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PROTECTING COMPANY INTELLECTUAL PROPERTY THROUGH THE USE OF EMPLOYEE AGREEMENTS

I. The Problem – Your Intellectual Property Goes Out the Door with a Departing Employee

A. Nightmare No. 1 – *Your sales director leaves your employ and goes to work for a competitor, calling on your accounts and soliciting your employees.*

1. The Problem – The sales director knows all the confidential and trade secret information and strengths and weaknesses about your products/services, future market and development plans, financial health, key employees, salary structure et al. He will use this to unhook accounts and steal employees.

B. Nightmare No. 2 – *A top engineer leaves (or a contractor that you had hired to do some development work finishes project) and starts to use the developed work at a competitor.*

1. The Problem – Each may claim ownership rights to the developed work (patent and copyright) regardless of the fact that you paid for it, and may prevent you from stopping such use.

C. Nightmare No. 3 – *You discover after the fact that without the proper Agreements in place when the employee and consultant started to work for you, it is frustratingly difficult to protect your company's intellectual property rights.*

Let's take a step back first to gain some perspective

II. The Background - How is Ownership Determined For Various Types of Intellectual Property in the Absence of an Agreement?

A. *Patents*

1. General Rule - Employee inventor who conceives an invention during the course of employment is the owner of the patent rights to it. If Company resources are used and invention within the scope of employment, then Company has a non-exclusive, nontransferable license to use the invention (a "Shop Right").

a) This is why almost all company patents show the employee as the "inventor" and the Company as the "assignee" owner.

2. Obvious Problems – Employee can make, use or sell the patented invention. The Company Shop Right may not be assignable in the event of sale of the business (company specific).

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B. Copyrights

1. General Rule No 1 – Copyrightable work created by an employee within the scope of employment belongs to the Company .. this is good.

a) Problem – there can be dispute about whether a creation was within the scope of employment or not.

2. General Rule No. 2 – Copyrightable work created by a contractor is owned by the contractor absent an agreement to the contrary ... this is not good, and the biggest pitfall in copyright law for companies

a) Exception – If the work fits one of the nine types of work defined as a “work for hire” in the federal Copyright Act, then it belongs to the Company.

(1) Problem – most of the statutory Work for Hire categories do not fit the type of commercial development work for which most companies will typically hire contractors, hence is often of little value to most companies.

C. Trade Secrets

1. General Rule – Protected from misappropriation by statute ... but to protect you must be able to prove its existence. To establish existence and ownership of a trade secret (a formula, pattern, compilation, program, device, method, technique or process), the trade secret must meet two tests:

a) Derives economic value from not being generally known, and not readily ascertainable by other persons (your competitors) who can obtain value from its use or disclosure;

b) it is subject to the reasonable efforts of the Company to keep it secret.

(1) Reasonable efforts by the Company to protect its trade secrets will include having all employees sign a form of agreement protecting use and disclosure of trade secrets; lack of such an agreement works against trade secret protection.

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2. Practical Examples of Potential Trade Secrets.

- a) Chemical formula, manufacturing process, customer lists, product idea, computer program (source code), marketing strategies, pricing mechanisms.

D. What Does All This Mean?

- 1. By relying only on the general rules, you may end up with some “nasty surprises” and find out you do not have ownership rights to what you thought you owned.

III. The Solution to the Problem

A. All employees and consultants, when hired, sign an Agreement that clearly defines ownership of created intellectual property, protects Company confidential information, and places reasonable restrictions on post-employment employee solicitation and competition.

B. Key Components of the Employee Agreement

1. Assignment of Inventions et al.

- a) Employee assigns to the Company, without compensation, all right, title and interest in and to any and all ideas, inventions, discoveries, creations, developments, patents and copyrights, made during the term of employment;
- b) Employee agrees to sign all documents that Company requires to vest such rights;
- c) Employee agrees to cooperate with the Company, (at Company expense) if subsequent employee assistance/testimony is required.

