Protecting Intellectual Property

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§1 Introduction

In addition to the issues that may arise with respect to determining whether the founders may be knowingly or unknowingly using intellectual property that is actually owned by their ex-employers the founders must also seriously consider how they intend to build and protect their new company’s own portfolio of intellectual property rights. The scope of the intellectual property portfolio obviously depends on a variety of factors specific to the business activities of the new company and the relevant technology. For example, the founders must determine whether they need to file applications for patent, copyright and/or trademark protection and will almost always need to take appropriate steps to ensure that proprietary information qualified for trade secret protection under applicable state laws. The issues become even more complex, and potentially expensive, if the new company intends to manufacture and/or market its products in foreign countries since it will then be necessary for the company to perfect its intellectual property rights in each foreign country where it will be conducting business activities using inventions, information, ideas and concepts that would qualify for intellectual property protection.

One of the first steps that must be taken by the founders and their counsel is an analysis of the ownership of the technology that will be used in, or developed by, the new company. The founders may not be aware of the need to protect proprietary information, such as inventions, products, or processes. Counsel should warn about the need to protect such information and should elicit enough facts to know whether to recommend association of a specialist in trade secrets, patents, trademarks, trade names, or copyrights. Steps and actions to be taken include an audit of the company’s actual and potential intellectual property; an analysis of the steps taken to avoid infringement claims by former employers of the founding group; remedial action necessary to correct any defects in the company’s rights to technology to be used in the business; and implementation of procedures to perfect and protect intellectual property rights developed or acquired by the company in the future. In order for this process to be effective and useful, the founders must have a basic understanding of the most common and important forms of intellectual property rights.¹

§2 Patents

The first, and usually most strategically valuable, form of intellectual property right to consider is the patent—patent protection for inventions that meet the requisite standards of novelty, utility and non-obviousness is available in the US and most other countries around the world grant patents to inventors on similar terms. The owner of a patent is

¹ For detailed discussion of the forms of intellectual property rights, see “Technology Management: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
granted a limited monopoly over the invention covered by the patent, which is defined by the claims allowed by the patent examiner at the time the patent is granted. This monopoly, which generally extends for 17 years in the US, allows the patent owner to enjoin others from infringing the patented claims and also obtain damages from the infringer. Patents are only issued following filing and prosecution of a patent application—prosecution may be take anywhere from 12 – 24 months—and the filing, legal and other fees and costs associated with obtaining a patent can be quite high depending on the subject matter and the objections raised by other parties.

§3 Copyrights

A second important form of intellectual property right, particularly valuable in the software area, is the copyright. Copyright protection in the US is available for original works that are fixed in a tangible medium and can extend for the shorter of 75 years from the date of publication or 100 years from the date that the work is first created. Unlike patents, a copyright can be asserted under common law without registration; however, it is recommended that the owner of a copyright register the work with the US Copyright Office since registration prevents infringers from arguing that any copying was “innocent” and also fulfills the basic requirement for actually bringing an infringement claim. Registration creates a presumption that the copyright is valid and allows the owner to seek and obtain an award of statutory damages and attorneys’ fees from the date of registration (or even from the date of first publication if registration occurs within three months of publication) in an infringement action.

