

## MAINTAINING INTELLECTUAL PROPERTY: KEEPING YOUR HOUSE IN ORDER

by  
William H. Venema  
[bill@thevenemareport.com](mailto:bill@thevenemareport.com)

Obviously, intellectual property assets (“**IP assets**”) are an essential component of the value of a software company. Consequently, it is important to keep them in order. There are four principal kinds of IP assets, each of which is managed differently.

### Types of IP Assets

- Patents,
- Copyrights,
- Trademarks, and
- Trade secrets (and other confidential information)

The first step in managing your company’s IP assets is to identify what the significant IP assets are. Then, you should assess, sometimes with the help of experts, exactly what the company’s rights are with respect to those IP assets. If you are considering a sale of the company, for example, some of the company’s rights could be affected by the contemplated transaction. The company’s rights in the IP assets could be based on either ownership of the intellectual property or on a license. Understanding the company’s rights is an essential prerequisite to managing them properly.

**Patents.** To check the company’s rights to patents and patent applications, including any assignments of either of them, you should review the records of the U.S. Patent and Trademark Office (the “**PTO**”) or the appropriate foreign patent office. You should particularly examine any patents that the company received by means of assignment from

the inventor or another party. Although the parties to a patent assignment are not required to file assignments of patents with the PTO, there are good reasons to do so. Section 261 of Title 35 of the U.S. Code provides:

An assignment, grant or conveyance shall be void as against any subsequent buyer or mortgagee for a valuable consideration, without notice, unless it is recorded in the Patent and Trademark Office within three months from its date or prior to the date of such subsequent purchase or mortgage.

In managing the company's patents, it is important to keep in mind the nature of the rights that a patent creates. A patent confers only the *right to exclude others* from practicing the "art" set forth in the patent. *It does not convey to holder of the patent the right to use the invention.* Consequently, even if your company has a patent on a particular software product (or other product) it might not be free to make and sell the product. To make that determination, you must examine all existing patents that might impact the product in question. Nevertheless, even a thorough review of all existing patents will not guarantee that the company is free to sell a particular product, because the PTO must keep patent applications secret for the first 18 months. Thus, there is no way to examine these patent applications, which might significantly affect the company's rights to its products. Accordingly, patent records should be reviewed periodically—in most cases, annually.

**Trademarks.** Trademarks can also be registered at the PTO, and therefore, you should also conduct a review of the company's trademarks that is similar to the review normally undertaken for patents. Unfortunately, examining rights to trademarks is not simply a matter of examining the records at the PTO, because not all trademarks are registered with the PTO. A person can establish trademark rights in the United States by simply using the trademark in commerce. For these "common law" trademarks there is no government register to review. Instead, the owner's rights in the trademark are defined by the scope of its use. To investigate such trademarks, you must examine a number of public databases to assess the company's rights in its trademarks. Fortunately, there are several commercial services that can assist with this task at relatively low cost.

**Copyrights.** A person's rights in a copyright are automatically created when a copyrightable work is reduced to a fixed tangible form. Although the owner can register

the copyright in the U.S. Copyright Office, there is no requirement to do so. If the copyright is registered, however, it will be indexed by registration number and title. Although parties may record assignments of registered and unregistered copyrights, there is no requirement to do so. Section 205 of Title 17 of the U.S. Code provides that recording the copyright gives constructive notice only where the document recorded specifically identifies the work, and the work is registered. Security interests in copyrights may be perfected only if the work is registered and the security interest is recorded. As with trademarks, there is no government register or other index that you can review to ascertain the company's ownership rights in a particular copyrighted work.

With respect to any type of copyrightable work, you should pay particular attention to the manner in which ownership was originally acquired. There are two aspects of copyright law that are of particular importance to software companies and deserve special attention:

- the ramifications of “work made for hire” rule of copyright law and
- the parties involved in the development of the software.

The “work made for hire” rule can be generally stated as follows: Absent a signed written agreement to the contrary, an employer owns the copyright to any work created by an employee in the scope of the employee's employment. If, however, the person developing the copyrightable work is an independent contractor, then ***the independent contractor owns the copyright***. Also, if an employee develops the copyrightable work ***outside the scope*** of the employee's employment, then ***the employee owns it***. Copyrightable works that are created by an independent contractor will be deemed to be works for hire only if:

- they fall within one of nine statutorily enumerated types of works, and
- there is a written agreement to that effect.

(See Title 17 of the U.S. Code, Sections 101 and 201.) Accordingly, with regard to any work performed by an independent contractor, you should review the terms of the company's agreement with the independent contractor, to ensure that the ***company*** owns the rights in the IP developed by the independent contractor, ***not*** the independent contractor.

**Special Scrutiny of Software.** Because the company's software is often one of the most critical factors in determining the value of a software company, the management of the intellectual property that comprises the company's software is particularly important.

There are many things that can affect the value of the software, and therefore, your management of this particular IP asset is likely to be multifaceted.

Problems with software can often arise if the development of the software in question involved the use of an independent contractor. If the company failed to require the independent contractor to execute an appropriate assignment, then the contractor might be in a position to assert ownership of the resulting copyright. During the course of the development of particular software, an individual involved in the development might start out as employee of the company, leave the company but continue to provide consulting services as an independent contractor, and then perhaps return to the company again as an employee. It is a rare company that can keep the paperwork straight in such a dynamic environment. Nevertheless, it is important to try to do so, especially with regard to the company's most important IP assets.

