

TOTAL ASSET MANAGEMENT

Software Licensing Law Your Rights and Responsibilities

A White Paper by:

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ABSTRACT

Computers, and the programs we run on them, are an integral part of our lives and essential to our work. It is easy to lose sight of the fact that they are a relatively recent addition to the workplace and that the law governing their use is still emerging. It behooves every company to stay abreast of the law in this area and be aware of both your rights and responsibilities with respect to your software assets. The software publishers have aligned into a formidable force and aggressively pursue their rights and the prosecution of any individuals or businesses who violate those rights, which translates into considerable fines, lost work time, and possible imprisonment for anyone who either willfully or inadvertently commits software piracy.

SOFTWARE LICENSE LAW HISTORY

At the genesis of the computer industry, software was not sold separately. Rather, hardware and software were bundled together and were distributed, priced and sold as a single unit. In 1969, IBM (the leading supplier of hardware/software systems at the time) decided to sell its hardware and software separately, and it is this unbundling that is credited as the origin of the software industry as we know it today. Computer Contracts, § 8.01 (Matthew Bender & Co. 2006). The advent of personal computers (PCs) in the 1980s again shifted the landscape, in that software sales were catapulted to a whole new level, but the licensing practice - premised on the traditional one user, one copy, one computer model of software sales - remained unchanged.

A "license" is an agreement that grants to the licensee enumerated rights to use specified technology, subject to the terms and conditions of the agreement. The software industry began using copyright protection for its software licenses after enactment of the Computer Software Copyright Act of 1980. Historically, the purpose of "licensing" computer software was to provide as much protection as possible against copying in an uncertain legal arena. In 2001, the Third Circuit concluded that the use of licensing to characterize the commercial transaction of a sale of computer software had become "largely anachronistic." *Step-Saver Data Systems, Inc. v. Wise Telecommunications*, 171 F.Supp.2d (C.D. Cal. 2001). But it is clearly advantageous to the computer industry to continue its practice of licensing, rather than selling, its software to end users. As was explained in the case of *Adobe Systems Inc. v. One Stop Micro*, "[s]oftware companies license because they need the control that licensing affords. The rate of change of technology is orders of magnitude greater than the ability of intellectual property laws to keep up. The industry must be able to license its products in order [to] create and protect innovation.,

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Inc., 84 F. Supp.2d 1086 (N.D. Cal. 2000). In addition, as pointed out by the authors of a comprehensive textbook on Computer Contracts, “the economic benefits of licensing are very favorable to the industry. Licensing permits the vendor to restrict the end user's right to use the software it has paid for beyond the limits proscribed for sales of copyrighted works by the Copyright Act, enabling the vendor to: make multiple “sales” to the same “buyer” of a copyrighted product that normally could only be sold once to a buyer, and prevent the licensee of a copy of a computer program of disposing of the copy under the first sale doctrine of the Copyright Act. One example suffices--an employee of a company that licenses site-specific software would not be permitted under the license to use the software at home for business purposes or to travel with the software. The employer would have to license additional copies, or pay additional license fees for the non-situs uses that are beyond the scope of the license.” Computer Contracts, § 8.01 (Matthew Bender & Co. 2006).

CURRENT SOFTWARE LICENSE LAW

Software licenses fall under both contract law and copyright law. The intersection of these two bodies of law is an emerging area of law and is not yet well developed. The general principle that has emerged thus far when interpreting software licenses is that the courts will apply principles of contract law, which vary slightly from state to state, except when federal intellectual property law and policies override the basic contract law. Computer Contracts, § 8.02 (Matthew Bender & Co. 2006).

Contract law first comes into play in that the license is not enforceable unless there has been assent by the licensee to the terms and conditions of the vendor’s license. This has opened up a new area of litigation and need for judicial interpretation of what is meant by assent since most software licenses these days are not signed by both parties. Shrinkwrap and clickwrap licenses (those contained in the small print on the shrinkwrap covering of a software program or those requiring the licensee to click his assent when purchasing the software online) are called contracts of adhesion.

