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TECH LAW L E T T E R



DON'T BE PENNY WISE AND POUND FOOLISH: HOW START-UPS CAN AVOID COSTLY IP MISTAKES

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Start-up companies have a lot to do: get organized, lease space, hire staff, develop products, market and advertise those products, sell them, and – ideally – make profits that can be taken out of or invested in the business. With all these activities going on, often at once, it is not surprising that many start-ups make legal mistakes early on that can come back to haunt them later, especially when the time comes to raise venture capital or to

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"WHAT DO YOU MEAN I DON'T OWN IT?" GETTING THE COPYRIGHTS YOU PAY FOR

Kevin W. Grierson



Many businesses, especially those that seldom deal with intellectual property (e.g., copyrights and patents), erroneously assume that they do not need to worry about securing intellectual property rights. Such businesses often think that if they pay an employee or independent contractor for creative work, they own the rights in whatever is created. The rules regarding ownership of intellectual property can be counterintuitive, however, and companies sometimes find that they do not actually own everything for which they paid.

Independent Contractors. The most important example concerns work done by independent contractors. Companies use independent contractors to perform any number of activities that may create intellectual property: developing software, creating web sites and designing advertising campaigns are some of the most common activities that lead to copyright protection in the relevant works. What many companies fail to understand is that in the absence of a written contract assigning copyright and patent rights to the company that hired the independent contractor, those rights generally stay with the independent contractor.

For instance, if a company hires a software programmer as an independent contractor, it will be entitled to use the end product that it paid for, such as a computer program. However, without a written agreement transferring the copyright, the programmer will retain copyright ownership of the program itself and can prevent the company from selling copies of that software product to third parties.

The scope of the company's ability to use the copyrighted material will depend on what the parties intended at the time

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IP SEMINAR HELD OCTOBER 6

Willcox & Savage was pleased to have Peter Jobse, President of Virginia's Center for Innovative Technology, speak at our Intellectual Property Seminar on October 6. Mr. Jobse



shared his perspective on how the Commonwealth of Virginia can become a world-class center of technology excellence and achievement by continuing its efforts to attract, grow and retain high-tech companies. Attorneys Tim Lockhart and Ross Reeves then addressed issues inherently faced by these high-tech companies, as intellectual property is often considered their primary asset. They explained how companies can effectively license software and protect intellectual property assets – even in the event of bankruptcy.

merge into or be acquired by other entities. There are five common IP pitfalls, but with proper planning start-ups can manage those issues and keep their IP assets protected. This article discusses those five common mistakes and provides some advice on how to avoid them.

Not Adequately Protecting Intellectual Property.

Patents, copyrights, trademarks, and trade secrets are all types of “intellectual property” or “IP,” and every start-up owns at least one piece of IP – its name. Often a trade name is also a mark that identifies the source and quality of the company’s goods or services.

Wanting instant consumer recognition, start-ups frequently choose trademarks and service marks that are either generic or so descriptive that they cannot be protected from competing use by other companies.

A much better approach is to choose a mark that is arbitrary – “Apple” for computers, for example – or coin a new one – such as “Xerox” for photocopiers. Once it has selected a strong mark, a company should conduct (or commission its IP counsel to conduct) an availability or “clearance” search to ensure that the mark is available for use and registration with the U.S. Patent and Trademark Office.

New, emerging companies often fail to seek timely U.S. and international patent protection for their inventions, including new methods of doing business (particularly e-business methods). For example, once a company introduces a patentable invention into the marketplace it has only one year to apply for a U.S. patent. In Europe, Asia, or elsewhere in the world a company may have already lost its ability to obtain patent protection if the product is already in the marketplace. The only safe course is to consult patent counsel early in the process – *i.e.*, prior to going to market.

Another common mistake that start-ups make is not claiming ownership of, and, if appropriate, registering, copyrights in important works of authorship such as proprietary software and user manuals. Using proper copyright notices and registering valuable copyrights with the U.S. Copyright Office can help to reduce copyright infringement and recover damages (actual or statutory) and perhaps even attorneys’ fees when infringement does occur.

