, with ongoing frustration fueled by the

delays and the parties' differences regarding the requirement for payments to MS.

25. The situation regarding delay and payment of money for the first year, 2010, is set out in the following emails sent in late 2010 and early January 2011:

November 19, 2010 at 12:06 PM
From: Brian McHenry
To: Mike Kennedy

Regarding the business portion of our joint venture…

As part of our contract agreement I agreed to forgo consult cases so as not to interfere with our development time. As a result I have declined new cases and lost approximately $10000 - $20000 in revenue per month.

Our agreement stipulated that there would be a minimum of $160,000+ in revenue to McHenry Software in 2010 from ARAS360.

So here we are at the tail end of 2010, and McHenry Software has only half of the minimum base amount, $80,000. Since we aren't ramping up development until 2nd week of December it doesn't look like we are going to have product (and sales) out the door until 2011.

The problem is that the delays have been seriously detrimental to my company's bottom line.

I believe it would be mutually beneficial to us that we bring the contract amounts up to date before the end of the year. I have done the prerequisite work per my end of the agreement and the only thing left is for ARAS360 to set up the communications between the programs and the user interface.

Brian

November 19, 2010 at 3:19 PM
From: Mike Kennedy
To: Brian McHenry

OK – I will get that done.

December 17, 2010 at 1:42 PM
From: Brian McHenry
To: Mike Kennedy

Mike,

Thank you for the wire transfer 12/1/2010.

Do you have an estimate for the date of the final transfer for 2010?

I am looking forward to taking ARAS360 giant steps in Singapore in January.

Brian

January 4, 2011 at 1:56 PM
From: Brian McHenry
To: Mike Kennedy

Mike,

(Portion deleted)

With the payment on the plane ticket and hotel/travel charges coming up, I need to know when next payment coming in for planning purposes, etc.

(Portion deleted)

Brian

January 4, 2011 at 6:29 PM
From: Mike Kennedy
To: Brian McHenry

(Portion deleted)

On the money – I cannot wrap my head around the payments but I am having Ricci wire you another 40k tomorrow as any monies pre-pay for licenses anyway and carry over if not used (please confirm).

(Portion deleted)

Mike

January 6, 2011 at 11:58 AM
From: Mike Kennedy
To: Brian McHenry

Hi Brian – we just wanted your confirmation that the advances all go to license pre-purchases and spills over to 2011.

January 6, 2011 at 1:40 PM
From: Brian McHenry
To: Mike Kennedy

Mike,

(Portion deleted)

The contract should speak for itself.

Ultimately, I believe the spirit of the contract is that all advances will go against license pre-purchases however it is a question of when and how.
I recall that there were to be annual minimum 'pre-payments'.
I can't recall how overages were to be handled.
Please consider the following:

1. *All during 2010 I worked to prepare for the integration of our software into ARAS360 as best I could per our discussions.*
2. *Per our contract I turned down consulting work to be sure that I was available for immediate work on the project.*
3. *Due to delays in the initial ARAS360 launch, we did not jointly work on our joint project in 2010.*
4. *Therefore no sales of our joint project software were recorded in 2010.*
5. *I only agreed to do 'no consult work' due to the specified minimums and the expectations that the joint project would produce the annual minimums as well as hopefully some additional income.*
6. *The minimum 'pre-payment' for 2010 was supposed to be $160,000.*
7. *In 2010 I only received $120,000 from ARAS360. That made for a very tough 2010 year financially. It was my worst year in 20 years.*
8. *It is now 2011 we are finally going to start working on the joint aspects of the project.*
9. *Sales should begin at some point this year (hopefully very soon!) and generate commissions.*
10. *Your email request that I confirm that the advances go against 'license pre-purchase' brings up a number of questions:*

    a. *Do you mean against all funds received to date? Or only against monies wired in 2010?*
    b. *How does this affect any annual minimum 'pre-payments'?*
    c. *Since you did not meet last years minimum of $160,000, what am I to expect for this year's minimum and when?*
    d. *The sporadic nature of the 'pre-payments' this year were very detrimental to my financial bottom line so scheduling of 'pre-payments' for 2011 would be appreciated.*

I didn't want to bog down our progress on the project with these details but obviously financially the delays in this project have adversely affected my bottom line.
So I am concerned of what is in store for 2011 and what the expectations of the contract are for 2011.

Obviously we may need to ultimately renegotiate the terms of the contract to better address the delays of 2010.

Let me know how we can best proceed.

Brian

p.s. I guess one other question is: Am I to be reimbursed for travel expenses to Singapore? And where are we staying?

January 6, 2011 at 4:59 PM
From: Mike Kennedy
To: Brian McHenry

Ok – to keep it simple – the additional 40k that has been sent is to be considered part of the 2010 contract.

We are assuming all payments go to license purchases – and will get things on schedule starting with next week in Singapore. After that everything will flow and sales are very strong on this end. We have already sold some simulation licenses and have customers waiting to receive it.

We have to adhere to minimum sales numbers by our contract so you are well protected in that sense. It will all come out great.

The only reason I asked the question is because the contract is kind of cloudy and I just want to be sure you are happy and in agreement.

In June we have to make another annual prepayment so you will be in the chips again.

We are way over our targets for 2010 for our normal software sales and that will continue.

We are paying your Singapore expenses of course.

We are trying to book into the hotel right now and will advise further later today.

Mike

26. In these emails Mr. McHenry and Mr. Kennedy both express concerns that the payment obligations are not clear. On November 19, 2010 Mr. McHenry is saying he only has $80,000 and he expected $160,000. Mr. Kennedy then sends another $40,000. On December 17th Mr. McHenry says thanks for the transfer and asks for "…*a date for the final transfer for 2010*." On January 4, 2011 at 6:29PM Mr. Kennedy says, in part, "…*I can't wrap my head around the payments but I am having Ricci wire you another 40K tomorrow…*" In the January 4th email as well as in the January 6th email Mr. Kennedy is asking for confirmation "…*the advances all go to license pre-purchases and spills over to 201*1." Mr. McHenry responds in his January 6th email, set out above, with several comments I will point out:

"Ultimately, I believe the spirit of the contract is that all advances will go against license pre-purchases however it is a question of when and how."

"I can't recall how overages were to be handled."

"Your email request that I confirm that the advances go against 'license pre-purchase' brings up a number of questions:

a. Do you mean against all funds received to date? Or only against monies wired in 2010?
b. How does this affect any annual minimum 'pre-payments'?
c. Since you did not meet last years minimum of $160,000, what am I to expect for this year's minimum and when?
d. The sporadic nature of the 'pre-payments' this year were very detrimental to my financial bottom line so scheduling of 'pre-payments' for 2011 would be appreciated.

"Obviously we may need to ultimately renegotiate the terms of the contract to better address the delays of 2010."

Mr. Kennedy responds in his email of January 6th at 4:59PM set out above:

"The only reason I asked the question is because the contract is kind of cloudy and I just want to be sure you are happy and in agreement".

27. The money uncertainty continued into March. Mr. McHenry sent an email on March 28, 2011, saying:

"Sorry for the delay in my response to your email.
I was out of town at a charity function so wanted to wait until this week to respond.

I will be reasonable and flexible with our agreement and as such will defer decisions on pricing changes/etc to you.

However I do have a concern with respect to your latest email with respect to our email exchange of Jan 6th 2011.
In the jan 6th 2011 emails I noted my need for continuity in the flow of the income (you may recall last year they came in spurts).
And in response to my email you stated that the next annual amount would be forthcoming June 1, 2011.
I thought we also agreed that concerning credits vs. royalties that all annual advances would go against sales (since last year no McHenry product went out (and not due to me).
However I agreed that I would not expect royalties until sales commissions exceeded accumulated advances.

Your latest email seems to indicate a change in that situation?

For planning purposed I need to know what I am to expect for 2011? Will there be an advance on June 1, 2011 or will I be waiting for monthly royalties?"

28. This email of March 28th was in response to an email from Mr. Kennedy of March 23, 2011 where he talked about ARAS having pre-sold some product and he states:

"At that rate it will not be long before we have gone through our $160,000 credit and we are paying monthly royalties to you."

Further on May 11, 2011 Mr. McHenry is asking about further payments and regarding payments says in his email of May 11th:

> "*I would like some plan of action/schedule for the hew year soon. Last year was tough waiting game and this year is shaping up in a similar fashion. Don't really want to go through it all again."*

Mr. Kennedy responds on the same day:

> *"I will go over the payment issue with Ricci tomorrow but was hoping- based on the estimates from yourself and Chamy to make a payment when this first release is done. However, since all payments are credited and accumulate as credit from one year to the next it likely makes little difference."*

Mr. McHenry requests a payment in June and eventually Mr. Kennedy says he will send $40,000 and it is sent. A month later, on August 9, 2011 Mr. McHenry emails:

> *"Now on another item, I know the advance was to be on release but obviously we haven't done that yet would sure enjoy some more headroom in my bottom line (ie another advance soon)".*

Mr. McHenry seems, in this email, to be accepting the money he gets is dependent on sales. As of August in 2011 he has only received $40,000 in addition to the 2010 payments.

