



# Who Owns Ideas and Know-How?

## A 360 Degree Look at Protecting Proprietary Information in a Competitive World

Presented to  Association of  
Corporate Counsel

Presented by  
**William Abrams, Daniel Cooperman and Wendy Lazerson**  
Bingham McCutchen LLP

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# Agenda

- Introduction of panel
- Rules of the road, protecting ideas and trade secrets in a competitive world
- Hypothetical and discussion
- Questions and answers



# Ownership of Intellectual Property

## Ownership of IP – No Contract

- Cal. Labor Code Section 2860 – “Everything which an employee acquires by virtue of his employment, except the compensation which is due to him from his employer, belongs to the employer, whether acquired lawfully or unlawfully, or during or after the expiration of the term of his employment.”
- Employer owns any invention created during the course of employment by an employee who is employed to invent. *Standard Parts Co. v. Peck*, 264 U.S. 52 (1924); *Banks v. Unisys Corp.*, 228 F.3d 1357 (Fed. Cir. 2000).
- If a “**work is made for hire**,” the employer – not the employee – is the owner.

## Ownership of IP – No Contract

- An employee who is employed **for purposes other than to invent**, but who invents during the course of his employment, owns the patent. *Dalzell v. Dueber Watch Case Manuf'g Co.*, 149 U.S. 315 (1893).
- BUT the employer has “**Shop Rights**”:
  - An irrevocable personal non-transferable license to use the invention. *Gill v. U.S.*, 160 U.S. 426 (1896); *California Eastern Lab., Inc. v. Gould*, 896 F.2d 400 (9th Cir. 1990).
- **Copyright ownership** vests initially in the employer or person for whom “for hire” work was prepared, since that entity is considered the “author” under the Copyright Act.

## Ownership of IP – No Contract

- A creator may challenge an employer's presumed **copyright ownership**.
  - Where the employee's work more closely resembles that of an **independent contractor**, his ownership rights may trump those of the employer. See *Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989).
  - Employee benefits and payroll taxes are highly probative of the nature of an employment relationship. *Aymes v. Bonelli*, 980 F.2d 857 (2d. Cir. 1992).
- *Justmed v. Byce*, 600 F.3d 1118 (9th Cir. 2010)
  - Employer owned IP even though it arguably treated worker as an independent contractor.
  - Court considered factors including indefinite employment duration, tasks performed, and salary.



# Changing the Common Law Rules of IP Ownership by Contract

# Written Agreements Can Change the Rules... to an Extent

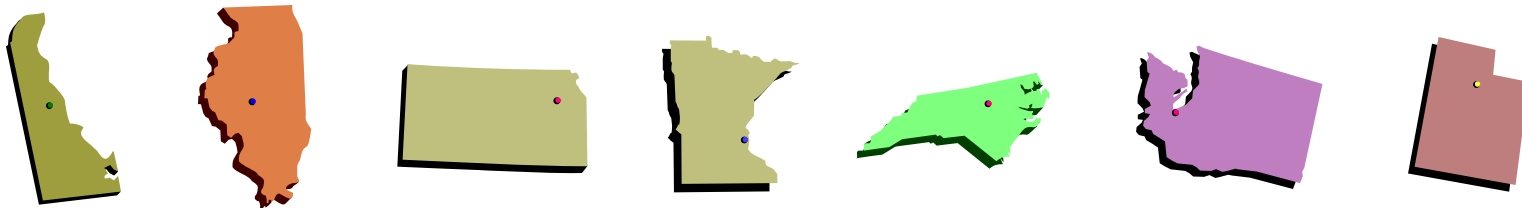
- Employer can require employee to sign an Assignment of Inventions Agreement as a condition of employment which:
  - Discloses prior inventions
  - Assigns inventions **under certain circumstances**, even post-termination
  - Agrees that all original works of authorship are “works made for hire”
  - Agrees that employer has the choice to commercialize or market inventions
  - Agrees to assist with securing intellectual property rights

# Assignment of Inventions: the Exception

- California Labor Code 2870(a) renders illegal any contract that requires an employee to assign or offer to assign the employee's rights in any invention that the employee:
  - Developed **entirely on his or her own time**
  - **Without using** the employer's equipment, supplies, facilities or trade secret information
  - **Except for** inventions that either:
    - Relate at the time of conception or reduction to practice of the invention to the employer's business, or actual or demonstrably anticipated research or development of the employer; or
    - Result from any work performed by the employee for the employer

# Assignment of Inventions

- **Seven other states have statutes regarding the assignment of inventions:**
  - Delaware
  - Illinois
  - Kansas
  - Minnesota
  - North Carolina
  - Washington
  - Utah



# Assignment of Inventions

- Consider foreign law.
- Laws vary as to ownership.
  - Employer who claims ownership may be required to pay compensation for inventions created within the scope of an employee's normal duties.
  - For example: in 2009, two employees in the UK were awarded \$2.2 million dollars, and a French employee was awarded more than \$750K.

