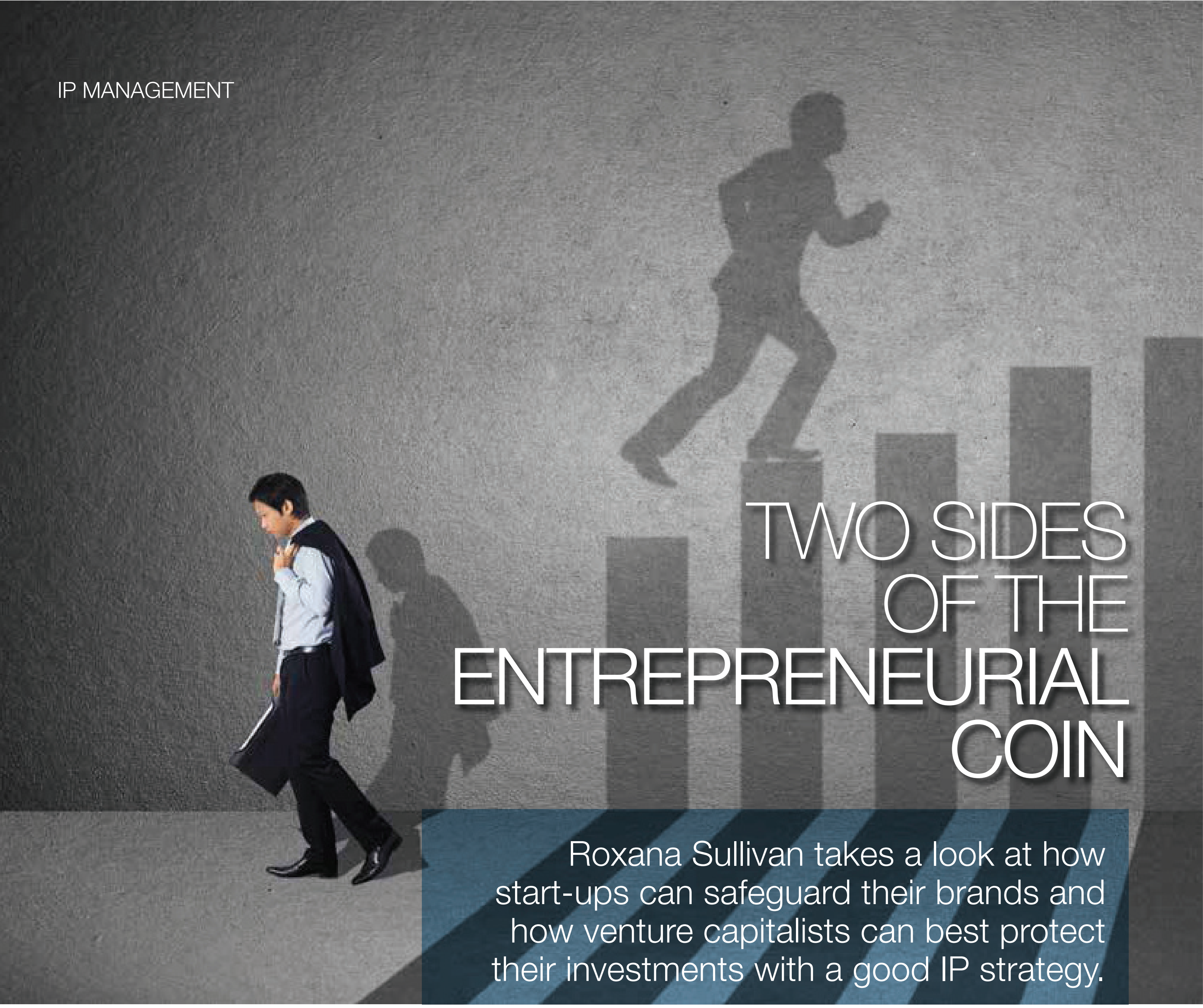


TWO SIDES OF THE ENTREPRENEURIAL COIN

Roxana Sullivan takes a look at how start-ups can safeguard their brands and how venture capitalists can best protect their investments with a good IP strategy.

