

The Metropolitan Corporate Counsel[®]

www.metrocorpcounsel.com

Volume 16, No. 7

© 2008 The Metropolitan Corporate Counsel, Inc.

July 2008

Managing Risks Associated With IP

Michael H. Brodowski, Ph.D.
John M. Edwards
Mark D. Pomfret
Thomas A. Turano

**KIRKPATRICK & LOCKHART
PRESTON GATES ELLIS LLP**

What is risk? Risk is the quantifiable likelihood or expected value of loss or less-than-expected returns. Risk is frequently subjective. It has been reported that some 1500 additional people were killed in automobile accidents following September 11, 2001, when more people chose to drive rather than fly. Sufficiently economically developed societies legislate to reduce societal risk. Failure to meet these legislative requirements may result in either civil or criminal liability. This discussion is about three areas of intellectual property (IP) risk management: the IP itself, employment and labor, and insurance.

Regarding IP, you only have to worry about your own IP and the IP of everyone else. Issues regarding your IP include:

- Whether you own what you think you own;
- Whether you are in breach of your agreements; and
- Whether your trade secrets are really secret and do you do all you should to protect those secrets.

To secure ownership of your company's patents, trademarks and copyrights, you should have in your possession executed

The authors are all Partners with the law firm of K&L Gates. Mr. Turano and Mr. Brodowski are members of the firm's intellectual property practice group, Mr. Edwards is a member of the firm's insurance practice group and Mr. Pomfret is a member of the firm's labor & employment group.



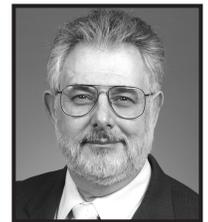
**Michael H.
Brodowski, Ph.D.**



**John M.
Edwards**



**Mark D.
Pomfret**



**Thomas A.
Turano**

employment agreements and explicitly executed assignments of the IP properties. You should have consulting and work for hire agreements in place for your nonemployees. These agreements are discussed in more detail below. If you used government money in developing your IP, you should take all the steps necessary to secure rights from the funding agency in what was developed with that money.

You should comply with all the provisions of your licenses and other agreements. If not, it likely will be discovered during any due diligence that accompanies an investment, a merger or an acquisition and could affect the deal. If your business involves computer source code, you should be aware if you use open source software, especially if you are using viral open source software. The use of viral open source software can cause your source code to become open source and available to the public. Even if you use nonviral open source, you must still comply with the license terms to maintain a license. Licenses and agreements that are not assignable could be problematic for any deal.

You need to decide whether it is better to retain trade secret protection for your developments or seek patent rights. You can't do both. If you are keeping something as a trade secret, you must have a policy and procedures in place that only allow the item to be revealed on a need-to-know basis.

You should consider "clearing" your products or services. That is, you might perform a "freedom-to-operate" search to find other parties' patents in an attempt to ensure your product does not infringe prior to commercial release. You may find you need a legal opinion relating to non-infringement and invalidity. You might attempt to invalidate a patent of a competitor in the patent office or in the courts. Knowledge is power. Finding out about a problem early may permit you to design around the problematic IP of others. However, if you are not willing to follow through on information you obtain from the search, you may have potential exposure to a charge of willful infringement which could in turn lead to your being assessed treble damages and attorney fees in a litigation.

You should also clear your proposed trademarks before using them. You must decide whether you will rely on common law rights or registration for trademark protection. You might attempt an opposition or a cancellation proceeding to remove another's trademark. You should record your copyrights. If you don't, you may not be able to sue in the United States. Your team needs to understand that the fair use of copyrighted material is extremely limited. Some improper use may result in both a trademark and a copyright infringement.

From an employment perspective, employees can be both a company's greatest

Please email the authors at michael.brodowski@klgates.com, john.edwards@klgates.com, mark.pomfret@klgates.com or thomas.turano@klgates.com with questions about this article.

asset and its greatest liability. To avoid having employees create exposure for an organization, you should devote proper attention at the inception of the employment relationship to ensure that the business is sufficiently protected from risk. Indeed, taking the proper steps with your workforce with respect to IP can minimize significantly the chance of IP being misappropriated or misused.

Although employers possess certain statutory and common law rights regarding their IP, it is critical that businesses supplement these rights through the implementation of various contractual restrictive covenants as suggested above. At a minimum, the rights contained in these types of agreements go beyond those that the law already protects and guard against the mere risk that a customer relationship may be compromised by a former employee for a competitor's benefit. However, if these agreements are used improperly or fail to contain certain requisite elements, their value can be questionable.

The four basic agreements that you should consider implementing are a Non-Disclosure Agreement ("NDA"), an Inventions Agreement, a Non-Solicitation Agreement, and a Non-Competition Agreement. Although the determination of whether these agreements are enforceable is state specific, when recognized these agreements can provide valuable protection for you when your star employee announces her intention to join the company's main rival.

