

DoD ESI White Paper

Commercial Perspective on Software Intellectual Property Ownership Rights

A Commercial Perspective on Intellectual Property
Ownership Methods Negotiating Guidance for
Commercial, Derivative, and Custom Software
April 19, 2016



About DoD ESI

The DoD ESI was formed in 1998 by Chief Information Officers at the DoD. To save time and money on commercial software, a joint team of experts was formed to consolidate requirements and negotiate with commercial software companies, resulting in a unified contracting and vendor management strategy across the entire department. Today, DoD ESI's mission extends across the entire commercial IT life-cycle to include IT hardware products and services. DoD ESI has established DoD-wide agreements for thousands of products and services.

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Background

The DoD Enterprise Software Initiative (DoD ESI) instructor team has often been asked what rights the Government has to commercial software source code, the derivative works of commercial software, or custom-built software. Often, this question is raised in ESI's class about Software License Agreement best practices, especially when ESI covers intellectual property (IP) and derivative works of IP.

This is a complex question to answer when attempting to apply the regulations contained in FAR and DFARS related to Data Rights, technical data and computer software. We will leave that analysis to Government lawyers and other Government specific IP experts.

This paper will share the commercial buyer's perspective to answer the question of who should own the intellectual property (IP) rights to commercial software, derivative works in a commercial software application, and custom developed software.

Why is this Important?

It is important to accurately define the owner of software IP because that ownership carries with it a broad array of powerful rights. Chief among them is the right to protect the IP from unauthorized use, copying, or distribution.

The commercial mechanism most often used by IP owners to assert IP rights, to grant rights to use the IP, and to monetize the value of the IP is a software license agreement, often called an End User License Agreement (EULA). Broadly speaking, the EULA

defines who can use the software and how it can be used, including whether permission is granted to create derivative works of the IP and, if so, who owns those derivative works. The license fee is the price charged by the IP owner for granting these rights.

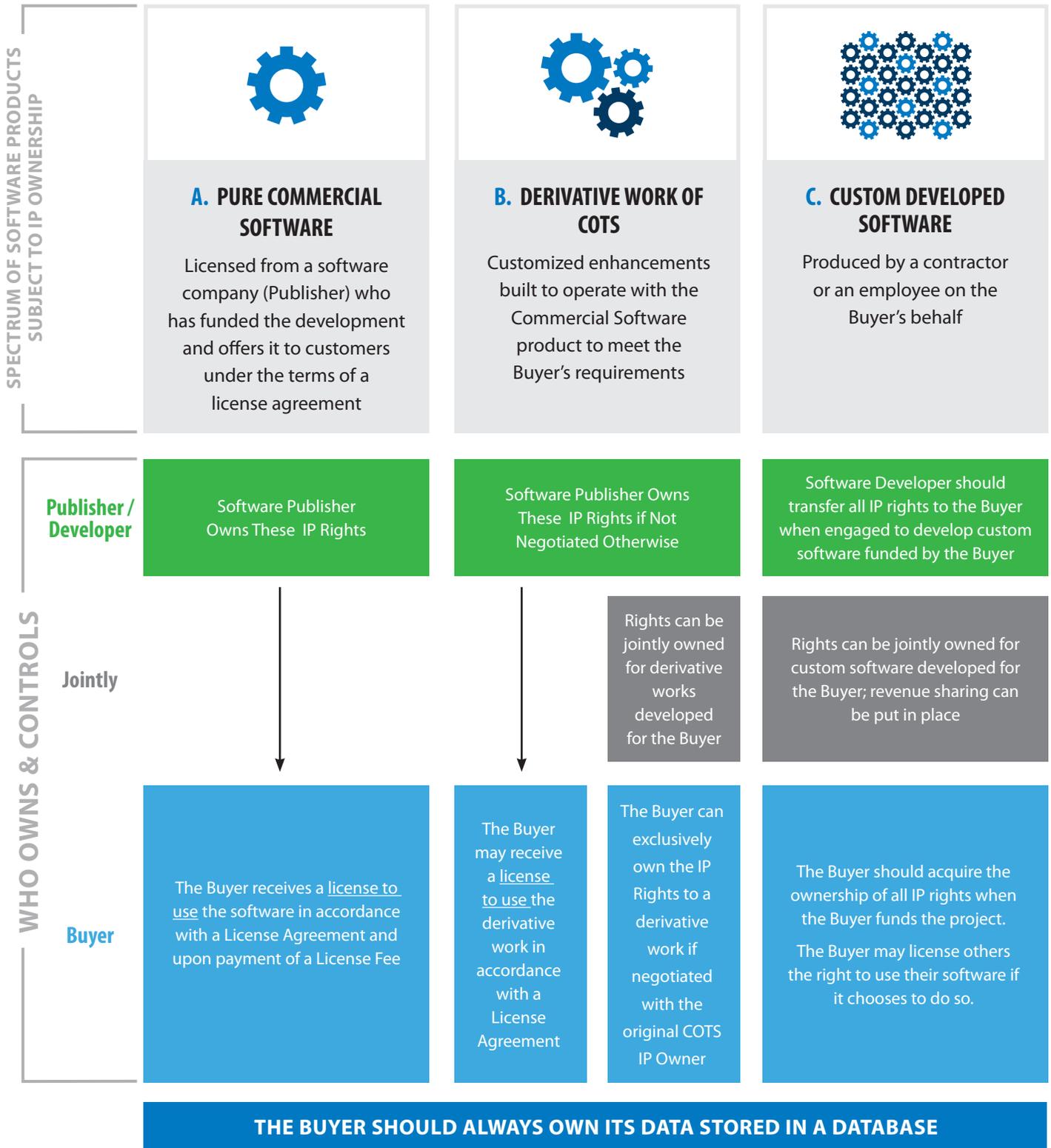
Typically, IP rights are secured through a copyright, trademark or patent registration in the US Patent and Trademark Office, but can be secured merely by placing a marking on the product, such as a copyright notice ©.