29. On August 16, 2011 Mr. McHenry emails Mr. Kennedy and says:

> *"Sorry I haven't sent a response to the email from 2 Friday's ago but as you can see I've been busy writing! Please have Ricci transfer the $20K (and also send the list of pre-sales) I'll try to send some questions/comments on the situation in the next few days."*

Mr. McHenry is asking for a list of pre-sales which indicates he is aware there have been pre-sales. His knowledge of pre-sales was shown in other emails in evidence. He is also requesting $20,000 "to give more headroom". In the above quote he also indicates he will try to send some questions/comments in the next few days. The only evidence of conversations between this August 16 email and an email of September 15 from Ricci is of discussions regarding programing.

30. On September 15, 2011 Ricci, who is the ARAS office manager, sends an email to Mr. McHenry explaining that ARAS has paid $200,000 to MS and the sales to that date generated royalties of approximately $160,000 which she says means "…we have absorbed a loss of nearly $40,000." Mr. McHenry responds by email dated September 16, 2011 as follows:

> *"I think we have a serious financial issue between ARAS and McHenry Software.*
>
> *It was never my understanding or agreement that you would be selling Collide3d for $3000?!!*
> *Collide 3D is a combination of MMIS and Collide which should go for a combined $8000.*
> *The 'discounted value' I thought you were selling it at was $6000??*
>
> *Selling it at $3000 without any renewal fee is financially unsupportable.*
>
> *At the time you mentioned you might discount the product I stated that a discount was OK as long as the annual minimums were met and that we needed to work out the details in writing.*
> *We need to work out the details now.*
>
> *It is September 2011, and you have only provided $40,000 towards annual minimums this year.*
> *We briefly discussed the $160,000 annual minimum from 2010 and I stated that I might allow you to recover that amount AFTER the annual minimums are met.*
> *The email from Ricci has no relation to our written agreement.*
>
> *Please review the contract as I will over the weekend.*
>
> *As per item 17 of that agreement, "This agreement may be amended only by a written instrument executed by both parties"*
>
> *We need to review and resolve the current serious financial issue and sign an agreement before we can move forward on this project."*

In this response Mr. McHenry complains about two things, first that he did not understand or agree Collide 3D could be sold for $3000 as Ricci said it was being sold stating, "*At the time you mentioned you might discount the product I stated that a discount was OK as long as the annual minimums were met and that we need to work out the details in writing*." Second, he says that there was supposed to be an annual payment.

31. With regard to his comments on discounting Mr. McHenry was confronted on cross examination with the email March 28, 2011, in which he had stated:

> *"I will be reasonable and flexible with our agreement and as such will defer decisions on pricing changes/etc to you"*

Mr. McHenry pointed to the word "will" and said that meant he would be reasonable when they were doing the rewrite of the agreement which had to be done before any price changes could take place. It is clear Mr. Kennedy did not understand it that way. His evidence regarding Mr. McHenry's comment in the email of March 28, 2011 regarding discounting was:

“**Well, we were in agreement with the pricing that I set out. ….. At this point in time, we didn’t have any monetary problems between us that I was aware of. And I guess, you know, what was really important to me going forward was that Brian understanding that we’re going to charge as much as we possibly can for the products. It would never serve our interest to price these products less than what they’re worth. Because he understood that, that’s why he said that he deferred his—well, I don’t know why. That’s what I thought he meant when he deferred his decisions about pricing over to me. He knew that, on the business side, I was going to do the best I could for both of us**.”

32. Mr. Kennedy during his testimony was referred to the email of March 28, 2011 and his response to Mr. McHenry:

Q. And that’s what you say in your email at the top?

A. Yes. I say, trust me; I’m going to charge as much as I can in this niche market.

It is clear that in June of 2011 Mr. McHenry was aware that there was some discounting of the price of the products being done and in his email said: “*I will be reasonable and flexible with our agreement and as such will defer decisions on pricing changes/etc. to you*”. First he is acknowledging that this is different from the agreement and second he is deferring to what Mr. Kennedy decides is the proper price. Mr. Kennedy accepts this proposal and responds “…*I’m going to charge as much as I can in this niche market*.”

33. When Mr. McHenry receives Ricci’s email of September 15, 2011, he responds to it on September 16, 2011 saying: “*At the time you mentioned you might discount the product I stated that the a discount was OK as long as the annual minimums were met and that we needed to work out the details in writing*.” There was no documentary evidence produced that Mr. McHenry said it needed to be covered in writing. Mr. McHenry testified that when he said “…will defer…” he meant when we amend the contract. I do not accept that Mr. McHenry ever said the change had to be in writing and I do not accept the interpretation of “will defer” put forward by Mr. McHenry. Certainly Mr. McHenry never mentioned this subject again for over two months. I find that the parties had an agreement that Mr. Kennedy could discount the price to suit how he saw the market.

THE ISSUES

34. The issues with respect to payment of “advances” and “royalties” for determination before me include:

- Did ARAS breach the Agreement by failing to pay the full amount of the annual prepayment that was due and owing to MS for the second contract year?

- Did ARAS breach the Agreement by failing to report sales and remit to MS 20%of the agreed upon pricing for the MS product sold by ARAS?

- Was the termination of the Agreement by MS wrongful?

Did ARAS breach the Agreement by failing to pay the full amount of the annual prepayment that was due and owing to MS for the second contract year?

35. With respect to the pre-payment issue the parties repeatedly, in their actions and in their conversations, proceeded in a manner inconsistent with what they now say the contract requires. In addition the parties expressed uncertainty about what the contract said and even mentioned that they should attend to rewriting the contract. Examples of this confusion and failure to amend the Agreement are:

    A. In an email dated January 6, 2011, Mr. Kennedy asked Mr. McHenry to confirm that the advances all go to license pre-purchases and spills over to 2011. As part of his reply Mr. McHenry said the question brought up a number of questions for him:

        1. *Do you mean against all funds received to date? Or only against monies wired in 2010?*
        2. *How does this affect any annual minimum 'pre-payments'?*
        3. *Since you did not meet last years minimum of $160,000, what am I to expect for this year's minimum and when?*
        4. *The sporadic nature of the 'pre-payments' this year were very detrimental to my financial bottom line so scheduling of 'pre-payments' for 2011 would be appreciated.*

    These questions show the confusion caused by the delay of a year but were not really addressed by the parties.

    B. Another example of the variation from the Agreement is the way the payments were actually made in 2010 and 2011. In simple terms paragraph 10.2 and 10.3 of the Agreement require that in the first year, in exchange for a product that was anticipated to be ready for sale at least by July 15, 2010, Mr. McHenry's company was to receive a total of $160,000 on or before July 15, 2010. The payments in 2010 to Mr. McHenry's company were in fact made, not on the schedule set out in the Agreement, but at various points throughout 2010 when requested by Mr. McHenry. None of the anticipated milestones in the Agreement were met because the integration could not start. The final payment to get to a total of $160,000 for 2010 was not made until early January of 2011.

Mr. McHenry complained about this but he did not do anything about it. In 2011, not counting the $40,000 paid to him in January that the parties agreed was to be considered to have been paid in 2010, Mr. McHenry was only paid $40,000 as of September of 2011. In August he requested $20,000 saying he could use more “headroom” not because it was due. In spite of this MS argues that under the Agreement ARAS was required to pay a prepayment of $192,000 to MS as at the beginning of 2011. Mr. Kennedy argues that after he paid the $160,000 in January of 2011 he did not even have the start of a product when the Agreement anticipated he would have at least six months of sales by January of 2011. Mr. Kennedy says he did not have an obligation to make further payments. He points to the fact the prepayments were to be recovered from the sale of the product. Mr. Kennedy also complains that under Mr. McHenry’s interpretation Mr. Kennedy would have invested $352,000 in licenses by January of 2011 and not have any product to sell to recoup the investment.

A further confusion is that in response to the questions raised in Mr. McHenry’s email of January 6, 2011 set out above Mr. Kennedy responds “…*In June we have to make another annual pre-payment so you will be in the chips again*”. On May 11, 2011 there is a further exchange of emails where Mr. Kennedy says “…*I was hoping …… to make a payment when the first release is done*.” On August 9, 2011 Mr. McHenry says “…..*I know the advance was to be on release but obviously we haven’t done that yet but would sure enjoy some more headroom in my bottom line (i.e. another advance soon)*.” There was only one pre-payment in 2011 and it was $40,000 paid in June.

The payments were shifting according to what the parties could agree to at any given time. The theory was as soon as they got the product out everything would be good. In the meantime no one wanted to rock the boat.

36. In its submissions MS argues ARAS cannot rely on its own failings. It says the problem arises from the fact ARAS was not ready to start until one year after it was supposed to be ready under the Agreement. It relies on the case of *Atlantic Paper Stock Ltd v St. Anne-Nackawic Pulp and Paper Company Limited* [1976] 1 S.C.R. 580. In that case, as soon as the defendant failed to accept any more secondary fibre in violation of the contract, the plaintiff immediately sued. This case is distinguishable because, when the delay in this case occurred, the parties continued to perform and adjusted the payments as they went. ARAS is not relying on its failings, it is relying on the acceptance and participation in adjustments by MS.

37. There is a written Agreement but on all of evidence I find that that paragraph 10.2 of the Agreement is unclear. The parties were aware of this and they simply went on working with each having their own understanding of the Agreement. While they seemed to understand each was acting on different

assumptions they never brought the issue to a head and rewrote the Agreement.

