Software and Software Tools:
Ownership and Use Contracting Considerations When Creating Digital, Online and Mobile Content

A Position Paper From the American Association of Advertising Agencies

Sixteenth in a series of Position Papers Addressing Key Industry Issues

I- Objective

The ownership, intellectual property and indemnification provisions of many agreements between agencies and advertisers have not been adapted to accommodate the change in the services that agencies provide.

This 4A's position paper addresses the ownership of, and contracting considerations related to, software and software tools. The paper notes that, at a minimum, the ownership provisions in agency services agreements need to carve out software related materials.

The 4A's recommends that agency agreements with clients preserve agency ownership and agency right to use agency developed software and tools.

II- Background

Technology has brought about many changes to the advertising industry. However, the provisions of the typical advertising service agreement have not evolved to accommodate these changes. In particular, the ownership, intellectual property and indemnification provisions of many agreements between agencies and advertisers have not been adapted to accommodate the change in the services that the agencies provide. In the past, all content that an agency created was relatively similar and could be subject to the same rules. For example, clients would pay for a thirty second commercial and own all intellectual property rights to that advertisement. It was simple. It worked well enough for the agency, because the commercial was only of value to the particular client for which it was created.

As the services that agencies provide have expanded and as the content has become more varied, there has to be an appreciation that not all content is the same, nor should it be treated the same. No client would ever think to try to own a stage direction in the production of a commercial, yet by not adapting the current agreements, clients, perhaps inadvertently, are asking the agency to grant all rights to the technological equivalent. In addition, many compensation structures treat all content the same, and for the most part, fail to recognize the different values of the different types of intellectual property that an agency creates. Finally, in the past, agencies generally could secure insurance coverage, at cost effective rates, for all the intellectual property claims that would typically arise out of the creation and use of advertising materials. As content has evolved, that is no longer the case.

III- Ownership and Use Considerations

In light of these technological changes, the agency must carefully review its agreements and ensure that the provisions of its agency-client agreements reflect the new paradigms. There are many different types of content that the agency creates for which the old, accepted ownership and compensation provisions do not make sense. This paper attempts to address one of these situations - the ownership of, and compensation models with respect to, software and software tools.

Historically, in an agency services agreement, the client would ask the agency to grant to the client all rights in all material that the agency creates on the client's behalf. As technology has changed and as the agencies are creating more and more online and mobile content, these provisions have become outdated and overly broad. If the agency is willing to live with the work for hire construct, at a minimum, the ownership provisions in the services agreements need to carve out software related materials.

Ownership involves two rights – the right to exploit the owned material and the right to preclude others from exploiting that material. Although the agency may be willing to grant ownership in the ultimate consumer-perceivable online and mobile creative that it produces for a client, granting the client ownership of the technology underlying these materials would technically prohibit the agency from using that technology for its other clients in the future and ultimately affect its ability to do business.

When thinking about the technology underlying internet or mobile content, one can divide the technology into a number of different categories – software licensed from third parties and open source software (which we are not discussing in this paper), software tools, software that is developed by the agency independent of the client, and finally software that is developed by the agency in the course of providing services for the client. Each of the last three categories will be discussed separately below.

Software Tools

Software tools can be defined as "certain knowledge, techniques, procedures, algorithms, protocols, routines and methods used in the creation, maintenance or support of computer software (both object code and source code) and certain functionality thereof." Simply speaking, software tools are basic technology building blocks that can be combined together to create, maintain, or otherwise support more significant computer programs and applications. Tools can be thought of as the rough equivalent of stage direction in the bricks and mortar world. Just like a client that commissions a picture or a film would not expect to own the camera or editing equipment that is used to create the picture or film, the client should not expect to own the tools that are used to create the ultimate website, banner ad or other digital end product.

As a practical matter, if an agency were to assign all rights to these tools to one of its clients, the agency, technically, could be foreclosed from using such tools to provide online services to any other client. Although it may be easier and philosophically appealing for a client to own everything that the agency creates, from the client's perspective, there is no real purpose to owning these software tools, nor as a practical matter does the client want to prohibit the agency or any other third party from using these tools in the future. Of course, the client will want to know that it will have the right to use and exploit the software tools incorporated in the final website or other material produced by the agency, and a provision to this effect can be incorporated in the agreement to give the client that assurance.

Finally, because the agency is creating content that in the past was more typically created by software developers, the form agreement to look to for guidance on these types of provisions should be the agreement between software developers and their clients, rather than a typical, historical advertising agency-client agreement. For the reasons discussed above, software developers generally include a similar carve-out for software tools from the ownership provisions of agreements that they enter into with their clients.