Scenario Based Analysis

To determine who owns the IP rights in a software system, we will address the following three (3) common scenarios (not every scenario) involved with software licensing and software development:

- the acquisition of a licensed right to use commercial software (Scenario A).
- the development of a derivative work built to work with the commercial software (Scenario B);
- the acquisition of professional services to develop custom software (Scenario C).

The graphical chart on the next page represents these three core scenarios to help apply our analysis.





Scenario A: Pure Commercial or COTS Software and Related License Rights

In Scenario A, the Publisher has paid for the full cost to design and develop the commercial software and therefore owns the IP rights to their (1) source code, (2) algorithms, (3) formulae, (4) processes, (5) flow charts, (6) software design specifications and documentation, and (7) related material that would enable the computer program to be produced, created, or compiled.

In this situation, the Buyer (as the Licensee) receives a license from the Publisher to use (not own) this “Computer Software” under the terms and conditions of a contract typically called an End User License Agreement (EULA). When the Buyer licenses COTS Software, it generally negotiates additional rights in the EULA to meet its unique requirements.

The Buyer’s rights in COTS software are limited to the usage (not ownership) rights negotiated and contained in the license agreement



Scenario B: Commercial Derivative Works and Related IP Rights

Sometimes, COTS software is enhanced, customized or modified (collectively called enhancements) to meet the Licensee’s unique requirements. Enhancements that are derived from the underlying IP (also called the “existing creation”) are called derivative works (also called the “new creation”). Usually derivative works are useful only with the original IP and not on their own.

Since derivative works of COTS software are often considered desirable by both the Licensee (to meet its requirements) and the Licensor (to win the deal), the question to ask is this – does the buyer want to create and own derivative works – or is the buyer okay with the Publisher or its contractors retaining the right to create and own the derivative works? Before answering these questions, more background information will be helpful.

Most COTS software is protected by copyright law. Under copyright law, the copyright owner has the exclusive rights to perform and to authorize any of the following: (1) to copy or reproduce the copyrighted work; (2) to prepare derivative works based upon the copyrighted work (e.g. write a screenplay based on a copyrighted book); and (3) to distribute copies of the copyrighted work to the public by sale or license or otherwise.

If the IP owner does not expressly grant the right to create and own derivative works to a Licensee, then all derivative works created by the Licensee or its Contractors are unauthorized and infringe on the copyright of the underlying COTS Software.