# What is an Invention?

- **An “idea” is not automatically an invention.**
- *Mattel v. MGA Entm’t*, 2010 WL 2853761 (9th Cir. 2010)
  - Assignment of Inventions Agreement between employer and employee defined “inventions” as “all discoveries, improvements, processes, developments, designs, know-how, data computer programs and formulae, whether patentable or unpatentable.”
  - Court held “ideas” not covered by the language of agreement.
    - Ideas were “markedly different” from most listed examples. Those examples were “**concrete, unlike ideas, which are ephemeral and often reflect bursts of inspiration that exist only in the mind.**”
  - Agreement listed less tangible inventions, e.g., “know-how” and “discoveries.” While it could be interpreted to cover ideas, the text did not compel that reading.

# Know-How

- **Know-how** is generally understood as the information or skills required to do something useful, or proprietary information that a company views as valuable.
  - **Hybrid patent and trade secret licenses:** Know-how questions have arisen when patent rights and trade secrets are covered in the same agreement. *St. Regis Paper Co. v. Royal Indus.*, 552 F.2d 309 (9th Cir. 1977); *Chromalloy Am. Corp. v. Fischmann*, 716 F.2d 683 (9th Cir. 1983).
- Know-how is “an amorphous, ill-defined glob of technology that has no clear time limits and no clear geographical limits. Its subject matter is not only vaguely defined; it is not even publicly defined.” Stedman, *Legal Problems in the International and Domestic Licensing of Know-How*, 29 A.B.A. Sec. Anti-trust Law 247, 250 (1965).

## Future vs. Present Assignments?

- “I will assign **and do hereby assign** my right, title and interest in each of the ideas, inventions and improvements.” vs. “I **agree to assign or confirm** in writing to Stanford and/or Sponsors” the rights to inventions conceived. *Board of Trustees of the Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc.*, 583 F.3d 832 (Fed. Cir. 2009).
- “**Do hereby assign**” effected a present assignment of future inventions.
- “**Agree to assign**” reflected a mere promise to assign rights in the future – not an immediate transfer of expectant interests.
  - Stanford may have gained equitable rights, but it did not immediately gain title.

# What About Employers' Rights Post-Employment?

- Use of Holdovers/Trailers to assign back to a previous employer following the end of the employment relationship any **post-employment inventions** for a period of time.
  - Only legal if employee used trade secrets or confidential information of previous employer.
  - Must be of limited duration.
    - One year upheld in *Winston Research Corp. v. Minn. Mining & Mfg. Co.*, 350 F.2d 134 (9th Cir. 1965).

## Unenforceable Holdovers

- May not have presumption that patent application **presumed to be conceived or made during the period of my employment.** *Applied Materials, Inc. v. Advanced Micro-Fabrication Equip. (Shanghai Co.)*, 630 F. Supp. 2d 1084 (N.D. Cal. 2009).
- May not require disclosure of ... “ideas and concepts I may have concerning the field of work of the company or concerning its products, which ideas or concepts occur to me during the period of my employment, or within one (1) year after the termination thereof, and **which might possibly be of value to the company for any reason.**” *Armorlite Lens Co. v. Campbell*, 340 F. Supp. 273 (S.D. Cal. 1972).



# Non-competition and Non-solicitation

## Cal Bus. & Prof. Code Section 16600

- Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void.

## Exception to B&P Section 16600

- Person selling a business or substantially all of ownership interest in business (including goodwill) may agree with the buyer to refrain from:
  - Carrying on a like business
  - Within a specified geographic area in which the business sold has been carried on
  - Provided the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business therein

## Non-competition and Non-solicitation

- California Supreme Court rejected the “narrow restraint” exception to B&P 16600 recognized by federal court and avoided ruling on the trade secret exception. *Edwards v. Arthur Andersen*, 44 Cal. 4th 937 (2008).
- The trade secret exception has been called in to question. “Although we doubt the continued viability of the common law trade secret exception to covenants not to compete, we need not resolve the issue here.” *Dowell v. Biosense*, 179 Cal. App. 4th 564 (2009).

