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Feature Article

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Unauthorized Software? What To Do When the BSA Calls

It is unfortunately too easy for businesses to unknowingly find themselves in a situation where they are accused of having unauthorized software. This article discusses how this can happen, suggests ways to prevent it, and evaluates methods for ameliorating the issue if it occurs.

Every business in America uses software. Most have multiple work stations, typically individual PCs with their own hard drives but connected to a local area network, or wide area network, with central servers that store data that can be accessed by each individual user.

Introduction and Overview

While many people, including business owners, refer to the acquisition of software in terms of a purchase, this is almost always inaccurate. Almost always, the right to use software is via a license agreement. It does not matter that the acquirer went to their local computer store, picked up a box that contained a disc, brought to the box to the counter, and paid for it. The box contains more than the disc; it also contains terms of use. The terms may be on the outside of the box, on sheets of paper inside the box, or in wrapping around the disc itself, which must be torn open to get access to the disc (often referred to as "shrinkwrap"). Or, the disc itself, once installed, may require, as a step to access the software, that the user review and accept the terms of the license (often referred to as "clickwrap"). Either way, the right to use the software is governed by the terms of a contract.

More often, software is acquired through internet downloads or transfers. Businesses contract with software vendors and sign negotiated contracts (although the extent of that negotiation may vary greatly depending on the sophistication of the acquiring entity). Regardless of the method of acquisition, however, it is almost universally true that the scope of use is determined by the terms of the licensing agreement—and almost all licensing agreements include limitations on the number of copies that the customer may make or have.

The very nature of software makes it relatively easy to copy. Businesses quite often have needs for multiple persons to use any particular item of software. Needs of the business may change—new employees, new customers—after the license agreement becomes effective, requiring access to the software by more users and on more computer terminals. A business, or someone on its team not familiar with the terms and limitations in the license agreement even if the business leaders themselves have that knowledge, may be tempted to make more copies of the software for these new users, either through ignorance of the terms of the agreement or due to the often considerable expense of acquiring additional licensed users. Therein lies the risk.

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The Copyright Act

We sometimes hear reference to a given work having been "copyrighted," meaning that the work has been registered with the United States Copyright Office, but that is incorrect. Software is copyrighted from the moment of its creation. Registration is *not* required for a copyright to exist, but does impact damages options for the copyright owner. Almost all sophisticated software vendors regularly register the copyrights to their software products.

The Copyright Act, 17 U.S.C. § 101 to § 1332, grants exclusive rights to the copyright owner. One of the exclusive rights held by the copyright owner is the right to copy (reproduce) the copyrighted work. 17 U.S.C. § 106. Thus, when a business makes copies of a software product beyond the scope allowed in its license agreement, it is potentially liable for copyright infringement.

The Copyright Act provides various possible remedies for infringement. These include:

Injunction: 17 U.S.C. § 502.

Destruction of infringing copies: 17 U.S.C. § 503.

Damages: 17 U.S.C. § 504.

Costs and attorney's fees: 17 U.S.C. § 505.

Section 504 sets out alternative damages remedies. A prevailing plaintiff may recover either (a) actual damages plus infringer's profits attributable to the infringement, or (b) statutory damages ranging from $750 to $30,000 per work (notably, *not* per infringement). Statutory damages, where elected, can be reduced to as little as $200 per work for innocent infringement, or increased to as much as $150,000 per work for willful infringement. Not surprisingly, copyright claimants tend to opt for statutory damages where they can, and almost always assert that the infringement was willful.

The plaintiff's opportunity to recover attorney's fees and to elect statutory damages has a further prerequisite: pursuant to 17 U.S.C. § 412, the plaintiff must have timely registered the copyright to be eligible for these remedies. With respect to software, the copyright owners have almost always made a timely registration.

The Players

There are two primary sets of claimants. The first, and most aggressive, is the Business Software Alliance (BSA), an organization including members of the most often used software such as Adobe, Microsoft, Apple, IBM, Intuit, Oracle, Symantec, and others. The other is the Software & Information Industry Association (SIIA), which defines itself as "the principal trade association for the software and digital content industry."

