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LEGAL ISSUES IN A START-UP. PART I - INTELLECTUAL PROPERTY PROTECTION.

The series of seven articles intend to highlight critical legal and business issues for start-ups. Part I discusses intellectual property law and the methods available to entrepreneurs to protect their company's primary assets. Considering such factors as personal liability, tax implications, and ownership flexibility, Part II examines choice of entity alternatives for a start-up. Part III discusses the factors to consider in deciding where to organize the start-up company. Part IV highlights employment law issues and related potential liability of officers and directors. Part V examines the critically important process of raising capital for a start-up company. Part VI addresses the securities regulation and the sale of equity interests in the business. In Part VII, this article reviews typical exit strategies for start-up companies including initial public offerings (IPOs), sales and mergers, and bankruptcies.

I. INTELLECTUAL PROPERTY

Various areas of intellectual property law specifically assist start-ups in protecting the fruits of a productive mind. In particular, trade secrets, copyright, patents, and trademarks provide protection for the business's intellectual property assets. Each form of intellectual property protection has its advantages and disadvantages, and each works best for certain kinds of intellectual property. In most cases, only one or two types of protection will be appropriate or available for a particular asset. At the same time, a company may have a variety of intellectual property assets, each of which may require a different type of protection. Several factors should be considered when choosing which type of protection to use.

First, start-up executives should consider the nature of the intellectual property to be protected. Written or artistic works such as books, movies, paintings, and architectural plans and drawings use copyright protection. Company names and symbols that are used to designate the source of a good or service use trademark protection. Certain advertising slogans may be eligible for either or both copyright protection and trademark protection. Patents protect items of invention if they meet specified criteria. Certain items not qualifying for patent protection may nevertheless be guarded by trade secret law. For example, food recipes are not currently eligible for patent protection, but may be protected as a trade secret. Usually, however, a choice must be made between patent law and trade secret protection.

Second, start-ups must focus on the importance of maintaining the confidentiality of the company's proprietary information. Company names, symbols, and authored materials are intended to be in the public domain. On the other hand, inventions must be closely guarded. If the invention could be protected as either a trade secret or patent, a clear choice must be made. Patents provide much stronger protection and protect for a certain term, but require complete disclosure of the invention. Trade secret law provides inexpensive protection and may last indefinitely, but the term of a trade secret is uncertain as there may be many ways to legally access the guarded information.

Third, cost may be a significant factor in choosing how to protect intellectual property. Copyright registration is available for a nominal fee, while trademark registration is more expensive, and patent protection is quite costly. The initial patent office filing fee for a utility patent is over $800. The various patent filing, patent prosecution, correspondence, issuance, and maintenance fees may amount to thousands of dollars. Although there are no filing fees for trade secrets, the cost of protecting them can vary widely. Lawyer fees for the prosecution of patent applications must always be considered, and they are the predominant portion of the expenses associated with the award of a patent.

1. Trade Secrets

As a first line of defence in protecting an idea, start-ups should treat the information as confidential and proprietary information of the company. Trade secret law basically protects valuable corporate information from being made public. For information to be a trade secret the information must be: (1) commercially valuable information, (2) guarded from disclosure, and (3) not general knowledge. Formulas, patterns, compilations, programs, devices, methods, techniques and processes all may be trade secrets if properly protected. Trade secrets may protect both patentable and unpatentable processes. They can protect any confidential information that provides the company with a competitive advantage. For many start-ups, customer lists, pricing information and marketing strategies may be ideal subjects for trade secret protection.

Federal law does not protect trade secrets. To win a trade secret lawsuit, a company must prove four elements: (1) the information had economic value, (2) the information was not generally known to persons with the legitimate means to discover the information, (3) the information was misappropriated, and (4) the information was guarded in a reasonable manner considering the circumstances.

Entrepreneurs who properly guard their proprietary and confidential information can legally enforce the information as trade secrets. Many claims involving trade secrets are brought by owners against employees or competitors. Courts can award monetary damages to entrepreneurs whose trade secrets have been misappropriated. In calculating any of these awards, the damage amount is equal to the greater of the pecuniary loss to the entrepreneur or the pecuniary gain to the defendant. Additional damage awards may be available if the use was wilful and malicious. In addition, courts may exercise their power to enjoin a defendant from using or further disclosing the trade secret.

Trade secret protection can be a powerful legal tool to protect a start-up's intangible assets. Because trade secrets have no statutorily defined time limits, they can protect information indefinitely. Moreover, trade secret protection can be achieved inexpensively. However, to do so, entrepreneurs must take strict security measures such as restricting access to the information and requiring all employees to sign non-disclosure and non-compete agreements. In summary, the entrepreneur must generally keep the information secret.

2. Copyright

Depending on the nature and use of the material, entrepreneurs may seek copyright protection. A copyright is designed to give protection for a specific period of time to authors of original works such as books, songs, dances, source code for computer programs, movies, sculptures, paintings, and other literary and artistic expressions. For some start-ups, copyrighting software is imperative to protecting their technology. Ideas alone cannot be copyrighted, but an author's unique expression of an idea is copy-

rightable. The original work must also be "fixed in a tangible medium of expression."