38. On all of the evidence I find that both parties were working on the premise that ARAS would pay for licenses in advance, and then what ARAS paid for the licenses would be offset by the money received by ARAS for sales of licenses. Beyond that there are conflicts between what the Agreement set out, what the parties testified was the agreement after the one year delay occurred, and what the evidence shows in the documents, particularly the emails.

39. I find that at the start of 2011 the $160,000 for 2010 had been paid. It was paid in installments which were made when Mr. McHenry would request money on the basis that he had been, during 2010, preparing his product for the integration and he had given up other work to concentrate on this project so he needed income. Mr. Kennedy does not dispute Mr. McHenry's evidence that the two had agreed that Mr. McHenry would give up his other source of income so he could focus on this project. However, Mr. Kennedy says he told Mr. McHenry he would have to agree not to do other work that was the same kind of software development; he was not referring to the litigation work. Mr. Kennedy also testified he doubts Mr. McHenry did give up the litigation work. Mr. Kennedy testified he did not believe Mr. Mc Henry had given up his litigation work.

40. The parties started work on integration and in an email on March 28, 2011 Mr. McHenry confirmed the previous conversation saying, "*And in response to my email you stated that the next annual amount would be forthcoming June 1, 2011*." On May 11, 2011 in an email Mr. McHenry is concerned about payment again. In response Mr. Kennedy says, in an email on the same day, "*I will go over the payment issue with Ricci tomorrow but was hoping based on the estimates from yourself and Chamy to make a payment when this first release is done*." A further payment of $40,000 is made in June. Then in his email of August 9, 2010 Mr. McHenry says, "*Now on another item, I know the advance was to be on release but obviously we haven't done that yet but would sure enjoy more headroom in my bottom line (i.e. another advance soon)*."

41. I find that as a result of the delay of a year, the parties were not adhering to the Agreement regarding the prepayments, but were agreeing to new terms as the year progressed. They were also not adhering to the provisions in the Agreement at paragraph 17 or 10.3 regarding amendments to the Agreement being made, "…..only by a written instrument executed by both parties."

42. The parties by their actions, viewed objectively as required in *MacMillan v Kaiser Equipment Ltd*. 2004 BCCA 270, para 44, followed a path of deciding when payments would be made as they went and not enforcing the requirements of paragraph 17 regarding amendments in writing. I find that

their changes were making modifications to the Agreement. As Madam Justice Griffin found in *Hawkeye Power Corporation v Sigma Engineering Ltd.* 2011 BCSC 1578 at page 23, “Not in every case will an inconsistency result in a declaration that there was no contract. For example, the parties may have agreed by their conduct to modify the contract, or waive performance of a term, but may have otherwise continued to rely on the contract.”

43. Further at page 24 Madam Justice Griffin describes how the named plaintiffs “…. conducted themselves …. as though they could modify the APA or waive compliance with its strict terms without the need for the modifications or waiver to be in writing.” She points out that in *Hawkeye* there was, as in this case, a clause which prohibited amendments or modifications to the agreement except if done in writing and signed. She states that the intentions of the parties to modify were clear and the modifications were consistent with the spirit of the agreement. The spirit of the Agreement here, both before and after the modifications, was to integrate the products in such a way that they could be sold with the profits of the sales to be shared. The roles of the parties did not change because of the modifications. Here Mr. McHenry mentioned several times that the Agreement should be amended, always in the context of amending to fit the new arrangements. The situation in this case also similar to *Hawkeye* where the Judge found that in many start-up businesses “after an agreement between friendly parties is entered into, the principals are focused mostly on making the business a success and are somewhat casual about ‘crossing the t’s and dotting the i’s’ of their arrangements” (at page 25).

44. I find that up to September 16, 2011 when the arguments between the parties over payment really started, ARAS had not breached the Agreement by failing to pay the full amount of the annual prepayment. The Agreement had been modified to allow a process on payments being made when requested by Mr. McHenry if they were agreed to by Mr. Kennedy. After September 16, 2011 the parties continued to discuss the issue of the annual payment. They now recognized that they had different expectations and it appears they were trying to figure out how to resolve the problems. In the meantime they continued to be optimistic about the product and its eventual success.

45. On October 16, 2011 Mr. McHenry emailed to Mr. Kennedy saying he is forwarding the final version of the product, i.e. the three parts, collide, MMIS and collide 3D. He states in part that it will “…bring in a lot of orders in the next month…” On November 1, 2011 Mr. Kennedy sends and email in which he says:

> “*Ricci and I met yesterday to try to get things on track so you are already getting some of what you want.*

She is going to send the October and Sept lists today and deposit a large amount in your account. I believe the amount will be approximately 100k. I know you want 200k per year and we are not going to pay that or even consider it.

The mediation folks are very slow in responding. I cannot control that. if you wish to take that over – go ahead.

Don't worry – about working with ARAS in the future. I have already made plans to find alternatives for our other simulation products because I have no idea how to work with you.

We do NOT have MMIS and that is a key milestone for me. If we now had MMIS we could continue and we would pay you larger amounts.

I*f you have some idea on how to settle this – let us know. We are completely out of ideas. And if you think your continual emails with the same complaints are effective in negotiation a working agreement going forward – you are wrong. That type of communication has no place in business negotiations by anyone's standards*."

From this point on all of the evidence shows that the parties simply agreed to disagree on the amount of the payment and how to do the calculation on the set off of revenue against annual payments. After the disagreement in September, they were discussing creating a new schedule of annual payments together with determining how the set off of revenues would be done right up to termination. The 2010 had been paid and accepted and the 2011 was, by the actions of the parties, being paid on the basis of request and agreement to pay. Where they left off in early November was with 2011 annual payments being requested from time to time. I find, as at the letter of termination, there was no annual payment money owing. There was a dispute over when and how much would be paid. In accordance with the previous payments in 2011 the parties need to agree on payments during 2011.

Did ARAS breach the Agreement by failing to report sales and remit to MS 20%of the agreed upon pricing for the MS product sold by ARAS?

46. The 20% amount is considered a royalty under the Agreement. That amount is set out in paragraph 10.3 as "MS will be paid 20% of the license fee paid to Reseller by the Reseller's end user customers for the Software." Section 10.4 sets out a formula regarding the 20%. However, there are problems regarding the interpretation because section 10.4 talks about monthly advances which were not discussed in the other parts of section 10 of the agreement. Also it says "Should the royalty due amount to less than the advance MS will not be required to make any reimbursement to Reseller and any shortfall will carry over as an offset against future royalty payments." Since I have found that the parties have modified the Agreement with respect to advances I believe the intention of this section is no longer workable. I find that the issue of interpretation of section 10.4 is unnecessary given my findings regarding

royalties later in this Award. However, there are still two parts to this issue that need to be resolved: one is the failure to remit and the other is the failure to report the sales monthly.

47. With respect to payment of the license fees, or failure to remit, the parties are in agreement that the intention of the Agreement is that if sales of the product are made and a license fee is received by ARAS then at the end of each year the parties, according to clause 10.2, were to reconcile the sales versus the receipts. Each however, has a different explanation of the way of this would take place.

48. Mr. McHenry testified:

> **Q.** Can I take you, if I might, to tab 21? If you go to the second page; Go to the, I think it's the fourth, fifth line:
>
> "However I agreed that I would not expect royalties until sales commissions exceeded accumulated advances."
>
> You wrote that on March 28th, 2011 didn't you?
>
> **A. Yes. And at that point, there were annual advances, and then royalties were supposed to be reconciled monthly, and it's the difference between advances and royalties. In other words, I wouldn't get my more than the annual advance per year and I wouldn't get any royalties above and beyond that until the royalties exceeded the annual advances for the five years that they were supposed to be given.**
>
> **Q.** I know you're anxious to get a rationale. My question didn't ask for anything like that. My question was did you write that on March 28th, 2011?
>
> **A. Yes.**
>
> **Q.** Thank you.
>
> **THE ARBITRATOR:** Well, I want to understand, there was something at the end which I believe Mr. Lunny started to speak. I thought I heard you say that you would not get royalties until after the sales commissions exceeded the five years of advances?

THE WITNESS:

Yes. In other words, each year there's annual – let's say the first year he sold a million dollars worth, all right, then I would be entitled to royalties for every sale from then on.

But if it took him two or three years to get up to that annual minimum he promised me, at that point I would not expect royalties until that point came.

So, in other words, this was set up so that during our five-year collaboration, and I have two years collaboration of integrating because it's two years to integrate these seven products, that I would get annual minimum to be paid to me, and the royalties were above and beyond those minimums.

They are trying to say that I would have to sit and wait to get any further payment until they sold enough to meet those minimums. And I couldn't continue working. There was just no way. That's not the way partnership was supposed to work.

49. Mr. Kennedy testified:

THE ARBITRATOR: I apologize for interruption Mr. Lunny. If you want to ask the question again or have the reporter read it back.

MR. LUNNY: I can't remember what the question was.
(Record read back).

A. Yes, what happened was we were due to start Integration of McHenry products into ours in early 2010 and we weren't ready, so the project was delayed. We wanted to make sure that our product was really solid before we started to bring anything else into it otherwise we would be sort of – it would be difficult to diagnose any problems that we had with simulation parts, so there was a delay in getting it started.