While it is still too early to state that a consensus has emerged among the courts’ decisions regarding these licenses/contracts of adhesion, they have generally been found to be enforceable under contract law provided the contract does not include surprising terms and the purchaser manifests assent through conduct. Restatement (Second) of Contracts, § 211. Assent through conduct essentially translates into something other than a signature on a written contract constituting one’s assent to the terms of the contract. An example of such conduct is the act of clicking “I accept” when presented with the terms of a license when purchasing software online or peeling off the shrinkwrap on a software package as acceptance of the terms for using the software inside. In *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996), the first case to consider the enforceability of shrinkwrap licenses in a mass market transaction, the Seventh Circuit ruled that the consumer had ample opportunity to read the license encased in the shrinkwrap that restricted the use of the software program in question to non-commercial purposes and was bound by its terms.

Clickwrap licenses are just beginning to be examined by the courts on a case by case basis. In *Spekt v. Netscape Comm. Corp. and America Online, Inc.*, 150 F. Supp.2d 585 (S.D.N.Y. 2001), the court rejected the argument that the mere act of downloading constitutes assent to a contract and that the wording (“Please review and agree to the terms...”) read more as an invitation than a

condition. Courts will likely examine the instructional language on the screen/click license to determine whether the Internet user has received adequate notice that a contract is being formed. Computer Contracts, § 8.02 (Matthew Bender & Co. 2006).

Since a software license is not only a contract between the software publisher and the licensee but also an intellectual property license, software licenses can also be adjudicated under federal intellectual property law. Under the Supremacy Clause of the United States Constitution, federal law preempts state law and federal policies override inconsistent contract provisions. Generally, “a copyright owner who grants a nonexclusive license to use his copyrighted work waives his right to sue the licensee for copyright infringement and can sue only for a breach of contract.” Computer Contracts, § 8.02 (Matthew Bender & Co. 2006). Courts found that “[i]f, however, a license is limited in scope and the licensee acts outside the scope, the licensor can bring an action for copyright infringement.” See *Sun Microsystems, Inc. v. Microsoft Corp.*, 188 F.3d 1115, 1121 (9th Cir. 1999). In this case, Microsoft was the licensee rather than the licensor. Sun Microsystems entered into a licensing agreement that allowed Microsoft to use, modify and adapt Java Technology, which Microsoft used to develop MS Internet Explorer 4.0 and other software products. Sun Microsystems claimed that Microsoft failed to pass Sun’s compatibility tests and therefore failed to comply with the conditions of the license. In most instances, however, the licensees at risk of violating the terms of the license and thereby subjecting themselves to copyright infringement suits will be the companies and individual consumers buying Microsoft’s products, or those of other software publishers who are well advised of their rights under the law and word their licenses accordingly. If, for instance, you legally purchase 48 copies of a software program for your company but the software is installed on fifty computers (even if two of those computers are laptops used at home by two of the individuals covered in the initial installation of the 48 programs), you have violated the terms of the license. The unauthorized duplication of software constitutes copyright infringement regardless of whether it is done for sale, for free distribution, or under a misguided understanding that such duplication was permitted under the terms of the license.

THE COPYRIGHT LAW

All software is automatically protected by federal copyright law from the moment of its creation. The federal copyright law that governs these licenses applies equally to an individual and a large corporation and to a product costing \$50 and one costing thousands. The Copyright Act, Title 17, United States Code, not only grants the software publishers exclusive rights to reproduce the copyrighted work but also sets forth several penalties for anyone who infringes on those rights.

The bottom line is that those who purchase a license for a copy of software do not have the right to make additional copies without the permission of the copyright owner (in most cases the copyright owner is synonymous with the software publisher) except when it is necessary to (i) copy the software onto a single computer in order to use the software; (ii) make a backup copy for “archival purposes only,” which are specifically provided in the Copyright Act and (iii) copy the software during activation of the computer in order to repair the computer. 17 U.S.C. § 117. The only exception is when the license accompanying the software allows for additional copies to be made.

The Copyright Act gives the copyright owners the “exclusive right” to “reproduce the copyrighted work” and to “distribute copies...of the copyrighted work.” 17 U.S.C. § 106. The

Act further states that “[a]nyone who violates any of the exclusive rights of the copyright owner” is guilty of an infringement of the copyright. 17 U.S.C. § 501. Section 504 of the Act sets forth the myriad penalties for such an infringement. In this regard, Section 504 stipulates that “an infringer of copyright is liable for either (1) the copyright owner’s actual damages and any additional profits of the infringer, as provided by subsection (b); or (2) statutory damages, as provided by subsection (c). 17 U.S.C. § 504(a).

