Owning what you pay for

How can you ensure you actually own intellectual property created by contractors

Intellectual property (IP), whether patents, copyrights, trademarks or trade secrets, is an important asset for almost every company, regardless of industry or market focus.

"Business owners should be careful not to fall prey to the misconception that if their business does not involve manufacturing, research and development, or high-tech innovation, there is no IP to protect," says Alexis Dillett Isztwan, member at Semanoff Ormsby Greenberg & Torchia, LLC. "In fact, with reliance on the Internet for the delivery of goods and services, as well as marketing, strong brand recognition and the development of original creative works have become an important driver for generating revenue. It is not unusual today for a business to have only one category of assets — its intellectual property."

Smart Business spoke with Isztwan about how you can know whether you really own the IP that you paid for.

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How does ownership typically work when a contractor develops IP?

Often, owners assume if they paid a contractor to create something — a website design, an Internet platform or portal, a logo design, a software program — then the business owns all the rights. The reality, however, is quite the opposite. Under copyright law, the author — the graphic designer or the software programmer — owns the copyright, and under patent law, the inventor owns the rights. This is true regardless of whether, or how much, the company paid.

For copyrights, there is a narrow, often-misunderstood exception called the 'work for hire' doctrine. The work for hire exception covers only two categories: (1) employees who create works within the scope of their employment, and (2) nonemployees who create a work that falls within one of the specifically enumerated categories in the copyright law. The second category applies infrequently, covering only works such as contributions to a collective work, parts of a motion picture or other audiovisual work, translations, an instructional text, a test, answer material for a test, or an atlas. The first exception covers works prepared by an employee, not contractors.

Determining whether a person is an employee requires evaluating the level of control the employer has over the work as well as the creator and his or her conduct. Even if the creator is an employee, it calls into question when the work was created and whether the subject matter is related to the scope of employment.

What can business owners do to ensure they own what they pay for?

The best way to solidify IP ownership is with a written contract signed by both parties *prior* to any services being performed, whether by an employee or contractor. The contract should clearly grant ownership of all works and inventions and related IP rights to the business. Ownership should not be dependent on or timed with payments.

Even businesses that attempt to cover ownership in a written agreement sometimes limit effectiveness by stating that all work should be considered 'works for hire.' Since copyright law does not cover all IP rights, the contract language should contain an immediate, explicit and irrevocable assignment of all rights in the work created.

One pitfall is failing to recognize when the contract is necessary. Whenever a business hires an outside party to prepare a product or other deliverable, a written contract for those services should contain a favorable ownership statement.

Too often, the contractor convinces the owner a written agreement is unnecessary or that the contractor operates on a purchase-order basis only. This is a red flag, as trying to extract an ownership statement later will come with a price and often be refused.

Is this an area of growing concern?

To many business owners, it is counterintuitive that IP ownership generally resides in the author or inventor rather than the party paying for the work. As a result, a number of owners are unaware of the problem until it surfaces in another context, such as when trying to sell the company, looking for financing, or in a dispute with the contractor or employee who created the work.

The ownership issue is not industry specific, but startup companies are more vulnerable to missteps. Startups, often low on cash, frequently look to friends to work for them based on a handshake promise of future interest in the company. When the business starts growing, those 'friends' come looking for their equity, and if you did not obtain an assignment of rights, you have little leverage, particularly when the savvy friend holds the IP ownership hostage in exchange for a percentage of the business.

During the due diligence of a sale or financing, buyers or potential investors look at whether the company owns all of the asset rights, either to determine the value or ensure security. Increasingly, those assets are entirely or largely IP related. An unclear ownership chain often devalues the business. For example, a business hires multiple programmers to develop software without agreements, and tying up ownership requires tracking down each programmer to obtain an assignment of rights. It may be impossible to find each programmer and, if you do, even harder to convince them to agree to an assignment.

If you don't have an assignment, what can happen to your property?

If your company does not own the IP rights, not only is the business potentially vulnerable to infringement claims but the actual owner also has the right to license or sell the work to other parties, including competitors. Imagine having a new software platform developed by a contractor without an assignment, and then that contractor licenses or sells it to your competitor. You lose control over what was supposed to add value to your business, and you could have to focus time and resources on either defending an infringement claim or obtaining the rights from other parties, likely at a much higher cost than originally paid. <<

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