And so what happened was Mr. McHenry asked that we – it's not his fault that we were putting off the start date, so he asked that we advance him some money during that year. And we did. And I wasn't even really certain if I had to do that by virtue of the contract. It was – I don't think it was covered in the contract, but I wanted to make sure that we were moving forward together and he wasn't upset or that it would hurt our business relationship.
So we advanced monies right up to the time that we actually started doing the Integration. And then at the time that we were going to start the Integration, we decided to have a meeting, a face-to-face, In Singapore. And that happened in January 2011 where Brian McHenry, Paul Heatherington, and Ponnuchamy met for a few days

> **in Singapore to get I understood on what the basic strategy was to move forward.**

When testifying about the events in the fall of 2011 Mr. Kennedy said:

> **Q.** Now, what was your – how did you consider your credit status to be in terms of licenses at this point because of your $200,000 prepayment?
>
> **A. Well, at that point it appeared that we had a substantial credit of licenses. In other words, the $200,000 had bought us a lot of licenses that we had not yet sold. Because all of the money that we paid to McHenry was supposed to be crediting license purchases.**

This is consistent with Mr. Kennedy's emails of January 6, 2011 at 11:58AM and 4:59PM where he says when the parties are discussing the Agreement: "*We are assuming all payments go to license purchase*s…."

50. I find from his emails and testimony that Mr. Kennedy's understanding of the Agreement was that ARAS was to pay $160,000 in the first 6 or 7 months. Then the sales money would come in and at the end of the year the money advanced to that date would be set off against the sales money. If there was an excess then MS would get paid the excess and if there was a shortfall MS would not get a further advance until the "credit" had been paid off. In his testimony Mr. McHenry explained the way he understood the Agreement would work saying that he was to get the $160,000 plus a 20% increase per year for five years. Further he would not expect royalties until the sales revenue caught up to the full amount of the annual payment paid to be paid over five years. Obviously on Mr. McHenry's understanding that would mean after close to one million dollars had been paid. No royalties were due.

51. Regarding the reporting of sales, I find that Mr. McHenry was aware of the "pre-sales" of the product as early as January 6, 2011. In his email of January 6, 2011 Mr. Kennedy says "*We have already sold some simulation licenses and have customers waiting to receive it*." There are other emails through the next 10 months including one dated August 16, 2011 that also mention the pre-sales. On August 16, 2011 Mr. McHenry asks for the list of pre-sales. The problem is that paragraph 10.4 of the Agreement calls for ARAS to prepare a list of licenses sold each month and provide it to MS on the final day of each month. This was not done. However, at this point in time, due to my findings above there are no damages that can be attributed to the failure to report pre-sales. In 2011 Mr. McHenry could not expect royalties since pre-sales did not exceed the annual payment to be paid over five years. Further McHenry never asked about reports until August of 2011 when he raised it in an email. The failure to send the reports is not a material breach and not relevant to Section 7.2.4, or any other part of section 7 of the Agreement.

52. Regarding money owing to MS as a result of the pre-sales, in her email of September 15, 2011 the ARAS office manager responds to Mr. McHenry's

request for a list of pre-sales. She reports, providing a spreadsheet, that the pre-sales are 164 licenses at a list price of $3000 and the 20% owing to MS totals 98,400. Mr. McHenry's counsel, in final argument, advised from his calculations taken from documents provided at the hearing that ultimately there were 247 licenses sold. Mr. McHenry claims that the royalties on the 247 licenses must be calculated on the value set out in the Agreement which he calculates to be $9000 per license. However, as I have already determined, Mr. McHenry deferred to Mr. Kennedy regarding the setting of the price in accordance with Mr. Kennedy's reading of the market. Mr. Kennedy set the price at $3000.

53. Using Mr. McHenry's testimony regarding the number of sales, when the actual value is used, the calculation shows that on that amount of revenue from pre-sales there are no royalties owing. On Mr. Kennedy's understanding the royalties were due when the royalties were over $200,000; which they would not be at the time of termination. On Mr. McHenry's understanding they would not be due because they only became due when close to one million dollars had been paid by way of advances over the five years. As I have already found, Mr. McHenry and Mr. Kennedy had modified the term regarding annual payments and no money was owed for annual payments either.

Termination of the Agreement in December 2011

54. The termination letter is dated December 9, 2011. Paragraph 7.2.4 of the Agreement only requires five days written notice to ARAS as opposed to the 30 days' notice required with 7.1. ARAS says if it had 30 days' notice it would have had a more reasonable time to work things out. ARAS argues the termination notice is wrongful. ARAS says paragraph 7.2.4 can only be used if a party fails to meet "sales minimums". ARAS submits the term is not defined nor is there a corresponding covenant by ARAS to meet any purported sales minimums. MS submits the "sales minimums" can only refer to the annual prepayment obligation set out in section 10.2. I agree with the logic that it must relate to annual payments. However, as I already found, the parties modified the provisions regarding annual payments and there were no annual payments owing. At best, there was the request for another payment, to give him "more headroom", made by Mr. McHenry in his August email. That request was followed by negotiations. Therefore the notice of termination was not validly made under 7.2.4.

55. In the alternative MS argues the notice is valid under section 7.2.5, and specifically points to three factors. First, that ARAS failed to meet its payment obligations. I have already found that ARAS did not fail to meet those obligations. Second, ARAS failed to make annual payments and to remit the royalties owing and also failed to charge contract prices. Again, I found that ARAS did not fail to meet those obligations. Third, ARAS breached 7.2.5 by cancelling the development of the remaining simulation products. This is a

reference to the email of November 1, 2011. In that email Mr. Kennedy does say he has made plans to find alternatives for the production of the next simulation products set out in the Agreement which had not been done yet. However, in the email he goes on to say ARAS does not have from MS the product MMIS, which McHenry had earlier said he had supplied. He states: "*if we now had MMIS we could continue and we would pay you larger amounts*." Mr. Kennedy also says at the end of that email, "*If you have some idea on how to settle this-let us know*. ….*that type of communication has no place in business negotiations by anyone's standards".*

56. While comments regarding "plans to find alternatives" is a strong statement, when it is combined with the next statements it is more a continuation of the negotiation than something that might be considered a breach. I do note that on cross examination Mr. Kennedy agreed that in an email on October 10, 2011 Mr. McHenry said the things that actually make up the MMIS product were not going to be done until version 2 and Mr. Kennedy agreed to the delay. However, in his emails he relies on the lack of validation documents, not the failure to provide MMIS, for his withholding a $100,000 payment.

57. On November 1, 2010, during the negotiations, Mr. Kennedy mentioned in his email he thought he could send $100,000 to MS. He states "*Ricci and I met yesterday to try to get things on track so you are already getting some of what you want*." On November 2, 2011 Mr. Kennedy sent a very strongly worded email mentioning the $100,000 and expressing his frustration that he doesn't have a validation document and finishes with "*I hope they will select a competent mediator so we can get on with this*." On November 6, 2011 there are a series of emails. At 9:47 AM Mr. McHenry states "*…….Please let me know date certain when the transfer it is to occur so we can try to move this process of compromise forward."* At 5:19 PM Mr. Kennedy responds "*We have met and decided to hold your payment until we receive the validation paper which has been promised."* I find, at this point, the parties are negotiating in an attempt to "….move this process of compromise forward". At 10:00 PM Mr. McHenry states "*Sorry Mike. Work has stopped. Let's schedule binding Arbitration. ….A copy of this email is to my attorney."*

58. ARAS took the position throughout the Arbitration that in order to sell the complete product they had to provide a validation document. That document would be from the vendor saying the result the software provides has been compared to actual results in a controlled experiment, a crash test and the software accurately reproduces the accident. This document says to Engineers and Lawyers that the product can be used in court. Mr. Kennedy in his evidence stated "….but it's also key for us as distributors of software if we're selling simulation, the customers will – the first question they will ask, has it been validated?"

59. Mr. McHenry mentioned several times in his emails of 2011 that he was working on the validation. At the Arbitration he took the position that he had said "…..that we would write a paper, validation paper, hopefully within 30 days of the release of the product." He testified that the product could be sold without the validation document. Mr. Raymond McHenry also testified at the hearing via Skype and conference call. Raymond McHenry is a part owner and employed by MS as a technical consultant. He is also the father of Brian McHenry. He testified regarding the importance of the validation papers as follows:

> **Q.** Okay. And the method of vouching to customers and to courts, people who are going to rely on the program, that it is reliable is to provide validation papers; isn't that correct?
>
> **A. That is correct.**
>
> **Q.** Okay. So for ARAS 360 to vouch for the reliability of their product to their customers and to the court, they had to have validation papers; correct?
>
> **A. Correct.**
>
> **Q.** I mean, reliability is the keystone to the product, is it not?
>
> **A. Yes, it is.**
>
> **Q.** The customer wants to know that what they are buying is reliable; correct?
>
> **A. Yes**
>
> **Q.** And not only the customer, the court before whom such program results would be furnished as scientifically accurate evidence, it has to be the assurance of reliability; correct?
>
> **A. Correct.**
>
> **Q.** No validation, no reliability; correct?
>
> **A. Correct.**
>
> **Q.** All right. The only way ARAS 360 or ARAS could avoid criticism of its products was to have validation papers; correct?
>
> **A. Correct. In terms of simulation.**

Mr. Raymond McHenry testified further on Day 1 pages 117-119 as follows:

> **Q.** "…we prepared to repeat 117 and double check the validation runs with the 'official' release version once it was released and prepare a validation

paper within 30 days of the 'official' release date. As mentioned, the 'official' release did not occur until late October 2011."