§4 Trade secrets

Trade secret law can also be used as the primary form of intellectual property protection even for inventions which might otherwise be eligible for patent protection. Although there is no universally accepted definition of a trade secret, the list of possible items can extend to almost any device or information, including formulas, databases, methods of operation, or materials that are used in a business and provide the owner with a competitive advantage over others who do not know or use the trade secret, provided that the trade secret is maintained in secret by the owner. The length of trade secret protection is not finite and may extend for so long as each of the essential elements (i.e., use, value, and secrecy) continues to exist. There are disadvantages of relying on trade secret law as opposed to seeking patent protection. For example, trade secret law does not create a legal monopoly in favor of the trade secret owner. Instead, the trade secret owner only has a cause of action against any party who wrongfully appropriates the trade secret, as well as a cause of action against persons who utilize any illegal or unethical methods to acquire the secret information. In addition, a trade secret owner cannot prevent others from independently developing the trade secret, even by reverse engineering, and thereafter practicing the trade secret as their own. In fact, in most cases, proof of lawful independent development and use of a device or information by another party will terminate the rights of the first owner to proceed against any other user of the secret.
One of the key strategic decisions that a technology-based company must make is whether to pursue patent protection for a particular invention or protect the invention as a trade secret. Ultimately, the decision to select either patent or trade secret protection will depend upon a variety of factors, including the anticipated life of the advantage that the invention provides over competitors; the costs and risks of maintaining trade secret protection; the difficulty of proving patent infringement after full disclosure of the invention in the patent application; and the anticipated efforts of third parties to replicate the invention, and the ease with which they may do so; pursuing a patent is more attractive when replication is easy. Although the exclusionary rights granted to the owner of a patent can have significant strategic value, there are a number of consequences which the inventor must take into account in deciding to file for a patent, particularly if the invention can be protected under trade secret law. For example, the information in the patent application will be available to permit the public to learn about the subject matter, thereby minimizing any advantage that the patentee may have had with regard to the general level of knowledge. Competitors can then use the information in the patent application in their own research programs, sometimes to allocate resources away from further work on products that would merely infringe upon the patented invention. Also, information in a patent application can often be used to develop non-infringing products which improve upon, or even replace, the original item. In some case companies will seek the best of all worlds and rely on patents and/or copyrights to protect the key elements of a new product or process and on trade secret law as the basis for protecting certain ideas and information that are ancillary to the invention or work that is the subject of the issued patent or the registered copyright.

Adequate and effective protection of any company’s portfolio of trade secrets requires the use of nondisclosure agreements, which establish a duty to the owner to maintain the confidentiality of the proprietary information that is disclosed under the agreement. Generally, a nondisclosure agreement should be executed by employees, consultants, and third parties afforded access to the new company’s proprietary information. Employees and consultants should be required to sign the agreement prior to beginning their relationship with the company and copies of the executed agreements should be maintained in the company’s files. Third parties, such as licensees and suppliers, should be asked to execute a nondisclosure agreement prior to the time that the company permits the party to have access to its trade secrets.

Employee nondisclosure agreements should include a covenant from the employee that, at all times during and after the term of employment, the employee will hold in confidence all of the trade secret information of the company to which the employee may have access. If the company has specific concerns about certain types of proprietary information, such as business plans or customer lists, they should be enumerated in the agreement so that the employee is put on notice as to those items the company is seeking to protect. Employees should be obligated to return all of the information he or she may have received relating to the company’s business upon termination of employment. Also, in some cases, consideration should be given to imposing post-employment restraints on the activities of certain employees, to the extent permitted by applicable law.
Although nondisclosure agreements with third parties will cover most of the same matters as those entered into with employees and consultants, it is important to take into account the specific circumstances pursuant to which the information is disclosed. For example, great care should be taken to identify the information that is to be protected and the permitted uses of the information by the third party. As with employee nondisclosure agreements, provision should be made for return of the proprietary information by the third party to the company following the termination of the relationship or transaction.

§5 Trademarks

Many companies derive substantial value from their selection and use their trademarks, which are words, names, symbols, devices, designs, phrases, colors, shapes, or any combination thereof used by a manufacturer or retailer of a product, in connection with that product, to help consumers identify that product as different from the products of competitors. A service mark is used for similar purposes in the area of services and can be used in any advertising or promotional activities away from the actual point of sale. Trademarks and service marks are used to identify the source or origin of a good or service, symbolize goodwill through the identification of the source and, in many cases, serve as a warranty or guarantee of the quality and utility of the good or service.

Trademark or service mark rights arise from the use of (or intent to use) a mark on goods or services. Although trademarks may be protected under common law, registration of the mark in accordance with the procedures established under the federal law relating to trademarks, described below, provides the owner with procedural rights, presumptions of validity and ownership, and the exclusive right to use the registered mark. A trademark or service mark has no separate existence apart from the commercial activities relating to the goods or services to which the mark relates. While trademarks will not prevent others from copying the goods themselves, the goodwill associated with the marks can be one of the most valuable assets of the business. Customer recognition of the marks can be a very important marketing tool, since the mark implies a certain level of quality and service which distinguishes the goods and services from nearly identical generic or “off-brand” substitutes. This advantage can be particularly important for new products, since customers may not be able to judge the features of the product other than by identification with the reputation of the trademark owner in the marketplace.