For both sides of the entrepreneurial coin, start-up companies and venture capitalists (VCs), due diligence is a key component. Due diligence is a company investigation conducted any time a company is acquired, an investor plans to invest in a company, venture financing is considered, or an initial public offering is made. Below, we focus on IP considerations that VCs need to take into account when performing due diligence and what start-ups need to examine to position themselves for investment.

A review of IP assets should be taken by all start-ups, regardless of the type of IP assets they own. For example, companies in the pharmaceutical, medical device or biotechnology fields regularly protect assets with patents or trade secrets and develop valuable trademarks as they go to market. For other start-ups, such as web-based technologies focused on user experience, patents can be less important than strong copyright and trademark portfolios. In either case, it's in the best interest of the start-up and the VC firm to examine the IP portfolio as a whole.

Due diligence

There are four main factors a VC firm needs to consider when performing due diligence.

First, it's important for a VC firm to verify that all IP assets have been assigned to the company and to review any licence agreements concerning the IP. If the chain of title regarding the IP in question is messy, then the valuation, and later monetisation process, will prove to be complicated at best. VCs should examine the agreements in place to ensure that employment and consulting agreements establish IP ownership in the start-up. An examination of the start-up's licence agreements can also help estimate future royalty obligations.

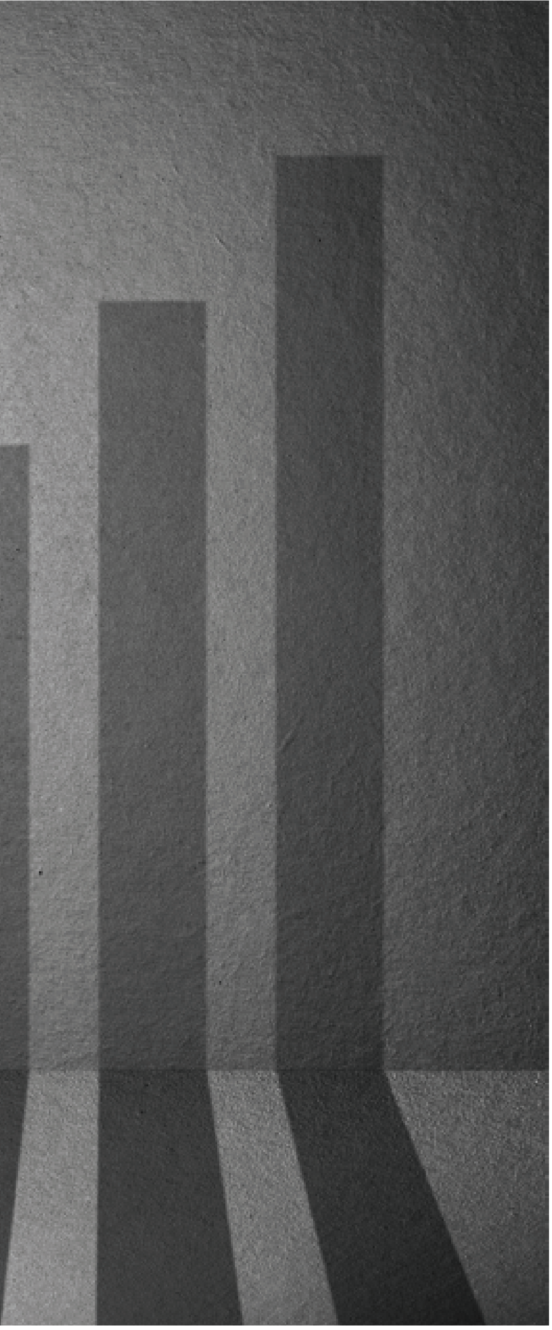
Second, VCs should consider the measures taken to protect the IP. Have proper forms been filed for patent, trademark, and/or copyright protection? Was an attorney used to prepare and file these forms? Have maintenance fees been duly paid on the IP assets?

