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Federal Circuit Establishes Framework for Government Disputes with Software Companies

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*Bitmanagement Software GmbH v. United States*¹ raises important issues for any company licensing software to the U.S. government, particularly those that utilize third party resellers. Under this decision, even when the government acquires a license with express limits on the scope of the government's rights (e.g., limiting installation to a set number of computers), the parties' conduct may give the government an implied license to use the software beyond the scope of the express license (e.g., vast deployments across government networks). However, even with an implied license, the government may be liable for copyright infringement if it fails to comply with a condition precedent to that license (here, an obligation to track its own software deployments). *Bitmanagement* offers significant lessons as to how parties can protect their rights when negotiating software licenses, throughout the course of performance, and in the event of litigation.

Background

Bitmanagement produces virtual reality software, including a program named "BS Contact Geo," which "enables the visualization of geographic information in third party hardware and software products." Over several years, Bitmanagement, through a reseller, licensed BS Contact Geo to the U.S. Navy. A series of three contracts provided the Navy with a specific number of "seat licenses," each of which authorized the Navy to install the software on a particular computer. By 2012, the Navy had acquired 119 such licenses. The Navy also had agreed to manage the use of its licenses through a licensing tracking software

program named Flexera, which enables organizations to limit the number of simultaneous uses of a program on its network.

In the ensuing years, the Navy significantly expanded its use of the software, installing copies throughout its entire "NMCI network"—thereby reaching several hundreds of thousands of computers—without acquiring any additional seat licenses or using Flexera to manage its usage. Throughout this period, the Navy and Bitmanagement continued to correspond via email. The Navy and Bitmanagement sharply dispute the significance of this correspondence. For the Navy, the correspondence demonstrated that Bitmanagement understood its plans to deploy BS Contact Geo broadly and that it approved of those plans. For Bitmanagement, however, the correspondence was merely a prelude to a new written license agreement. In Bitmanagement's understanding, the Navy would install BS Contact Geo broadly and use Flexera to monitor usage, and then the parties would enter a new agreement providing the Navy with an appropriate number of additional seat licenses based on the Navy's actual use. Bitmanagement and the Navy never entered into a new license agreement.

Bitmanagement brought a copyright infringement claim against the United States in the Court of Federal Claims (COFC), asserting that, because the Navy had only purchased 119 seat licenses, it lacked authorization to install BS Contact Geo throughout its network. The COFC recognized "there is no real dispute that Bitmanagement has established a *prima facie* case of copyright infringement."² Following a trial, however, the court found no infringement, concluding that the Navy had held an implied license to install BS Contact Geo throughout its network, as the interactions among the parties "unequivocally show that Bitmanagement was not only aware that the Navy planned to install [its software] 'across a broad spectrum of the NMCI realm' but also that Bitmanagement authorized such installations."³

Bitmanagement then appealed to the United States Court of Appeal for the Federal Circuit. On appeal,

Bitmanagement argued that the COFC had violated the principle that courts may not find an implied contract where an express contract already exists—and that in any event the parties’ conduct did not satisfy the prevailing legal standard for finding an implied license. The government responded that the existence of an express contract does not necessarily preclude an implied license, particularly here, where the express contract had been between the Navy and the reseller, not Bitmanagement.

Bitmanagement also argued that, irrespective of any implied license, the government had infringed Bitmanagement’s copyright by failing to follow a condition precedent to the license (*viz.*, monitoring its usage with the specified software). The government responded that its obligation to monitor deployment was not a condition precedent to the license, but rather a covenant—the breach of which would at most give rise to breach of contract liability.

The Federal Circuit’s Decision

In a majority decision authored by Judge Kathleen O’Malley and joined by Judge Timothy Dyk, the Federal Circuit upheld the COFC’s finding that the Navy had held an implied license to copy Bitmanagement’s software throughout the NMCI network, but had violated a condition precedent of that license by failing to use Flexera to monitor usage, and therefore infringed Bitmanagement’s copyright. The majority remanded for the COFC to address damages. Judge Pauline Newman issued a concurring opinion.

