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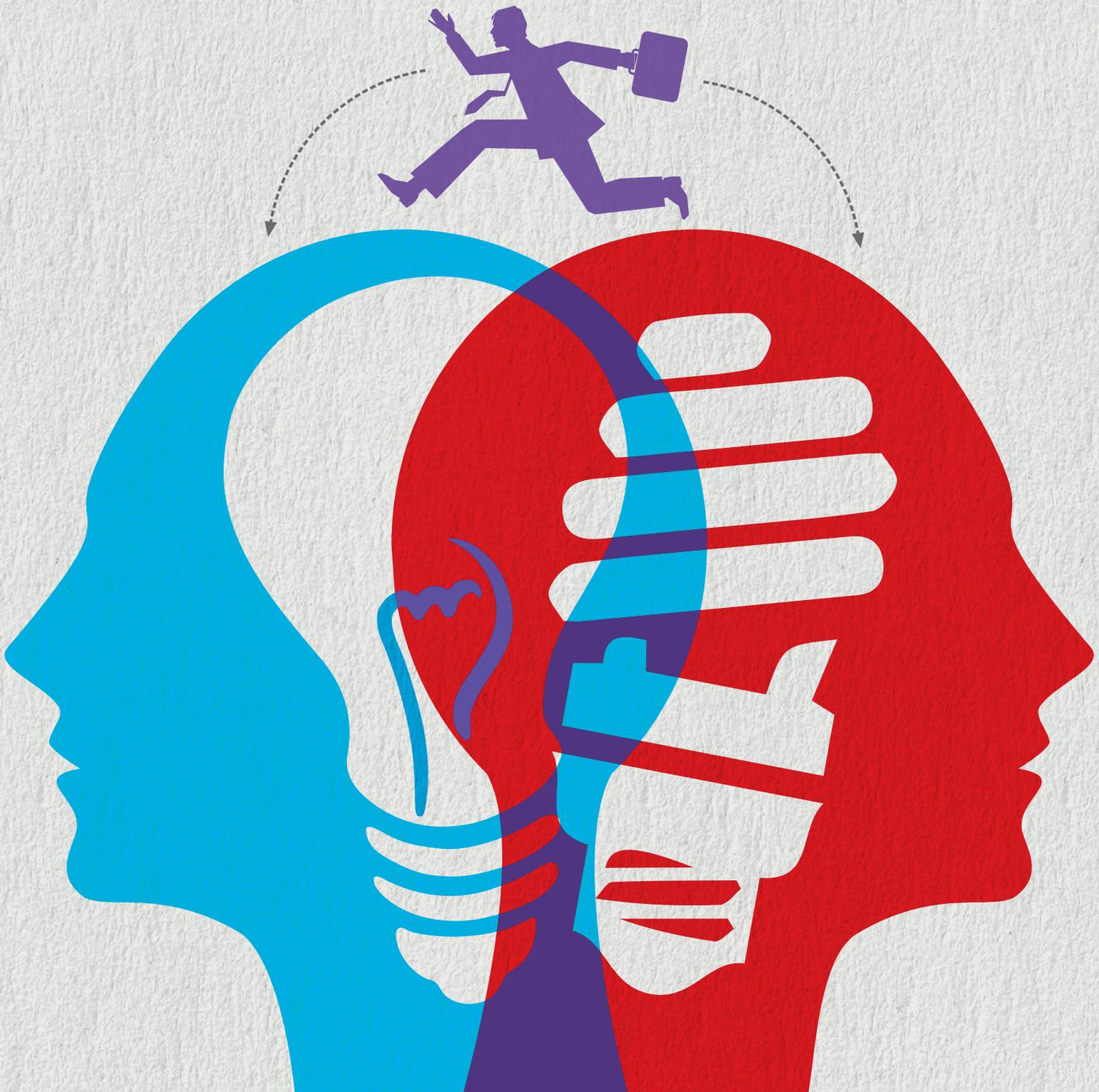
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Protecting Your IP Assets

IN THE DIGITAL AGE

NO MORE FREEBIES:

A COMMON SENSE APPROACH TO OWNING YOUR INNOVATIONS





30-SECOND SUMMARY

Companies that want to own their own innovations should know two things: what technologies are highly strategic, and if there are current obligations to disclose, license or assign technology. Moving forward, for a company to be successful at owning its innovations, it must implement a strategic culture at all levels. Product development must consistently be disciplined in documenting its innovations; sales and marketing must be prepared to have difficult conversations with customers; legal must be well versed in IP ownership issues and risks; human resources must support training employees in preserving IP and dealing with a high-risk IP transaction; and finally, management must support the culture from the top down.

