



Rights and Ownership in Technology Development Agreements

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I. INTRODUCTION

In any technology development project – from short-term contract programming to long-term outsourcing relationships, from product customizations to Web design agreements – the question of who owns the resulting developments is often a source of intense negotiation. It may also be an enormous red herring. Experienced negotiators who understand intellectual property recognize that there are many alternatives to sole and exclusive ownership that may suit either or both of the parties equally well. This article will examine these alternatives as a means to assist negotiators in protecting their (and their client's) interests in a development relationship without allowing IP ownership disputes to sidetrack the deal.

There are three basic approaches to this issue, namely:

- The party developing the technology, customization or design (the “Developer”) owns the intellectual property in the resulting work product (the “IP Rights”); the party commissioning (and paying for) the work product (the “Client”) gets some type of license.
- The Client owns the resulting IP Rights; the Developer may or may not receive back a license to the work product and associated IP Rights; and
- The Client and Developer jointly own the IP Rights, often with stipulated limitations on the rights each may exercise – for example, the Developer agrees not to use the co-owned IP Rights in serving the Client's competitors – or with cross-obligations that each party owes the other – for example, each party must account to the other party for its pro rata share of net revenues derived from exploiting the work product or IP Rights.

Lying beneath these primary structures are complex issues. For example, if the work product is a derivative work of preexisting elements, or a compilation created out of preexisting components, how does ownership of the IP Rights affect use of these preexisting items? If one party owns the IP Rights and the other receives a license, what are the terms of the license regarding scope, exclusivity, geography, duration and transferability? This article will identify, but not always resolve, these complex issues, by focusing on each of the three basic structures and considering issues that may arise and answers that may be offered.

II. DEVELOPER OWNS, CLIENT LICENSES

If the parties are negotiating from the Developer's contract, the starting position is generally that the Developer owns the intellectual property in its creations, notwithstanding that the Client is paying for them.

However, the Developer can compromise on this opening position – indeed, may readily accept a different approach – if certain factors are present. For example, if the Client devised the underlying idea for this work product, or provides the specifications or designs, it will be hard to deny the Client ownership of the resulting IP Rights.

Furthermore, if the work product is a compilation of preexisting components that are owned by the Developer – for example, a Web Site created using the Developer's toolbox and preexisting design elements – the Developer may be willing to allow the Client to own the IP Rights (primarily copyrights) in the resulting Web Site as a derivative work or compilation, provided this doesn't limit or affect the Developer's continuing ownership of and rights in the underlying components and features that have been combined uniquely to create this derivative work product. (The Developer ceding ownership of the intellectual property in a Web Site, as a copyrighted compilation or derivative work, does not thereby give up its right to reuse

the same tools, designs, functions and elements, provided they are combined in a noninfringing manner, that is, in a different selection or arrangement. Of course, it will be prudent for the contract to state this clearly so that no one will misconstrue the breadth of the Client's ownership rights.)

Suppose, however, that this is not a situation where the Developer is prepared to concede ownership of the IP Rights and work product to the Client. (This will generally be the case if the work product involves mainly customizations of or improvements to the Developer's core tools and technology.) Presumably that means the Developer will retain title and ownership and the Client will receive "only" some type of license. Is that adequate? Shouldn't the Client, who after all is funding this development effort, strongly object to this approach and insist on ownership?

If the Client intends to be a venture capital-backed entity, and the work product is the core technology underlying the Client's business, then it has no practical choice but to insist on ownership of the work product and resulting IP Rights, or some significant subset of them. It is risky to build a company around technology that the company doesn't own. The risk may be acceptable, provided the license is broad enough; but the Client's VCs may not recognize this and may refuse to fund a company that doesn't control its destiny because it doesn't own its core technology.

Still, if the Developer insists on retaining ownership itself and only granting its customer a license and if this is not the core technology of a VC-funded entity (or if there is no choice but to use this Developer), it is not necessarily a glaring mistake for the Client to settle for a license. The key is to make sure that all of the Client's real needs can be met by a license. In short, the question to ask is not how to get this stubborn Developer to change its tune and grant the Client ownership rights. Rather, the real questions are, first, what does the Client need and, second, can these needs be met by a properly drafted license? Surprisingly, the answer to the latter is often yes.