§6 Intellectual property rights in foreign markets

It is important to remember that even though the company acts to perfect it intellectual property rights in its home country, such as the US, it must also take separate action in each foreign country where it intends to exploit its intellectual property and/or prevent others from unauthorized practice of the same invention or use of materials, designs, logos and information that might qualify for other forms of legal protection. Building a global portfolio of intellectual property rights can be a costly proposition since filings must be made in multiple countries, each of which has its own requirements with respect to filing fees, and local counsel will generally have to be engaged to assist in the filing and prosecution process. It should be noted, however, that international conventions...
covering patents, copyrights and trademarks have helped to streamline the process somewhat and provide companies with limited windows to test the commercial viability of their inventions in their home country and other foreign markets before a final decision must be made as to whether to make filings all around the world. If there is a reasonable belief the product will be successful in both domestic and foreign markets it is worth the investment to ensure that infringers are deterred. Global intellectual property protection for a new product may also be mandated when the cost of developing the product is so high the company cannot expect to recoup its investment unless it can sell the product within and outside its home market.

§7 Intellectual property audits

As mentioned above, one of the first steps that must be taken by the founders and their counsel is an analysis of the ownership of the technology that will be used in, or developed by, the new company. Evaluation of the ownership of technology should, if possible, be done by conducting an intellectual property audit. The primary purpose of the audit is to determine the origin of the intangible assets and the extent of the company's interest in the technology and related intellectual property rights. In addition, the intellectual property audit will determine the scope of rights that third parties may have, by license, ownership or otherwise, in the company's assets. Intellectual property audits also provide information to a company with respect to implementation of systematic procedures for protecting and perfecting intellectual property rights. Finally, the intellectual property audit may allow the company to avoid liability for third party claims and infringement resulting from the development of new products. As a result, not only does the intellectual property audit provide information regarding the ownership of technology that was created, but it also helps the company implement the procedures to ensure that it will own the technology that is created in the future.

Although the intellectual property audit is important for all technology-related start-ups, it is crucial for companies that are seeking venture capital financing or contemplating licensing or joint venture arrangements. Venture capital firms potentially interested in funding the company, licensees or potential joint venture partners will conduct their own audits. An audit conducted by these entities may vary in scope, depending on the circumstances of each transaction. As a result, it is very important for the company to perform its own audit prior to seeking those arrangements. By conducting the audit, the company will be able to identify and potentially correct any problems prior to entering into negotiations. If problems are not detected until these entities conduct their due diligence, the agreements will be significantly delayed or the defects in the chain of title will simply cause these parties to look at other opportunities. Depending upon the complexity of the audit, the process can take from several weeks to several months. The final audit report may be in a letter or in a more detailed comprehensive report.

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2 For detailed discussion of intellectual property audits, see “Technology Management: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
The intellectual property audit may reveal unprotected technology, defects in the chain of title or that a third party has rights in the technology. If there is a defect in the chain of title, remedial action may include obtaining written assignments from parties that may have an interest; licensing the rights of third parties; reverse engineering the technology or part thereof; or independent development of the technology or part thereof using cleanroom procedures. The audit is also the best way to ascertain the likelihood of infringement claims by former employers of one or more of the founders. Where the founders are involved in the development of similar technology with their former employer, the former employer may have a claim to the technology. In order to determine the level of risk associated with potential claims by former employers of the founders a thorough analysis should be made of the founders’ past duties and activities and any written agreements they might have with their former employers regarding ownership and use of technology and other work product that qualifies for one of the forms of intellectual property protection described above.

§8 Designing and establishing an intellectual property portfolio

Once the array of the possible forms of intellectual property protection are understood it is time to review the particular circumstances surrounding the efforts of the founders to develop and launch their initial products or services. Assume, for example, that the founders of a US company have decided to build a business around the development and manufacture of sophisticated widget products to specified niche markets that they believe to be of no interest to their ex-employer. The finished product would include both hardware and software designed by the engineer on the founder team and would be marketed under a catchy new trade name chosen by the other founder. Since the basic widget products have already been introduced and been successful in the US and in selected foreign markets the founders have reason to believe that the new products can quickly and easily be marketed and sold around the world and they are already laying plans to contact candidates to act as authorized agents and distributors in Europe and Asia as well as hiring employees to build a domestic sales force. While the founders have generally kept a low profile regarding their new project, elements of the technology to be used in designing the products have been discussed in a presentation that one of the founders made to an academic conference of engineers while he was still working for his ex-employer and the founders have also explained the new technology to a small number of potential investors.