By Daniel Shulman and Donald W. Rupert

Companies face many challenges to ensure that they own their innovations. These challenges arise from the way in which innovations are developed and from the way in which companies do business. To address these challenges, companies must first recognize them and then proactively take the steps necessary to lock up ownership. Challenges and suggested solutions are discussed below in a hypothetical telephone conversation between in-house counsel John and outside counsel Fred.

John: Hi, Fred. Thanks for taking my call. I need to brainstorm with you for a bit. Here's the situation: We've gotten into some bad deals relating to our IP where we've hurt ourselves by not getting value from our innovations. I've been tasked by upper management to really hammer home the theme that we need to own our innovations. From a business perspective, the only way we can get value for our innovations is to own them. If we don't, anybody can practice our innovations, and then even the best innovations become a commodity. That hurts the bottom line. I've got a few areas where I know we need to clean things up, but I'm interested in hearing some of the strategies you've developed for clients to own their innovations.

Fred: Thanks, John. I'm happy to help. It seems to me that if you want to own your innovations, you need to know two things: First, you need to know what technologies are highly strategic for your company so that you can make the right call about what innovations you need to own to be successful, and what innovations you may be able to share or license. Second, you need to understand the current obligations your company may be under to disclose, license or assign technology and the ownership of jointly developed technology. Those may arise under license agreements, development agreements, supply agreements or confidentiality agreements with other parties. Having a clear understanding of what claims other parties may already have on your technology and innovation is necessary to owning anything your company develops going forward.

John: That's a great idea, Fred. Although it sounds really resource intensive, I can immediately see where doing both of those things will bring immediate value. I'll schedule a meeting with our head of R&D, our chief technology officer and our lead marketing team. I'm sure I've seen a technology "roadmap" for the company.

That would be a good place to start to identify those key technologies. And I know I've got some paralegal resources to help with contract management. Making sure IP provisions are accurately noted in our contracts database is a really important point.

Fred: The other thing to point out is that owning your innovations literally means "owning" your innovations. So I would make sure all assignments are up to date on any patents and patent applications you have, that you haven't missed any and that they're all recorded. This is important, because in a number of countries, including some in Europe, a patent license is not effective if a co-inventor has not assigned his rights in the licensed patent and has not consented to the license.

John: I think I can handle that. It occurs to me that I should probably add to that list by making sure all of our employees have IP assignment clauses and confidentiality clauses in their employment agreements.

Fred: Absolutely. If you don't have assignments or assignment obligations from your employees, even if they make an invention on company time using company resources, you may have some rights to use the invention, but because the inventor is the legal owner, you do not have legal title to it. All of this becomes complicated when considering how inventions come about. Innovations typically arise in a number

of ways, such as those developed by an employee or a consultant, or in a joint collaboration or even in an informal brainstorming session. Each of these situations may give rise to different ownership issues. One thing you want to keep in mind is that the language of the employee agreement should state that the "employee hereby assigns." Courts have construed this type of language as a present assignment of a future invention that effectively gives you immediate ownership of the invention. However, this may not apply in all countries, so you should ensure that the employee assigns the rights to each patent application before it is filed. Both the employment agreement and the assignment should be drafted to comply with the laws of the jurisdiction in which the employee resides.

John: That sounds sensible. Is there anything else we should be doing in relation to the employment agreement?

Fred: Several other things come to mind. For a new hire, the employment agreement should require the employee to list all inventions made prior to the start of his employment with you and to describe any obligations the employee has to the prior employer. This approach can help avoid disputes with the prior employer over who is the owner of an innovation made by the employee. Another thing you could do is include a clause that says that any patent application in your



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field that is filed by an employee for a period of time after his employment ends belongs to your company. That prevents an employee from taking any in-progress projects directly to a competitor and filing a patent for his new employer, when the employee actually conceived of the invention while still employed by you.