Also, the copyright to all derivative works created by the Licensor (and its contractors), including those created specifically for a Licensee, even when paid for by the Licensee, belong to the Licensor – and may be incorporated into the Licensor’s product for use by all of its customers.

Therefore, the Licensee needs the express right from the copyright owner to create and own derivative works and to use them with the software. Even if the right to create derivative works is not granted to the Licensee, it will need to negotiate ownership or unlimited use rights to any derivative works created by the Licensor or its Contractors.

If the right to create and own derivative works is granted to a Licensee, then the rights in the derivative work consists of a copyright in the new creation only. The ownership rights of the pre-existing material (i.e. the COTS Software) remain with the original copyright owner. The Licensee’s copyright in the new creation would preclude the Licensor from incorporating the derivative work into its product or otherwise distributing that derivative work. This is a key factor in the Licensee’s negotiation strategy about derivative works.

In either case, the ability to use the derivative work beyond the term of the license agreement (if it’s not perpetual) might also be a consideration for the Licensee.

In summary, there are three aspects of derivative works for a Buyer to consider:

1. Ownership – should the Buyer negotiate the license right to create and own derivative works?
 - a. The answer depends somewhat on whether the Buyer is comfortable relying on the Licensor to provide required derivative works or whether the Buyer wants more

control over the timing and design of them.

- b. The answer also depends on the next factor – distribution rights.

2. Distribution – is it important for the Buyer to control distribution rights of the derivative work?

- a. If the Buyer receives authorization to create derivative works, it will own the copyright to the derivative works it creates. Therefore, it will have control over the distribution of them. This impacts the Licensor’s ability to incorporate derivative works into its product.

- i. If the Licensor grants authorization for the Licensee to create derivative works, then the Licensor would not be able to incorporate the Licensee created derivative works into its underlying product without Licensee’s permission because the Licensee owns the copyright in the derivative work.

- ii. But if the Licensor creates derivative works at any time (whether Licensor has authorized Licensee to create them or not), said derivative works are owned by the Licensor. In that case the Licensor will have the right to incorporate the Licensor created derivative works into their pre-existing product.

- b. NOTE: It is a common commercial practice for Publishers to grant the right to Licensees to create derivative works in exchange for a grant to the Publisher to use the derivative works in the Publisher’s product. Buyers need to be wary of this arrangement as it

defeats one of the key reasons for the Buyer to own the copyright to the derivative work; i.e., to prevent the derivative work from being incorporated into the COTS product.

3. Use – what are the Buyer’s use rights in derivative works?

- a. If the Buyer has received authorization to create derivative works, its copyright in the new creation gives it all the use rights that go with that copyright. It does not, however, automatically grant a right to use the pre-existing work it was derived from beyond the term of the license agreement. Therefore, the Buyer might want to negotiate the right to use the pre-existing work with the derivative work beyond the term of the agreement.
- b. If the Buyer has not received authorization to create derivative works, then the Buyer needs to negotiate use rights – both during the term of the license agreement and afterward- for any derivative works connected to its licensed product that are lawfully created by others.
- c. Where ownership of the derivative work is not required, the standard commercial practice is to negotiate a world-wide, perpetual, royalty-free license for Licensee to use all derivative works.

All of these derivative works issues are extremely important to the licensing of COTS Software. Detailed discussions of IP rights can be found in case law and other literature. For our purposes in this paper, the important take-away is that the rights in derivative works are subject to the copyright owned by the Publisher of COTS Software. A properly worded and binding contractual clause should be

developed and included in the agreement with the Publisher to secure the full extent of derivative works rights required by the Buyer. Sample language is provided in Appendix A.

The Buyer’s rights to derivative works in COTS software are limited to the rights negotiated and contained in an agreement with the Publisher as the original copyright owner. If nothing is addressed in the written agreement, the legal presumption grants all rights to create and use a derivative work to the original copyright owner.



Scenario C: Non-Commercial / Custom Developed Software and Related IP Rights

The general rule from the Copyright Act of 1976 is that anyone who publishes a work of the mind receives a copyright in that expressed or published work. Examples include art, music, books and software. The general rule even applies to a contractor hired to produce a unique creation (with very narrow exceptions under the “work for hire” doctrine).

