IP Audits: Exploring the Attics and Depths

By Antoinette M. Tease

IP audits usually consist of half a day of interviews (ordinarily half an hour each) with key personnel. In addition to interviewing top management (the CEO, CFO, and president), you should also interview the managers of the human resources, information technology, and sales and marketing divisions. This enables you to get a comprehensive view of the business and to cover the areas that are most likely to involve some form of intellectual property. The deliverable resulting from the IP audit is an IP audit report that includes a list of action items. You should continue to work with a client for one to three years after the IP audit to complete the action items included in the IP audit report.

The four areas of intellectual property that are ordinarily covered in an intellectual property audit are patents, copyright, trademarks, and trade secrets, which are discussed below, as are open source code issues and infringement.

Patents

In the area of patents, the questions to ask during an IP audit should be directed toward determining whether the company being audited has any kind of invention that may be patentable. A patentable invention could be anything from a hand tool to a cosmetic product to a business method. If the company does not have patentable inventions, then you should focus the remainder of your questions on the other types of intellectual property addressed below. If it does have such inventions, you should ask questions related to both ownership and disclosure.

The default under U.S. patent law is that the individual inventor owns the patent rights to his invention, regardless of whether someone else paid him to develop it. Clients often assume that because they paid someone to write a software program for them or to design a product for them, they own the patent rights to that invention. However, when it comes to independent contractors, the client does not own the patent rights unless the inventor has signed a written assignment of his or her patent rights to the client. When it comes to employees, the situation is a bit more complicated.

In the absence of a written employment agreement, the employer does not own the patent rights to inventions that its employees develop unless the employee was specifically hired to solve a particular problem and the invention relates to that problem. The problem with relying on the "hired-to-invent" doctrine is that it is highly fact-specific; the burden will be on the employer to show—through offer letters, job descriptions, etc.—that the employee was hired to solve a particular problem. The far better approach is to have all employees sign a pre-invention assignment agreement as a condition of hiring. Without a written patent assignment agreement, and without evidence to support an argument that the hired-to-invent doctrine applies, the employer will have a nonexclusive right to practice the invention (a "shop right"). A shop right is a license, however; it does not constitute ownership of the patent rights.

The other patent issue to address during IP audits is the issue of disclosure. Under U.S. patent law, an inventor has one year after the first public disclosure of an invention to get a patent application on file, or else the invention will be deemed to have entered the public domain. The term "public disclosure" includes publication, sale, offers for sale, and public use.[1] If, as a result of the IP audit, you identify a potentially patentable invention, and you establish that the client owns the patent rights to that invention, then you must determine whether there is still enough time to file a patent application before the end of the one-year grace period. Going forward, you should continue work with clients to develop timelines to ensure that they will not miss patent deadlines in the future.

With the exception of a few countries, most foreign countries are "absolute novelty" jurisdictions, which means that there is no one-year grace period. If a client is interested in foreign patent protection, then you must ensure that the U.S. patent application is filed prior to any public disclosure. The foreign patent application may claim priority back to the U.S. filing date.

Lastly, even if you are unable to identify a patentable invention owned by the client and for which the one-year grace period has not expired, clients are often interested in monitoring the patent applications of their competitors to ensure that they will not some day receive a cease-and-desist letter that could threaten the future of the company. You need to regularly work with clients to identify and monitor competitor patent applications and, where appropriate, take steps to prevent them from issuing.

Copyrights

Under U.S. copyright laws, employers automatically own the copyrights to works generated by their employees within the scope of their employment; thus, no written copyright assignment is necessary for employees. The rule for independent contractors, however, is different. Even if the client pays to have an independent contractor write a manuscript, prepare an illustration, generate artwork, participate in a sound recording, etc., the client does not own the copyright to the work unless there is a written copyright assignment between the author/artist and the client.

This issue often arises with respect to software and website content. Clients often hire outside firms to write software for them and to develop content for their websites. The services agreement between the client and the outside firm should include a copyright assignment provision so that the client will own the copyright to any works generated as a result of the engagement.

The term "work for hire" (or "work made for hire") is often used in connection with intellectual property, and more often than not, it is used incorrectly. First, the term "work for hire" has no relevance to patent law; instead, it is a term that has meaning only under copyright law. Clients often assume that something is a "work for hire" if they pay for it, but that is no longer the case (it was under pre-1976 copyright laws). Today, the term "work for hire" applies only to works generated by employees or to a very limited body of works (such as atlases, test material, answer material for a test, etc.) for which there exists a written "work for hire" agreement between the client and the author.