John: That's great advice, Fred. I actually think that we're in a good place relative to all of those thoughts, but it does make sense to double check. My real issue is that I've identified a number of high-risk IP transactions that just haven't been adequately protected, and I need to develop strategies for protecting ourselves.

Fred: Such as?

John: I find that people just don't understand when a non-disclosure agreement is appropriate and when it's not. Sometimes, a non-disclosure agreement can do more harm than good.

Fred: You're exactly right. One thing I see often is a client wanting to begin some sort of joint development project with another party. They know instinctively that they will need an NDA to cover the discussions, but all too often, the discussion ends there. They sign the NDA and then immediately jump into development. That can be really dangerous.

John: Fred, you've got it exactly. An NDA is an agreement facilitating the parties' discussion about a development project, but it is almost always insufficient to actually begin the development project. Most NDAs don't address the key issue in any joint development — namely, who is going to own the jointly developed technology. And even NDAs that have some IP clauses usually don't handle them in a way that's thoughtful or nuanced enough to properly treat a true joint development.

Fred: Well, it's actually worse than that. As you know, joint ownership of IP can be a horrendously bad deal for both parties. If you don't allocate IP, and you jointly own the development

with the other party, you've essentially given away your IP for nothing, because the other party can use, license and exploit the technology that you contributed to without being accountable to you at all, at least in the United States. In other countries, those rights may be limited, but absent a definitive agreement, joint ownership of IP is almost always a bad result.

John: The other thing I find is that when we instinctively think we need an NDA, those instincts are sometimes wrong. For example, if we haven't gone through the proper step of actually implementing a joint development agreement, in all likelihood, we don't want to receive another party's confidential information. If we do, we get stuck with this information that we can't use. It may get really complicated if it was an idea we had already thought of, because the other side will contend we stole it from them.

Fred: You raise a great point. Even if you have a joint development agreement, making sure you've documented all of your existing ideas before sharing them in a joint development is critical. People think that under the new patent laws, found in the America Invents Act, which switched from first to invent to first inventor to file, that documenting inventorship with lab notebooks and other written materials isn't as important. That's wrong. Before any joint development session, it's a good practice to document all of the technology you might bring to the table, including things your personnel may have thought of, even if they don't present them at the meetings. That way, if the other party makes a contribution that you've already thought of, you can show that you invented it first and can avoid having to include that party on any patent application for that invention. That leads to you owning your innovation.

John: I hadn't thought of that. It makes sense. Of course, training our product development team on good

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Avoiding high-risk IP encounters in joint development

PRIMARY PRINCIPLES

- Avoiding joint development
- Only company inventors
- No brainstorming with outside parties
- An NDA is not enough. Joint development requires a joint development agreement.

GUIDELINES

- Document all ideas, even if not disclosed, prior to disclosure.
- Do not share any inventions where your company's inventorship position cannot be definitively established.
 - Notebooks, drawings, CAD files — all dated and signed
 - Patent applications on file

invention documentation strategies, like getting lab notebooks signed and dated on a regular basis, can help mitigate some of those risks.

So once we've realized we want to do joint development, what are some of the common mistakes you see people make related to joint development agreements?

Fred: The agreement should describe ground rules, such as the types of inventions that may arise out of the joint work. Then, the agreement should identify those types of inventions that will be assigned to your company irrespective of who develops them. The agreement should also identify the types of inventions that will be assigned to your collaborator and those that will be jointly owned, although, as we said, joint ownership would ordinarily be limited to the types of innovation that aren't core to either party, so that all you care about is the freedom

to practice and not actually owning that technology. Each joint development agreement is different, but if you concentrate on allocating technology to particular fields associated with each party's business strategy, you can usually find an equitable way to allocate ownership, and then make accommodations through, for example, a license back to allow some limited freedom to practice in an adjacent field.

John: So, in the joint development context, the invention ownership could be split three ways?

Fred: Yes, but there is also one final consideration. The agreement needs to address an exit strategy that provides for how any jointly owned IP will be divided when the relationship ends. That part can be tricky. Depending on how much development has been done before the agreement terminates, and the reason why the relationship ended, one party may have significantly more invested than the other, or may still see significantly more value in the technology than the other. For example, if your company decides to terminate development because it comes to believe the technology is going to be too expensive and it can't develop a market for the technology at the current price, you may need to agree to give up ownership of IP if the relationship terminates at that stage. However, if the other party takes the jointly developed technology and further improves it on their own to the point that the technology is now commercially viable, your company may want some right of first refusal on any license to that technology in exchange for having given up ownership. Aligning the IP strategy to the various milestones in the agreement ensures that everyone is treated fairly when the relationship ends.

