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Navigating Copyright Act Section 117 in software licensing and litigation: The often-overlooked copyright infringement exception

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Software developers, software licensees, and their legal advisors need to consider many business and legal considerations when drafting and negotiating software license agreements: How do we reduce legal exposure? How can we effectively prevent unauthorized copying and use? When can we terminate the license?

But a potentially serious issue with software ownership often flies under the radar that can have an outsized impact on any ensuing software license dispute or copyright infringement litigation involving the scope of allowed copying and use.

Parties to software agreements should carefully consider anticipated uses of the software in crafting license terms.

Importantly, the terms of the software license might inadvertently give software licensees a free pass to make certain types of copies of the licensed software without paying. This is where Section 117 of the Copyright Act — which articulates a potentially powerful exception to software copyright infringement claims — comes in.

Section 117 can provide a powerful defense to software copyright infringement claims because it may allow a software licensee, depending on the language of the license agreement, to make "essential" or "backup" copies of software without consequence. And as illustrated by recent cases, assertion of the defense can represent a *case dispositive* issue.

Those recent cases, discussed below, highlight the risks associated with Section 117 and potential strategies to traverse it. Software developers and professionals tasked with managing software licensing should be aware of what Section 117 is, how it impacts their intellectual property rights, and how they can clarify and reduce associated risks during — or even better, before — litigation.

The basics — What is Section 117?

The Copyright Act provides the owner of a copyright in a computer program the exclusive right to reproduce and distribute the computer program. But these exclusive rights are not absolute.

Section 117(a) of the Copyright Act provides a limited exception to these exclusive rights that allows an "owner of a copy of computer program" to make copies of a computer program without authorization of the copyright holder, so long as the copies are either (1) "created as an essential step in the utilization of the computer program" or (2) created for "archival purposes only."

This carveout recognizes that software users need to make copies of software in order to use the software on their servers and computers, and for backup purposes in case the software is damaged or lost. Because the number of copies that a user could potentially make that fall in these categories is high, Section 117 can provide a powerful defense for software licensees faced with copyright infringement allegations.

Meeting the threshold — Ownership of the copy

The Section 117 exception is only available where the party asserting the defense is an "owner of a copy" of the computer program at issue (not to be confused with the owner of the *copyright* at issue). A party that is simply a licensee to use the software typically cannot invoke this defense.

"Owner of a copy" is not defined by the Copyright Act, but a recent decision from the Court of Federal Claims, *4DD Holdings, LLC v. United States*, provides insight into how courts consider this issue in light of the terms of the applicable software license agreement.

In *4DD*, plaintiff 4DD sued the United States government, alleging that the Department of Defense and Veterans Administration made tens of thousands of unauthorized copies of its software despite express prohibitions against copying the software in the parties' software license agreement.

The government argued that "the 'vast majority' of the copies at issue were 'either backup copies or copies created as an essential step in running'" the software, and thus, under Section 117, those copies were not infringing.[1]

Before determining whether the government could make "essential step" or "archival" copies, the court held that Section 117 did not apply because the government was not an "owner" of the software copies. Specifically, although a software licensee like

the government could potentially be an owner of a copy of the software,[2] the government was not an owner based on the terms of the license agreement between the parties.

That is, the parties' license agreement stated that "[a]ll right, title and interest, including, without limitation, all intellectual property and proprietary rights, in and to [the software] (including, without limitation derivatives and modifications therefore) ***and any copies thereof are owned by [4DD]*** or its suppliers. You disclaim all interest therein."[3] This provision stating that the government did not own any copies of 4DD's software weighed heavily against the government's case for ownership.

Courts have held that the archival copy privilege allows the owner to make a copy to guard against physical distribution of a computer program.

Also persuasive were the strict license restrictions on the government's use of 4DD's software — uses that an owner of a copy of software would typically enjoy under the Copyright Act.

For example, the parties' license agreement explicitly stated that the government could not (i) distribute any copies of the software, (ii) sell or sublicense any copies of the software, or (iii) make any copies of the software. These restrictions, in the courts view, indicated the government was not an owner and that Section 117 did not apply.

The court also considered three cases and fact scenarios where software licensees were considered owners of copies of software.[4]

In all three instances, the licensees paid substantial consideration to the copyright holder for the software, the software was specially customized, the software copies were stored on the licensees' servers, and the license allowed the licensee to destroy or discard the software as they saw fit.[5] Further, in *Krause* and *Universal Instruments*, the licensees were permitted to continue using the software even if their relationship with the copyright holder ended.

These fact patterns were starkly contrasted by the limited rights held by the government under the license agreement in *4DD*, where the government was required to stop using — and delete all copies of — the software should the parties' relationship end, and forbidden from distributing copies of the software, selling or sublicensing the software, or making copies of the software.

The *4DD* case is a recent example that illustrates how courts scrutinize license agreements to determine software ownership under Section 117. Strict software license prohibitions on how software can be used, along with the type of software under consideration, can be dispositive of the issue.

Assuming a party accused of software copyright infringement passes this threshold inquiry, a court will then consider under Section 117 (a)(1)-(2) whether the copies at issue were made (1) "as an essential step in the utilization of a computer program in conjunction with a machine and ... used in no other manner," or (2) "for archival purposes only."

The 'essential step' copy

First, what constitutes an "essential step" under Section 117? The court in *Krause* found that copies made in connection with modifying code qualified as an essential step where the modified copies were made to "facilitate the effective use of the program."