Do you see that?

A. Yes.

Q. 2011. My apologies. 2011.

A. Correct.

Q. All right. So within 30 days of the official release date would have been the end or late November 2011?

A. Yes.

Q. All right. And you never did produce validation papers by late November 2011, did you?

A. We did not.

Q. And that's because you decided to down tools, for whatever reason, you decided to stop work on producing the validation papers; correct?

A. We decided to stop work on the project.

Q. All right.

60. There was a legitimate need for the validation document. I find the validation document was necessary to make the product "ready for sale" as contemplated by Section 10.2 of the Agreement. Mr. Brian McHenry and Raymond McHenry testified that they had promised the validation documents would be provided within 30 days of the release. On the evidence the release was October 10, 2011. The email regarding needing the validation documents before the payment of $100,000 was November 6, 2011. The 30 days would have been up in a couple of days, yet Mr. McHenry said the work is stopped. The request for the document by Mr. Kennedy before a further payment would be made was part of the negotiation. As of the day before termination Mr. Kennedy did not believe he had a product ready for sale without the validation documents and Mr. McHenry believed he should get a payment before he did further work. The Agreement provisions regarding timing for annual payments as well as the timing for delivery of a "ready for sale" product had been modified by the parties. The new terms were that payments would be when agreed by Mr. McHenry and Mr. Kennedy and the delivery date of the product would be as soon as possible. The failure of the negotiations is something that Section 14 of the Agreement relating to Dispute Resolution was designed to deal with. In fact the parties did discuss using this section of the Agreement to assist with their dispute but before that happened the termination letter was sent out by MS.

61. Counsel for MS says, regardless of section 7, if grounds existed at the time the contract was terminated, it is immaterial that those grounds were not relied on or even known. I do not accept that any of the grounds put forward by MS support a violation as required under section 7.2 of the agreement. Nor do I accept that any “material breach” as required under section 7.1 has occurred.

62. Both parties to this Agreement expected this project would be extremely lucrative. Over the course of almost two years the relationship between the parties deteriorated to the point they were not able to finish the last steps to complete bringing the product to market. In November/December of 2011 the parties reached the point that ARAS wanted the last steps in making the product marketable completed before there was any further payment. The reason for this was ARAS was fearful MS would take the payment then not do any further work to complete the process. MS wanted the payment first because they were afraid the further work would never be paid for. The cause of the loss of this opportunity was the mistrust and intransigence of the parties.

Disposition of MS Claims

63. In its submissions MS claims three categories of damages:

   i. Damages for the license fees (i.e. royalties) due and owing under section 10.3 of the agreement when it was terminated on December 21, 2011, in the amount of $244,600.

   ii. Damages for copyright infringement in the amount of $428,213.

   iii. Punitive Damages in the amount of $100,000.

i. Damages for license fees

64. I hereby order that the claims of MS for damages for license fees (i.e. royalties) in (i) above are dismissed.

ii. Copyright Infringement Claims

65. There are two categories for claims for copyright infringement in (ii) above:

   a. Providing multiple license keys to customers;

   b. Post-termination sales of the product, that is sales made after the December 21, 2011 termination.

66. Regarding multiple license keys, this arises out of evidence that on a number of occasions ARAS provided additional keys to customers who requested that they be allowed to operate the program from more than one computer. There is no doubt that MS held copyrights over the software that it created and was integrated into the ARAS software to create the product. The providing of the extra license key arose where a customer had the ARAS/MS program on his/her desktop and they wanted to also be able to do such things as, work from a more mobile laptop. In those situations it was necessary that the customer contact ARAS and arrange the accommodation. This is required because ARAS used a security system to ensure the customer was not able to circulate the program to third parties. When they sold a program the customer was given a "license key". The program is designed so that when a customer first installs the program the program checks, over the internet, with the ARAS licensing server to validate the license. If found appropriate the licensing server advises the program it can run which allows the customer to start to use the program. If the customer installs the program on a second device it has to have a second license key to activate or the license server won't give permission to run. Mr. PH from ARAS testified that allowing a person to use the program on a second devise is not uncommon in the industry. The evidence shows that PH had been working in the industry for 12 years as a programmer and had been programing for over 30 years.

67. MS claims this allowance to use the program on a second device is a copyright infringement. It relies on the case of *Harmony Consulting Ltd v G.A. Foss Transport Ltd*, 2011 FC 340 (at para 256) where the court says "infringement is doing anything, without consent, that only an owner of the copyright has the right to do according to the *Copyright Act*." The Supreme Court of Canada in *CCH Canadian Ltd v Law Society of Upper Canada*, 2004 SCC 13, spoke on the issue of authorization under the *Copyright Act* saying:

> "Authorization is a question of fact that depends on the circumstances of each particular case and can be inferred from acts that are less than direct and positive including a sufficient degree of indifference."

68. It is clear the provision of the extra key was a business decision made by ARAS to satisfy its customer's expectations. The question is whether or not this decision was made with consent i.e. in accordance with the terms of the Agreement. In section 1.1 of the Agreement it provides "The scope of the Reseller's authority is specifically limited to the MSA-SOFTWARE and the minimum authority necessary to perform the duties accepted pursuant to this Agreement." Sections 3.1 to 3.5 the Agreement make it very clear that ARAS has the complete obligation of selling the product and MS has no responsibility or liability arising out of the process of selling the product. In section 3.6 the Agreement provides:

> "Reseller shall provide all technical support to customers for issues related to the software which includes any MSA-Software or hardware/or enterprise systems provided by Reseller."

69. On the evidence I find it was the responsibility of ARAS to sell the product, maintain the product and manage the client's expectations. It is important to note that the Agreement that ARAS had with purchasers obtaining the second license key made it clear that the product was covered by copyright and the purchaser was not to remove the "copyright notices". It was the intention of ARAS to provide a product to the purchaser and to insure as best they could that the product not be transferred to a third party by the purchaser. They admitted that by providing the key there was risk but they "straddle that balance between prevention of piracy and permitting legitimate customers to use their legally purchased software." In the *CCH* case at page 73 the Supreme Court of Canada said: "As noted a person does not authorize copyright infringement by authorizing the mere use of equipment (such as a photocopier) that could be used to infringe copyright. In fact, courts should presume that a person who authorizes an activity does so, only so far as it is in accordance with the law." I find ARAS had authorization to assist the client to get the program operational for the client even if it meant getting the program duplicated onto a second device. I note the focus of the Agreement is a sale to a customer, I find that allowing the customer to use to machines is not a violation of the agreement. There is no evidence that, in spite of the precautions of ARAS, any customer who received an additional license key passed the product on to third parties. I am prepared to assume that, with the precautions that ARAS took, the customers receiving the benefit would use it "…only in accordance with the law."

70. MS claims, in the alternative, if the providing of license keys does not constitute breach of the *Copyright Act* it triggers payment of the license fees described in section 10.3 of the Agreement. The provision in section 10.3 refers to the "license fee" which was to be paid to MS when the program was sold. I have referred to that payment as a royalty. The Agreement clearly contemplates that MS will receive 20% of what is paid by a customer to the reseller for the program. The Agreement states in section 10.3:

    > "MS will be paid 20% of the license fee paid to Reseller by the Reseller's end user customer for the Software."

    Section 10.3 does not say money must be collected for various things. It only says if money is received a portion must be paid to MS. If ARAS had received money from a customer for the extra license key they would have had to pay 20% of that money to MS. In these cases they did not receive any money for the extra license key. I have already found that, by inference, ARAS had the authority to provide the extra license fee and since they received no money there is nothing due.

71. Another copyright claim relates to sales of the product after the notice of termination. ARAS has agreed it sold product after the purported termination. Since I have found there was no basis upon which the Agreement could be terminated on December 9, 2011, ARAS still had the right to sell the product up to the acceptance of the repudiation by ARAS. I find there is not a breach of copyright from the end of the notice period of December 21, 2010 to February 6, 2012.

72. There is a claim related to sales after ARAS accepted the repudiation of the Agreement by MS on February 6, 2012. In the letter of February 6, 2012 ARAS acknowledged ARAS that as of that date "……*the Agreement is now at an end and no further sales incorporating your client's software will be made*…" In its submissions MS claimed damages for 27 sales that were made between the purported termination and the acceptance of the repudiation but nothing for sales made after the acceptance of the repudiation. If there had been evidence of the number of sales and a specific claim for those sales I would have made an order for payment of the royalty on those sales. MS submits the amount of royalty would have to be based on the royalty that would have been charged had the product been sold legally. I find any royalty would be calculated on the actual selling price of the product.

iii. Claim for Punitive Damages

73. In its claim for punitive damages MS relies on three particulars of conduct which it describes as "outrageous", "highly reprehensible" or conduct that can constitute "callous disregard".

a. Sales After Termination

74. The first relates to ARAS selling Collide long after the Agreement was terminated, in particular the 27 sales after December 21 and before February 6, 2012. I have found that the Agreement had been improperly terminated. In light of that finding that the Agreement was improperly terminated, during that time frame ARAS still had the right to make sales.

b. Violation of the Injunction

75. MS also pointed to the fact that ARAS violated the injunction issued by the U.S. Federal Court and was found to have been in contempt of that court. On May 17, 2012 MS commenced an action in The United States District Court for the Eastern District of North Carolina Western Division, No. 5:12-CV-277-BO. That action was based on the same facts as this Arbitration. On November 1, 2012 the court awarded MS a preliminary injunction against ARAS. The action itself was stayed pending the outcome of this Arbitration. On May 2, 2013 there was a hearing in the District Court regarding an application by MS to enforce the preliminary injunction. The enforcement order was granted and ARAS was required to pay the legal fees of MS in the

amount of $43,870. Then on December 13, 2013 MS made an application to enforce the contempt order contained in the earlier enforcement order. On December 20, 2013 the motion was granted. During the application counsel for MS argued based on his interpretation of the penalty clause in the earlier order the penalty should be $111,000. Counsel for ARAS argued the acts were not continuing offences and the penalty should be $4000. The Judge ordered $4000.

