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Fifth Circuit Undoes \$1.6B Judgment Against IBM

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A three-judge panel of the U.S. Court of Appeals for the Fifth Circuit determined Tuesday that U.S. District Judge Gray H. Miller got it wrong when he handed down a massive \$1.6 billion judgment against International Business Machines for breach and fraud in a lawsuit against Houston-based BMC Software.

The 13-page ruling, authored by Judge Edith H. Jones and joined by Judges Carl E. Stewart and Kyle Duncan, held Judge Miller's liability determination — in the lawsuit where IBM was found to have committed fraud and breached a contract by removing BMC's mainframe products from their largest mutual client, AT&T — “was in error.”

“The district court determined that IBM breached Section 5.4 of the 2015 [outsourcing agreement] as a matter of law by executing AT&T's request to replace BMC's software with IBM software in AT&T's mainframe,” Judge Jones wrote. “According to the court, this ‘non-displacement provision’ unambiguously barred IBM from replacing BMC's software with IBM software in AT&T's mainframe even if AT&T requested IBM to complete this task. Though we, too, find the language of Section 5.4 unambiguous, we hold that ‘other valid business reasons’ under Section 5.4 supported IBM's service in effecting AT&T's switchover, which partially included IBM software.”

Tonja D. DeSloover, IBM's vice president and assistant general counsel for litigation, mergers and acquisitions, issued a statement about the ruling to *The Lawbook*.

“This decision demonstrates that IBM will defend its contractual rights and protect the interest of its clients,” she said. “These are things IBM is committed to and

will continue to do.”

In a ruling issued in May 2022 following a bench trial, Judge Miller found IBM made a “material misrepresentation” that it wouldn't displace BMC's products from AT&T's mainframe systems but did so anyway, entitling BMC to \$1.6 billion in damages. He called out IBM's “routine eschewal of rules” in handing down the massive award that included \$717 million in contractual damages and \$717 million in punitive damages.

“IBM is one of the largest technology companies in the world — and it exploited BMC's justifiable reliance for its own gain, cementing its abdication of good faith and fair dealing in the service of its own self-reliance,” Judge Miller wrote. “IBM's conduct vis-à-vis BMC offends the sense of justice and propriety that the public expects from American businesses.”

In September, Paul D. Clement of Clement & Murphy represented IBM and Jeffrey L. Oldham of Bracewell represented BMC in oral arguments before the court. The meaning of section 5.4 of the contract between the parties was central in much of the court's questioning.

Judge Miller found IBM fraudulently induced BMC into signing a 2015 revision of their outsourcing agreement. Section 5.4 of the deal included a list of mutual customers that used BMC products and barred IBM from replacing those with its own products unless it paid additional licensing fees, which were detailed in section 8.1.

On appeal, IBM argued the “other valid business reasons” language in section 5.4 meant it had the right to act on AT&T's request to swap out the BMC software for IBM's. BMC offered an interpretation of that section that had the effect of “narrowing the ambit of ‘other valid business reasons,’”

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Judge Jones wrote.

“We disagree with BMC’s and the district court’s interpretation of Section 5.4 for several reasons,” Judge Jones wrote. “First, reliance on dictionary definitions of ‘displace’ and ‘discontinue’ does not fully explain the section’s meaning. A holistic reading of the provision better harmonizes the entirety of the provision and accords with other parts of the parties’ contract. Second and third, BMC’s interpretation either renders the descriptor ‘other valid business reasons’ superfluous or arbitrarily and unreasonably cabins it. Fourth, as construed by BMC, Section 5.4 runs a serious risk of being an unenforceable restrictive covenant.”

On appeal, IBM told the court that the damages awarded in this case are among the most in a commercial business dispute

in U.S. history and that the judgment is “deeply flawed” and “riddled with errors.” Because the contract between IBM and BMC bars punitive damages, IBM told the Fifth Circuit the most it can possibly recover in this case is \$5 million.

The Fifth Circuit ruling zeroed out all damages for BMC.

IBM is also represented by Erin E. Murphy, Andrew C. Lawrence and Joseph J. DeMott of Clement & Murphy and Paul Yetter, Constance H. Pfeiffer and Reagan W. Simpson of Yetter Coleman.

BMC is also represented by Warren W. Harris and Walter A. Simons of Bracewell, Sean Gorman and Christopher L. Dodson of White & Case, Jeffrey B. Wall, Morgan L. Ratner and Daniel J. Richardson of Sullivan & Cromwell and Harriet O’Neill of Austin.

The case number is 22-20463.