

IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF NORTH CAROLINA  
WESTERN DIVISION

No. 5:12-cv-277-BO

MCHENRY SOFTWARE, INC., )  
Plaintiff, )  
v. )  
ARAS 360 TECHNOLOGIES, INC., )  
Defendants. )  
\_\_\_\_\_ )

ORDER

This matter is before the Court on plaintiff’s motion for preliminary injunction [DE 3] and defendant’s motion to compel arbitration and to dismiss or stay this case [DE 13]. Plaintiff’s motion for preliminary injunction is GRANTED. Defendant’s motion to compel arbitration is GRANTED and the matter is STAYED in this Court. A hearing on these motions was held in Raleigh, North Carolina on October 3, 2012.

BACKGROUND

The instant dispute is over defendant’s use of source code developed by the plaintiff. Plaintiff McHenry Software, Inc. (McHenry) entered into a Software Licensing and Development Agreement with Defendant ARAS 360 (ARAS) on February 11, 2010. This agreement provided for the integration of McHenry’s proprietary code into ARAS’s “graphical environment” and indicated that McHenry would retain ownership over all software, trademarks, and trade secrets associated with its proprietary code. The agreement also includes a dispute resolution clause that states:

14.3 The parties agree to attempt to resolve all disputes arising out of or in connection with this Agreement, or in respect of any legal relationship associated with it or from it, by mediated negotiation with the assistance of a neutral person appointed by the British Columbia International Commercial Arbitration Center (the "BCICAC") administered under its Commercial Mediation Rules.

14.4 If the dispute cannot be settled within 30 days after the mediator has been appointed, or such other period agreed to in writing by the parties, 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.

Further the agreement provides:

[ARAS 360] acknowledges that the unauthorized use or disclosure of the [Software] or other Confidential Information will give rise to irreparable injury to [McHenry], inadequately compensable in damages. Accordingly, [McHenry] may seek injunctive relief against the breach or threatened breach of the foregoing undertakings, in addition to any other legal remedies which may then be available.

On October 27, 2011, after some delays, McHenry delivered the code, later copyrighted under the registered name "msmac3D," to ARAS for integration and distribution for sale. At some point in late 2011, McHenry determined that ARAS had breached the licensing agreement and, on December 9, 2011, McHenry sent a notice of termination to ARAS. On February 6, 2012, ARAS acknowledged the termination of the agreement. Despite this termination, and subsequent acknowledgment, ARAS continued to market, distribute, and sell products containing McHenry's copyrighted code. Further, ARAS continued to use McHenry's trademarks and name on its website and on marketing materials.

Plaintiffs allege that ARAS's continued use of McHenry's trade secrets, trademarks, and copyright-protected materials infringes on their intellectual property. Examples, of this infringement include the continued sale of software that contains McHenry's proprietary code, the use of McHenry's trademarks and logos on ARAS's website, and the continued referral of

software purchasers to McHenry for ongoing maintenance, support, and troubleshooting services. Because of these and other injuries suffered by the plaintiff, a preliminary injunction has been requested. At the hearing on this matter, defense counsel stated that ARAS may have continued to use some of McHenry's intellectual property after McHenry purported to terminate the licensing agreement in December. However, defense counsel went on to state that as of the date of the hearing, the defendant had ceased any and all use of the plaintiff's intellectual property including the proprietary source code and trademarks. He further conceded that any burden created by the issuance of a preliminary injunction would be slight.

### DISCUSSION

#### I. PLAINTIFF IS ENTITLED TO A PRELIMINARY INJUNCTION.

##### **a. Despite Compelling Arbitration, this Court Has the Authority to Issue a Preliminary Injunction.**

The defendant argues that if this Court grants the motion to compel arbitration it will be precluded from considering the plaintiff's request for a preliminary injunction. Despite ordering the parties to proceed to arbitration, the court may grant injunctive relief "to preserve the status quo pending the arbitration of the parties' dispute if the enjoined conduct would render that process a "hollow formality," meaning that "the arbitral award when rendered could not return the parties substantially to the status quo ante." *See Aggarao v. MOL Ship Management Company LTD.*, 675 F.3d 355, 376 (4th Cir. 2012). This is the case when plaintiff faces an irreparable injury. *See e.g. Disston Co. v. Sandvik*, 750 F.Supp. 745, 749 (W.D.Va. 1990).

Irreparable injury regularly flows from copyright and trademark infringement and misappropriation of trade secrets. *See Christopher Phelps & Assocs., LLC v. Galloway*, 492 F.3d 532, 544 (4th Cir. 2007)(finding that irreparable injury often flows from copyright infringement);

*Lone Star Steakhouse & Saloon, Inc v. Alpha of Virginia, Inc.*, 43 F.3d 922, 938-39 (4th Cir. 1995)(recognizing that irreparable injury regularly flows from trademark infringement; and *Outdoor Lighting Perspectives Franchising, Inc. v. Home Amenities, Inc.*, 2012 WL 137808, at \*2-\*3 (W.D.N.C. Jan 18, 2012)(finding that irreparable harm flows from misappropriation of trade secrets).