The founders may begin creating the intellectual property portfolio for their new company by preparing and filing patent applications covering the hardware and, if feasible, the software associated with their new widget product. The decision to seek a patent for a new invention is based on a number of factors including the relevant “prior art,” which is important in evaluating whether the invention will be sufficiently “novel” to warrant patent protection; the likelihood of opposition from the owners of patents covering similar inventions; and the anticipated life cycle of the invention. In fact, if the company believes that the invention will become obsolete well before the end of the term of a patent, if issued, it may forego applying for a patent and rely on trade secret
protection in order to avoid the disclosure of proprietary technology that must be made at the time that the patent application is published as a condition to issuance of the patent.

The scope of the patent application and prosecution effort depends on the anticipated market for the invention. Since they expect to market the products globally the founders should plan on filings in the US and in all of the potential primary foreign markets—Canada, Europe and major Asian markets. The US filing must be made within one year following “publication” and international patent treaties will provide the founders with a grace period of up to 20 months following the US filing to submit applications in most foreign countries that will be deemed to have the same filing date as the US application. This can be a substantial benefit for new companies that lack the funds to prosecute patent applications in all of the jurisdictions from the outset because the company can test the product in key markets before deciding whether to move forward with the actual patent application filing. Unfortunately each country still has its own standards for reviewing patent applications and it may take a significant amount of time before a company is able to fill out its portfolio of issued patents.

A universal requirement for patent protection is “novelty” and the founders need to consider whether they have intentionally or inadvertently “published” the invention more than a year before the anticipated filing date for the application and thus destroyed the novelty necessary for the patent to be issued. Ideally this issue will be considered well in advance and the in the fact pattern above the founders need to pay particular attention to the presentations made at the academic conference and to prospective investors. If the founders prepared written materials that are widely disseminated there is a great risk that they will not be able to overcome the novelty hurdle if they fail to file the patent application in a timely fashion. On the other hand, oral disclosures of the invention in general terms to investors who have signed non-disclosure agreements may not constitute “publication”. It should be noted that even if patent protection is not available the founders may be able to build a wall around proprietary information relating to the conception and use of the invention by relying on trade secret law; however, this strategy may be less effective outside of the US since many countries do not aggressively enforce trade secret laws. In addition, the software included in the new widget product can be protected under the copyright laws and copyright protection will continue even after the patents covering the software, if any, have expired.

The other issue to consider is what steps can be taken to begin building and protecting a “brand” relating to the company’s new product. In the intellectual property area this means establishing a trademark portfolio that includes the trade names and logos that have been created to identify and distinguish the new products in the marketplace. As is the case with patents and copyrights, trademark registrations must be completed in the US and in all relevant foreign countries. It is important to act quickly since most jurisdictions will give priority to registrants who are the “first-to-file.” The registration process should be launched as soon as the company has decided on the names and logos and can made on an “intent to use” basis if the product has not launched at the time that the registration is filed. If a pre-use filing is made the company must be sure to provide the governmental authorities with evidence of actual use in the jurisdiction as soon as it is
available or risk have the registration application deemed to be abandoned. It generally takes 15-18 months to receive a final decision on trademark registration application and other parties will have the opportunity to oppose the registration on various grounds. Once registration is completed the company will need to establish a process for monitoring potential infringers and counterfeiters around the world. One useful strategy is to notify customs officials of the registration so that they can keep an eye out for imported goods that bear the trademark without the authorization of the trademark owner.

§9 Intellectual property protection programs

In addition to auditing the company’s intellectual property rights portfolio and establishing and executing strategies to expand that portfolio the founders must also ensure that procedures are implemented to perfect and defend any intellectual property rights that the company may develop or acquire in the future, as well as rights that exist at the time the company is originally formed and organized. Among the steps that should be taken are protecting the company's rights in inventions conceived by employees; establishing a program for identifying and protecting trade secrets used in the company's business; and perfecting the company's copyrights in creative works developed by employees and/or independent contractors.

In the technology arena, employees often are hired specifically to create and develop new products that are eligible for protection under patent laws. While employers generally have ownership rights in inventions conceived by their employees during the course of the employment relationship, it is prudent for the company to have each of its creative employees execute some form of formal assignment of inventions agreements at the time they begin their employment with the company.