Both entities follow the same basic approach. Both actively advertise for whistleblowers to turn in their current or former employers. Both promise to keep the identity of the whistleblower confidential, unless disclosure is required by law (which it certainly is if a lawsuit is filed and discovery initiated). Both offer substantial rewards to the whistleblowers depending on how much is paid by the target to the claimant, ranging from $5,000 to as much as $1 million for a very substantial recovery.

The Process

Most often a company's first notice that it allegedly has unauthorized software is a letter from an attorney. Neither the BSA nor the SIIA tend to contact the target company directly; rather, they have a stable of law firms to handle these matters. A typical initial letter will identify the BSA (or the SIIA, where applicable) and advise that it has recently learned that the target has more copies of a particular software than the target is licensed to use, providing no further details. In addition, the letter will usually:

(a) alert the recipient that the claim can be up to $150,000 for each copyrighted product, plus attorney's fees. The letters always assert the maximum, always asserting that any infringement is willful;

(b) suggest that rather than litigation, an amicable resolution may be reached;

(c) demand that the company perform an audit of all of the software from any of its members (not just those whose software has allegedly been copied according to the BSA's information) on all of the company's computers—and provide evidence of existing licenses and proofs of purchase for each copy found in the audit;

(d) advise the target not to destroy or replace any of the software currently installed on the target's computers; and

(e) set a time for a required response to the letter.

Ignoring the letter will not make the issue go away. The BSA's law firm will only get paid for results, and will send increasingly aggressive letters. Additionally, ignoring the letter can potentially be used later as evidence of willful infringement, especially if combined with continued use of unauthorized copies of the software, if any, after receipt of the letter.

Further, it is in the target company's own interest to know whether it does or does not have unauthorized software. If the audit determines that there is proof that all software is authorized, that can end the matter. And if it discloses that some software is unauthorized, or at least that proof cannot be located to confirm that it was properly acquired (a not infrequent occurrence), the company can take steps to rectify the situation and minimize its exposure, all while potentially limiting any claim of willful infringement due to unauthorized use after notice.

So, what should the target company do when it received the letter?

1. Hire an attorney familiar with the issues. That may sound self-serving considering that the author is one such person, but these are issues that lay people rarely encounter—and the consequences are potentially severe, with exposure sometimes in multiples of six figures if not handled with knowledge and sensitivity.

2. Preserve the evidence. Follow the letter's instructions not to destroy any currently existing software. Failure to follow this instruction can result in adverse consequences for spoliation of evidence.

3. Locate any proofs of purchase or other evidence to document the scope of authorized software acquisitions. This is not always easy to do, because for most businesses, such records are not part of their core business and record-keeping is sometimes lax.

4. Do the audit. As noted above, this is in the target's interest in any event. But, do not share it with the requesting entity immediately. And, when the results are sent to the BSA or the SIIA, send only the results for the particular software identified in the letter—the ones that the whistleblower identified. Keep in mind that the letter includes an overreach in demanding an audit for *all* products of *all* members even though they have no evidence or even a reasonable belief based on the anonymous whistleblower of any unauthorized copies of other products, and no right to any of that other private information.

   Caveat, some license agreements permit the software vendor to request periodic audits. So, another due diligence task should be to locate the license agreements and review their terms.

5. Do *not* follow the demand in the letter not to replace any of the software if unauthorized software is found. Most often, the software (authorized and unauthorized) is needed to operate the target company's business. Continued use of unauthorized software after knowledge of its existence can be evidence of willful infringement.

   Acquiring authorized software (and keeping careful records to document the acquisition) to replace the unauthorized software will not defeat any claim for past infringement, but it will end any claim of continuing damages or infringement. Additionally, the price paid to acquire the replacement software will be potentially useful in negotiating resolution of the claim.

6. Negotiate a resolution if the audit determines that presence of unauthorized software.

Negotiating a Resolution

No one endorses having and using unauthorized software. If the audit reveals its existence, the target company ought to pay a fair amount to resolve past infringement, and take steps to prevent future infringement. All too often, however, the BSA and the SIIA seek remedies far in excess of what they could have obtained even if a lawsuit were filed and they prevailed. Moreover, they typically also seek invasive and inappropriate non-monetary relief.