The legislators who drafted the Copyright Act discussed the punishments for violations of the Act at length. As is made clear in the historical language accompanying the bill, they allowed for both actual damages (those suffered by the licensor as a result of the copyright infringement) and the infringer’s profits because “section 504 (b) recognizes the different purposes served by awards of damages and profits. Damages are awarded to compensate the copyright owner for losses from the infringement, and profits are awarded to prevent the infringer from unfairly benefiting from a wrongful act. Where the defendant’s profits are nothing more than a measure of the damages suffered by the copyright owner, it would be inappropriate to award damages and profits cumulatively, since in effect they amount to the same thing. However, in cases where the copyright owner has suffered damages not reflected in the infringer’s profits, or where there have been profits attributable to the copyrighted work but not used as a measure of damages, subsection (b) authorizes the award of both.” The language of the subsection makes clear that only those profits “attributable to the infringement” are recoverable; where some of the defendant’s profits result from the infringement and other profits are caused by different factors, it will be necessary for the court to make an apportionment. However, the burden of proof is on the defendant in these cases; in establishing profits the plaintiff need prove only “the infringer’s gross revenue,” and the defendant must prove not only “his or her deductible expenses” but also “the element of profit attributable to factors other than the copyrighted work.” *House Report No. 90-1476*, Historical and Revision Notes.

How does this alarming statutory language play out in the real world? The first important conclusion a company can draw from both the text of the Copyright Act itself and the legislative intent behind it is that the law favors the licensor. If you are found to have violated the terms of the license for the software at issue, the presumption will be that you have illegally profited from that unauthorized use and the burden will be on you to prove that you didn’t or to prove that the profits are not what the licensor claims that they are. If your company produces 600 widgets per hour using a software program that creates the inventory spreadsheets for your widget sales and the software you are using was in violation of the terms of its license (in that it was installed on too many computers or used by unauthorized users/individuals or used beyond the terms of the initial license without a renewal), then the software publisher can seek, as part of the damages to which it is entitled under 17 U.S.C. §504, your widget sale profits during the entire term of the infringement. You can try to establish that other products and services played a role in your widget sale profits and make a case for such costs to be offset from your recoverable profits, but the burden will be on you to do so.

The statutory damages are as follows:

- (1) Except as provided by clause (2) of this subsection, the copyright owner may elect, at any time before final judgment is rendered, to recover, instead of actual damages and profits, an award of statutory damages for all infringements involved in the action, with respect to any one work, for which any one infringer is liable individually, or for which any two

or more infringers are liable jointly and severally, in a sum of not less than \$500 or more than \$20,000 as the court considers just. For the purposes of this subsection, all the parts of a compilation or derivative work constitute one work.

[Note: These statutory damages may not exceed \$20,000 per infringement, meaning that the unauthorized use of the software – even if it is on 200 unauthorized computers – may not exceed \$20,000. However, pursuing these statutory damages rather than the actual damages and profits allowed for in § 504 (a) are at the discretion of the licensor.]

- (2) In a case where the copyright owner sustains the burden of proving, and the court finds, that infringement was committed willfully, the court in its discretion may increase the award of statutory damages to a sum of not more than \$100,000. In a case where the infringer sustains the burden of proving, and the court finds, that such infringer was not aware and had no reason to believe that his or her acts constituted an infringement of copyright, the court in its discretion may reduce the award of statutory damages to a sum of not less than \$200. The court shall remit statutory damages in any case where an infringer believed and had reasonable grounds for believing that his or her use of the copyrighted work was a fair use under section 107.

[Note: All software is automatically protected by federal copyright law from the moment of its creation. Any violations of the terms of the license agreement also constitute infringements of the copyright.]

17 U.S.C. § 504(c).

The Act also sets out what constitutes a criminal infringement of a copyright in Section 506. While allowing for the fact that “evidence of reproduction or distribution of a copyrighted work, by itself, shall not be sufficient to establish willful infringement,” the Act defines willful infringement as anyone who does so “for purposes of commercial advantage or private financial gain,” or “by the reproduction or distribution, including by electronic means, during any 180-day period, of 1 or more copies or phonorecords of 1 or more copyrighted works, which have a total retail value of more than \$1000.” 17 U.S.C. § 506.