First, the court rejected Bitmanagement’s position that the parties’ express license had precluded any implied license. The court agreed with the government that, because the government had purchased the license through a reseller and there was no express license between the Navy and Bitmanagement, the implied license was not precluded. The decision explains that, in these circumstances, an implied license is only prohibited “when the totality of the specific facts and circumstances shows that such an agreement was precluded by the first contract”—a standard not satisfied in this case.⁴

Second, the Federal Circuit rejected Bitmanagement’s argument that the question of whether an implied license exists must be governed by a strict application of the “*Effects* factors”⁵—a three-part test that courts throughout the country frequently apply in the copyright context to determine whether an implied license exists. That test looks to “whether (1) a person (the licensee) requests the creation of a work, (2) the creator (the licensor) makes

that particular work and delivers it to the licensee who requested it, and (3) the licensor intends that the licensee copy and distribute his work.”⁶ This is a narrow rule that limits implied licenses to circumstances in which the party claiming the license specifically requested the creation of the copyrighted work. Here, the rule likely would have barred the Navy’s claim to an implied license because BS Contact Geo is commercially available software that Bitmanagement had not created at the Navy’s specific request. In rejecting the *Effects* factors as a constraint to finding an implied license, the Federal Circuit recognized that other courts, as well as a leading copyright commenter, have endorsed an “entire course of conduct” analysis to determine whether an implied license exists.⁷

Third, the majority concluded that the COFC did not clearly err in finding an implied-in-fact license under the totality of circumstances. The opinion confirms that “an implied-in-fact license may be found only upon a meeting of the minds that is inferred, as a fact, from conduct of the parties showing, in the light of the surrounding circumstances, their tacit understanding.” The majority recognized that the record facts could support a different conclusion but held that COFC “did not clearly err in finding a meeting of the minds on the record before it.”⁸

Finally, despite finding that the Navy had held an implied license to broadly deploy the software, the Federal Circuit held that the Navy did infringe Bitmanagement’s copyright by failing to satisfy the condition precedent of monitoring its own software deployments. In doing so, the decision navigates the critical distinction between (i) breach of license covenants, which generally only gives rise to liability for breach of contract, and (ii) violation of a condition precedent to the license, which may be actionable as infringement:

Normally, a copyright owner who grants a license to his copyrighted material has waived his right to sue the licensee for copyright infringement and must instead pursue a claim for breach of contract. If, however, a license is limited in scope and the licensee acts outside the scope, the licensor can bring an action for copyright infringement. Whether a licensee acts outside the scope of a contract by failing to comply with a term of the parties’ agreement turns on whether that term is a condition that limits the scope of the license or is merely a covenant. Terms of a license or contract are presumed to be covenants, rather than conditions, unless it is clear that a condition precedent was intended.⁹

Ordinarily, courts prefer to construe license terms as covenants rather than conditions. The Federal Circuit concluded that in this case, however, the Navy's obligation to track its software usage rose to the status of a condition precedent, as it was clear from the parties' interactions that the only circumstance under which Bitmanagement would have granted such a broad license was on the condition that the Navy could track its usage:

This is one of those rare circumstances where the record as a whole reflects that the *only* feasible explanation for Bitmanagement allowing mass copying of its software, free of charge, was the use of Flexera *at the time of copying*. Thus, the Flexera term was clearly a condition rather than merely a covenant. Unlike payment, which is typically considered a covenant, the use of Flexera at the time of copying was critical to the basic functioning of the deal. The timing of Flexera was key because the Navy's tracking of BS Contact Geo users was intended to establish how many additional licenses the Navy would purchase. Without tracking, the Navy would have no basis to purchase more licenses and, consequently, Bitmanagement would have had no reason to enter into the implied-in-fact license. Unlike payment, which can feasibly come at any time after contract performance, Flexera was only useful if it could track, from the beginning, the number of Navy users.¹⁰

Having found that the government infringed Bitmanagement's copyright, the court remanded with relatively detailed instruction that the COFC engage in a hypothetical negotiation analysis to ascertain damages.

