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Blurry Software License Results in Failed Claim and More

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As a computer programmer, I know that if I write a computer program, all it takes is one character (e.g., an alphanumeric character or symbol) to be out of place or incorrect to cause the program to fail. While such level of exactitude may not be necessary for drafting some contracts, when drafting software licenses that divide up certain copyright rights, it is important that the contract accurately and adequately define the scope of those rights.

Likewise, when litigating software license agreements, it is important to understand the boundaries of the grant of license rights in these agreements before filing a claim. This is particularly true when there are allegations of copyright infringement in which the federal copyright statute (17 U.S.C. §101 et seq.) provides for award of attorney fees to the "prevailing party" in some cases.

As an arbitrator with more than 26 years of experience arbitrating information technology transactions disputes, intellectual property disputes and licensing disputes, I have had occasion to review a large number of contracts drafted by others in a variety of situations when it was my task being, in part, to try and ferret out what the parties intended. Although, to date, all of the contracts for large computer system acquisitions that I have personally drafted and negotiated have resulted in my client receiving a computer system that substantially performs in accordance with the contract, and none of these agreements has ever resulted in litigation (though past performance, is of course, no guarantee of future results!), this experience as an arbitrator has taught me to approach each of these business-critical transactions thoroughly and meticulously. In these business-critical transactions, my client wants to acquire, or deliver, a computer system, not a lawsuit.

While there are many cases that speak to the problems that can arise in failed computer system acquisitions or software licensing transactions, a recent U.S. Court of Appeals 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., vs. N'Site Solutions, Inc., and Unitrin Direct Insurance Company, N'Site Solutions, Inc. (N'Site), received a nonexclusive license (the N'Site License) to certain copyrighted software called "eDoc" from a company known as Quivox Systems (Quivox). 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. (Safelite), including the copyrights for the eDoc software.

Safelite subsequently entered into a license agreement with HyperQuest, Inc. (HyperQuest) in which HyperQuest was granted certain rights to the eDoc software (the HyperQuest License). In the HyperQuest License, the parties thereto acknowledge 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 states 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 in the HyperQuest case concerned a dispute between N'Site and HyperQuest over the terms of their respective licenses. In part, HyperQuest was concerned that N'Site had sold the source code to its modified software to Unitrin Direct Insurance Company (Unitrin), 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 district court then dismissed HyperQuest's lawsuit with prejudice and awarded attorneys' fees and costs to N'Site and Unitrin as the "prevailing party."

In affirming the district court's opinion, the Court of Appeals undertakes an extensive analysis of the language in the respective 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 Court of Appeals explains 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 states that "[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 Court of Appeals states "…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." As if to underscore the need for critical analysis in the drafting of software licenses, the Court of Appeals states "…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."

In addressing the issue of the award of attorney fees to the defendants by the district court, the 7th Circuit points out that the district court has discretionary authority under 17 U.S.C. § 505 to grant attorneys' fees in favor of the prevailing party and cites to the United States Supreme Court 1994 decision in Fogerty v. Fantasy, Inc.. Finding that the district court did not abuse its authority, the Court of Appeals affirmed the award of attorneys' fees.

The bottom line is that in both business-critical transactions (e.g., the "bet your company" technology acquisition), as well as in other significant technology transactions, and before filing a claim for copyright infringement, the contracting parties and their counsel must carefully consider the language and nuances of the agreement, the technology and the applicable law. And, remember that someday someone not involved in the transaction (i.e., a judge or arbitrator) may be tasked with reading the agreement to determine the parties' intent and the legal rights thereunder.