The 4A's recommends that agency agreements with clients preserve agency ownership and agency right to use agency developed software and tools.

With the proper explanation and understanding, carving out software tools from the grant of ownership rights should not be particularly controversial.

Software Created By The Agency Independent of Clients

Many agencies are developing software independent of any services for clients. Clients tend to be more sympathetic to the agency's retaining ownership of technology that was developed by agencies independent of the agency-client relationship. From a business perspective, agencies should think about investing in agency owned technology. If times are slow, agencies may have creative, talented and technologically savvy staff on hand that may be underutilized. Just as agencies are willing to invest in new business pitches, if circumstances are right, it may make sense to invest in a product that could ultimately result in ongoing, long-term revenues for the agency. Having proprietary technology on hand will allow the agency to diversify its offerings to clients, and because the agency developed the technology with its own resources and in its own time, may allow the agency to charge the client a reasonable license fee for the use of the software.

Software Created During Services For The Client

There are two categories of software that an agency can create in connection with its services for its clients. The first is software that is a specific stand-alone deliverable for a client. Since in this situation the client is engaging the agency for the purpose of creating a specific software program that is itself the "deliverable," ownership of the program can be agreed to by the agency and the client at the time based on the particular deal and the software being created.

This section addresses the second category of software - software programs that are created when the agency is retained to develop a website or other online or mobile advertising material and the development of the software program is more of a by-product of those services or a means to achieve the underlying technological objectives of the assignment.

Because many clients pay based on a labor-based model, there is some notion that everything that is created by the labor should be owned by the client. It may be acceptable that the client own all physical work product that is created by the agency; however, there is a distinction between ownership of the physical property and ownership of the intellectual property. Within the context of traditional advertising, agencies may also be willing to grant to the client all intellectual property rights in the materials produced by the agency for the client. However, this construct does not really work in the world of online and mobile advertising.

First, the distinction between a software tool and "software" as used in this paper is blurry at best, and the analysis discussed above of software tools applies equally to the software discussed here. For example, if software is developed to create a special effect or other visual technique in connection with the creation of a website, the fact that the software is characterized as a tool or more full-blown software should not change the analysis or suggest that ownership of the software should reside other than with the agency.

Even if a distinction can be drawn in a particular situation, the value to the agency of original software generally far exceeds the hourly charges or other fees paid to create the material. Unlike a commercial or other advertisement that likely has no applicability beyond the value to the specific client, software will likely have applicability beyond the project for which it was originally produced. If the agency were to grant ownership of software to a client, the agency would be precluded from providing the same software to any other client. In order to compensate the agency for this loss of future use of the software, the agency would have to price the project to take into account not only the labor charges in developing the software but also the cost to the agency of foregoing the use of that software in the future.

Based on this economic analysis, the agency would have to charge its client significantly more for online and mobile advertising than what the agency charges under the current compensation models – a result that neither the agency nor the clients ultimately want.

In addition, unlike a commercial or other advertisement, which is the ultimate end product, the software is not the end product – but rather a means of achieving the functionality of the ultimate website, banner or other deliverable. The value to the client is not in the software, but rather in the way the final material communicates brand benefits, position and strategy to the consumer. So long as the client receives a royalty-free license to use the software, the client is not hurt by not owning the software. The client is not in the business of exploiting the software that underlies the material that the agency is creating. The client's concern is simply to be able to use that software to achieve the objectives of the website or other application created by the agency. For example, if the agency creates a word processing program during the course of providing services for a client and uses that program to write a book extolling the virtues of the client's product, the client does not need to own the word processing program in order to receive the benefit of its bargain.

This approach is not a new one in the creative arena. Photographers charge a certain amount to shoot a photograph and to allow an advertiser to use some number of photographs from the shoot in a particular manner for a particular period of time. Yet the most seasoned photographers will insist on retaining the copyright in all of the photographs from the shoot. If an advertiser wishes to purchase the copyright (assuming the photographer is even willing to sell it), the advertiser will pay the photographer a significant premium to account for the potential license fees that the photographer believes he or she is potentially giving up with respect to the photograph.

If, however, each client insists on owning the software that is created, the agency would have to recreate the software each time (if possible), which would cause delays and increase the costs to all clients. If the agency is precluded from leveraging software and software tools developed during previous engagements, the amount of time, labor and cost to perfect and complete online and mobile materials could increase dramatically. By the agency's retaining ownership and allowing all clients to use the software, the agency can focus its energies on adding to, adapting and improving the software in connection with each client project. All clients then benefit by being able to use the improved software. Operating in this way allows the clients to ultimately receive software that is of better quality, with more functions and features, and allows the agency to provide clients with online and other digital services in a more cost effective manner and with greater efficiency and speed.

