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The 5 intellectual property mistakes startups must avoid to protect ROI

Companies can avoid many of the common mistakes without spending substantial time or money

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Early and growth-stage companies are justifiably focused on developing the next big idea, getting that idea to market and ensuring the company has enough financial runway to make it all happen. Missteps in protecting the startup's intellectual property, however, can be devastating when it comes time to translate the company's growth efforts into future investment. Fortunately, companies can avoid many of these mistakes without spending substantial time or money (each a premium within most startups).

Mistake No. 1: Crowdfunding without protection

Crowdfunding has become incredibly popular in the last several years — early-stage companies have raised billions of dollars without seeking the help of friends and family or a subsequent round of financing from angel investors. This trend is likely to continue with the passage of the Jumpstart Our Business Startups Act (JOBS Act), designed to make it easier for companies to receive financing through crowdfunding. Crowdsourcing's hallmark is its public sales pitch, which moves out of the closed boardroom and onto the very public web. Entrepreneurs share their early ideas and prototypes with the world in hopes that individual members of the public will jump on board (often by pre-purchasing the company's products).

While the public disclosure of ideas pursuant to a crowdsourcing initiative can be an effective way to quickly raise capital, it can be devastating for companies that have not already sought protection for their intellectual property. For example, under U.S. patent law, a crowdsourcing pitch may be a "disclosure" or "sale" that starts the clock on the one-year grace period for the company to file a patent on the technology. Once this grace period expires, the startup will be unable to protect its invention using the patent system. Even more troubling, in pure international first-to-file systems, a public, crowdsourcing disclosure may open the door for others to swoop in and claim the rights to the startup's invention or may prevent the startup from obtaining international patent protection altogether.

For both startups and established companies, patent protection is the foundation of intellectual property protection. Discovering down the road that you are unable to obtain adequate patent protection for your big idea may foreclose interest when trying to attract more institutional investors in the future. Therefore, it is usually advisable for startups to submit at least a provisional patent application covering their ideas.

Mistake No. 2: Letting inventions walk out the door

Even if your consultants and employees develop the next Facebook or WhatsApp while working for your startup, that invention is not necessarily your company's property. Few things unravel an investment deal quicker than discovering the company does not own the inventions they thought it did. To help avoid this nightmare, startups should at least ensure they have and use three key agreements for consultants or employees.

First, startups must create and use non-disclosure agreements (NDAs). NDAs ensure that your trade secrets remain just that: secret. Failure to take reasonable actions (i.e., disclosing company secrets to a third party without an NDA) will negate a startup's ability to stop others from using those secrets. It goes without saying that prematurely letting the "secret sauce" into the wild can substantially devalue the company.

Second, startups must require every employee (including the ones working in the garage) to sign an employment agreement. Startups often operate in an informal, "handshake" fashion in their early days. However, this can lead to regret down the line when an employee walks out the door with an invention and the company has no formal agreement memorializing who actually owns the invention. While each agreement should contain nuances tailored to the situation, a company should always include a provision mandating the "present assignment" of legal rights to inventions developed by employees as part of their work. In other words, the employment agreement must contain language of performance ("I hereby do assign") as opposed to merely language of a promise ("I promise to assign or I will assign"). This key language can mean the difference between a company owning an invention and never owning it to begin with.

Third, startups should use work-for-hire or independent consultant agreements. Often, startups cannot afford to bring on full-time employees. Instead, they rely upon independent contractors to perform various discrete tasks. In these circumstances, the company should have an agreement that provides protections similar to an employment agreement. In general, these agreements should cover key issues such as the scope of the work, who owns the finished product, and the relationship between the parties, as well as the elements discussed above, including confidentiality and assignment of rights. Startups should also consider including language clearly establishing who owns any copyrightable work developed as part of the relationship.

The good news here is that a startup can have these types of agreements drafted up relatively inexpensively. Failure to do so, however, can be extremely costly for the company during subsequent rounds of investment.

Mistake No. 3: Being too "open" with your software

Most startups undergo some element of

software development. Custom software will likely be a key component to the business, regardless of whether the startup is developing an app, a medical device or self-driving cars. To expedite development of the software, a startup may be tempted to use preexisting open source tools or libraries. This mistake, however, can jeopardize the value of the software and create numerous legal headaches down the road. Open source licenses are often very complex and may require distributed derivative works to be open sourced or similarly licensed. Depending on the license at play and how the startup uses the code, there can be dire consequences for the valuation of the startup's end product or even the possibility that the startup will be sued for breach of contract or copyright infringement if the code is used improperly. These issues may create red flags during subsequent investment due diligence periods. Those red flags often mean less money for the business.

Mistake No. 4: Failing to make your mark

Trademarks drive significant value for startups and established companies. And, in an era where countless competitors have the resources and means to copy a successful model, it becomes essential for a startup to corner the market by making its brand synonymous with their product offering. Registering a trademark is relatively easy and has significant benefits. It expands the reach of the company's use of that mark, informs the world of the company's ownership of the mark, and will immediately inform the company if it is building a name around a mark it does not and cannot own. By contrast, failing to obtain broad trademark protection may expose the startup to liability or to knockoffs with confusingly similar names that steal market share. That lost market share may ultimately translate into lost investment dollars during future rounds of investment.

Mistake No. 5: Jointly owning little

Early and growth-stage companies often look to collaborate with other companies on innovation. These joint-development efforts may expedite development but can substantially devalue the resulting intellectual property. Jointly-owned intellectual property can add significant complexity when attempting to monetize that asset. For example, in the context of patent protection, if a single claim within a patent was invented by more than one party, *all of the claims* of the patent are jointly owned by all of the parties. Even worse, any party with an ownership interest in the patent can license that patent for whatever amount they chose without the permission of any other party. This creates significant risk for subsequent investors since they do not have full control over how that asset is leveraged. At a minimum, startups must understand how joint ventures can impact the value of their intellectual property assets. In doing so, they should ensure that joint development agreements clearly define intellectual property ownership, and ensure the startup adequately segregates jointly-developed technology from technology developed in-house.

When it comes to a startup's intellectual property, what seems like small mistakes today can have big consequences for tomorrow. Protecting the company's intellectual property from day one will help transform hard work and big ideas into real investment returns down the road.

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