In addition to protection of inventions that meet the strict criteria for patent protection, the company should also implement a trade secret protection program, including a set of procedures designed to ensure that trade secrets are not disclosed to the public or misappropriated by persons with access to such trade secrets. The steps that should be taken include making sure that all employees and all other persons (e.g., licensees, vendors, consultants, etc.) with access to the company's trade secrets and other confidential information execute and deliver a confidentiality agreement; implementing physical security measures; marking documents “confidential”; and informing employees of their trade secret protection obligations with posters and notices. To have an effective trade secret protection program, an employee within the company should be appointed as the trade secret coordinator with responsibility for the continuous monitoring, review and assessment of the program. Such person should have the ability to enforce the program and periodically evaluate how well it is working, adding or deleting features as required.

Many products and services are based upon drawings, diagrams, reports, and other items reduced to a tangible medium of expression. In addition, many products involve software ranging from a microcode embedded on an integrated circuit to a stand-alone software product. As a result, copyright law is often used to determine ownership rights. A copyright is usually owned by the author of the work who is generally the person who
translates the idea into a fixed, tangible expression entitled to copyright protection. However, in cases of a “work made for hire,” the employer or other person for whom the work is made is considered the author. While the “work made for hire” doctrine sets the ground rules for ownership of the work that has been created at the direction of someone who might not have expended any labor in its creation, (i.e., a person or company who engages the services of an independent contractor to develop the particular work), uncertainties with the application of the doctrine makes it absolutely essential that companies obtain written agreements with consultants that assist in product development. The company should also make a practice of filing copyright applications for all qualifying works, regardless of whether they were created by employees or independent contractors.
About the Author

This chapter was written by Alan S. Gutterman, whose prolific output of practical guidance and tools for legal and financial professionals, managers, entrepreneurs and investors has made him one of the best-selling individual authors in the global legal publishing marketplace. His cornerstone work, Business Transactions Solution, is an online-only product available and featured on Thomson Reuters’ Westlaw, the world’s largest legal content platform, which includes almost 200 book-length modules covering the entire lifecycle of a business. Alan has also authored or edited over 90 books on sustainable entrepreneurship, leadership and management, business law and transactions, international law and business and technology management for a number of publishers including Thomson Reuters, Practical Law, Kluwer, Aspatore, Oxford, Quorum, ABA Press, Aspen, Sweet & Maxwell, Euromoney, Business Expert Press, Harvard Business Publishing, CCH and BNA. Alan is currently a partner of GCA Law Partners LLP in Mountain View CA (www.gcalaw.com) and has extensive experience as a partner and senior counsel with internationally recognized law firms counseling small and large business enterprises in the areas of general corporate and securities matters, venture capital, mergers and acquisitions, international law and transactions, strategic business alliances, technology transfers and intellectual property, and has also held senior management positions with several technology-based businesses including service as the chief legal officer of a leading international distributor of IT products headquartered in Silicon Valley and as the chief operating officer of an emerging broadband media company. He has been an adjunct faculty member at several colleges and universities, including Berkeley Law, Golden Gate University, Hastings College of Law, Santa Clara University and the University of San Francisco, teaching classes on corporate finance, venture capital, corporate governance, Japanese business law and law and economic development. He has also launched and oversees projects relating to sustainable entrepreneurship and ageism. He received his A.B., M.B.A., and J.D. from the University of California at Berkeley, a D.B.A. from Golden Gate University, and a Ph. D. from the University of Cambridge. For more information about Alan and his activities, and the services he provides through GCA Law Partners LLP, please contact him directly at alangutterman@gmail.com, follow him on LinkedIn (https://www.linkedin.com/in/alangutterman/) and visit his website at alangutterman.com.

About the Project

The Sustainable Entrepreneurship Project (www.seproject.org) was launched by Alan Gutterman to teach and support individuals and companies, both startups and mature firms, seeking to create and build sustainable businesses based on purpose, innovation, shared value and respect for people and planet. The Project is a California nonprofit public benefit corporation with tax exempt status under section 501(c)(3) of the Internal Revenue Code dedicated to furthering and promoting sustainable entrepreneurship through education and awareness and supporting entrepreneurs in their efforts to launch and scale innovative sustainable enterprises that will have a material positive environmental or social impact on society as a whole.

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