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11/19/2019 | In the Media

Building an IP Strategy: IP as Investment

As an early stage company, you may be a disruptor or seek to advance a key technology in which your team has particular expertise. No matter the driver, even the most idealistic startups fail to achieve their goals if they do not position themselves for investment funding of some kind. Those investments are typically based on the potential financial return of a subsequent acquisition or public offering.

At each stage of the investment cycle, your investors and business partners will scrutinise your people, technology and operations. A robust intellectual property (IP) programme will ensure that the efforts of your people are owned by your company, that your technology is safe from theft or copying and that your operations (such as branding, goodwill and customer relationships) are protected from free riders. In short, a sound IP strategy adds value to your business – IP is an investment, not a cost, if handled well.

The first two sections of this chapter, 'Establishing IP Best Practices' (Section 1) and 'Acquiring IP Assets' (Section 2), detail the steps of building an IP programme. Follow the principles outlined in these sections, and you will be well positioned for funding events, third-party IP issues and IP disputes (Sections 3–5).

1. ESTABLISHING IP BEST PRACTICES

Founders often think of IP in terms of monopoly rights, such as patents and trademark registrations. In fact, virtually all early stage agreements a company will sign – whether with founders, employees, contractors, business partners, suppliers or customers – will have a core IP element. An established recognition of IP in your systems and business practices, from founding through funding, will dictate whether the benefits of your business-building efforts accrue to your company, other companies or the general public.

The following are subjects to address with founders, employees and contractors:

- If possible, obtain a forward-looking assignment of all pre-existing IP that is related to the company's business. A s a second-best option, obtain a licence to use the IP. Otherwise, the IP holder may hold the company hostage later, particularly if relationships sour.
- Obtain assignment of all IP developed by personnel while employed or retained by the company. If possible, include related developments from employee side projects.
- Require confidentiality and non-disclosure obligations for any non-public information related to the company or derived from company information.
- Where allowable (check laws in local jurisdictions), obtain a reasonable non- compete clause (reasonable as to time, scope and geography) at the beginning of engagement to address subsequent separation from the company. Depending on local laws, consider limitations on the use of retained information in human memory (residuals).
- Require ongoing obligations to co-operate in the acquisition, enforcement and/ or defence of IP.
- Require compliance with approved device policies that limit where, how and with what devices employees can access company information.
- For contractors, ensure by contract that any creative works (including source code) are explicitly works made for hire on behalf of the company.

All of these rules are equally likely to also apply to agreements with third parties, such as suppliers, joint venture and business partners, distributors and customers. In addition, you should also consider the following:

- disclosure of IP and establishment of licences to use IP of suppliers, joint venture partners and other business partners;
- allocation of jointly developed IP rights for joint venture and business partners – either ongoing rights to use or co-ownership;
- indemnification and defence obligations for infringement due to company use of supplier and business partner products and technology, and for infringement by business partners and customers through use of the company's products and technology; and
- limitations on liability incurred due to IP indemnification, IP defence or breach of any other obligations.

Suitable agreements can be provided by your business or IP counsel. As a practical matter early stage companies are generally able to obtain pragmatic IP terms from employees and contractors, while larger established firms often attempt to impose unfavourable IP terms on early stage companies. In the latter instance, the established firms' lengthy 'form' documents often include onerous buried terms that may compromise your company's core IP. Identifying and addressing those terms can secure the company's long-term prospects. In our experience, most large firms know that some of their terms are onerous (even unenforceable) and are willing to walk those terms back during negotiations. If an agreement sacrifices too much of your company's IP and the large firm is unwilling to negotiate, you must be willing to walk away.

While the right agreements establish that you own and control your IP, proper business practices are key to creating IP in the first place. Section 2 addresses the types of IP and how they are established in more detail, but as a general matter the company should consider at least the following steps:

- Establish and enforce standards for electronic storage systems, physical document retention and device usage.
- Document code and product development activity and revisions, and establish protocols for storage and maintenance of these materials.
- Maintain reasonable access controls to facilities and documents, particularly for key technology, customer lists, supplier information, business plans and financial data.
- Establish onboarding and exit procedures to ensure that employees sign required agreements, have appropriate access to company-related information and remain informed of their ongoing obligations to the company.

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- Establish branding and marketing guidelines that ensure consistent messaging, provide notice of copyright and trademark ownership and prevent inadvertent loss of trademark rights through dilution.
- Establish invention disclosure processes to establish a record of invention, and initiate reviews for considering patent versus trade secret protection.
- Perform pre-disclosure reviews before technology is disclosed to any third part y or prior to any sales efforts (even under a non-disclosure agreement [NDA]) to prevent inadvertent disclosure and loss of trade secrets or patent rights.
- Periodically monitor for third-party use of company IP (including by business partners) to identify problems early, when resolution is more likely and less costly.