Here, plaintiff has made a prima facie case of copyright infringement, trademark infringement and misappropriation of trade secrets. Further, there is some evidence that defendant continues to infringe plaintiff's intellectual property. Because it may take some months for the completion of an arbitration proceeding a preliminary injunction is necessary to protect the plaintiff from irreparable harm. As such, this Court finds a sufficient showing of irreparable harm to render the arbitration a hollow formality unless an injunction is ordered. As such, this court possesses the authority to entertain the plaintiff's motion for preliminary injunction despite ordering this matter to arbitration.

**b. Under the Fourth Circuit's Balancing Approach, Plaintiff is entitled to a preliminary injunction.**

The Fourth Circuit's current standard for the issuance of a preliminary injunction is whether the plaintiff is able to make a clear showing "that [it] is likely to succeed on the merits, that [it] is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in [its] favor, and that an injunction is in the public interest." *The Real Truth About Obama, Inc. V. Fed. Election Comm'n*, 575 F.3d 342, 346 (4th Cir. 2009) (quoting *Winter v. Natural Res. Def. Council, Inc.*, 555 U.S. 7 (2008)), *vacated on other grounds*, 130 S.Ct. 2371 (2010) (memorandum opinion).

As noted above the plaintiff has made a prima facie case for copyright infringement, trademark infringement, and misappropriation of trade secrets and is likely to succeed on the merits of these claims. Further, as is also noted above, irreparable harm is presumed to flow from these types of intellectual property injuries. Both of these factors weigh in favor of granting injunctive relief.

Third, the balance of the equities tips in the plaintiff's favor. The defendant continued to use the plaintiff's intellectual property beyond the purported date of termination by the plaintiff. The defendant now acknowledges that termination. Further, the parties agreed that injunctive relief would be available to the plaintiff if the defendant breached the terms of the licensing agreement. Because the defendant's continued use of the plaintiff's intellectual property, in spite of the termination, was wrongful and because the defendant was aware that such behavior could lead to the issuance of an injunction against it, it is equitable to grant the plaintiff's instant request for a preliminary injunction.

Finally, granting an injunction in this matter is in the public interest because it serves to protect the plaintiff's intellectual property, which forms the basis of his business. It is proper for the Court to grant relief in such an instance because it is necessary to protect proprietary intellectual property. Further, such relief encourages the mutually beneficial exchange of intellectual property between parties who will take comfort in the understanding that their licensing agreements, and subsequent terminations, will be respected and enforced.

Accordingly, this Court grants the plaintiff's motion for preliminary injunction and orders the defendant to refrain from the use, duplication, or transmission of copyright-protected material owned by McHenry; to refrain from using any trademarks, images, or logos owned by McHenry;

to refrain from the use, duplication, or transmission of any McHenry trade secrets; and to refrain from implying any continued association between ARAS and McHenry.

**c. Plaintiff Must Post a Bond as Security for the Injunction.**

“No . . . preliminary injunction shall issue except upon the giving of security by the applicant, in such sum as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined . . .” Fed. R. Civ. Pro. 65 (c). This Court is free to set the bond amount, but is not free to entirely disregard the bond requirement. *Hoechst Diafoil Co. v. Nan Ya Plastics Corp.*, 174 F.3d 411, 421 (4 th Cir. 1999). The obvious purpose underlying Rule 65(c) is to provide a mechanism for the guaranteed reimbursement of injuries suffered by a wrongfully enjoined party. *Id.* at n.3. Therefore, the amount of the bond depends upon the gravity of the potential harm inflicted on the defendant by a wrongfully issued injunction. *Id.* If the risk of harm is remote or non-existent a nominal bond may suffice. *Id.*

Here, the defendant does not argue that it should be allowed to continue using McHenry’s intellectual property. Defendant has stated to the Court that it has already discontinued its use of McHenry’s intellectual property. In light of this concession, the gravity of the potential harm to ARAS is non-existent and, as such, only a nominal bond is warranted in this matter. Accordingly, this Court provides for a bond of \$1.00 (ONE DOLLAR) to secure this preliminary injunction.

**II. ARBITRATION OF THE REMAINING CLAIMS IS PROPER AND THE MATTER SHALL BE STAYED IN THIS COURT.**

**a. Arbitration is Proper**

Defendant seeks to enforce the arbitration provision contained in the parties’ licensing agreement. In considering a motion to compel arbitration, the Court may engage only in “a

limited review to ensure that the dispute is arbitrable.” *Hooters of Am., Inc v. Phillips*, 173 F.3d 933, 938 (4th Cir. 1999). The Supreme Court has articulated a presumption in favor of arbitration in that “[a]n order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage.” *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 650 (1986)(quoting *United Steelworkers of Amer. v. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 582-83 (1960)). This federal policy favoring arbitration is embodied in the Federal Arbitration Act. 9 U.S.C. § 1 et seq.

In addition to the Federal Arbitration Act, the United States adheres to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“New York Convention”).

*Aggarao*, 675 F.3d at 366. Article II of the Convention, provides:

Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.