Similarly, new companies often do not protect their trade secrets adequately. As the term implies, a “trade secret” is confidential information that gives its owner a business advantage. Trade secrets should be carefully protected through proper labeling and handling of documents and data, the implementation and maintenance of physical security, and putting into place appropriate confidentiality or nondisclosure agreements with a variety of entities.

Not Having Appropriate Agreements with Contractors.

Executives of start-up companies often make a common mistake of engaging a consultant or some other type of independent contractor (a software developer or an advertising agency, for example) without having a written agreement relative to ownership rights. These contractors are often asked to develop programs or materials on behalf of the company, with the assumption that IP rights will be retained by the hiring company. They are often surprised to find out that under U.S. law the contractor, absent a written agreement to the contrary, will retain rights in the deliverables (*i.e.*, all copyrights).

Thus, having the contractor execute an appropriate agreement is very important. Such an agreement should state that all IP rights associated with the contractor’s deliverables would be bestowed upon the company. Depending on the circumstances, such rights might include ownership of the deliverables or they might be license rights, particularly if software is involved. If an assignment of all rights is appropriate, the agreement should also specify that the contractor would not challenge or seek to register, directly or through a third party, any of the company’s rights in the deliverables.

The various provisions of such agreements can be very complicated, especially those dealing with infringement of others’ IP rights, indemnification for third-party claims, limitations on liability, and the parties’ respective termination rights. An attorney specializing in IP will have the expertise to ensure the client company is protected. (Kevin Grierson’s article on page one discusses this issue in more detail.)

Not Having Appropriate Agreements with Employees.

In their desire to get their businesses “up and running” quickly, executives of start-ups often fail to require their employees to enter into written employment agreements. Such agreements are important because they can require employees to:

- Keep the company’s trade secrets and other proprietary information confidential;
- Disclose to the company any IP that they create on company time or with the use of company resources;
- Assign to the company any company-related patent applications filed in their names as inventors; and
- Agree not to compete with the company for a reasonable period after terminating their employment.

Fortunately, it is sometimes possible to have employees enter into such agreements even after they have joined the company. Regardless of the timing, however, employment agreements, to be enforceable, must be carefully drafted.

Not Properly Preparing and Negotiating Software License Agreements.

Although “shrinkwrap” and “click-

wrap” software licenses (*i.e.*, those entered into by removing the shrinkwrap plastic from CD-ROM cases or by clicking the “I accept” or equivalent icons on a web site) are generally not negotiable, most other types of software licenses are, and if properly executed can put the emerging company in a much more favorable position. This fact is true regardless of whether the license is inbound – that is, applies to software licensed to the company – or outbound, applying to the company’s proprietary software being made available to others.

Software licensing – and technology licensing in general – is as much an art as it is a legal science, and broad experience is a prerequisite to practicing the art well. For example, protecting a licensee’s right to continue to use software in the event of a licensor’s bankruptcy is very important and requires knowledge of software escrow procedures as well as the applicable sections of the U.S. Bankruptcy Code.

Whether they are technology licensees, licensors, or both (as many companies are today), companies should seek legal guidance in implementing and managing their licensing programs.

Not Having a Software Ethics Program. Watchdog groups such as the Business Software Alliance, which represents the interests of software developers such as Microsoft and Apple, are always on the prowl for companies whose employees are illegally copying software, either by bringing unauthorized copies from home or making them at the office. When they learn about such activities, often from disgruntled current or former employees of the target companies, the groups typically send “cease-and-desist” letters that call for the copying to stop and for the companies to provide an accounting of all of their installed software – legal and illegal. Often stiff penalties are imposed on the illegal software.

Start-ups can avoid or at least minimize the effect of this unpleasant scenario if they (1) adopt, and have each employee agree to abide by, a software code of ethics prohibiting illegal copying and (2) regularly audit the software installed on company computers, including laptops used for business travel. Obviously, any unauthorized software should be deleted, and the employee(s) responsible for having copied and installed it should be appropriately counseled.

The expense of a software ethics program is much less than that of conducting an internal investigation in response to a watchdog group’s inquiry and then settling with that group.