76. MS also asked for its legal fees. The Judge agreed that legal costs could be ordered. However the Judge said:

> "However the maxim 'he who seeks equity must do equity' applies here. This dispute has been acrimonious and lengthy. Arbitration is currently proceeding apace in British Columbia. The parties have been unable to cooperate and resolve relatively simple matters without this Court's involvement. Plaintiff's repeated refusals to work with the defendant and efforts to involve the Court are not to be rewarded nor encouraged. As such, the Court will not award attorney's fees."

77. The records before me demonstrate while ARAS has been found by Judge Terrence W. Boyle to have violated court orders I do not sense the violations can be considered in the categories set out above and cited by the Plaintiff from the case of *Louis Vuitton Malleteier S.A. v 486353 B.C. Ltd*., 2008 BCSC 799. Judge Boyle has a very good handle on the matters and certainly would not allow the actions of the parties before him to become outrageous or highly reprehensible without serious penalty.

c. Bypass Program

78. MS points to the fact ARAS "...is providing customers with a bypass program that allows them to activate the Collide software without leaving any foot print or trace that the software has been activated." I believe the "bypass program" is the same problem that is referred to in Judge Boyle's Order of December 20, 2013 where he refers to "resetting license keys" and states this is a breach of the preliminary injunction. Resetting license keys is a different issue than the multiple license key referred to earlier in this Award. However Judge Boyle goes on to state that ARAS "…has engaged in a good faith effort to stop its violation of the Court's orders." The Judge further states there is no ongoing violation of the courts orders. I find that this evidence does not constitute the kind of behavior that warrants punitive damages.

79. I find it has not been demonstrated that there are sufficient grounds for an award of punitive damages. The claims for punitive damages are dismissed.

80. MS did not put forward any evidence or any argument regarding the claims for Trademark violation. I find those claims have been abandoned and are dismissed.

MS Claim for Injunctive Relief

81. As part of its claims in this Arbitration, MS seeks two forms of Injunctive relief as follows:

A. MS applies for an Injunction pursuant to the *Copyright Act* prohibiting ARAS from selling, distributing or representing it can sell or distribute the MS software in issue in these proceedings. ARAS objects to the granting of an injunction on the basis that MS has not complied with section 39.1(a) of the Act. That section requires that the applicant for an injunction provide evidence that the defendant "…..will likely infringe…. unless enjoined". MS responds that the evidence at the hearing in this matter and the proceedings in front of Judge Boyle are sufficient for injunctive relief. I have before me a letter from counsel for ARAS dated February 6, 2012 stating that the Agreement is ended and no further sales of the product with MS' software will be made. Also, the orders of Judge Boyle make it clear that ARAS was making good faith efforts to end the use of the MS product. The evidence at this hearing is that ARAS has moved on to create its own product and I understand it is focused on moving that product forward. Finally, at this time there is still an outstanding injunction from Judge Boyle prohibiting the very activities that the requested injunction would prohibit. Whether or not Judge Boyle will make his order permanent is yet to be seen. If it is not made permanent that is only further confirmation that there is no need for a permanent order. I find it is not appropriate for me to make an order pursuant to the *Copyright Act* in the nature of an injunction as part of this Award.

B. MS applies for an order that will permanently confirm the order of Judge Boyle. ARAS states in its submissions that I do not have the jurisdiction to enforce an interim order from foreign courts. MS in its reply does not respond to this objection. First I question my jurisdiction to make such an Order. If I am wrong in my belief I do not have jurisdiction, given that I have not found grounds for the issuing an injunction in these proceedings, I see no reason to make Judge Boyle's order permanent in these proceedings. I say this with all due respect to The United States District Court for the Eastern District of North Carolina Western District and Judge Boyle who will take whatever steps he deems appropriate with respect to the matter before him.

ARAS Counterclaim

82. Since I have found the contract was wrongfully terminated I must look at the possible damages to ARAS. In this case damages to ARAS are very difficult to assess. In these circumstances counsel for ARAS submits the test is set out in the cases of *Bradshaw Construction Ltd. v Bank of Nova Scotia*, 1992 CanLII 4038 (BCCA) and *Penvidic v International Nickel* [1976] 1 S.C.R. 267. In these situations *Bradshaw* states:

> "Determining the amount of damages in these circumstances is largely a matter of assessing the strength and weaknesses of various possibilities. It is much like measuring the amount of a past or future loss of income in a personal injury action."

The case of *Penvidic* (at page 279) the court cites the case of *Chaplin v. Hicks* [1911] 2 K.B. 786:

> "Where it is clear that there has been actual loss resulting from the breach of contract which it is difficult to estimate in money, it is for the jury to do their best to estimate, it is not necessary that there should be an absolute measure of damages in each case."

83. The types of damages ARAS has claimed in its submissions are:

    A. The decline in ARAS's revenue after the termination;

    B. The expense of putting together an alternative simulation component;

    C. The loss of sales where an order form is requested by a customer.

84. First I will deal with paragraphs A and B above. To prove their claims under these two heads ARAS relies on its financial statements of ARAS from 2012 and a bundle of Order forms. The financial statements show the decline in revenue and the order forms are intended to show there were sales ready to go. In addition Mr. Kennedy testified that he believes the company would have sold "….200 licenses at $3000 for the simulation and 200 licenses of the HD upgrade at $2000, because the cost to go from ARAS 360 to ARAS HD was a 2000 dollar upgrade." With respect to the order forms they do say there was an order for a product and services at a price. However in the rest of each of the forms relating to payment type, billing information and shipping information are not completed. On the forms there is a slot for "sales rep" or sales person and that information is on the documents, however, there is no further information in evidence. Not even information with respect to the identity of the people whose names are on the documents, let alone any confirmation verifying the validity of the document.

85. All I have is a Schedule "A" to the ARAS submissions that set out a list of amounts of claims for lost sales of various products without any information connecting the amounts to any of the evidence. Mr. Kennedy testified that ARAS had a record of converting 90% of its orders into sales. I find I cannot convert 90% of these forms into sales. I find that the evidence gives me no assistance in measuring those damages. The case law put forward by ARAS states "*Where it is clear that there has been actual loss result in from the breach of contract which is difficult to estimate in money……"* Here I find the evidence of actual loss is not clear. There is no evidence to form a basis for

me to estimate damages. The order forms are incomplete and have only been put in evidence and not identified by the people who prepared some or all of them.

86. Mr. Kennedy's testimony regarding the financial statements says the company ran a deficit but that does not explain the details of the problem. I don't have evidence the loss is solely attributable to the lack of sales of the product in issue or other matters. I have some incomplete order forms and a statement that they convert 90% of orders. I have no evidence of the validity or reliability of these order forms. Assuming that these order forms are the type that would be converted, I have no evidence of the profit margin. There is a significant doubt in my mind as to how many sales there might be and what if any contribution they would made to the company's bottom line. I am sure ARAS was confident they would make money in selling this product but sufficient coherent evidence has not been presented in this Arbitration.

87. Mr. Kennedy was the only person called from ARAS regarding the claim for damages. He testified, under cross examination, at the hearing about his knowledge of the accounting at ARAS:

> **Q.** All right, I'm going to come back to that. So you don't know anything about how the accounting is done at ARAS? Seems to be what you're telling me.
>
> **A. Well, to clarify, I understand the overall big picture of our accounting, but I definitely entrust all the details to Ricci and our accountant Peter Witzerman.**
>
> **Q.** And you never look at these kinds of reports?
>
> **A. No.**
>
> **Q.** All right, so this morning you gave evidence about anticipated sales and projected sales and the number of sales and the prices, and you speculated off into the future. I take it you never looked at any of these kinds of reports then about sales that are being made in order to come up with those numbers?
>
> **A. Well, it's a – the answer is no.**
>
> **Q.** No, you did not look at any of these kinds of reports?
>
> **A. No, I looked at other reports that we have.**
>
> **Q.** All right. So you haven't disclosed any of those reports in this litigation, in this arbitration, you made reference this morning to having a lot of reliable metrics and reports, but you'll agree with me that you haven't provided any of those to us in this arbitration?

A. Well, I'm not sure. I can tell you what reports I relied upon to, when I said metrics, that would allow us to predict into the future how many sales we might possibly be making. That's not accounting. We have a contact management system that we use extensive, extensively at ARAS call Salesforce.

Q. Right. And you haven't provided any Salesforce reports in this arbitration, have you?

A. I don't know. I don't think so; But I'm not sure.

88. I find that the evidence gives me no assistance in measuring those damages. The case law put forward by ARAS states "*Where it is clear that there has been actual loss result in from the breach of contract which is difficult to estimate in money……"* Here I find the evidence of actual loss is not clear. There is no evidence to form a basis for me to even estimate damages.