Since the contractor is considered the default copyright owner, a Buyer must decide how much control they need over the custom software and then negotiate the appropriate clauses in the engagement contract. Similar to the derivative works discussion above, the three kinds of rights to be considered are ownership, distribution and use.

Buyers who want complete and exclusive control over custom software include clauses in the engagement contract requiring the contractor to assign all rights, title and interest in the software, including the copyright, to the Buyer. With these clauses, the Buyer acquires complete control over

ownership, distribution and use rights for the software. The Buyer can use, modify, reproduce, publish, release or disclose the software in whole or in part, to the public or internally, for any purpose whatsoever, and to authorize third parties to do so. The contractor will not be authorized to use the software for any purpose whatsoever without the Buyer's written permission. This is the usual and standard practice for commercial buyers of custom software.

The rationale for this kind of commercial arrangement is usually based on the fact that the Buyer is paying for the work and there is a desire or need for exclusive rights in the custom software. The typical mantra is: "We paid for it. We will own it."

When exclusivity of ownership, use and distribution is not required by the Buyer, the Buyer may negotiate a license to use the custom software and recognize that the contractor, as copyright owner, will be able to sell, license or otherwise distribute the custom software without restrictions.

Appendix A: Sample IP Rights Language

1. INTELLECTUAL PROPERTY OWNERSHIP AND USE RIGHTS

- 1.1. Publisher retains all right, title and interest in its intellectual property (“IP”) licensed to Licensee. Licensee’s rights to use the IP are defined in this Agreement. Publisher’s IP is protected by copyright and other laws of the United States.
- 1.2. Licensee retains all right, title and interest in Licensee’s IP.
- 1.3. Licensee Data belongs exclusively to Licensee, regardless of where the Data may reside at any moment in time, including but not limited to Licensor hardware, networks or other infrastructure and facilities where Data may reside, transit through or be stored from time to time. Licensor makes no claim to any right of ownership in Licensee Data. If Licensor is granted access to Licensee’s Data, Licensor agrees to keep the Licensee Data Confidential as that term is defined in the Glossary (Exhibit 1) and the relevant FAR and DFARS provisions pertaining to Confidential Information and Confidentiality. Licensor is not permitted to use Licensee’s data for any purpose that is not explicitly granted in writing by Licensee. Upon Licensee’s request, for any reason whatsoever, Licensor must promptly return all Licensee Data in Licensor’s possession in comma separated value (CSV) format or other format as may be designated at the time of the request by Licensee.
- 1.4. Licensee might create or hire others (including Licensor) to create modifications, customizations or other enhancements to the Software which might be classified as “Derivative Works” of the Software.
 - 1.4.1. **Option A: [USE WHEN IT WOULD BE ACCEPTABLE THAT THE GOVERNMENT ALLOWS THE PUBLISHER TO SELL THE NEW DERIVATIVE WORK TO OTHERS]** The parties agree that the intellectual property (IP) rights to the Derivative Works shall be owned by the Publisher. The Derivative Work shall be made available to Licensee through a royalty free, perpetual, worldwide, no charge license to the Licensee.
 - 1.4.2. **Option B: [USE WHEN THE GOVERNMENT MUST EXCLUSIVELY OWN THE DERIVATIVE WORK AND NOT ALLOW ANYONE ELSE TO USE IT]** In recognition of Licensee’s unique requirements for confidentiality and mission integrity, whether Licensee creates Derivative Works directly, through Licensor or through other third parties, whether they are “Works for Hire” or not, whether they are based on transactional software or other types of software, Licensee shall retain all right, title and interest to such Derivative Works free of any claims by Licensor to title, restrictions on use, royalties, or other fees.
 - 1.4.2.1. Licensor has no claim to these Derivative Works, whether by Copyright Law or otherwise, and hereby covenants to keep them confidential, to not incorporate them into Licensor’s products or to otherwise distribute them in whole or in part to any third party.
- 1.5. Licensee covenants that it will not distribute Licensor’s IP to anyone outside the Authorized Users or authorized transferees (Affiliates) defined in this Agreement.



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