As this article illustrates, there are many IP pitfalls for the unwary start-up company. Working with experienced IP legal counsel can help a company avoid those traps and focus on its core business. ■

“WHAT DO YOU MEAN I DON’T OWN IT?” CONTINUED FROM FRONT COVER

of the transaction, which can be difficult to determine. Consider a company that hires an ad agency to create a marketing brochure. The company would clearly have the rights to copy that brochure and use it for marketing purposes. But what if a company wants to take parts of the brochure, such as photographs taken by the ad agency, and use them in a new medium (such as the Web) or sell them to a third party? Without a written agreement, the company hiring the ad agency may well find that its rights do not extend as far as it thought.

Employees. The situation is somewhat clearer for works created by a company’s employees, at least for copyrights. If an employee creates a work for his employer in the scope of his or her employment, the work is generally considered to be a “work made for hire,” and the employer will own the work even without an explicit assignment of the employee’s rights.

However, if an employee creates a work that will be helpful to the company but is outside the employee’s usual scope of employment, the employer might not own that work. If the employee invents an item that is patentable (even if he or she does so on company time and using company facilities), the company may not own the patent rights to that invention unless the employee was specifically hired for the purpose of working on such inventions or has a written agreement assigning inventions to his employer. If its time and resources were used in creating the invention, the employer may be entitled to “shop rights,” or the right to practice the invention without paying a royalty to the employee; however, the employer will be unable to license that right to other parties or to prevent anyone else from practicing the invention.

Regardless of whether you are dealing with an independent contractor or your own employees, the rule for protecting intellectual property is clear: get it in writing. Companies that hire independent contractors should have a written contract spelling out who will own the copyrights and patent rights in anything created as a result of the work done by the independent contractor. If the independent contractor will retain ownership of the copyright and/or patent rights, the agreement should clearly set forth the company’s intended uses of the work product. Similarly, employees who may create inventions that have value for the employer should be required as a condition of employment to assign their inventions to their employer and to cooperate in its attempts to obtain patents for their ideas, even if they later leave the company.

The rules of copyright and patent ownership are different from what most businesses expect, because the analogy to rights in tangible property for which a company pays or that is created by its employees, although intuitive, is not accurate. However, careful planning, along with a well-drafted contract, can ensure that businesses do, in fact, get what they pay for. ■

CASES OF INTEREST

Kevin W. Grierson

The courts have decided several tech-related cases in the past year. Among them:

Shrinkwrap/Clickwrap Agreements can Prohibit Activities otherwise Permitted Under Copyright Law.

In *Bowers v. Bay State Technologies, Inc.*, 320 F.3d 1317 (Fed. Cir. 2003), the Federal Circuit upheld a clickwrap agreement prohibiting reverse engineering of a template to improve computer-assisted design software, even though such reverse engineering is traditionally protected under fair use principles in U.S. copyright law. The Supreme Court declined to hear this case. 2003 WL 2113991 (S. Ct. 2003).

Domain Name Proceedings are Not Arbitrations Under the Federal Arbitration Act.

In *Dluhos v. Strausberg*, 2003 WL 360964 (3rd Cir. Feb. 20, 2003), the Third Circuit held that UDRP proceedings are not arbitrations within the meaning of the Federal Arbitration Act and thus are not entitled to deferential judicial review under the Act. ■

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THREE MAJOR TRADEMARK OFFICES STREAMLINE TRADEMARK APPLICATION PROCESS

Kevin W. Grierson

The U.S., European, and Japanese trademark offices have reached an agreement on a list of acceptable descriptions of goods and services for trademarks and service marks. Applicants using a description from the list may use the same description for applications in all three offices, which should make the examination process smoother for applications in each office and for applications using the Madrid Protocol to extend protection from one country to others. The initial list contains over 7,000 entries, and more will be added as the three offices reach agreement on new designations of goods and services. ■

FIRM HOSTS FALL INTA ROUNDTABLE

The Intellectual Property Practice of Willcox & Savage is proud to host once again the Hampton Roads Roundtable of the International Trademark Association (INTA). After hosting in June the first INTA Roundtable ever held in Hampton Roads, we were very pleased to be asked to host the late October session on counterfeiting and trademark enforcement. If you would like to attend this seminar please visit www.inta.org. INTA is the world's largest trademark organization, and consists of 4,500 trademark owners and professionals from over 180 countries.

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