The Ownership of Software Copyright in Offshore Outsourcing

------A Comparative Study of China and U.S.

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I. Introduction

The global offshore outsourcing becomes an option for many companies as it could reduce costs and make companies more competitive. Beyond traditional destinations like India, China has captured the fancy of buyers globally. It is estimated that the Chinese offshore services market, mainly BPO and ITO,[1] reached about US$2 billion in 2006, and will grow at a compounded annual growth rate of 38% to cross US$7 billion by 2010.[2] The Chinese government is also intensely promoting the outsourcing services to China.[3]

The software outsourcing, as the primary services of ITO, may remain a "complex business strategy"[4] due to legal and cultural barriers in different circumstances. The intellectual property (IP), especially the ownership of copyright in software, is the critical concern in offshore outsourcing,[5] as it is the most valuable assets to companies. The failure to define clearly the ownership in software outsourcing

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1 BPO refers to the Business Process Outsourcing and ITO means Information Technology Outsourcing, which are the main business in the outsourcing market.

2 From the Everest Research Institute: *What's happening in China: A Curtain-Raiser on the IT and Business Process Service Export Market* (February, 2007) See http://www.everestresearchinstitute.com

3 Chinese government announced the 1000,100 and 10 Project in October 2006 to show its active commitment to establish China as an international service outsourcing base. See http://www.mofcom.gov.cn

4 Fraser Mendel: *Offshore outsourcing and offshoring to China; Patents, Copyrights, Trademarks, and Literary Property Course Handbook Series*, Practicing Law Institute, (24, October 2005)

5 Donna Ghelfi: *The 'outsourcing offshore' Conundrum: An intellectual Property Perspective*, See http://www.wipo.int/export/sites/www/sme/en/documents/pdf/outsourcing.pdf

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contracts would bring about much uncertainty and problems. This paper presents the legal diversities concerning the initial ownership of software copyright through two approaches to a hypothetical case, and gives some advice to avoid such problems.

II. Two approaches to initial ownership of copyright in software

Software,[6] under most national and international laws, is protected as "literary works"[7] within the scope of copyright protection. The problem of initial ownership of software, which is sometimes omitted or deliberately neglected in the outsourcing contracts, may "produce results that are contrary to the reasonable commercial expectations"[8] of both parties.

1. A hypothetical case[9]

The Superb Operations and Performing Service, Inc. ('SOPS') is a small yet sophisticated U.S. company possessing several well-qualified computer programmers. It decides to focus on the sophisticated end-to-end system development and outsource the compounded software engineering to Best-Choice Software Company ('BCSoft') in China. In the contract, the SOPS describes the precise needs of the software and prescribes that it could give recommendations of modifications during the software development, while the BCSoft could freely create the code and choose the modules on their own staff. However, no mention of copyright ownership is made in the

6 It is also referred to as "computer software" in Chinese Copyright Law and "computer program" in E.C. Software Directive and WIPO and other international treaties. Most definitions about this term share a basic substantive aspect: a set of instructions performing certain task, while the preliminary material is only copyrightable in some countries. See more from Mihaly Ficsor: *The law of Copyright and the Internet*, Oxford University Press, 2002, New York,465-7

7 It is described in Paragraph 1of E.C. Software Directive, Article 4 of the WCT and Article 10 of the TRIPS Agreement.

8 See Chris Reed & John Angel: *Computer Law*, (2000), Blackstone Press, London, P191.

9 Due to the territorial character and the nature of copyright, every country has its own legal systems and provisions for copyright protection. So only the U.S. and Chinese law are compared in the following case.

contract. After the project is completed, both parties intend to market it and claim copyright ownership of the software resulting from the contract.

Two simple yet primary problems arise from the above case:[10]

(1) Is the **developed software**[11] regarded as commissioned work or the work made for hire?

(2) Who owns the copyright in the **developed software**?

2. The Chinese approach

Under Chinese legal jurisdiction, problems concerning software are resolved by the Regulations on Computer Software Protection revised in 2002 (RCSP). The copyright in a piece of software "shall belong to its developer",[12] but others may enjoy the ownership on a commissioned or an occupational basis.

The "occupational" software vests the ownership of the copyright directly in the employer, provided that the software:[13]

(A). is developed in the course of employment; and

(B). is "occupational work"[14]

The copyright of a commissioned work, in the absence of a written agreement between the commissioning and commissioned parties, is enjoyed by the commissioned party.[15]

10 Other problems such as the software licensing problems, either form SOPS licensing to BCSoft and vise versa; the third party's copyright; the ownership of the copyright in the by-products and derivative work, etc. See from Jon K. Halvey &Barbara Murphy Melby: *Information technology outsourcing transactions process, strategies, and contracts*, (1996) John Wiley & Sons, Inc. U.S.A., P54-7.

