

How to Avoid Common IP Mistakes Made by Early-Stage Companies—Part 2: Copyrights, Open Source Software, and Trade Secrets

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This is the second in a regular series that the Intellectual Property Group at Lowenstein Sandler will produce relating to common IP mistakes early-stage companies make when building a business.

One of the most frequent concerns raised by early-stage companies is the need to protect their proprietary intellectual property. As most venture-backed deals rely on the scalability of some form of intellectual property, this is not surprising. What tends to surprise founders is that the special, proprietary, and valuable development that they have created and plan to base their business on may not be the sort of intellectual property protectable through a patent issuance from the United States Patent and Trademark Office. In fact, many of our successful clients have found that their most valuable intellectual property is best protected via internal practices and contracting. This allows the company to protect items such as software code and business methods through a combination of copyright, trade secret, and contract law.

The best advice for an early-stage company looking to protect its nonpatentable intellectual property is to maintain good corporate hygiene, including the maintenance of employee nondisclosure and invention assignment agreements (NDIAAs), confidentiality agreements for prospective new business relationships, a strong intellectual property protection policy, and to the extent applicable, an open source code usage policy. Three common missteps made by companies that do not incorporate these methods into practice, as well as solutions to avoid these missteps, are below.

- **Mistake:** Many companies rely on the premise that any intellectual property developed by employees or contractors on behalf of the company will automatically be owned by the company. This is not true. Although copyrightable intellectual property developed in the scope of an employee's employment would be owned by the employer, employees may retain certain "shop rights" in patentable intellectual property, leaving the company's rights encumbered in a manner that could frustrate the goals of investors or acquirers. Additionally, the default rule for independent contractors is that the contractor will own the intellectual property, unless such intellectual property is specifically deemed "work-made-for-hire."
- **Solution:** By maintaining form employee NDIAAs and intellectual property assignment language for inclusion in contractor agreements, companies can avoid the headache of needing to chase down former employees or contractors who have developed material intellectual property used in the business, when inevitably asked to do so in future financing transactions. By clearly laying out the ownership rights of the company at the start of an employment or engagement, companies will avoid any confusion or unexpected claims in the future from a potential disgruntled former colleague.
- **Mistake:** Software is subject to copyrights in the object code, source code, and expression of the functioning software that is output on a computer. Therefore, copying a portion of source code, or

working around the use of particular source code to achieve the same output, may in each case create a copyright violation. If your company provides services on behalf of customers, you must ensure you retain all intellectual property rights to your developments that are necessary to continue operations of the business.

- **Solution:** Companies that are not in the practice of developing intellectual property on behalf of their customers, but are still engaged in providing software-related services, should include intellectual property ownership provisions clarifying that the customer shall not obtain any ownership rights in any developed intellectual property. Companies that are engaged in such development on behalf of customers may be required to assign ownership rights of certain developed intellectual property to their customers. Such ownership rights granted to the customer should be tailored as narrowly as possible, and should apply only to entirely new intellectual property specifically requested by the customer. Additionally, the company should seek to maintain an irrevocable and perpetual license to continue using such assigned intellectual property in its own business of providing services to

customers. When negotiating agreements such as these, the company will need to be forward looking in determining whether the intellectual property they plan to assign will be needed for future customers, rather than relying on a belief that they can find a work-around to provide similar intellectual property to others while avoiding infringement claims.

- **Mistake:** Open source software is often available free of charge, but there are usually restrictions associated with the licenses for such software that must be followed. Failing to review and adhere to the license terms prior to integration into a proprietary code-base may result in a violation of the underlying source code's copyright, or worse, could lead to a requirement to release proprietary source code to the public on the same license terms as those of the applicable open source license, including for free.
- **Solution:** A company that's value proposition relies on the provision of software to its customers should maintain a robust open source software usage policy. Such policy should include a process for review of open source licenses and acceptable usage, as well as regular code reviews to maintain code-base and license integrity.

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