Judge Newman concurred, joining the majority's order for remand, but disagreeing that there had been any implied license for the Navy's mass copying: "there plainly was no mutual intent that Bitmanagement would abandon its commercial purpose and grant the Navy unlimited free licenses....Bitmanagement did indeed hope for wide Navy installation, but not as a gift to the United States."¹¹ Judge Newman also objected to the majority specifying the measure of damages to be applied on remand, as that issue was not presented on appeal.

Implications

While there are many lessons to glean from the *Bitmanagement* litigation, and surely more to come,

four key implications are apparent from the Federal Circuit's decision.

First, stepping back from the four corners of the decision, it is critical to keep in mind that enforcing a software copyright against the government is fundamentally different from enforcement against private entities. The government's sovereign immunity shields it from liability for copyright infringement or breach of contract, except as authorized by the Tucker Act, 28 U.S.C. § 1491 and 28 U.S.C. § 1498. These actions will take place in a bench trial at the COFC (without jury) and be subject to binding Federal Circuit precedent. Moreover, many theories of damages and liability that could be leveraged against a private party are simply not available when litigating against the federal government (particularly those that sound in equity or tort), and a multitude of jurisdictional traps lay waiting for the uninitiated.

Second, while using a third party reseller to license software to the government can create efficiencies for both sides in terms of minimizing compliance obligations and utilizing simplified acquisition methods (e.g., the Federal Supply Schedule), *Bitmanagement* confirms that doing so can put the software licensor at greater risk of granting an implied license to the government that is broader than intended. But for the use of a reseller in *Bitmanagement*, the Federal Circuit might have found that the Navy's express license had precluded any implied license for the Navy's broader deployment.

Third, the Federal Circuit's decision to adopt an "entire course of conduct" test rather than the predominating *Effects* factors increases the government's ability to persuade a COFC judge that a copyright holder has implicitly authorized the government's usage beyond the terms—or in the absence of—of any express license. In light of this standard, companies should carefully scrutinize correspondence with the government concerning the government's use of their software to ensure that it does not unintentionally convey greater rights than the company intends. Companies licensing software to the government, and resellers, cannot rest on restrictive license terms alone, as the government may cite exchanges among the parties as evidence that the government had broader authorization to use software than its express license permits.

Fourth, *Bitmanagement*'s success turned on its ability to persuade the Federal Circuit that the contractual mechanism for monitoring the Navy's software usage is a condition precedent to the license, rather than a contractual covenant. This distinction is also critical to licensing disputes among private parties, but the stakes are somewhat higher when

dealing with the government because, when software is licensed through a reseller, the licensor may have a difficult time establishing the privity of contract needed to bring a breach of contract action against the government. Accordingly, in some cases, contractual covenants may not be enforceable as a practical matter. When negotiating software licenses with the government, parties should be careful to identify those contractual obligations that are conditions precedent and therefore may give rise to infringement liability. And, in the event of litigation, the parties must be careful when characterizing license terms as covenants or conditions.

* * *

The Federal Circuit's decision in *Bitmanagement* answers many fundamental questions about the legal frameworks that apply when a company seeks to enforce the terms of a copyright against the government. As the government increasingly relies on commercial software, often acquired through resellers, parties on all sides of these transactions should heed the warnings of *Bitmanagement* and understand the extent to which the government will (or will not) be bound by the express terms of the license. Practitioners should continue to monitor this litigation through the damages phase, which is likely to bring more important lessons at the intersection of government contracting and intellectual property.

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1. No. 2020-1139, 2021 WL 727278 (Feb. 25, 2021), available here.
 2. *Bitmanagement Software GmbH v. United States*, 144 Fed. Cl. 646, 655 (2019).
 3. *Id.* at 657.
 4. *Bitmanagement*, No. 2020-1139 at *8–9.
 5. *Effects Associates v. Cohen*, 908 F.2d 555 (9th Cir. 1990).

6. *Bitmanagement*, No. 2020-1139 at *7.
7. *Id.*
8. *Id.*
9. *Id.* at *9–10 (cleaned up).
10. *Id.* at 9–10.
11. *Id.* at *13 (Newman, J., concurring).

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