11 The "developed software" refers to the object of the contract and is created by the developer, distinguished form the pre-existing software or third-party software.

12 China, RCSP: Article 9(1).

13 China, RCSP: Article 13(1)-(3).

14 As provided in the RCSP: "either in connection with the development objective, or foreseeable or ordinary result of fulfilling his duties, or developed with the technical or material resources from the employer."

15 China, RCPS, Article 11

The main difference between the two categories of software lies in the basic relationship of the two parties, whether it is in the employment relationship interpreted in terms of Labor Law when one party is subordinated to the other, or in the commission relationship in terms of Civil Law that both parties are equal in their legal status.

3. the U.S. approach

Under 1976 U.S. Copyright Act, copyright in a work "vests initially in author or authors of the work".[16] One significant exception to this rule is the "work made for hire"[17] doctrine that, the initial owner of the copyright in a work is the employer,[18] provided that the work[19] is either

(A) within the scope of his or her employment; or

(B) a work specially ordered or commissioned, that is within one of the nine categories of works and under a written agreement.

As to the "employee" prong of the provision, the "common law of agency test[20]" is employed in determining the nature of the work; while the second prong concerning commissioned works follows strict requirements to vest copyright in the employer, otherwise the copyright resides with the employee.

4. Analysis and comparison

Returning to the hypothetical, in China, the software developed by BCSoft is categorized into commissioned work for no vertical supervision between two parties, therefore the copyright ownership belongs to the BCSoft; whereas in U.S., the BCSoft

16 17 United State Code § 201(a) (2003).
17 17 United State Code § 101 (2003)
18 17 United State Code § 201(b) (2003)
19 17 United State Code § 101 (2003)
20 See *Community for Creative Non-Violence v. Reid*, 430 U.S. 730 (1989), the court holding that "… the term 'employee' should be understood in light of the general common law of agency."

as an independent contractor is not an employee in terms of the law of agency. Only when the contract has declared expressly the software to be work made for hire, as well as the software could fall within the nine categories (for example, as "collective work"), this doctrine could be interfered and SOPS will enjoy the copyright ownership.

By comparison of the corresponding regulations on ownership of software copyright in China and U.S., it could be concluded that:

(1) the concept of works made for hire in the RCSP is narrower in scope than it is under the U.S. Copyright Act, thus it is strictly applied in China; while the U.S. law is more favorable to the employer;

(2) the ownership of the copyright in commissioned software is determined by the written agreements between the two parties in the RCSP; while in the case of U.S. Copyright Act, the ownership of copyright is determined by the nature of the commissioned work within the concept of work made for hire.

However, noticeably, both legal systems allow parties to determine ownership of the copyright by written agreements.[21]

III. Conclusion

China is still a nascent market for software outsourcing and is worthy of great expectation. Both parties could take several steps before and during the cooperation dealing with the ownership of copyright:

(1) make a complete analysis of what you own and what you need before

21 See China, RCPS, Article 11 and 17 United State Code § 201(b) (2003)

negotiations;[22]

(2) expressly designate the ownership of software copyright in the outsourcing contract; to sign another IP agreement would be much better;

(3) Do not insist on sole and exclusive copyright ownership in similar cases as in hypothetical, find other alternatives tailored to your real needs[23], which could encourage better performance of the suppliers[24]

Although there are no 'bullet-proof vests'[25] to protect copyright ownership, most, if not all, of the problems can be avoided by appropriate and timely agreements that clearly set forth and delineate the rights and obligations of each party.

22 It's necessary to classify different types of software from the ownership and licensing perspective, such as third-party software, customer's software, the supplier's software and software developed or modified during the term of the outsourcing. See more from Burnett Rachel: Outsourcing IT—The Legal Aspects,(1998), p119-136

23 Such as joint ownership or proper licensing, etc. See Zaharoff, Howard G., *Rights and Ownership Options in Technology Development Agreements*, Morse, Barnes-Brown & Pendleton, P.C. http://www.mbbp.com.

24 See Sara Cullen & Leslie P. Willcocks: *Intelligent IT outsourcing: eight building blocks to success*, P38, "Best practice to encourage innovation in suppliers is to give them appropriate intellectual property rights …In this way, the supplier has a higher degree of motivation as they can use the IPR in other services."

25 See Donna Ghelfi: *The 'outsourcing offshore' Conundrum: An intellectual Property Perspective*.