Criminal infringement of a copyright, stemming from any infringement that meets the above definition of “willfull,” is subject to the penalties set forth in Section 2318 of the United States Criminal Code. These penalties are in addition to any other penalties stemming from other sections of the Act. 18 U.S.C. § 2319(a). If the willful infringement is not for financial gain but rather a knowing violation of the license as set forth above, the infringer is subject to the following criminal penalties as provided for in the statute:

- (1) shall be imprisoned not more than 3 years, or fined in the amount set forth in this title, or both, if the offense consists of the reproduction or distribution of 10 or more copies or phonorecords of 1 or more copyrighted works, which have a total retail value of \$2,500 or more;
- (2) shall be imprisoned not more than 6 years, or fined in the amount set forth in this title, or both, if the offense is a second or subsequent offense under paragraph (1); and
- (3) shall be imprisoned not more than 1 year, or fined in the amount set forth in this title, or both, if the offense consists of the reproduction or distribution of 1 or more copies or

phonorecords of 1 or more copyrighted works, which have a total retail value of more than \$1,000. 18 U.S.C. § 2319(c).

While those serving jail terms for software piracy thus far are individuals who were found guilty of the unlawful manufacture and widespread distribution of pirated software, the criminal sanctions could be brought against anyone who violates the statute willfully. As defined above, such willful violations do not need to be proactive, revenue-producing criminal acts. Criminal sanctions could apply to a company executive who allowed, either explicitly or simply by virtue of having it occur under his or her leadership, the piracy of software exceeding \$1000.

INFRINGEMENT CONSEQUENCES

The ease of copying software makes the software industry uniquely vulnerable to theft. A 2004 study commissioned by the Business Software Alliance (BSA) found that 23 percent of business software applications installed on PCs in North America were pirated and this piracy resulted in a loss of \$7.2 billion. (<http://www.siaa.com>) The software industry and its policing trade associations take this theft extremely seriously and vigorously pursue cases of software piracy.

In the workplace, software piracy is often referred to as “softlifting.” This play on words is misleading because companies and individuals who would never dream of shoplifting an item from a retail store could easily – either willfully or with total ignorance – commit softlifting. Workplace softlifting is characterized by two common activities: extra copies of software are made for employees to take home and extra copies are made for the office. Both situations result in the same actionable violation; namely, that a greater number of computers are running copies of the software than were originally licensed.

It is first of all important to note that the penalties for under-licensing are the same as those for software piracy. Both civil and criminal penalties can be assessed for each violation. In the United States, the maximum civil penalties for copyright infringement amount to \$150,000 in statutory damages for each work harmed. It is easy to do the math and see that this sum, when multiplied by the number of violations, can prove onerous for even the largest, most profitable companies. In addition, if the violations are considered willful (as defined by the Copyright Act, above), the infringer could be fined up to \$250,000 and face a jail term of up to five years. This amount stems from a general criminal code provision, not specific to copyrights, which states a person found guilty of a felony may be fined “not more than \$250,000.” 18 U.S.C. § 3571.

Lest you think that possible imprisonment is simply written into the statute to scare you but that in actuality no one is sent to prison for software piracy, think again. In its 2005 Year In Review publication for its anti-piracy efforts, the Software and Information Industry Association (SIIA) points to several examples of software “pirates” who were sentenced to jail terms and substantial fines. The SIIA also notes that the largest number of software titles pirated are those most often used by businesses, such as anti-virus, firewalls, word processing, office suites, etc. (<http://www.siaa.com>)

Trade groups such as the BSA and the SIIA, the two major anti-piracy organizations, or the software publisher itself can take legal action when a company is either reported to be using pirated software or when a company chooses not to cooperate when contacted about copyright infringement concerns. If contacted, you must submit to a full software audit. The results of this

audit are then compared to the products you have licensed. Illegal software is destroyed and replaced, and the offending organization pays a fine based on what copyright law allows. In addition to paying a fine per title, organizations can be prosecuted criminally for software piracy. (“Software Compliance,” www.siaa.com.)

PRACTICAL PRECAUTIONS

Copyright law does not require the person committing the violation, or responsible for the violation, be aware that his or her actions are in violation of the law. The absence of knowledge or even intent does not excuse the violation and is not a defense in a copyright infringement law suit. SIIA also cautions that “[c]ompanies must be continually mindful of the possibility of piracy. If even one employee is convicted of software theft, company officials can be held legally responsible and prosecuted accordingly.” (Software Compliance, www.siaa.com). It is therefore in every company’s interest to increase awareness and compliance so that inadvertent violations do not result in copyright infringement penalties.