You should note, however, that even if an independent contractor owns the copyright, it does not mean that the company has no rights in the software. Generally, the company would have an "implied license to use" the software. Unfortunately, the scope of such a license is vague; it will not be exclusive; and it might not include all of the uses that the company contemplates for the software. Your program for managing the company's IP assets should be designed to ensure that the company has obtained all necessary assignments from independent contractors in connection with its software products.

Beyond the work-made-for-hire issue, problems can also arise if all or a portion of the software was copied from another, rather than developed as original work by or for the company. You should maintain detailed records that establish the originality of each of the company's software products.

**Trade Secrets.** The Model Trade Secrets Act, which has been enacted by most states, protects information that derives independent economic value from the fact that it is generally unknown to others. "Trade secrets" include technical or non-technical data, formulas, patterns, compilations, programs, devices, methods, techniques, drawings, processes, financial data, financial plans, product plans, and lists of actual or potential customers or suppliers. The key is that such information must be secret; that is, not commonly known by, or available to, the public. In addition, to be a trade secret the information must:

- Derive economic value, actual or potential, from the fact that it is not generally known to other persons who could obtain economic value from its disclosure or use; and
- Be the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

For trade secrets, there is no governmental or other index that can be reviewed to determine ownership. Because there is no governmental role in the creation of a trade secret, it is more difficult to establish the company's ownership of, and/or rights in, this type of IP asset than it is with a patent, a copyright, or a trademark.

#### **Two Critical Questions To Ask In Assessing A Company's Trade Secrets**

1. Did the company develop the trade secrets *independently*, free from reliance on any proprietary information of a third party?
2. What *level of security* has the company employed to maintain the secrecy of its trade secrets? Specifically,
  - (a) Was it sufficient to qualify the information as a trade secret?
  - (b) Are additional or alternative measures warranted?

Because your company cannot disclose its trade secrets without jeopardizing their trade secret status, you must be careful in selecting individuals to assist you with this portion of the management of the company's IP assets. The task of managing the company's trade secrets will involve interviewing key employees and reviewing company employment and security policies. In addition, you should inventory, and provide names for, all of the material trade secrets utilized by the company, if for no other reason than to have a basis for discussing and managing them.

After preparing a list of all of the company's important trade secrets, you should try to determine whether all key employees, independent contractors, and other individuals or entities having access to the company's confidential information have executed valid non-disclosure agreements, and whether the company's key employees have also executed valid non-competition agreements. You should also review and evaluate your company's security policies, including its physical, technical, and administrative security policies and procedures to ensure that they: (i) provide appropriate levels of protection for each of the company's trade secrets and other confidential information and (ii) satisfy the requirement

of most state statutes that the trade secrets and confidential information are subject to efforts that are reasonable under the circumstances to maintain their secrecy.

**Third-Party IP: “Licenses In.”** Often, significant portions of a company’s IP assets are owned by third parties, and the company’s rights to such IP assets arise pursuant to licenses. Such licenses are commonly referred to as “licenses in.” In examining licenses in, you should focus on two principal issues:

1. Does the company have the rights that it needs to such third-party IP assets?
2. Will the company continue to have such rights if it sells substantially all of its assets or its shareholders sell their stock and cause a change of control?

Because licenses of IP assets are personal services contracts, the rights and obligations set forth in them are not assignable, absent a provision to the contrary. In fact, most license agreements specifically state that the rights and obligations they create cannot be assigned or sublicensed. Some licenses go even further and provide that the licensor can terminate the license in the event of a change of control in the licensee. Accordingly, if you are contemplating a sale of your company you should determine how, if at all, each license would be affected by the sale.

If the sale of the company might cause critical third-party IP rights to be terminated, then you might try to modify the structure of the transaction to avoid the termination of such rights. For example, if the sale of the company is structured as an acquisition of substantially all of the assets of the company, and the parties have been unable to obtain a third-party licensor’s consent to assign a license from the company to the buyer, then the parties might consider restructuring the transaction as a stock acquisition, in which case no assignment of the rights and obligations under that agreement would be necessary. Caution is in order, however, because there could be a provision in the license that causes it to terminate in the event of a change of control.

Merger is also an option under the laws of some states. In Delaware, for example, when a corporate licensee is merged with and into another corporation, no assignment of rights or obligations under the license agreement is necessary. Instead, the surviving corporation assumes those rights and obligations by operation of law. Note, however, that some anti-assignment provisions specifically provide that a licensee may not assign the

license without consent, even pursuant to an assignment by operation of law. Consequently, be careful in modifying the structure of the transaction. In addition to being an ineffective attempt to solve problems caused by an anti-assignment provision, modifying the structure might also have undesirable ramifications in connection with other legal or commercial issues, such as liability issues, tax issues, etc.

Altering the structure of the transaction should not be undertaken lightly. If, however, it is impracticable to obtain all of the necessary consents to assignment from third parties, and the the rights to the IP assets in question are more important than the possible undesirable ramifications arising from changing the structure of the transaction, then changing the structure of the transaction might be a viable way to consummate the deal.

**Conclusion.** It is highly likely that a software company's IP assets are an extremely important part of the company's value. Therefore, they should be managed with the same care and attention that are afforded to other company assets. Managers should ensure that they understand the company's rights with respect to each IP asset so that they are managed properly.

***The matters discussed in this paper involve a complex area of the law. Despite the length of the paper, it is not an all-inclusive discussion of the issues presented and does not represent legal advice. Accordingly, it should not be relied upon without consulting with a qualified attorney.***