2. Confidential Information

- a) Employee shall not, both during and after the term of employment, use or disclose any Company confidential information or trade secrets, other than in the course of employment (no time limits).

3. Non-Competition

- a) During the term of employment and for 12 months thereafter, not to work for any (i) competitor or (ii) customer of Company, providing the same or substantially similar products/services.

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(1) Theory of Protection – In the course of providing the same or similar product/services, the employee will “inevitably disclose” the Company trade secrets which the Company has a right to protect.

(2) Tension – Courts balance the employee right to earn a living against the Company right to protect its trade secrets and confidential information, and will give great weight to the employee rights.

(3) Narrow Scope – The non-compete must be narrow in its scope in terms of duration, geography and restrictions to be enforceable; blanket prohibitions against working for a competitor in any capacity will not be enforceable. (Customer Focus Concept)

(4) Contractors – Very difficult to get contractors to agree to a non-compete; negotiating point.

4. Non-Solicitation

a) Employee shall not, directly or indirectly, hire, encourage or induce any employee of Company (in place at time of employee departure) to leave the employ of Company.

(1) Theory of Protection – The ex-employee is in possession of non-public information with regard to the employees, and can use such information to harm Company to unfairly take away valuable employee assets.

(2) Tension – Rights of current employees to seek other employment versus the right of the Company to prevent unfair “raiding” by ex-employees.

(3) Precision in Drafting – The non-solicitation must be carefully drafted to close all loopholes; (Monday- Tuesday Problem)

5. Disclosure to Future Employers

a) Company has the right to provide copies of the employee covenants with regard to Confidentiality, Non-Competition and Non-Solicitation to the future employer of employee.

(1) Rationale – no employer want to be embroiled in any dispute involving a new hire’s post-employment obligations, nor be deemed a contributing party; thus the disclosure puts the new

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employer on notice not to put the employee in any role that would likely cause the employee to violate its obligations to the Company.

(2) Reality – done only in exceptional cases, but knowledge of the right has a deterrent effect on ex-employees.

C. Key Component of the Contractor Agreement

1. Assignment of all Rights to the Work Product

a) Contractor assigns to the Company all right, title and interest in and to the work product including all copyright, patent, trade secret and all other intellectual property rights (turns work product into a “work for hire”).

(1) Exception – Contractor pre-existing intellectual property incorporated into the work product, in which case the Contractor provides a perpetual, royalty-free license to the Company to us with the work product.

IV. Timing and Process – When to Implement the Agreement and How To Use

D. New Hires

1. Execution of the Agreement must be a condition of employment as stated in offer letter.

2. Copy provided w/offer letter.

3. New hire returns signed Agreement on first day of employment, dated as of hire date.

a) Important Issue- The employment is the consideration for the new hire employee obligations in the Agreement. If the new hire is not notified of the requirement before commencing employment, the argument can be made (and has been made) that it was not part of “the deal”, thus there was no consideration for it, and it is not a valid and enforceable contract.

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E. Current Employees

1. There must be adequate consideration given in return for having the employee sign. Continued employment is not adequate consideration.
 - a) Consideration must be something the employee is not “otherwise entitled to”.
 - b) Examples – stock option grant, new bonus program, promotion, increase in salary, retention bonus et al. Can “bake into” new Company-wide stock option program, for example.
2. Effective Date of Agreement will not relate back to date of hire, but be effective as of date of signature.

F. Contractor Agreement

1. Signed by both parties prior to the commencement of work.

G. Employee Termination Process

1. Part of exit interview should be a verbal reminder of the employee’s post-employment obligations to the Company (confidentiality, non-compete, non-solicitation, assistance with invention right perfection).
2. Written reminder can be signed by employee in exit interview (defeats any argument that post-employment obligations were waived by Company in the exit interview).
3. Copies of key provisions sent to new employer as may be required (exception, not rule).

Please contact Bruce L. Galaro of the Business Law Group for further information or if you have any questions on anything above