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Use caution in contracts

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For nearly three decades my work as an attorney in private practice and as an arbitrator has involved a wide range of technology contracts.

Before I worked as an attorney I worked as a computer programmer and as a systems operator. As a programmer, I learned that when I write a program all it takes is one character to be out of place to cause a computer program to fail. While that level of exactitude may not be necessary for drafting or interpreting some contracts, when drafting computer contracts that divide copyright and other intellectual property rights, the contract must accurately define the scope of those rights.

Similarly, when litigating software license agreements it is important to understand the boundaries of the grant of license rights in these agreements before filing a complaint.

As an arbitrator of information technology disputes, I have reviewed contracts drafted by others with my task being to ferret out what the parties intended. This experience has taught me to approach business-critical transactions thoroughly and meticulously. In these business-critical transactions, my client wants to acquire, or deliver, a computer system or a computer program, not a lawsuit.

While there are many cases that speak to the problems that can arise in failed computer system acquisitions or software licensing transaction, a recent case discusses the problems that can arise in the case of a software license grant where the boundaries of the grant of rights are blurry at best.

In *HyperQuest, Inc., v. N'Site Solutions, Inc., and Unitrin Direct Insurance Company* (USCA, CA7, 2011), N'Site Solutions received a nonexclusive license to copyrighted software called "eDoc" from Quivox Systems. The eDoc software is used to process insurance claims. The N'Site license granted N'Site the right to use the eDoc "… software only within its own facilities; the license conferred no rights to modify the software or to sell it to others."

Quivox subsequently sold its assets to Safelite Group Inc., including the copyrights for the eDoc software.

Safelite then entered into a license agreement with HyperQuest Inc. In the HyperQuest license, the parties acknowledged the existence of the N'Site license and agreed that Safelite retained certain rights to the eDoc software, including the right to use and develop software. In addition, the HyperQuest license stated that "… all right, title and interest in and to the eDoc Software (including, but not limited to, all Intellectual Property Rights) will remain the exclusive property of Safelite and all right, title and interest in and to the HQ Modifications shall vest in Safelite upon creation."

The nexus of the dispute concerned a disagreement between N'Site and HyperQuest over the terms of their licenses. In part, HyperQuest was concerned that N'Site had sold the source code to its modified software to Unitrin Direct Insurance Co. and sued both N'Site and Unitrin for copyright infringement of the copyrighted eDoc software.

The district court found that HyperQuest held only a nonexclusive license and thus lacked statutory standing to sue N'Site and Unitrin for copyright infringement. The court dismissed HyperQuest's lawsuit with prejudice and awarded attorney fees and costs to N'Site and Unitrin as the prevailing party.

In affirming the district court's opinion, the appeals court undertook an extensive analysis of the language in the software license agreements in light of the Copyright Act provision that restricts the set of people who are entitled to bring a civil action for copyright infringement to those who qualify as "[t]he legal or beneficial owner of an exclusive right under a copyright … ."

The appeals court explained that "HyperQuest's right to recover for N'Site's alleged infringement therefore hinges on its ability to prove that it was an exclusive licensee of at least one of the divisible rights recognized by the [Copyright] act." And the court stated: "[I]t is the substance of the agreement, not the labels that it uses, that controls our analysis."

In holding that HyperQuest was not an exclusive licensee of the copyright, the appeals court stated "… the problem for HyperQuest is that the boundaries between its rights, those that Safelite retained, and those that N'Site was entitled to exercise, are blurry at best."

To underscore the need for critical analysis in the drafting of software licenses, the appeals court added "…just as the use of the word 'exclusive' here and there in the license is not enough to resolve the question of the nature of HyperQuest's interest, the failure to use any particular word is not dispositive. The decision whether Safelite, as the owner of the copyright, has conveyed clear exclusive rights to HyperQuest is one that can be made only after careful analysis of the agreement between the parties."

The bottom line is that in business-critical transactions the parties and their counsel must carefully consider the language and nuances of the agreement, the technology and the law. And remember that someday someone not involved in the transaction (a judge or arbitrator) may be tasked with reading the agreement to determine the parties' intent and legal rights.