There is no "one size fits all" approach.

John: A lot of our product development arises from discussions with suppliers or customers. Those are the activities that really have the potential to hurt us. If we give our customers

our innovation and get nothing in return, then the customer can just shop the innovation to the lowest bidder, leaving us with no return on our innovation.

Fred: There are several things to keep in mind. Starting with the supplier issue, if a supplier wants to discuss a possible change to a product it is supplying to you, the supplier often will want you to sign a non-disclosure agreement. You may want to be careful about doing that and may need to negotiate the terms. For example, if you sign a broad NDA, you may be restricted in your ability to deal with other suppliers of similar goods.

Similarly, you should be alert in dealing with customers. Customer relationships are especially difficult, because no company wants to alienate its customer by taking an aggressive position on IP. But, there are a handful of really high-risk customer encounters that you should keep in mind. A customer may ask you to design a product and make the project exclusively for that customer. However, your product design is your IP, and you need to ensure that asset is not lost. For example, if the customer wants the ability to have a second source of supply, your IP is at risk because you might not be able to effectively control that second supply source. If the customer demands second source ability, consider agreeing to that only in limited circumstances and for a limited time, such as where you cannot supply due to a catastrophic accident at your facility. This essentially means that you sell exclusively to that customer, and the customer buys exclusively from you. Depending on the customer, you may agree not to sell to other customers, or you may agree to allow a second source of supply, in exchange for a significant volume commitment. You may be able to command a royalty for that second source, but typically, clients find that the customer will not allow its suppliers to be so disadvantaged. In that case, it helps to look

at your volume commitment, which you hope guarantees you some majority share of the supply, as the royalty that compensates you for your innovation.

John: You're right, Fred. Most of the time our larger customers require a second source of supply — and not just for catastrophic shortages. Some might even require a minimum of three suppliers. But to your point, a volume commitment can be an effective “royalty” payment for the innovation. For example, if we create a new product for a customer, and as a result take our volume commitment from 40 percent of the customer's share to 60 percent, that volume improvement should give rise to a guarantee of future earnings. Say the total revenue for all of that product sold to that customer by all suppliers is \$100 million, and we just received an additional \$20 million in revenue by getting 20 percent more share. If our earnings on that additional volume is \$8 million, then we can figure the effective royalty rate on the other suppliers' \$40 million in sales of the product is 20 percent (\$8 million/\$40 million). In most patent cases, you would love to get a reasonable royalty of 20 percent.

Aside from volume commitments, though, the customer agreement is something we really struggle with. Part of the issue is that these IP clauses find their way into the sales or supply agreements, and the sales team that is responsible for closing the deal doesn't

recognize the IP risks. I'll give you a few examples. The first one is where we do some development for a customer and agree that in exchange for that volume commitment you described, we will assign the customer rights in the design of the product. Usually, we're just talking about ornamental designs — you know, design patents. The customer will take that and put some clause in the supply agreement granting it rights under “all Company IP related to the product” so they can have that second source of supply. Of course, that's a non-starter. If we have manufacturing know-how, or other materials technology, or any utility type rights, we need to keep that stuff exclusive. If we're obligated to teach our competitors how to make this product just as cheaply, efficiently and effectively as we do, then we lose any market advantage.

Another example is when a customer comes to us to improve on some product they already sell, and they want to own the improvement. While that sounds justifiable in theory, the problem is that what we do to improve their product is frequently pull things out of our standard “tool kit.” We have tricks of the trade that we've developed over time, and if the customer “owns” those improvements, they'll be the last customer we're ever able to do that for!

Fred: Speaking of improvements, I see clients get tripped up in licenses and agreements where they agree to license back or grant ownership of

improvements on technology. I bet that happens to you, too.

John: Absolutely. We might create a new product for a customer, and the customer wants to own the design (which we may or may not give depending on how we're protected), but also wants “all improvements” to the product. Well, every new product we make is, in some sense, an improvement of something that came before. We can't give away improvements we haven't created yet. That functions as this ongoing lien on all future innovation. At some point, you can be sure the customer will look at some new product and say: “That's an improvement on what you made for me, and we should own it.” It would be impossible for us to continue to innovate.