One brief note on dealings with investors: venture capital firms (VCs), and even seed investors, do not typically sign NDAs. It is therefore recommended that you work with your IP counsel to distinguish your business idea from your 'special sauce' that uniquely addresses that business idea. The former is suitable for initial discussions, while the latter should either be covered by a patent filing prior to discussions or held for a later meeting, when the investors are willing to sign an NDA that protects your trade secrets and potential patent filings. As with all bad business deals, if a VC requires that you give away your special sauce to get a meeting, you need to stand your ground.

2. ACQUIRING IP ASSETS

You might ask: why address IP best practices before introducing the different types of IP assets and how they are acquired? The simple answer is that companies automatically acquire most IP as a result of following these best practices. As for IP that requires the grant of rights from a government agency (e.g. patents) or that is enhanced by such approval (e.g. trademarks, design rights and sometimes copyright), following these best practices establishes the baseline for registration.

For each of the four core types of IP, we provide examples of protected subject matter, how the IP rights are acquired and international considerations in Table 1.

Assuming a company establishes and maintains IP best practices, the next step is to establish a strategy for securing IP by patents, trademark registrations, copyright registrations, design right s and domain name registrations. This strategy will vary depending on the technology area, type of business and available funding. The IP strategy should be developed with an IP professional to provide a realistic cost–benefit balance. As a rough rule of thumb, a product company will typically file provisional patent applications prior to product release or sales efforts, obtain trademark clearance for company and product names well before launch, and register core trademarks, domain name and copyright s as necessary. Most international filing regimes provide a grace period (around 6–12 months) from an initial filing, and international protection is typically pursued as these deadlines approach and the company has further considered product development and it's likely international footprint.

While the basic concepts of protecting IP around the world adhere to a common format, there are wrinkles that can trip up the unwary. For example, the average US company will often want to rely on the protection afforded under US patent law on the effect of the sale of goods subsequently covered by a patent application. However, much of the rest of the world (China, Europe, Japan and Korea, for example) will regard such sales as a potentially public disclosure of the invention, which could invalidate patent rights. The general advice is not to assume the law is uniform and check with IP counsel in advance.

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Table 1. Types of IP: What they protect, how they are acquired and international considerations

IP right	**What is protected?**	**How is it acquired?**
Trade secrets	Confidential information that has value to the business, such as source code, schematics, business plans, customer lists, suppliers and sourcing and pricing. Trade secret rights last as long as the information is kept secret.	The company must engage in reasonable to keep the information secret. No governm is available. Trade secrets require docume to maintain secrecy, including agreements processes.
Patents	New inventions in technological fields, including electronics, software, pharmaceuticals, compositions, biotechnology and mechanical devices. Patents are a monopoly right with a limited term (typically 20 years).	The company must apply for a patent by fi prior to a filing by a third party and prior to disclosures of the invention, often including filing and examination is generally not che are strategies for deferring costs until later process.
Trademarks, design rights and domain names	Branding and goodwill from company name, advertising, taglines, product design, user interface design and domain names. Trademarks may be maintained as long as the mark is in use and used properly, while design rights have a limited term .	Some jurisdictions establish ‘common law use in the jurisdiction, with enhanced right registration and notice. Other jurisdictions registration as a prerequisite to bringing a Design rights and domains typically must b exceptions exist.
Copyright	Creative works, photographs, videos, source code and unique interface elements. Copyrights have a limited term, but that term is lengthy in many instances.	Copyright is established with the creation o enhanced in some jurisdictions through reg notice. Costs of registration are generally n costs can escalate for businesses with an of creative content.

3. FUNDING EVENTS

Fancy lunchrooms and company jacket saside, founders, early stage employees and investors are compensated and motivated by an eventual return on their company stock due to acquisition or a public offering. But until that day comes, the company's operations must be funded. At each stage of your journey, from notes on a napkin to acquisition or initial public offering (IPO), sophisticated third parties considering investing will scrutinise your IP.