In recognizing such an agreement under the Convention, the Court should look to four jurisdictional factors: (1) there is a written agreement within the meaning of the Convention; (2) the agreement provides for arbitration within the territory of a Convention signatory; (3) the agreement arises out of a commercial relationship; and (4) either a party to the agreement is not an American citizen or the relationship has a reasonable connection with one or more foreign states. *Aggarao*, 675 F.3d at 366.

Here, all four jurisdictional considerations are satisfied. First, there is a written agreement between the parties in which they agree to submit to arbitration under the domestic commercial

mediation rules of the British Columbia International Commercial Arbitration Centre (“BCICAC”). [DE 1-2]. Second, the agreement provides for the arbitration to take place in “Vancouver, British Columbia, Canada” and Canada is a signatory to the Convention. Third, the arbitration agreement arises out of a larger commercial licensing agreement. Fourth, and finally, defendant ARAS is located in British Columbia, Canada. As such, under the Convention, it is proper for this Court to compel arbitration on those disputes actually encompassed by the arbitration agreement.

Whether a dispute is actually encompassed by an arbitration agreement is evidenced by the factual allegations of the claim and the agreement’s language. In *Cara’s Notions, Inc. v. Hallmark Cards, Inc.*, 140 F.3d 566, 571 (1998), a case cited by the plaintiff, the Fourth Circuit found that where an arbitration agreement’s language is unambiguous the intent of the parties will be determined within the four corners of the document. In that case, the arbitration agreement applied, by its own language, to “any controversy or claim” and “any aspects of the [parties’] relationship.” *Id.* The court found that such breadth of language showed unambiguous intent to apply the arbitration agreement to all conflicts between the parties - even conflicts beyond those relating to the contract currently at issue. *Id.*

Here, plaintiff concedes that its breach of contract claim is subject to arbitration, but disputes the submission of its other claims to an arbitrator. The Court looks to the agreement’s language to determine the parties’ intent. That agreement states, in pertinent part:

14.3 The parties agree to attempt to resolve all disputes arising out of or in connection with this Agreement, or in respect of any legal relationship associated with it or from it, but mediated negotiation . . .

14.4 If the dispute cannot be settled within 30 days . . . the parties agree to submit

*any and all disputes between them*, to final and binding arbitration . . . [emphasis added] [DE 1-2].

This language is similarly broad to the language at issue in *Cara's Notions*. The unambiguous language of the instant arbitration agreement evidences an intent to arbitrate all disputes arising between the parties. The Court disagrees with plaintiff's argument that the termination of the licensing agreement places the intellectual property claims beyond the scope of the arbitration provision. Even if the termination of the licensing agreement precipitated those claims, because the intellectual property claims comprised the subject matter of the underlying agreement, it did not preclude their arbitration. In other words, but for the licensing agreement, the instant copyright, trademark and trade secrets claims would not have arisen, regardless of whether the termination was earlier in time. Plaintiff argues for a rule that would allow all plaintiffs to escape arbitration by simply terminating the underlying agreement before filing suit. Such a rule would obviously cut against the strong federal policy in favor of arbitration. Because the plain language of the agreement indicates an intent to resolve all disputes through arbitration, all of plaintiff's claims must now be submitted to arbitration.

**b. The Remainder of this Matter is Stayed Pending Arbitration.**

This Court recognizes that a tension exists in the Fourth Circuit as to whether a case should be dismissed or stayed after being ordered to arbitration. *See Aggarao*, 675 F.3d at n.18. In *Hooters of America, Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999), the Fourth Circuit found that it is appropriate for the district court to stay a matter when an arbitration agreement covers the matter in dispute. On the other hand, in *Choice Hotels International, Inc. v. BSR Tropicana Resort, Inc.*, 252 F.3d 707 (4th Cir. 2001), the Fourth Circuit found that the district court should

order a dismissal when all of the issues presented are arbitrable.<sup>1</sup>

Here, the Court finds that a stay is appropriate for at least two reasons. First, by this Order the Court has issued a preliminary injunction. A stay is appropriate in order for the Court to monitor that injunction. Second, under the BCICAC rules the arbitrator is given discretion to determine whether certain issues are not encompassed by the arbitration agreement.<sup>2</sup> Given the arbitrator's discretion, it is proper to stay this matter in order to preserve the plaintiff's access to this Court on any matters not subjected to arbitration.

#### CONCLUSION

Accordingly, Plaintiff's motion for preliminary injunction is GRANTED. Defendant's motion to compel arbitration is GRANTED and the matter is STAYED in this Court.

SO ORDERED, this 31 day of October, 2012.

  
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TERRENCE W. BOYLE  
UNITED STATES DISTRICT JUDGE

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<sup>1</sup>In the past, this Court has followed the rule as it is set forth in *Choice Hotels. See Cook v. General Elec. Co. GE Aviation*, 2010 WL 4885115 (E.D.N.C. 2010). However, for the reasons given in support of this Order, that case is distinguishable.

<sup>2</sup>"The arbitration tribunal may rule on its own jurisdiction, including ruling on any objections with respect to the existence or validity of the arbitration agreement." BCICAC Domestic Commercial Arbitration Rules of Procedure, § 20(1).