NDAs are your most fundamental means of avoiding unnecessary exposure. NDAs protect against the improper use and/or dissemination of confidential or proprietary information. You should utilize these agreements for all employees, regardless of title or duties. To ensure maximum benefit, it is incumbent upon you to make sure that, at a minimum, the NDA properly defines the confidential information it is seeking to protect, describes the obligations of the party receiving such information, and sets out the ramifications in the event the agreement is violated.

Inventions agreements are critical for those organizations that operate research and development departments, but can be equally important to those businesses that are or will be developing a product. Among the points that you should include in these types of arrangements are requiring employees to disclose any inventions to you, mandating that all rights to such inventions are assigned to you, and insisting that the employee take all steps to help perfect and enforce your rights to the invention.

Non-solicitation agreements generally focus on two protectable interests: employees and customers. These agreements are

designed to prevent a departing employee from hiring or even soliciting a colleague or a client (or prospective client) with whom they have come in contact. Unlike NDAs or inventions agreements, non-solicitation agreements are generally required to have temporal and geographic limitations in order to be enforceable.

The most severe restrictive agreements and, thus, the most strictly construed are non-competition agreements. These agreements are not permitted in all jurisdictions and, even where they are recognized, must meet specific requirements. In particular, non-compete agreements will only be upheld where they protect legitimate business interests such as trade secret or confidential information, or customer good will. Conversely, courts generally disfavor the use of such agreements when they are simply implemented to prevent an employee from moving to a direct competitor. It is equally important that non-competition agreements contain reasonable content, duration and geographic restrictions. A defect in any of these areas can render the non-compete clause void.

Finally, although disseminating the aforementioned restrictive covenants to employees is a good first step, you should recognize that any benefit obtained is undermined if the document is not executed or is somehow lost. Filing executed documents immediately upon receipt from a new employee and presenting a copy of the document to a departing employee should be automatic.

Even with scrupulous implementation of strategies to minimize IP risk directly or through employment agreements, IP liabilities will rear their ugly heads. It is precisely for this reason that any comprehensive IP risk management effort should include a thorough review of liability insurance in place and liability insurance which might be needed.

The foundation of any business's liability insurance program should be its general liability insurance policy. This policy is likely written on an "occurrence" basis and will offer a separate commitment to defend claims against the insured that does not erode the limits of coverage for any resulting settlement of judgment. These features of general liability insurance make it worthy of thought when managing IP risks even though many general liability policies contain exclusions that purport to exclude coverage for IP claims. Many IP-related liabilities come cloaked in claims alleging defamation, negligence, tortious interference or other anti-competitive conduct that often is covered under general liability insurance. These types of claims may be enough to trigger a duty to defend all of the claims – covered and uncovered – and that defense would be

given without limitation and without eroding available coverage for any resulting settlement or judgment. The same cannot be said for more specifically tailored IP-related liability coverage, and it is for this reason that you should review general liability insurance carefully at the time of purchase and when claims are made.

The principal source of IP-related liability coverage is found in IP defense and IP defense and indemnity specific liability insurance policies. These policies provide, as their name suggests, coverage either for the costs of defending or the cost of the damages assessed in a judgment or paid in a settlement. Covered damages might include past royalty or profit payments, interest, taxed costs and fees. It is important to underscore that, unlike in general liability policies, under these IP-specific policies every dollar expended defending an IP claim erodes the limits of available coverage, and typically they contain provisions that compel the insured to bear a percentage of the defense costs, typically 5-25 percent.

Another important difference between IP-specific liability insurance and general liability insurance is that IP-specific liability insurance is written on a claims-made basis. There can only be coverage if an IP claim is made against the policyholder during the effective period of the policy. When this feature of IP-specific liability insurance is combined with typical exclusions for any and all acts that take place prior to a set date and for claims that are "related" to litigation that began sometime prior to the effective date of the policy, there are real dangers that significant gaps in coverage might exist. Close attention must be paid to the interplay of these provisions at the time of purchase and when claims are later made on the policies.

Another type of IP insurance that you might consider is IP Infringement and Abatement insurance. This insurance covers the costs of legal fees and expenses incurred to prosecute an infringement action. This insurance can be called upon when the policyholder can identify infringing activity that takes place during the policy period and when the insurer authorizes the commencement of the litigation. These policies are subject to significant deductibles and litigation costs participating percentages. Further, they are often subject to provisions that compel the insured to return the sums advanced for the cost of litigation in the event it can be shown that the result of the infringement litigation delivers an "Economic Benefit" to the insured. A very careful review and understanding of these provisions is required before concluding that it makes business sense to purchase IP Infringement and Abatement Insurance.