As part of the IP audit, you need to work with clients to

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identify works (software, manuals, press releases, website content, photographs, etc.) that are potentially copyrightable. You also need to determine whether the client owns the copyright to those works, and, if so, develop a schedule for filing federal copyright applications. For something that is updated regularly, like software or a website, clients should file a federal copyright application at least once a year. Although copyright attaches from the moment a work is created, that right can only be enforced if the work is registered with the U.S. Copyright Office. If the infringement occurs prior to registration, then the client may have no recourse.

Trademarks

Trademarks may be registered on the state or federal level. For clients whose business occurs solely within a single state, a state registration is the only option. For those clients, however, who conduct business across state lines, a federal trademark registration is highly recommended. Particularly for clients who are considering undergoing a rebranding process, it is imperative that trademark searches be performed to ensure that the new trademark will not pose any conflicts with trademarks owned by other parties.

One issue that arises frequently involves state assumed-business-name registrations. Clients often assume that a state assumed-business-name registration affords them trademark rights, but it does not. A state assumed-business-name registration is not a trademark registration, and it does not confer the benefits obtained by registering a trademark. Clients also sometimes confuse company names and assumed business names with trademarks. A company name also may be used as a trademark, but the requirements for trademark usage go beyond use as a company name.

The rules for registration of a trademark relating to goods (i.e., physical products) differ from the rules for registration of a trademark relating to services. In order for a trademark relating to goods to be registrable, the trademark must be physically affixed to the product itself (as in a product label) or packaging. Use of the trademark on business cards, stationery, invoices, or purchase orders or in contracts or other legal documents does not ordinarily constitute trademark usage. In order for a trademark relating to services to be registrable, the trademark must be used in connection with some form of advertising (a website, brochure, print advertisement, etc.) that mentions those services.

The United States requires proof of actual use of a trademark before it can be registered; however, most foreign countries do not. Instead, most foreign countries are "first-to-file," which means that if your client owns a trademark and is doing business overseas, it may be prevented from using that trademark in a foreign country if it is not registered. Although registrations can be obtained in foreign countries without proof of use, registrations are subject to cancellation proceedings based on nonuse after a certain period of time.[2]

One scenario that commonly occurs is when a foreign distributor registers its supplier's trademark in the foreign country without the supplier's knowledge. In those situations, the supplier should demand that the distributor assign the foreign trademark registration to the supplier and enter into a licensee agreement with the supplier for use of the mark. Otherwise, the supplier may be prohibited from using its mark in the foreign country if it severs its relationship with the foreign distributor.

During the IP audit, you should identify trademarks that need protection and ensure that trademarks are being used properly. For those clients interested in international trademark protection, you should develop a schedule for filing of international trademark applications. In order to claim priority back to a U.S. trademark application, an international trademark application must be filed within six months of the U.S. filing date.

Once the client's trademarks have been identified and registered, for some clients, you can initiate a regular trademark monitoring program pursuant to which a search can be conducted for other applications (filed by third parties) for the same or similar marks. You do this so your client can oppose registration of those marks if the trademark examiner approves them for publication. If the client prefers to conduct the monitoring process in-house, you can work with clients to train them on proper search procedures.

From time to time, clients are concerned about goods being imported into the United States bearing their trademarks and without their authorization. In those cases, the client may choose to record its trademarks with U.S. Customs and Border Patrol, which has an electronic process for the recordation of trademarks.[3]

Trade Secrets

There are really only two ways to protect a trade secret: through written agreements and by restricting access to the trade secret. There are many different ways to restrict access: computer files can be password-protected, laboratory notebooks can be maintained in locked file cabinets, and formulations or processes can be revealed selectively to certain individuals so that only a few people have knowledge of the entire formulation or process.

Without exception, every business should have written confidentiality agreements in place with its employees and those independent contractors who have access to the company's trade secrets. Examples of trade secrets include customer lists, supply sources and pricing, marketing strategies, business plans, computer source code, and inventions for which the client elects not to pursue a patent application. Depending on the level of security required at the client site, some clients also may want to have visitor confidentiality agreements in place. For example, visitors who have access to the manufacturing floor and who may be in a position to view proprietary manufacturing processes should be required to sign confidentiality agreements.

