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PERSPECTIVE

Protect your startup's IP from the very beginning

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Even in the earliest stages, startups should be thinking about protecting its intellectual property — the “secret sauce” of a company’s true value. While IP usually comes in the form of trademarks, copyrights, trade secrets and associated issues, it can come in many different varieties early on in a company’s life cycle. For example, an early-stage founder might ask friends, colleagues or contractors (paid or unpaid, in cash or in equity) to help develop early code, provide valuable business advice or attend creative brainstorming sessions. Often, this work is done without any written agreement; startups may not have cash available as compensation and may not yet be ready to formalize equity arrangements.

There is a hidden danger to this common practice. Early-stage IP does not automatically belong to the company. Therefore, workers and contractors may claim (in the future, naturally) that they themselves own the work, rather than the company itself. Disagreements and lawsuits that involve IP can hinder venture financing and, in some cases, even destroy early-stage startups.

Common IP Assignment Mistakes and Issues

One common scenario is: early-stage companies with a group of original founders where one of them decides to leave the company very early on. That original founder will return many years later, without a signed IP assignment contract, claiming that he or she owns part of the company due to his or her work early on with the company.

Another example arises when a contractor develops tens of thousands of dollars worth of software code for an early-stage compa-

ny in exchange for a handshake agreement for compensation. The contractor could then demand extra compensation when the time comes to hand over the code. Essentially, the contractor acts as a “holdout” and can keep the valuable IP until the company meets his or her demands. As the company failed to have the contractor sign an agreement containing an IP assignment clause before the work had commenced, the company’s “code” was not really the company’s at all — it was still the IP of the coder himself or herself.

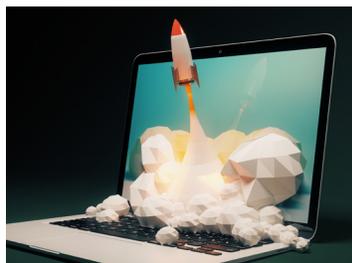
Fortunately, there is an easy solution to avoiding many of these problems.

Create IP Assignments

A well-drafted IP assignment agreement assures that any work the employee, consultant or advisor completes for the company will be the sole property of the company, not the employee, consultant or advisor. An IP assignment is a set of legal statements that transfers the IP from an employee, contractor or advisor to the company itself.

IP assignments protect the “secret sauce” of the company by guaranteeing that the IP is indeed the property of the company itself. This will effectively prevent an early-stage employee or contractor from claiming (often many years later and after the company has become successful) that he or she owns a portion or all of the company’s IP.

In our view, companies should require all employees, contractors, interns and advisors to sign an agreement containing an IP assignment clause before they perform any work, i.e., on or before such service providers’ start date. Startups should also ensure that all founders assign any IP created prior to incorporating the company at the time of incorporation.



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IP assignment clauses can come in many different varieties and can be included in contracts signed by employees entitled “confidentiality and invention assignment agreements” or “proprietary information and invention assignment agreements,” or they could be separate clauses written into advisor or independent contractor agreements. Regardless of the type of person or entity with the company or type of contract, any interaction with third parties should always include an IP assignment clause.

In California, there’s an additional step. Companies must always be aware of the limitations imposed by Calif. Labor Code 2870 and should include the text of this statute within any IP assignment agreement. CA Labor Code 2870 refers to offsite, off hours and unrelated work; if it is developed without using company resources, on the employee’s own time, and is unrelated to the company’s business, then an invention is excluded from assignment to the company.

These IP assignments should also be exchanged for valid consideration — usually in the form of monetary payment or equity compensation. The amount of con-

sideration (i.e., money or stock) exchanged for the IP assignment is generally not as important as the fact that some consideration was paid in exchange for the IP assignment.

The solution, in every case, is to have anyone who contributes or volunteers to help your startup sign an agreement containing an IP assignment clause. This will prevent thorny issues from arising down the road and will make future financings much smoother. In fact, reviewing proper IP assignment is one of the most important due diligence issues in a venture financing. Investor’s counsel will make sure that all past and present third parties that worked with the company signed IP assignments. Early-stage investors will be happy to know that they are supporting a company that truly owns all of its “secret sauce.”

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