It is essential to keep and maintain comprehensive and accurate record keeping. Even if every software program you are using was legitimately purchased, without proof, you are in the same legal trouble as someone who pirated the software. You must also understand the terms of your various licenses, which can be very complex. For instance, you must determine whether the license for the software you have purchased allows for concurrent or non concurrent licensing (whether you need one license per computer or one per use of the software in question); and whether or not the license is transferable (if it can be transferred from one computer to another). The terms and conditions will be reflected in the software’s purchase price; the more lenient the terms, the higher the price. A site license with unlimited users will have the highest cost, whereas per-seat licenses will be the cheapest.

As Hewlett-Packard puts it in its own cautionary literature, “[y]our license with HP provides permission for you to use the software within certain restrictions. For example, some licenses permit use of the software on only a single system within a certain classification, eg., a Workgroup system. Others permit use by a specified number of concurrent uses. All licenses restrict copying to the licensed systems as well as for backup. To fully understand your rights you should read the terms of your license agreement carefully.” *HP Policy: Proof of Software License*, www.hp.com.

Many companies and organizations have wisely opted to be proactive in addressing software ethics. This makes good business sense since the entire company can be held liable for one employee’s failure to comply. The University of North Dakota, for example, lists the following “General Software Ethics,” in its university standards of conduct.

Tips to keep pirated software off your machines:

1. If you don’t have a license for the product – don’t install it.
2. For shareware software – either buy the license or uninstall it when the trial period is over. Just leaving shareware products on your machine after trial period expirations is considered pirated software. If it doesn’t work – get rid of it.
3. If you have annually renewable software on your machine but have not renewed it “because it still works,” you need to renew it or remove it. It’s kind of like driving with

- an expired driver's license. Law enforcement officials tend to frown on that, as do software companies. The penalties are less for the driver's license infringement...
4. If your department is ever audited, you will need to have proof of purchase for each copy of a software product that you have installed. Having the CD is not proof of purchase. Your receipt (paid invoice, cash register, receipt, etc.) is your proof of purchase. (UND 2004).

Hewlett-Packard offers the following advice with respect to ensuring that you can prove that you purchased software from them. "You will receive a Proof of License document for each of your HP license purchases. For signed licenses, these are either a License Certificate or License PAK (Product Authorization Key). For shrinkwrap licenses you will receive a License Agreement. PATHWORKS is an exception. It is provided under shrinkwrap terms, however, the proof of license is a License Certificate/PAK. You should make sure that your Proof of License is an original and not a photocopy. Make sure that you store your license documents in a safe place." *HP Policy: Proof of Software License, www.hp.com.*

Another option that gets around the cumbersome rule of one software package/license per computer is for businesses to enter into special site license or concurrent use agreements with publishers. With a site license, the user company agrees to pay a certain amount for a specific number of copies they will distribute on site. A concurrent license permits a specified number of users to access the software at any given time, but prohibits the number of users to exceed the number of licenses the business acquired. The program tracks the number of simultaneous users. As SIIA puts it in their publication, *Software Use and the Law*, "[b]y buying the correct number of programs or the right type of license, a company removes the incentive for employees to make unauthorized copies. Following the rules will pay off in the long run, because a firm that illegally duplicates software exposes itself to tremendous liability."

CONCLUSION

The copyright law governing the use of software is very straightforward. While the inequity of the current approach is being battled in the courts and the legislature, the bottom line in the interim is that it is illegal to copy a piece of software for any reason other than as a back up or for maintenance or repair unless expressly permitted by the copyright holder. It is illegal to use that software on more than one computer or to make or distribute copies of that software for any other purpose. Anything deviating from these delineated uses constitutes software piracy and the perpetrator will face not only a civil suit for damages and other relief, but criminal liability as well, including substantial fines and possible jail time.

About the Author

Katya Lezin is a graduate of Brown University (BA in Psychology) and Georgetown University Law Center (JD and LLM in Advocacy). She is the published author of a nonfiction book on the death penalty (FINDING LIFE ON DEATH ROW by Northeastern University Press) and several law review articles.

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