Fred: And how receptive do you find customers are to those discussions?

John: It depends. As the in-house IP lawyer, I find it's really important to talk to the right people in the customer's organization. If I can talk to an IP lawyer, as opposed to our sales folks simply talking to the customer's procurement folks, I can explain our position to somebody who undoubtedly understands the position we're coming from. It helps if you can say to a customer: “I can't give you *all* my technology related to this product, but I am willing to allow you to benefit from being my customer. What are the rights that you really need?” When we talk about what the customer *needs* as opposed to what he thinks he

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Avoiding high-risk IP encounters – the customer agreement

BROAD KNOW-HOW LICENSE

- Example: Customer owns the design of a container. Customer also wants a license under your company's IP to make the container.
- Answer: No! Your "company IP" can include all company IP, including trade secret know-how.

OWNERSHIP OF YOUR COMPANY'S "TOOLKIT"

- Example: Customer wants to own "improvements" to an existing container that your company makes for it. Improvements, however, consist of items out of your company's toolkit: ribs, finishes, manufacturing strategies, etc.
- Answer: No! "Improvements" can include ordinary tricks your company does all the time.

IMPROVEMENTS LICENSED BACK

- Example: Customer wants ownership of design of container "and all improvements."
- Answer: No! What future design is not an improvement over something else?

EXCLUSIVE SUPPLY V. EXCLUSIVE LICENSE

- Example: Customer wants exclusivity for a particular container.
- Answer: Exclusive supply is OK; exclusive license is like giving away ownership.

wants, frequently, we can make some headway on finding a fair arrangement.

One approach that I have found works is to identify precisely what the expectation is of any joint development. Different joint development activities have different risks, and you may be able to accommodate a customer by placing the activities in different "tiers" of development. For example, a customer may come to us with a particular well-formulated idea, but just needs help optimizing or manufacturing it. In that case, we're not likely to contribute much innovation to that process, and so we can comfortably identify that type of project as a "first tier" project where we keep any manufacturing rights, but anything else related to the product belongs to the customer. However, the customer needs to understand that if the idea they thought was well developed really needs serious modification

or improvement, we have to move to a "second tier" project, and in that case, ownership of IP rights may be handled differently. The tension arises because customers will try to shoehorn as many projects as possible into the first tier. However, establishing a framework up front with a customer that there are different "tiers" of activity helps set expectations for the type of projects we might engage in together.

Fred: We've been talking a lot about patents and inventions. Some of the innovation you have won't be appropriate for patents. Certain types of manufacturing know-how and processes, for example, can make poor patents. You can't detect infringement unless you're in someone's manufacturing plant, and you end up teaching your competitors when the patent publishes. You should review the procedures you use to maintain these items as trade secrets. For example, the provisions in employee

agreements that cover non-disclosure of business information should be revisited and revised as necessary. Facility security measures, including visitor sign-in, access badges and access restrictions, are important considerations and should be in place. Finally, off-site and home use of proprietary business information by employees need to be addressed and controlled.

John: Fred, this is great stuff. It sure seems like you're seeing the same things with your clients that I'm experiencing in-house every day. If we transcribed this conversation and published it, I bet we could prevent a lot of headaches for a lot of companies.

Fred: Now that you mention it ...

While each company is different, what remains consistent is that a company that does not own its innovations cannot get paid the premium it deserves for the value it brings to its customers. Customers can get access to those innovations without paying a premium by engaging the innovator's suppliers or co-development partners, or through unfavorable agreements that grant the customers rights to those innovations. Implementing a culture of getting paid for innovations needs to happen at all levels: Product development must consistently be disciplined in documenting its innovations; sales and marketing must be prepared to have difficult conversations with customers (even potentially walking away from deals that bring short-term gain but which give away long-term advantage); legal must be well versed in IP ownership issues and risks, and be creative in resolving difficult issues as they arise; human resources must support training employees in preserving IP and dealing with high-risk IP transactions; and finally, management must support the culture from the top, down. More than ever, for a company to own its innovations, the in-house IP lawyer must be skilled enough, creative enough and confident enough to interact with a variety of functions, both inside and outside of his company. **ACC**



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