89. I understand the case law and the practice of setting "future damages" in motor vehicle claims, but even in those cases there has to be a reasonable amount of reliable evidence so that the trier of fact can see a pattern of loss. My second concern is with regard to the suggestion in the submissions of MS where they rely on section 9 of the agreement. That section is a limitation of liability in favor of MS:

> **"**Notwithstanding any other provision in this agreement, or any applicable statuary provisions; MS shall not be liable under any circumstances for any special consequential or incidental damages, including, but not limited to , lost profits or lost savings for loss of use arising directly or indirectly from any breach of this agreement fundamental or otherwise or from any improper act or omissions of employees or agents of MS, and under no circumstances whatsoever shall the liability of MS exceed payments made to MS by reseller for the sales of the MSA-Software."

90. Section 9 has in addition to the limitation a "cap" on damages that limit the amount of damages so they may not "…exceed payments made to MS by Reseller…" I find the amount paid is $200,000. With respect the claims in A and C above ARAS has responded that the clause deals only with "loss of use". I find the claims are barred by the limitation provision in section 9. If they are not barred, I am prepared to assess damages but I am not prepared to speculate. The modicum of evidence needed to assess is not here, I find there are no damages under A and C.

91. With respect to B. regarding damages for development of a simulation tool, MS submits the damages with respect to the claim for wrongful termination were pleaded as arising from defects in the MS products which MS failed or refused to remedy. MS states that now ARAS is claiming these damages are caused by the termination. Mr. Kennedy did testify there was a defect because MMIS was supposed to be integrated and was not integrated into

the product that became the October release. However Mr. Kennedy, in his email of October 10, 2011, expresses frustration with the lack of complete integration of MMIS, he still states "*As it is now we can release and promise an update to cover off the advanced features."* Mr. Hetherington testified that partial MMIS was included. Both Mr. Raymond McHenry and Mr. Brian McHenry testified there was not a defect, MMIS was properly integrated. From the emails I accept that MMIS was not completely integrated at the time of release. However, I find that the state of the MMIS integration was not what caused the damages related to the need for development of a simulation tool. It was the wrongful termination.

92. In its submissions ARAS says the claim is based on the wrongful termination. Can this claim go forward based on the termination? It is clear that, on all the evidence, ARAS found it necessary to try to develop alternate software after the termination. This is not a surprise and is a natural and foreseeable result of the termination. It could not go forward with or without the complete simulation because the product it had released was integrated with McHenry software on which MS had a copyright or copyrights. But again, as evidence, all I have is Mr. McHenry saying this is the money he expended for this purpose. I have no copies of bills from Chamy as a consultant or timesheets from either of them. Nor have I been directed to records of payment. Again I am prepared to assess but not to speculate. There are also the difficulties arising from section 9 of the Agreement. I find there are no measurable damages regarding development of an alternate simulation tool.

ARAS Counterclaim for Defamation

93. In its submission ARAS put forward four statements made on, what I am advised, is a blog of MS. The steps in a defamation action are for the plaintiff to prove: first, that the impugned words were defamatory in the sense that they would tend to lower the plaintiffs reputation in the eyes of a reasonable person; second, that the words in fact referred to the plaintiff; and third that the words were published, meaning they were communicated to at least one person. At that point certain defences, including qualified privilege, are available to the defendant. These defences reflect the courts wish to protect reputation while sustaining the public exchange of information that is vital to modern society.

94. In *Grant v Torstar Corp.*, 2009 SCC 61, the Supreme Court of Canada identified that the defence of qualified privilege has only occasionally been applied in situations of publication to the world. The court decided that a new defence should be formulated with respect to publication to the world and specifically decided to "…leave the defence of qualified privilege intact." The new defence is now referred to as "responsible communication on matters of public interest". The court included the communication by "blogs" in this defence. Further the court acknowledged that to find publication in this context it was sufficient that some segment of the community would have a

genuine interest in receiving information on the subject. The test involves two steps. First, it must be determined that the publication was on a matter of public interest. At his stage the publication must be considered as a whole. Second, it must be decided if the inclusion of the inflammatory statement in the publication was necessary to communication on the matter of public interest.

95. ARAS claims damages as a result of the publication of the following statements on the MS blog:

> "*The problem isn't with the collide simulation. The problem is with the aras360 environment*".
>
> MS argues that words which disparage a person's goods or property are not the subject of defamation. It also submits that the statement is not defamatory as it does not say anything improper or disreputable. I agree with those submissions and find that this statement is not defamatory. This claim is dismissed.
>
> "*You might ask them why they didn't immediately post up the fix for everyone since they've had it for more than six months*."
>
> MS argues that this is not defamatory and in any event, it is subject to qualified privilege. I also note claim of the defence of responsible communication on matters of public interest is available. It is made as part of a blog posting to members of the community of people who are interested in crash simulation tools which includes engineers, police forces, expert witnesses etc.
>
> I find that the claim of defamation in this situation is weak. There already had been a ruling by Judge Boyle in the injunction proceeding that statements being made by ARAS to customers that MS "is legally obliged to update the software" were not accurate. It was not part of the Agreement that MS would have any duty involving the technical support so the statements are a violation of the preliminary injunction. Statements of this kind were causing purchasers of the product to go to MS expecting assistance, something it was never intended MS would have to do. MS needed to advise people of these facts. The community is the people in the crash test business already described. The statement was necessary to communicate on the matter of public interest. The way the message is framed is ill advised but it does get the message across that people should be going to ARAS, not MS, for technical support and that for that particular problem ARAS does have a solution for the purchasers. This claim is dismissed.

"*ARAS was seriously misrepresenting the situation*."

This statement is made in the context of the proceeding before Judge Boyle regarding the injunction. Immediately prior to this statement the Blog indicates that during the proceedings Judge Boyle asked ARAS why they say an injunction would shut them down. ARAS did not have an answer. The Blog then says "*McHenry then stated that ARAS was seriously misrepresenting the situation*." This was a blow by blow report of what went on at the injunction proceedings. It is true that the statement was made and it was made in a legal proceeding. Furthermore, I accept the submissions of MS that ARAS had other products to sell and their accounting available at the time of the termination indicated this statement was true. I find the statements were true and made in the context of reporting on judicial proceedings and as such subject to absolute privilege. This claim is dismissed.

"*ARAS has no comparable product and never had any simulation products prior to working with McHenry Software*."

Mr. Kennedy testified that ARAS had a simulation product. However, the evidence was the product they had was not what they needed for this project. McHenry had a very good simulation product and that was what was needed. At worst the first part of the statement is true and the second part is an error or an overstatement of the situation. During the Arbitration Mr. McHenry testified ARAS did not have a simulation product. I believe the debate was what was good enough to constitute a simulation product. With regard to the defence of responsible communication on matters of public interest, again this posting on the Blog was to "the public". Was it necessary to communicate on the matter of public interest? I find it was a part of the story of the legal dispute and was reporting the legal proceedings before Judge Boyle. Just above this statement it makes reference to the discussions before the court and the briefs. I find the claim is defamatory but subject to the defence of responsible communication on matters of public interest. This claim is dismissed.

96. Mr. McHenry is also alleged to have made comments in email communications with various individuals. I find the statements in these various emails, except paragraph C below, meet the test of being defamatory. The following is my analysis on whether or not various defences are available to MS so that the claims must be dismissed.

    A. "….*Aras is ruining our reputation*"

    The full statement is "*We stopped working with Aras in November 2011. Since then we have only received a few tech support questions which we felt compelled to respond to since ARAS is ruining our* *reputation".* The recipient of the email is Carl Lakowicz who had purchased one of the products and was worried about his investment. One of his questions was when is the next court hearing. MS says the statement is true because by sending customers with technical support questions to MS there is a suggestion is that MS is at fault and is not servicing the customers. Further they say it subject to absolute and qualified privilege because it is part of a judicial proceeding and reasonably related to that proceeding. Mr. Lakowicz in his enquiry advises that he has requested some updated information on the Collide court issue. The question about the issue of ARAS referring customers to MS for technical support has come up in the injunction proceeding and Judge Boyle has specifically found that this practice of referring client to MS for support is a violation of the injunction. I find the statement is true and subject to absolute and qualified privilege and this claim is dismissed.

B. There are allegations of defamation made by ARAS regarding six statements made in a string of emails all dated December 6, 2011.The email conversations are between Mr. McHenry and Mr. Ivan Mancella. These are set out in the particulars as paragraphs f. through k. I will paraphrase some of the alleged defamatory comments.

The string begins with Mr. McHenry indicating he believes Mr. Mancella has entered a partnership with ARAS. He tells Mr. Mancella that MS has a law suit and an injunction against ARAS and he states where Mr. Mancella can get copies of the documents. He goes on to say that Mr. Mancella should be careful he is not marketing the collide program or he could be in violation of the injunction. Mr. McHenry in a subsequent email states that Mr. Mancella should do his due diligence because the injunction could affect the ability of Aras to do business. Then he warns Mr. Mancella that he needs to be careful he does not end up with a "new" ARAS product that has MS copyright material in its software. In a further email he warns that Mr. Mancella that if he or his company sell or distribute a product with MS copyright material Mr. McHenry will do something about it. Mr. Mancella asks it that is a threat and Mr. McHenry replies *"How is it a threat if a merely alert you to the fact that you may unknowingly enable Mike/ARAS to continue to steal my software.'* Mr. McHenry then expresses the concern the partnership with Mr. Mancella may be a way to hide sales. Mr. McHenry then says sorry if it sounded like a threat. He goes on and says "*Dealing with Mike and ARAS sometimes angers me since it is a waste of energy to try to recover what is rightfully mine."* All of this is in the context of Mr. McHenry trying to make sure Mr. Mancella is aware of the court action and in particular the injunction.