Liability and Indemnification

In light of the new technology, agencies also have to be careful to review the intellectual property and indemnification provisions of their agency-client agreements. Many agency-client agreements contain provisions that may have been acceptable in the past, but, in light of emerging technology, place the agencies at greater risk than fairness would dictate. One of those areas where caution must be exercised is the agency's responsibilities with respect to intellectual property claims, and specifically with respect to claims of patent infringement.

With the increase in the use of technology has come an increase in claims for patent infringement. Patents can cover both novel inventions as well as new methods of conducting business (so-called business method patents - such as "new" ecommerce methods, etc.). Whereas an agency may be able to conduct cost efficient searches for copyright and trademark, particularly in light of business method patents, conducting patent searches with respect to the agency's services tends to be both impractical and cost prohibitive. In addition, there are companies whose sole business model is to bring patent infringement claims and extract a settlement. These companies purchase patents principally to troll the internet to find people who could arguably be violating their patents and then bring claims in an attempt to secure a license fee under the threat of potential litigation. Many of these patents are so-called junk patents upon which baseless infringement claims are brought in the hopes of securing a quick settlement from a company that wishes to avoid the expense and risks of litigation. Because patent litigation tends to be

very costly, many companies settle these claims and pay a license fee for even these so-called junk patents simply to avoid litigation. Because insurance companies recognize the high cost of defending these claims and the difficulty of preventing these claims, if an insurance company is willing to issue patent insurance at all, patent insurance tends to be prohibitively expensive.

As a result, if the agency agrees in its contracts with the client that it will take on responsibility for all patent infringement claims – either through an indemnification or an affirmative representation, warranty or agreement - the agency's role is tantamount to that of an insurance company taking on risk over which it has no control. Under the terms of many agency-client agreements, the agency is asked to be responsible not only for its own independently developed materials, but also for third party materials, which would likely include third party and open source software. Even if the agency is indemnified by a third party with respect to the third party software, the third party could go bankrupt or contractually cap its liability and, as between the agency and the client, the agency may be left covering the cost to defend or settle a costly claim with respect to the licensed material. Agencies - particularly those that are paid on some form of labor-based method - are not being paid to cover the cost of these additional risks. Therefore, agencies have to reevaluate their agreements and review the scope of their representations and indemnification to make sure that the agencies are not indemnifying or otherwise taking on responsibility for claims beyond those that the agency believes are fair or cost effective to cover. If, based on the facts in a particular situation, an agency agrees with its client to somehow share the risk with respect to patents, then, at a minimum, fairness would dictate that the agreement should include a cap on the agency's total liability for any claims that may result.

Agency-Client Agreements

The agreements that the agency enters into with its clients must be reevaluated and negotiated in the context of the new realities addressed by this paper. Unfortunately, it is not simply a question of fixing one provision. In order to effectively and consistently address the issues raised by this paper, agencies should review their agency-client agreements as a whole, including ownership provisions, intellectual property provisions, representations and warranties, compliance with law and indemnification provisions, to ensure that the issues discussed above are properly taken into account and addressed consistently throughout the agreement.

By recognizing that all content created by the agency cannot be treated equally and by reevaluating the agreements that the agency enters into with its clients, the agency and the client can reach agreements that are fair to both parties and more accurately reflect the world in which the agency and the client now operate.

This guidance is not a substitute for legal advice and may not be suitable in a particular situation. Consult your attorney for legal advice.

Postscript

SAMPLE SOFTWARE AND TOOLS PROVISION

Advertiser acknowledges that Agency may own certain computer software ("Software"), as well as certain "Tools" (which shall be defined as certain knowledge, techniques, procedures, algorithms, protocols, routines and methods used in the creation of computer software (both object code and source code) and certain functionality thereof) that are and have been developed and used by Agency in the course of Agency's business and that Agency uses or may use for multiple clients or projects. All such Software and Tools, including those developed by Agency in the course of Agency's services for Advertiser, shall be and remain Agency's sole and exclusive property; provided, however, that to the extent the Software and Tools are included in any materials produced by Agency on Advertiser's behalf in finished and final form ("Final Materials"), unless otherwise agreed by Advertiser and Agency, Advertiser shall have a non-exclusive, royalty-free license to use the Software and Tools in the manner agreed upon by Advertiser and Agency, in and as incorporated in the Final Materials furnished by Agency to Advertiser.

This provision is not a substitute for legal advice and may not be suitable in a particular situation. Consult your attorney for legal advice

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