## Non-competition and Non-solicitation

- Employer cannot refuse to hire or terminate employee because the individual entered a non-compete with a previous employer. *Silguero v. Creteguard, Inc.*, 187 Cal. App. 4th 60 (2010).
- Non-solicitation of customers also illegal restraint. *The Retirement Group v. Galante*, 176 Cal. App. 4th 1226 (2009).
- However, can prevent the use of trade secrets in competing and soliciting, but remember California does not recognize inevitable disclosure.

# Non-competition and Non-solicitation

- Can prohibit solicitation of employees by a departing employee
- Non-competes during employment (duty of loyalty)
  - BUT be careful about non-competes for independent contractors
- Garden leave? Untested by the courts

# Trade Secrets and Preemption

- *Banks.com v. Keery*, 2010 U.S. Dist. LEXIS 17850 (N.D. Cal. 2010)
  - CUTSA preempts common law claims based on the same nucleus of facts as the misappropriation of trade secrets claim
- *Acculmage Diagnostics v. Terarecon*, 260 F. Supp. 2d 941 (N.D. Cal. 2003)
  - Held that common law trade secrets misappropriation claim could not survive alongside a statutory misappropriation claim under UTSA
- *Ajaxo v. E-trade*, 187 Cal. App. 4th 1295 (2010)
  - Reasonable royalty appropriate for CUTSA violation, and allowable where
    1. it is unreasonable to enjoin future use of a misappropriated trade secret, or
    2. neither actual loss nor unjust enrichment are provable

# Trade Secrets and Preemption – *Contrary Views*

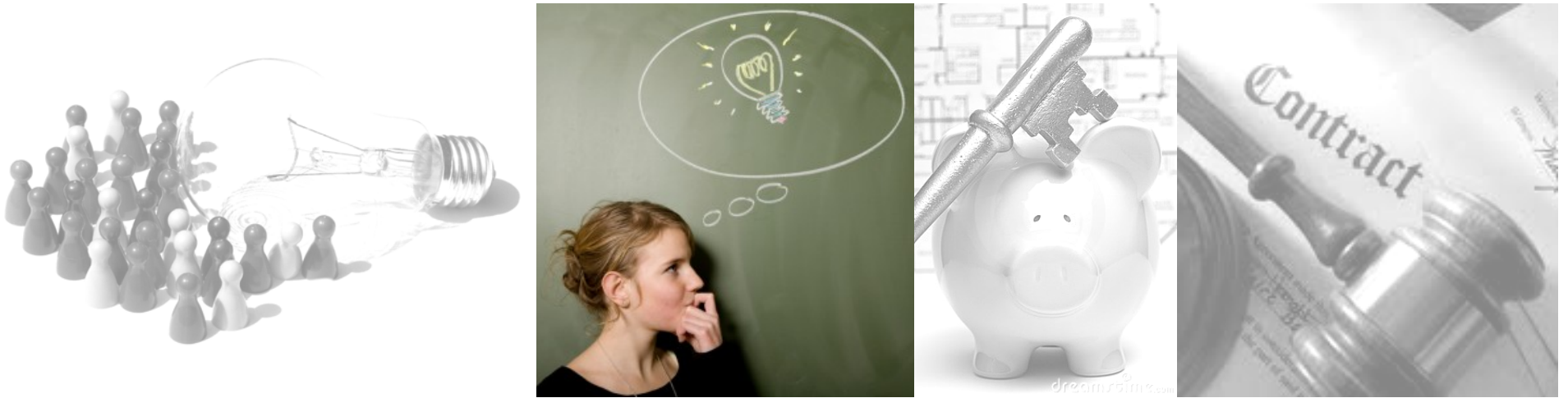
- *City Solutions v. Clear Channel Commc'ns*, 365 F.3d 835 (9th Cir. 2003).
  - Rejected defendant's argument that the jury could not have found it liable for unfair competition because it did not find it liable under UTSA.
    - Record supported the jury's misappropriation finding, even if property was not a trade secret.
- *PostX v. Secure Data in Motion*, 2004 U.S. Dist. LEXIS 24260 (N.D. Cal, Nov. 20, 2004)
  - Clear Channel strongly suggests a plaintiff may allege trade secrets misappropriation and unfair competition as alternative theories of liability.
  - Noted that UTSA had not necessarily superseded the tort of common law unfair competition in the 9th Circuit.