A copyright grants the author exclusive rights to the material for the author's life plus 50 years in Canada and life plus 75 years in the USA. A copyright holder receives the exclusive right to reproduce, prepare derivative works, distribute, perform, or display the work. These rights are subject to compulsory licenses and the "fair use" doctrine. Compulsory licenses require the copyright holder to license, for a fee, the material to certain limited users, such as cable television operators. In contrast, the fair use doctrine permits certain "justifiable uses" of copyrighted materials.

The last important feature of a copyright is the ownership aspect. Usually, the creator of the original work owns the copyright, but a copyright may be partially or completely transferred by sale or gift. Also, if an employee creates a copyrightable work that is within the scope of employment, then the employer is considered to be the owner of that copyright. In addition, if a person specifically commissions a work and the parties agree in writing that the work will be considered as a work for hire, then the person who commissions the work is deemed to be the owner of the copyright. Entrepreneurs should consider these issues when developing intellectual property that is copyrightable.

3. Patents

Though finite in duration, patents allow entrepreneurs to protect ideas and processes. A patent allows the holder to exclude others from "making, using, importing, offering for sale, or selling the invention." For start-up companies, patents protect their technologies and may be attractive to potential investors. A patent grants the holder a monopoly in the subject of the patent for a specific time period. If a third party infringes a patent, the patent holder can through litigation stop the infringing user from continued infringement of the patent and can also seek damages, lawyer's fees, and costs. The duration of the patent depends on the type of patent. Patents are not renewable, and when the term expires the subject matter of the patent becomes part of the public domain and is open to public use.

Currently, the United States Patent and Trademark Office (USPTO) and Canadian Intellectual Property Office (CIPO) issue three types of patents; utility patents, plant patents, and design patents in the USA and industrial design registrations in Canada. Utility patents are granted for the invention of a process, machine, articles of manufacture, or composition of matter (chemical composition). Utility patents must be novel, non-obvious, and useful. The novelty requirement means that the invention must be new and not previously patented, described, or otherwise anticipated. Non-obviousness requires that the invention, in light of the prior art, is not obvious to a person skilled in such prior art. The usefulness element requires the invention to have specific and substantial benefits that the inventor must disclose.

The USPTO and CIPO will grant a plant patent to entrepreneurs who invent a new and distinctive variety of asexually reproducing plants. The same requirements of novelty and non-obviousness apply to a plant patent. In addition, the invention must be distinctive. There is no usefulness requirement for a plant patent.

A design patent in the USA and industrial design registration in Canada is granted to protect new, original, and ornamental designs for an article of manufacture. A design patent or industrial design registration must meet the criteria for novelty and non-obviousness, as well as a requirement of ornamentation. A design patent need not have utility.

4. Trademarks

In addition to protecting the business's ideas or their expression, an entrepreneur should protect the business's identity and marketing strategy. While trade secrets, copyrights, and patents focus on the methods, products, or services of the business, trademarks protect a business's distinctive symbols, logos, marks, words, or designs that are used to identify and distinguish its goods and services.

To register a trademark: (1) the subject matter must be trademark eligible; (2) the trademark must be distinctive, and (3) the trademark must not be likely to cause confusion with a previously used or registered mark. The eligible subject matter is very broad. Almost everything can be trademarked, such as the three chimes of NBC or the shape of a Coca-Cola bottle. To be protected by the Trademarks Acts both in the USA and Canada, a trademark must be distinctive enough to identify clearly the origin of goods or services. Moreover, a trademark will lose its eligibility for protection if prospective purchasers come to perceive a trade symbol primarily as a generic designation for the category, type, or class of goods or services with which it is used. For example, aspirin and thermos used to be trademarks, but as they became more and more descriptive of the product and less distinctive, they lost their ability to be trademarks.

Entrepreneurs can register trademarks under Trademark Acts in the USA and Canada, which provide an initial protective period of ten years in the USA and fifteen years in Canada. Trademark protection can be renewed for additional ten year (USA) and fifteen year (Canada) periods indefinitely. The benefits of registering a trademark include (1) being able to prevent others from using the marks in a manner that would likely lead to confusion in the market place; (2) obtaining a statutory presumption of ownership of the trademark; and (3) putting others on constructive notice of ownership. If others use a trademark without permission or use a substantially similar mark that will likely cause confusion, an entrepreneur controlling a particular mark can bring an action to end the infringing use of the trademark. Also, entrepreneurs may seek damages and lawyers' fees in exceptional cases. Finally, the entrepreneur can have the infringing objects destroyed.

Because of the importance of a presence on the web, a start-up should search to determine that the domain name it chooses is not already registered as a trademark. Choosing a domain name that is registered as a trademark almost certainly is an infringement, and as such would subject the entrepreneur to anti-cybersquatting laws. A start-up should also periodically conduct web searches to be sure that its trademarks are not infringed. A common misappropriation of trademarks occurs when a competitor uses a start-up's registered name as a metatag. By doing so, the competitor steers web surfers to its site rather than the start-up's website.

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