There, the plaintiff wrote numerous computer programs for the defendant.[6] Importantly, the defendant paid the plaintiff to develop the software at issue "for its sole benefit," and the software was customized for the defendant's particular use.[7]

After the relationship between the parties ended, the plaintiff left executable versions of the code and gave the defendant permission to use it but forbade the defendant from modifying the code in any way.[8]

However, because the inability to modify the code rendered the program useless, the defendant modified the code after the conclusion of the parties' relationship to (1) correct programming errors; (2) change the source code to add new clients and update client information; (3) incorporate the programs into a new operating systems; and (4) add new functions.[9]

The *Krause* court held that these actions fell under the essential step exception because they facilitated the effective use of the program for the purposes from which the programs were purchased. The court found that the defendant's inability to modify the source code would have severely limited the value of the programs to defendant, including its ability to perform routine functions, bug fixes, and more.

The court thus concluded that the "adaptation of their copy of the software so that it would continue to function on the defendants' new computer system" constituted an "essential step" under Section 117(a).[10] The approach in *Krause* represents a more liberal construction than some other courts' requirement that a step be "absolutely essential" to qualify under the statutory language.

In contrast, in *Wall Data Inc. v. Los Angeles County Sheriff's Department*, a defendant overdeployed software to speed up installations and ensure that employees would be able to use the software regardless of location.[11] The Ninth Circuit held that the defendant's conduct failed to qualify as an "essential step" because it was not absolutely *essential* and instead "a matter of convenience."[12]

The above examples suggest that courts are more likely to find that copying constitutes an essential step where it is absolutely essential to the use of the software, but may in some circumstances find that copying is essential where the copying simply facilitates the effective use of the software. Accordingly, parties to software agreements should carefully consider anticipated uses of the software in crafting license terms.

The 'archival purpose' copy

Section 117 also provides an exception to copyright infringement for copies made "for archival purposes only." Some courts have held that the exception only applies to computer programs stored in a

medium that may be destroyed by "mechanical or electrical failure," and not physical dangers like shredding or fire damage.[13]

Other courts have held, however, that the archival copy privilege allows the owner to make a copy to guard against physical distribution of a computer program.[14]

In any event, the express statutory language and caselaw provide that the copy must not "perform functions in addition to archival functions." In *Allen-Myland, Inc. v. Int'l Vus. Machines Corp.*, for example, the court held that copies which "actively operated reconfigured ... systems or served as standby backups" were not used "for archival purposes only" and thus fell outside of Section 117.[15]

Practical considerations

Section 117 can be a broad, case dispositive defense to software copyright infringement allegations, so litigants in software copyright infringement cases should evaluate whether it applies.

If it does apply, an early analysis of how many allegedly infringing copies might be affected is important. And because license terms can determine whether Section 117 applies, litigants should develop a thorough understanding of the operative license agreement(s), as well as the course of use of the software, as early as possible.

Simple, proactive acts of due diligence when negotiating and managing software licenses can help mitigate the risk of unanticipated consequences of Section 117 in software copyright litigation. For example, software developers negotiating software license agreements should consider explicitly articulating the scope of all rights they retain in the software and the scope of copying or use that is allowed.

In the event rights conferred on the software user under the agreement could potentially rise to the level of an "owner" of a copy of software under Section 117, software developers should also closely consider (and articulate in the operative license agreement) any and all allowed uses of the software, bearing in mind any unique software deployment characteristics, operating environment architecture, anticipated third party software integration, access restrictions, automated disaster recovery services that apply to the operating environment, and restrictions on backup copies.

Likewise, professionals tasked with managing software licensing agreements should carefully review and remain apprised of the terms of their license agreements, with a focus on ownership, as well as limitations and restrictions on rights to make or use copies of software.

Notes:

[1] *4DD Holdings v. United States*, 159 Fed. Cl. 337, 353 (2022); *see also* Case No. 1:15-cv-00945-EGB, Doc. 256.

[2] Courts vary on whether a licensee can be an owner of a copy of a computer program. *Compare, e.g., DSC Communications Corp. v. Pulse Communications, Inc.*, 170 F.3d 1354 (Fed. Cir. 1999) (holding that a licensee can still be an "owner" of a copy of a copyrighted software under Section 117) and *MDY Industries, LLC v. Blizzard Entertainment, Inc.*, 629 F.3d 928, 939 (9th Cir. 2010) (players of "World of Warcraft" computer game did not own their copies of the software, and therefore "may not claim the essential step defense" and "may infringe unless their usage is within the scope of" their limited license).

[3] *Id.* at 354 (emphasis in original).

[4] *Krause v. Titleserv, Inc.*, 402 F.3d 119 (2d Cir. 2005); *Universal Instruments Corp. v. Micro Systems Engineering, Inc.*, 924 F.3d 32 (2d Cir. 2019); and *Softech Worldwide, LLC v. Internet Technology Broadcasting Corp.*, 761 F. Supp. 2d 367 (E.D. Va. 2011).

[5] *4DD*, 159 Fed. Cl. at 355.

[6] *Krause*, 402 F.3d at 120.

[7] *Id.* at 124.

[8] *Id.* at 121.

[9] *Id.* at 125.

[10] *Id.* at 126.

[11] *Wall Data*, 447 F.3d 769 (9th Cir. 2006).

[12] *Id.* at 785.

[13] *See, e.g., Atari, Inc. v. JS & A Grp., Inc.*, 597 F. Supp. 5, 9 (N.D. Ill. 1983).

[14] *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255, 264-266 (5th Cir. 1988).

[15] *Allen-Myland*, 746 F. Supp. 520, 537 (E.D. Pa. 1990).

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