A. Monetary Relief

Once they receive the results of the audit, the BSA will determine what it believes is the number of unauthorized copies, and thereafter make a resolution demand. As to damages, the demand typically includes the following elements:

1. A dollar amount consisting of the number of unauthorized copies times the Manufacturer's Suggested Retail Price (MSRP) for each item of software.

2. A multiplier (usually 3x) of the total of the MSRP calculations.

3. A demand for attorney's fees.

In making these calculations, the BSA will also treat each type of product as a separate item of software, even where the product is typically sold as a bundled unit. For example, even though Microsoft Office can be purchased as one product at a group price, the BSA's resolution demand will assert that Access, Excel, Outlook, PowerPoint, Word, and more, are each separate copyrighted products, each separately registered, and each a separate product for calculation of damages.

In addition to refusing to acknowledge the true business marketplace in which the products are sold at a fraction of the unbundled price asserted by the BSA, the use of the MSRP as the starting point is entirely unjustified. The MSRP refers to the *retail* price. But the BSA or the SIIA member is the copyright owner, not the retailer. The copyright owner's gross revenue share of any particular license is only a very, very small fraction of the amount the retailer receives from the customer.

The typical initial demand is based on an "actual damages" model rather than the statutory damages model used in the initial letter seeking to scare the target company. The copyright owner's "actual damages" are not the loss of gross revenue, but rather the loss of *profit*, itself a small fraction of the revenue that trickles down to the copyright owner through the chain of distribution, yet another reason why using the MSRP as the starting point ought to be contested from the outset.

While section 504 allows recovery of actual damages plus infringer's profits attributable to the infringement, there is almost never evidence that any of the infringer's profits are attributable to the infringement. 17 U.S.C. § 504. The profits provision usually applies to situations where, for example, someone copies a novel and resells the copied novel, thereby earning profit on the sales of the infringing volumes. In most situations involving unauthorized software, however, the software is not itself being resold. It should be a rare situation indeed where the target company has any profits at all that are attributable to the infringement.

Note also that the posture taken by the BSA and the SIIA is to demand that the target company provide them with information—an audit and proofs of purchase—but they refuse to provide information in return, all the while maintaining the guise of seeking an amicable resolution. The target company, therefore, should turn the tables, and make reasonable requests for information from the copyright owner. For example, what is its profit on each unit of software? How often is the product sold unbundled compared to the frequency of sales in bundled format? A copyright owner's refusal to provide this information is meaningful and useful, demonstrating that the copyright owner is not bargaining in good faith. A defendant, or potential defendant, is entitled to information to allow it to make an informed decision, including an evaluation of the claimant's actual damages.

There is a wide body of law holding that statutory damages, when sought, should bear some relation to the actual damages suffered. *See, e.g., New Line Cinema Corp., v. Russ Berrie & Co.*, Inc., 161 F. Supp. 2d 293, 303 (S.D.N.Y. 2001); *Fitzgerald Pub. Co., Inc., v. Baylor Pub. Co., Inc.*, 670 F. Supp. 1133, 1140 (E.D.N.Y. 1987). Cases cited by a copyright owner seeking a damage multiplier almost always involve either default judgments or extreme willful infringement—and deterrence of future infringement is noted as an important element. Few, if any, of the cases actually used a multiplier in calculating damages. Deterrence must be balanced against the inequity of imposing heavy financial burdens on small businesses. *See, e.g., Joe Hand Promotions, Inc., v. Hernandez*, No. 03 Civ. 6132(HB), 2004 WL 1488110, at *5 (S.D.N.Y. 2004). Thus, not only is there no basis for asserting use of the MSRP as the starting point, there is also no basis for compounding that erroneous starting point by application of a multiplier. Because even statutory damages should bear some relation to actual damages, discovery regarding the BSA's actual damages is proper. When the BSA or the SIIA refuse to respond to discovery regarding damages, it should be used as evidence that they have failed to negotiate in good faith.

Target companies and their counsel should also keep in mind that most software has a limited useful life; it becomes obsolete or is replaced by a newer version frequently. This too supports arguments to reduce the value of the claim. For example, if the useful life of the software is ten years, but the infringement occurred only over a two-year period, the unauthorized use was only for 20% of the useful life. The price for resolution of the past infringement should be adjusted accordingly. This is an additional reason for acquiring appropriate licenses moving forward upon initial notice of the claim; "getting legal" potentially cuts off any continuing infringement claims.

