IP Strategy Pitfalls for Startups (Part 2)

This post is a continued discussion of the mistakes that startups often make with IP, covering (3) failure to establish ownership rights; (4) neglecting conflicting third party rights; and (5) poorly negotiated agreements with outside contractors, development partners, vendors, and customers. Each of these is yet another way a company can end up with fewer or less valuable assets than it might have otherwise.

(3) Failure to Clearly Establish Ownership Rights in IP

Many problems can be avoided with careful consideration in the agreements made with founders, employees, consultants, contractors, customers, suppliers, and joint venture partners.

A. Founders and Employees

Startup founders sometimes continue to work for a prior employer. In many instances, the prior employer may have required the employee to grant ownership of all new ideas conceived during employment or using the employer’s resources to that current (or even prior) employer. This is particularly problematic if the startup’s business is closely related to the prior employer’s business. Current employment agreements should be carefully reviewed to fully understand obligations to prior employers, including IP assignment clauses and non-compete language. It is also prudent to avoid using the prior employer’s resources to develop projects for the startup company without pre-approval.

Multiple stakeholders may contribute IP to the startup. As a general rule, IP rights belong to the individual who conceived of an invention or created the work first, absent any agreement to the contrary. Well-crafted written employee invention agreements can ensure all rights belong to the startup.

B. Independent Contractors

Businesses often believe that hiring a contractor to create new IP for them automatically gives them all ownership rights in all IP that results. But this is not always true. To avoid problems down the road, all employees and independent contractors should enter into “work-for-hire” or IP assignment agreements that explicitly grant rights in all IP to the startup.

Independent contractors are routinely hired to create websites, demo software, marketing materials and prototypes. Failure to implement written work-for-hire or consulting agreements with suitable IP clauses favorable to the startup will often lead to problems down the road that can be devastating.

(4) Failure to Identify Third Party IP Rights

The company should be cognizant that commercialization of an idea may be blocked by an established competitor who holds a broad patent. Accordingly, “freedom to operate” (FTO) clearance search(es) should be timed before product rollout to assess litigation risks. Doing so at the right time ensures that product designs can still be modified, if necessary, to avoid the risk of infringement. Patents that can’t be easily “designed around” and thus limit the startup’s FTO can be dealt with by buying or licensing patent rights from others.

Almost all software products now incorporate open source code of some kind. Open source might mean “free to use” but it does not mean “free from liability for infringement.” Open source licenses also need to be carefully reviewed to ensure compliance with their terms. In some instances, the combination of open source code with your own code may transform what would otherwise be maintainable as proprietary code into open source software, resulting in public disclosure and loss of all rights.

Trademark searches should be another part of an IP strategy. They should be conducted early in the product planning cycle to ensure that the desired business or product name does not conflict with a similar registered trademark. Failure to do so exposes the startup to being sued and incurring costs needed to rebrand itself. Caution should be taken when hiring new employees, especially those that may have knowledge of a competitor’s trade secrets. New employee agreements should prohibit possession, disclosure or use of proprietary information belonging to prior employers, and provide for immediate termination in the event that such terms are breached.

(5) Using Poorly Drafted Agreements or No Agreements at All

The valuation of a startup is based not just on the company’s IP but also the strategic agreements the startup makes. Examples include consulting, funding, collaboration, customer, supplier, settlement, licensing, research, and material transfer agreements. Poorly drafted or non-existent IP-related clauses in these agreements can become problematic.

Collaboration agreements, particularly joint research agreements, often include confidentiality, publication, and IP rights clauses. Most importantly, the startup should ensure agreement language allows for retaining its own IP and for protecting jointly developed IP, while avoiding entanglement with IP that the joint research partner might bring to the table.

Early-stage startups may attempt to save on legal expenses by using template agreements from a variety of non-professional sources, including the internet – or worse, use no formal agreements at all. Either of these situations will often fail to adequately protect the startup’s interests, sufficient to even scare away a future investor.