The level of scrutiny will vary depending on the stage of your company and the investor or purchaser. For example, early stage investors typically know or are connected to the founders and may be willing to sign on to convertible notes (a type of 'loan' in which the investor receives equity instead of principal and interest in return) on a handshake or based on a high-level view of the IP position. By the time of your first venture capital roadshow, expect to get into the weeds on your IP portfolio and operations. The company may be expected to make numerous representations and warranties, for example:

- ownership of IP, including IP developed by employees, contractors, joint venture partners, etc.;
- confirmation that employees and third parties are subject to appropriate confidentiality obligations;
- licences necessary to operate the company's business, and a lack of obligations to third parties who may compete with or impede the company's operations;
- non-infringement of third-party IP, particularly in technical areas related to the company's core business and technology; and
- IP rights obtained to create barriers to entry for third parties, IP rights obtained legitimately from the relevant IP authorities and IP rights still being valid.

It may be entirely reasonable to include a qualifier (e.g. 'To the company's knowledge, it does not infringe . . .') for any of these representations and warranties, which, if incorrect, can form the basis for a later lawsuit against the company.

Depending on the transaction, the company may also be required to provide detailed schedules listing relevant IP assets, pending or threatened infringement litigation, employment status of key inventors and key licences.

Particularly for later venture capital rounds, acquisition or IPO, companies will typically work with outside IP counsel to negotiate the IP portions of the deal and put together these
schedules. The counterparty will scrutinise your disclosures very closely, typically with a team of lawyers and consultants. Particularly in the US, a company's IP disclosures may also be reviewed by national regulatory agencies, such as the Securities and Exchange Commission.

Many companies have failed to attract funding or suffered a significant drop in valuation due to a lack of attention to the IP details. Investing in an IP strategy early more than pays for itself.

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4. THIRD-PARTY IP ISSUES

Consider third-party IP issues before investing significant capital in your brand, technology and people. Does your trading style infringe on third-party trademark rights in the jurisdictions where you are likely to do business? What is the patent landscape like in your field? Before they begin working on your products, code or sales, are your key employees subject to non-compete obligations to third parties? Are they relying on third-party trade secrets? Does your business plan rely on use of copyright-protected third- party materials that may attract regulatory scrutiny? Are you using open-source software or having to adhere to specific technical standards? Any of these issues may compromise your freedom of movement.

Implement appropriate action early to address third-party IP issues. Although the ‘bet ter to ask for forgiveness than permission approach sometimes works for high-growth companies, it is not recommended unless you want to risk buying your way out of trouble and paying large legal bills in the process. The better approach is to work with IP counsel early to perform a comprehensive IP analysis, consider potential design-arounds, monitor competitor hires and onboarding, build compliant copyright practices into your business, and set up safeguards to make informed decisions about the use of open-source software and participation in standard-setting organisations.

Your early stage company does not exist in a vacuum . However groundbreaking your technology or business may be, you stand on the shoulders of the inventive individuals and companies that came before you. In an interconnected global economy awash with liquidity, not only are there likely to be early stage and established competitors pursuing the same market as you, but those competitors could also be well funded. By taking early steps to create a convincing IP position, an early stage company can focus on beating the competition in the market, rather than battling them in court.

5. IP DISPUTES

A s a startup, your company is always at risk of being on the receiving end of a writ for IP infringement. IP litigation is expensive and consumes company resources that are better dedicated to building and selling your product. Thus, IP assertions for early stage companies should generally be avoided, or at least limited to ‘bet-the-company’ disputes typically involving patents or trade secrets for core technology. Particularly if you have followed the steps outlined in this chapter, other IP issues, such as trademark, copyright, unfair competition and non-core technology disputes, can typically be handled through negotiation by competent counsel at a fraction of the cost of litigation.

Lawsuits by patent trolls – companies that do not sell products but file nuisance lawsuits in large numbers, each with a low damages demands – are a receding but irksome menace, particularly in the US. They can typically be handled at minimal cost or disruption by competent IP counsel.

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When settling IP disputes as a defendant, consider the impact on your future business. Early stage companies can be tempted to settle on a royalty based on a percentage that is inconsequential to the current business, but that will bite with a vengeance when the company grows. Make sure the settlement is also to the benefit of any third party acquiring your company in the future. Numerous other considerations come into play, such as exclusivity, field of use, sublicence rights, remedies, rights to pursue litigation and restrictions on challenges to the licensed IP. Better to have a clean break with no comeback later on.

Gradually, as your company gains traction, the shoe may be on the other foot. You may want to dedicate a portion of your funding to an active campaign to notify other companies that entry into your space will involve significant IP hurdles. If you invest in your IP processes and portfolio, you should be at a significant advantage against latecomers seeking to attack a market that you have built.

The keys to an effective IP strategy are early stage adoption and clarity. Good luck — the rewards are likely to be worth significantly more than the investment costs.

Originally published in Yes Business Can. Page 35-43, Chapter 6. Access entire PDF version here.