# Independent Development Trail

- Companies should document development of concepts, strategies, inventions, works for hire, etc. with clear trails to show who did what, when and how
- This protects the company against claims of trade secret misappropriation or unfair competition
- Also protects the company in proving what employees and contractors may have developed and then taken
- **This is a key evidentiary foundation that is needed in every trial, TRO and injunction hearing – and often is lacking**

# M&A Considerations

- Due Diligence
  - Review of employee confidentiality agreements
  - Review restrictive covenants affecting target as a result of prior deals
  - Review all restrictions covering key employees
- Drafting Restrictive Covenants to Benefit Acquiror
  - “Owner” requirement
  - “Sale” requirement



# Hypothetical

**AcmeTech develops and markets cutting-edge software and hardware for computers. The company is headquartered in St. Paul, Minnesota, and has a major product development facility in Santa Clara, California. AcmeTech has recently been dealing with the following problems:**

1. Michael Scott is the head of R&D at AcmeTech. Scott has been working at the Santa Clara facility on a blazingly fast new chip for computers. Scott started in the St. Paul office in 2001, and transferred to Santa Clara two years ago, where he has devoted most of the past two years to this endeavor and is the chief architect of the technology. Scott announced two days ago that Friday will be his last day at AcmeTech because he has accepted a position at Bigco, a competitor of AcmeTech. Bigco is located across the street from AcmeTech's Santa Clara facility, and Scott will become Bigco's chief technical officer, a significant promotion. AcmeTech is worried that Scott will take with him the plans and specific architecture for the new chip.
2. Scott said that this is a big promotion and opportunity for him, and promises not to take or use anything he gained from his employment with AcmeTech. AcmeTech asked Scott what he will be doing at Bigco, and Scott replied that he will be working on developing new products, including chips, but states that he cannot disclose his upcoming job responsibilities.
3. When Scott started at AcmeTech ten years ago he had six years as a hardware engineer at Dunder Mifflin Enterprises, and two years as an assistant product manager at DwightCo.
4. AcmeTech is headquartered in Minnesota, where the inevitable disclosure doctrine is recognized and enforced, but most of its work force, including all of its R&D staff and Michael Scott, are based in California. Scott has a written employment contract with AcmeTech that provides that Minnesota law will apply and that jurisdiction and venue of any disputes are to take place in Minnesota. Scott signed Acme's standard NDA and PIA, which contains a one year non-solicitation and no-hire clause, and a non-competition agreement for one year post departure. The day after Scott departs, two of the individuals who reported to him in Santa Clara gave notice that they, too, are moving to Bigco.

**How would you advise AcmeTech, Scott and Bigco?**

1. Meanwhile, AcmeTech has just hired three marketing and sales people who were employed by Plinga, a software company that makes video games, an area in which AcmeTech wants to expand. One of the new hires is Tinker Belle, a senior vice president of regional marketing at Plinga. Another was a product manager, and the other was an administrative assistant. Belle designed several marketing campaigns for Plinga and was working on a new strategy for the company when she accepted the job at AcmeTech as senior vice president for global marketing and sales. Plinga's general counsel, Barb Wire, sent a letter to AcmeTech objecting to the use of proprietary or confidential information or strategy from Plinga. AcmeTech's general counsel asked the head of human resources, Hiram Fast, to confirm that no proprietary information was brought over from Plinga. Fast reported that the administrative assistant had already put into the AcmeTech network the contact list, annotated, that the Plinga 3 put together before they left.
2. Plinga is a California corporation headquartered in San Francisco. Belle was one of the first employees hired by Plinga and sold \$789,034 in stock a month before she left Plinga. She retains 50 shares and has 20 vested options. Her stock option agreement had a provision that if she went to work for a competitor within one year, her options are forfeited. Belle had a one-year non-compete agreement with Plinga.

**How would you advise AcmeTech, Plinga and the three employees?**

1. While all this is going on, Macrosoft Corporation is considering acquiring AcmeTech in a reverse triangular merger. Macrosoft is trying to determine what liabilities and risks it might be assuming, and is looking for advice on how to structure a due diligence process, and to evaluate legal problems that might be lurking for it.

**How would you advise both Macrosoft and AcmeTech in this situation?**

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## Take Aways

- You can control ownership to an extent by drafting careful agreements
- Do not rely on non-competition or non-solicitation clauses for protection
- Do rely on non-solicitation of employees
- Do rely on non-disclosure agreements
- Do have a documented trail of development of inventions, works for hire, innovations and trade secrets to prove who developed what, when and how

# Questions?



Please contact any of the lawyers listed below:

- Bill Abrams, *Co-chair, Intellectual Property*  
william.abrams@bingham.com; 650.849.4880
- Dan Cooperman, *Of Counsel, Corporate, M&A and Securities*  
daniel.cooperman@bingham.com; 650.849.4849
- Wendy Lazerson, *Co-chair, Labor & Employment*  
wendy.lazerson@bingham.com; 650.849.4840

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