In the event of trade secret misappropriation litigation, the party asserting misappropriation of its trade secrets will be

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required to prove that steps were taken to maintain the confidentiality of the trade secrets. Without written confidentiality agreements in place, it is not likely the client will prevail. Because the client's employees are often the only people who have access to the trade secrets, the most frequent scenario in trade secret misappropriation cases is an employee leaving an employer and taking the employer's trade secrets with him.

IP audits often reveal the client's concern about trade secrets to which its employees have access. For example, one client may be concerned about its client list, and another client may be protective of its manufacturing processes. You need to work with clients to ensure that the appropriate agreements are in place and that reasonable steps have been taken to restrict access and prevent misappropriation.

Open Source Code

Another area of law to address during an IP audit, particularly (but not exclusively) with respect to software companies, is open source code. The term "open source code" typically refers to computer source code that is both publicly available and free, subject to the terms of an open source code license agreement. A full discussion of open source code and its legal implications is beyond the scope of this article, but suffice it to say that if a company has developed a computer program that it believes is proprietary, you should interview the developers to determine whether that program incorporates open source code. If so, then you need to conduct an open source code audit to determine (a) which open source licenses are at issue and (b) whether the client is in compliance with the provisions of the applicable licenses.

Open source code licenses are not one-size-fits-all; some have greater strings attached than others. For example, there are some open source licensees that only require that certain notices (copyright disclaimers and the like) be included in the source code files. There are other open source code licenses that require that the entire code base be made public under certain circumstances (i.e., where the open source code is incorporated into the code base and where the code at issue is "distributed" or "conveyed"). It is important to avoid the latter types of open source licenses if the client has an expectation of maintaining a proprietary interest in the computer program.

Both copyright and patent issues are typically implicated in open source code audits. For example, the GNU General Public License version 3.0 includes both copyright and patent provisions.[4] A fairly comprehensive list of open source licenses can be found at www.opensource.org.

Infringement

Lastly, your IP audits also should address infringement issues with respect to all of the above forms of intellectual property law. There can be infringement of a patent, copyright, or trademark and misappropriation of a trade secret. The client may be accused of infringement, or the client may want to pursue an infringer. Either way, these issues need to be addressed in the IP audit.

In Conclusion

A comprehensive IP audit benefits the client in several ways. First, it may identify intellectual property assets the existance of which the client was not aware. Second, it should ensure that those assets are properly protected. Third, it may lead to efforts to enforce the client's intellectual property assets. Fourth, it serves as an inventory of intellectual property assets that may be used in connection with any due diligence process, such as, for example, a corporate merger or acquisition. Fifth, it should result in deliverables in the form of a comprehensive IP audit report with a series of action items that can be shared with the management team. For these reasons, an IP audit is well worth the investment and should ultimately increase the value of the company participating in the audit. ■

IP Audit Checklist

1. Patents

- ❑ Identify patentable inventions and explore patent protection.
- ❑ Ensure that appropriate ownership agreements are in place.
- ❑ Discuss disclosure rules.
- ❑ Monitor competitor patent filings.

2. Copyrights

- ❑ Identify and register copyrightable works.
- ❑ Ensure that appropriate independent contractor agreements are in place.
- ❑ Establish regular filing schedules for works that are updated regularly.

3. Trademarks

- ❑ Identify and register trademarks.
- ❑ Ensure ownership of marks used by foreign distributors.
- ❑ Explain the rules of trademark usage.
- ❑ Establish a trademark monitoring program.

4. Trade Secrets

- ❑ Identify trade secrets.
- ❑ Ensure that appropriate confidentiality agreements are in place.
- ❑ Establish or confirm procedures for restricting access to trade secrets.
- ❑ Police any misappropriation of trade secrets.

Endnotes

1. For more information on the one-year grace period under U.S. patent law, please go to http://www.teaselaw.com/newsletter/2004_april.html.

2. Registrations may be obtained in the United States without proof of use if they are based on registration of the same trademark in a foreign country.

3. For more information on the recordation of trademarks and copyrights with U.S. Customs and Border Protection, please see http://www.teaselaw.com/pdf/testimony.pdf.

4. For an article addressing the GNU General Public License version 3.0, please go to http://www.teaselaw.com/media%20quotes/media1.html.

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