Third, examine the company's trade secret protection measures. Have non-disclosure agreements been utilised if the start-up worked with outside companies or individuals to develop the technology? What other systems are in place to ensure that proprietary information stays protected?

Finally, VCs must identify competing third-party technology and whether any claims exist against the company's IP. This analysis is used to determine if there are third-party patents that could block the technology in which the VC firm is interested in investing. It can also determine if infringement actions are likely in the future.

Start-ups

It's important for a start-up to position itself appropriately and take the steps to protect its IP assets in order to attract VCs. By effectively protecting IP, a start-up can increase the value of its business, protect its competitive advantage, and use the IP as a potential revenue stream through licensing.



Building a strong IP portfolio both gives investors comfort and builds credibility in a company. For some VC firms, a management team that is thinking about IP and how it can protect its assets is a sign of a well-run company—one that could provide a good return on investment. Start-ups should examine each type of IP asset.

Patents

A well-thought-out patent portfolio can be valuable to a start-up. Not only do patents give the patent holder a competitive advantage, but patents can be monetised in multiple ways.

VC firms will typically look at issued and pending patents to determine the value of a company. Also, technology covered by a patent can sometimes be licensed, giving the company a second revenue stream. However, developing and building a comprehensive patent portfolio can be cost-prohibitive. Therefore, it's important for start-ups to focus on key products and/or technologies and file applications for the inventions that are in line with their business objectives. Depending on the

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patent and business objective, it will be important to also examine whether it would be worth filing the patent in other countries.

Copyright

Start-ups need to examine their assets to determine if any works, including software code, are copyrightable and to secure copyright registrations with the US Copyright Office. Having copyright registrations with the US Copyright Office enables the copyright holder to file suit against infringers and to seek statutory damages and attorney's fees.

Trademarks

Trademarks are the linchpin of a start-up's IP assets. A strong trademark will act as a source identifier and help set the owner apart from the competition. It will enable the company to establish a strong identity in the marketplace and build goodwill with consumers. Securing a trademark registration with a patent and trademark office gives exclusive rights to the trademark owner and prevents confusingly similar trademarks from entering the marketplace, which helps the company establish a strong and recognisable brand.

Trade secrets

Trade secrets can be valuable assets to a start-up. Trade secrets include special know-how, consumer lists, or any process that gives the company a leg up on competition and that is not generally known. The key to trade secrets, however, is that they remain secret. Companies should implement safeguards to ensure trade secrets are kept secret, so that they can bring suit against a breach if needed.

Special considerations

Today, many start-ups are using crowdfunding platforms such as Kickstarter to raise money for their businesses. Although a more informal means to raise funds, precautions should still be taken to ensure the protection of IP.

A key feature of these crowdfunding platforms is that they are open to the public and anyone can access the information available on a fund page. As a result, start-ups soliciting funds need to consider carefully what information they disclose to the public.

For example, one of the requirements for patentability is that the invention must be novel. Disclosing an invention to the public before a patent application has been filed can mean that the invention loses its novelty. As a result, a start-up needs to strike a fine balance between providing enough information to impart company credibility and investor peace of mind without disclosing information that will invalidate the novelty requirement for patent protection.

Furthermore, start-ups seeking funding from crowdsourcing campaigns need to perform their due diligence in examining prior art to avoid potential infringement claims. For example, the US District Court for the Western District of Virginia has found that even offering a potentially infringing product as a reward for a crowdfunding campaign could be enough to infringe a patent-holder's rights.

A thorough look at a start-up's IP assets is important from both the VC side and the start-up's side. A strong IP portfolio can make a difference not only in obtaining a positive valuation by a VC firm, but also in the continued success and growth of the company during a hopefully long and healthy life. ■

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Roxana Sullivan holds a *Juris* Doctor degree in law. Her experience covers trademark and copyright prosecution, licensing, business-related agreements, and internet/e-commerce issues. Dennemeyer & Associates is an international IP law firm, providing the full range of legal services relating to intellectual assets worldwide.