In summary, there are a wide variety of potentially quite powerful arguments to counter those often asserted by the copyright owner in these situations. Making, and documenting them, puts the target company in the best position to obtain a fair and reasonable financial resolution.

B. Non-monetary Relief

In addition to monetary relief, the BSA and the SIIA also insist on non-monetary relief as part of the resolution. Even if the parties can agree on the correct financial measure, these claims for non-monetary relief can often scuttle a resolution.

The typical demand for non-monetary relief includes:

(a) Destruction of all unauthorized software, even though the target company, in making the financial settlement, is essentially paying the full license fee for past infringement. This, in essence, doubles the cost of the settlement, because the target not only has to pay for new replacement software, but in the settlement is paying for the to-be-destroyed software as well.

(b) Execution of a "Code of Ethics" and giving the BSA or the SIIA the right to inspect the target's computers over a period of years to confirm no further unauthorized software.

As with the monetary relief, there is little justification in the law for these requested remedies, and the odds of the copyright claimant achieving them even in a successful infringement lawsuit are slight. Destruction, while a permitted remedy under section 503, is rarely granted by courts, especially where payment has been made for past infringement—and the accused infringer is not using the copyrighted product to make its own profit (e.g., not re-selling the infringing software at a mark-up, as distinct from—as more typically occurs—using it solely internally).

Inspections and certifications of continuing non-infringement have no basis in any provision of the Copyright Act. Further, the target company is negotiating for a *final* resolution of all claims up to the date of the agreement, just as in most settlement negotiations. They should, therefore, object to any attempts to leave the claim open or enter into a resolution agreement that merely creates the opportunity for future invasion into their businesses and systems, and future exposure.

C. Attorney's Fees

The copyright claimants always include in their initial demand an amount for attorney's fees. Section 505 does indeed permit a qualified claimant (one who has timely registered under section 412) to seek attorney's fees. But the United States Supreme Court has recently repeated that an award of attorney's fees to a prevailing party, whether the plaintiff or the defendant, is far from automatic, but rather is vested in the discretion of the district court applying a variety of factors. *Kirtsaeng v. John Wiley & Sons, Inc*., 136 S. Ct. 1979, 1985 (2016); *Fogerty v. Fantasy, Inc*., 510 U.S. 517 (1994).

The attorney's fees part of the equation underscores the need for the target company to act with alacrity, integrity, and reasonableness to respond appropriately to the initial letter. Not only will these actions weigh against an award of attorney's fees in favor of the claimant, but at least one court has allowed an award of attorney's fees in the defendant's favor in the face of unreasonable demands by the claimant, even though the defendant was an acknowledged copyright infringer. In *Baker v. Urban Outfitters, Inc*., 431 F. Supp. 2d 351, 355 (S.D.N.Y. 2006), the court noted that the defendant's conduct was eminently reasonable: "Upon being informed of Baker's claims, Urban apologized for its mistake, voluntarily stopped selling the products at issue, and repeatedly offered Baker settlements in amounts that more than doubled the $3,896 in profit that it received from selling the picture frames."

The court went on to hold that the plaintiff's refusal to accept these reasonable actions justified an award of attorney's fees in the *defendant's* favor.

> [A]n award of costs and fees is crucial here, so as to deter this plaintiff, and other similarly situated plaintiffs, from bringing unreasonable claims based on a cost/benefit analysis that tells such plaintiffs that they can score big if they win and that there will be no adverse consequences if they lose.

Baker, 431 F. Supp. 2d at 359. Therefore, in evaluating a negotiating posture, the target company should include a fair position on any request for attorney's fees.

Conclusion

The best alternative for software users is to avoid the situation in the first place. No one condones or endorses infringement by making unauthorized copies of copyrighted software. Copyright owners have every right to seek appropriate remedies when license agreements and copyright exclusive rights are violated. Companies ought to establish policies that allow using only authorized software and educate their employees about it to prevent unknowing or uncaring actions. They should establish procedures and policies to maintain excellent record keeping to prove that all of its software is appropriately acquired and used.

But perfection cannot always be maintained. On those occasions where unauthorized software is found, target companies should act to minimize the exposure, object to overreaching, and seek a fair and reasonable resolution.

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