In *Martin v Lavigne*, 2011 BCCA 104 at para 33-36, the court discussed the fact that with the defence of qualified privilege there must be reciprocity of duty or interest between the publisher and the recipient of the defamatory remarks. In this exchange there is reciprocity of interest. The recipient here will potentially be dealing with the MS property and may run afoul of the injunction and Mr. McHenry wants to protect his property. I find these comments are subject to the defence of qualified privilege.

Once qualified privilege attaches to these remarks, even if defamatory remarks are made as part of the statement, the privilege attaches unless it can be shown there exists malice. Once there is qualified privilege the court presumes any defamatory words were made in good faith and not defamatory. An exception to this is if the words are not reasonably appropriate in the context of the circumstances existing on the occasion on which the information was given. The privilege can also be defeated if the dominant motive is actual or express malice. See: *Hill v Church of Scientology of Toronto*, [1995] 2 SCR 1130 at pages 1189-1190.

In these statements to Mr. Mancella in the emails there were a few comments that were in addition to the facts of the injunction and or the court action. On one occasion Mr. McHenry adds "*…Mike/ARAS to continue to steal my software.?", "His partnership may be a way to try to hide sales.",*and *"Dealing with Mike and ARAS sometimes angers me since it is a waste of energy to try to recover what is rightfully mine."* I find that these additional statements are reasonably appropriate and do not remove the qualified privilege.

In an attempt to overcome qualified privilege ARAS also raises an allegation of malice. This allegation is raised in response to the claim of qualified privilege by MS. In the *Hill* case the court gives three descriptions of malice: "spite or ill will"/ "any indirect motive or ulterior purpose"/ "the defendant spoke dishonestly". The evidence of malice relied on by ARAS is the fact that MS, rather than using the dispute resolution provisions of Section 14 of the Agreement, went directly to termination just when ARAS was going to be able to make a profit on its investment. Further, MS went to North Carolina and started an action there to obtain an injunction thereby causing ARAS to incur excessive cost. Also, ARAS points out that in his testimony Mr. McHenry did not recant from any of the statements and instead appeared to be smiling and "ready to take on counsel".

There is no doubt that Mr. McHenry took a very aggressive approach to the dispute with ARAS. Instead of using the Section 14 remedies he went straight to termination. He did commence action in North Carolina and after he obtained his injunction he vigorously pursued remedies on two separate occasions. This caused the court to comment "*The Plaintiff's repeated refusals to work with the defendant and efforts to involve the court are not to be rewarded or encouraged*."

It is easy to see an aggressive approach to utilize the legal remedies of the courts as malice. However I have to be careful to look at the other side of the coin as well. It is not appropriate for me to find malice when a claimant is, within its rights, simply aggressively utilizing the court process. There needs to be something more, some abuse of the privilege. It is appropriate for the court to ensure it does not encourage the behavior described here, as was done by the North Carolina court. While I can understand the feelings of ARAS, looking at the whole of the circumstances, I do not find malice in these circumstances. These claims of defamation are dismissed.

C. ARAS alleges that statements made in an email between Mr. McHenry and Mark Johnson were defamatory. The statements are set out in paragraph i. of the particulars as "*I expect you purchased collide because of its association with McHenry. Who now is their simulation expert?"* These statements are made as part of a series of rhetorical questions which are challenging towards ARAS. Mr. McHenry is suggesting the recipient ask the questions of ARAS. However, I find that in the context these two statements are not defamatory and this claim is dismissed.

D. The particulars at paragraphs m. and n. set out statements which were made in emails to Mr. Wesley Vandiver. In these emails, ARAS alleges Mr. McHenry make two defamatory statements: "*I am wondering if ARAS ever reported the sale (that would be interesting)"* and "*I know I probably haven't been paid for the sale (that's why we're in a lawsuit)".*

These statements are made with respect to matters which are the subject of the law suit and the injunction in North Carolina. Mr. McHenry first answered an email enquiry from Mr. Vandiver who wanted assistance from someone knowledgeable about the "Collide" product which was released by ARAS in October of 2011. The reason he is interested is because he is an accident reconstruction expert and he is involved in a trial at the time of his enquiry where the Collide product is being used by the other side. The full context is that Mr, McHenry is asking the questions with the stated purpose of gathering evidence regarding sales not reported to him by ARAS and which he may not have been paid for. In that context the statements would not normally be defamatory. However the way in which they are asked is of concern.

First, is there reciprocity? I find there is reciprocity because of Mr. Vandiver's clear interest in the product and his statement regarding the trial he is in that "*I'll keep you posted*". He also says he teaches accident reconstruction courses and he has an interest in the current products. While he does not express a specific interest in Mr. McHenry's trial he clearly has a general interest in knowing what is going on in his field. Of course Mr. McHenry has an interest in the trial involving the ARAS product. Mr. McHenry is communicating two of the areas that are in issue in the current law suit, reporting sales and payment for sale. He is also communicating that he wants the information to possibly provide information at his trial. Third, he is communicating a suggestion that ARAS is dishonestly not reporting the sale and he may not have been paid.

This is an example of a derogatory statement where there is reciprocity and the defence of qualified privilege applies. Once that defence applies, although there are defamatory statements (here the suggestion in the statements of dishonesty), the defence stands unless there is malice or the information is not reasonably appropriate in the context of the circumstances. As analyzed in paragraph B above there is no malice and the statements are reasonably appropriate. The claims are dismissed.

97. In its summary of the total impact of all of the statements ARAS makes general comments on the meaning of the totality of the statements. ARAS submits that in totality one of the natural meanings is that "*ARAS, its principals and its employees are dishonest*". The statements must not be looked at in totality but on the basis of each occasion they were made. When looked at in that fashion I find the statements are defensible in law.

ARAS Economic Tort Claims

98. The claim for economic torts was raised by ARAS in its final submissions regarding its counterclaim. However, there is no discussion of the basis for the claims. MS point out this lack of explanation in their reply to the counterclaim. MS then went on to deal with their defence to these claims in detail. In the reply of ARAS to the submissions of MS to the Counterclaim, ARAS covered many areas of the dispute but, again provided no meaningful discussion of the basis of the claims. I will deal with the following claims:

i. Injurious Falsehood or Slander of Goods

99. The specific items of falsehood or slander are simply alleged to be contained in the particularized statement of particulars related to paragraph 30 and 31(e) of ARAS' statement of defence and counterclaim. It has been pointed out by MS that there is a fatal flaw in this submission in that special (or actual)

damage is an essential element of this claim: *Clowes v Bell*, [1981] B.C.J. No. 164. The pleading must include the amount of loss and damage suffered and how that amount is made up and calculated. ARAS did not plead special or actual damage. In its submissions it relies on the proposition that I must assess damages as best I can "even if it amounts to guess work." Even if the damages were be held to be general damages or they could be assessed I would not speculate. Just as I found in dealing with the damages in contract, I have such little information in this matter regarding the possibility of ARAS' damages that I do not have any basis on which to make an award.

ii. Interference with Contractual Relations

100. MS points out that the case law requires a person claiming damages under this head to demonstrate three things. First, that they have contracts with third parties. In this case there are contracts with the purchasers of the product, but there is no evidence about what contracts are we dealing with, how many contracts there were, and whether they related to the discussions set out in the particulars. Second, that MS was aware of that contract. There is no evidence of that here. Third, that there was a breach of the contract procured by the other parties wrongful interference. There is no evidence of any breaches or how they were procured. Also again I have the problem of how to assess damages when little or no evidence is available on which to base even "guess work".

101. The claims for economic torts are dismissed.

Summary of Disposition of Claims

102. With respect to the MS claims I hereby Order:

1. The claim that ARAS failed to make annual payments is dismissed.
2. The claim that ARAS failed to make the 20% fee or royalty or license fee is dismissed.
3. I find that the termination of the Agreement was wrongful.
4. The claims for violation of copyright up to February 6, 2012 are dismissed. The claims after February 6, 2012 were not pursued and are dismissed.
5. The claims for trademark violation were not pursued and are dismissed.
6. The applications for injunction relief are dismissed.

103. With respect to the ARAS claims I hereby Order:

1. The claim regarding wrongful termination is granted. However, I find there are no measurable damages. The claims for damage are dismissed.

2. The claim that MS failed to deliver the product is dismissed.

3. I find that MS did fail to deliver the validation document but that was part of the negotiation and therefore not wrongful.

4. The claim for defamation is dismissed.

5. The claim for economic torts is dismissed.

Costs

104. It was agreed Counsel would make submissions as to costs after this Award and I reserve jurisdiction with respect to costs. If the parties cannot agree on costs counsel may apply for directions on those items.

March 26, 2014

J. Gary Fitzpatrick, Q.C., Arbitrator