So what are the factors that must be taken into account in evaluating and drafting a license agreement respecting the IP Rights in the work product commissioned by the Client and created by a third party Developer? Consider the following issues:

Exclusivity. Probably the first issue is whether the license will be exclusive to any degree. For example, the license could be drafted to give the Client the sole and exclusive right to do everything – in effect, the Developer retains title in name only, while the Client is the only person allowed to exercise the IP Rights. (This often happens to authors contracting with publishers. The author may own the copyright, but the publisher has full control over the copyright and all associated rights until the agreement terminates, or until identified subsidiary rights go unexercised for an unreasonable period.) This would be unusual in a situation where the Developer insisted on ownership, since its reason for doing so is generally that it means to use the work product and IP Rights in some manner (unless, perhaps, the Developer is only providing the labor to implement the Client's vision -- a type of developer sometimes referred to in the industry as a "body shop").

However, it would not be unusual for the Client to have an exclusive right to exploit the IP Rights and use the work product for a period of time (e.g., 3-6-12 months); or in a given geographic area (e.g., in the U.S. or European Community); or for a particular purpose or in a given field (e.g., to monitor residential ambient air quality, or for biomedical applications). Often a long-term, exclusive, unlimited license for use in a particular field or for particular applications (including rights to further develop, sublicense, assign, etc., as described below) is all that the Client really needs to get full value from its developmental expenditures.

Assignability; sublicensability. Courts have often held that intellectual property licenses are personal to the licensee and, unless the parties agree to the contrary, are not assignable (except sometime upon a sale of the entire business).

Therefore, it is important for the license to state that the Client may assign the licensed IP Rights to affiliates, acquirers and successors. Depending on the type of technology involved and the business plans of the Client, it may also be important to state that the Client can sublicense the IP Rights and work product to resellers and customers.

Scope. Defining the scope of the license is always important. Consider that each form of intellectual property has its own scope: A patent owner may exclude others from making, using, selling, offering to sell and importing the invention; a copyright owner has the exclusive rights to copy, prepare derivatives of, distribute, publicly perform and publicly display the work; a trade secret owner can prevent others from using or disclosing the secret, if improperly learned; and a trademark owner can prevent others from identifying and marketing products and services using that mark or similar marks, if confusion would result or, for famous marks, if dilution (blurring or tarnishing) would occur.

Thus, for every license it is important to identify clearly the types of intellectual property covered and the rights being granted and withheld. The most extensive grant – which is not always appropriate – might read as follows: the licensee has the rights to make, modify, offer, sell, distribute, import, publicly perform and publicly display [if applicable], and in all other respects use the work product, under all intellectual property rights now owned or later acquired by the Developer; to sublicense those rights to third parties [perhaps specifically to resellers and customers]; and to transfer and assign these rights to its business successors and affiliates [one should define "affiliates," typically by reference to controlling relationships].

Term. Another key consideration is the duration of the license and the conditions under which it can terminate. The Client would surely prefer – and may even require – a license that is perpetual and irrevocable. The Developer may argue that at least some events – typically uncured breaches by the Client, and perhaps the Client's

bankruptcy or insolvency as well – should cause the license to terminate, or at least give the Developer the right to do so.

If the work product is mission-critical to the Client, or if the development cost is high, it has no choice but to limit the circumstances under which the license can terminate (other than by its own election). Occasionally Clients will have the leverage to deny the Developer rights of termination, leaving the Developer with a right to sue and recover damages as its only remedy for the Client's breach. But more often the Client is forced to concede termination rights, at least for (1) failures to pay all amounts owed, (2) misuse of the retained IP Rights and uncured violations of the license terms, and (3) possibly cessation of business, insolvency or bankruptcy proceedings (despite the fact that clauses providing for termination automatically in the event of bankruptcy are generally unenforceable under Federal bankruptcy law).

Territory. Which licensed IP Rights may be exercised in which geographic areas is often an important consideration. Normally the Client will want worldwide rights, but occasionally it may agree to narrower rights if the license involves redistribution of a technology product. It is not unusual for the Client to have the right to develop and manufacture the work product (or its original equipment that includes the work product as a component) in more locales than it is authorized to sell these products into.

Royalty. A final issue is whether the license is royalty-free or royalty-bearing. If the Client is paying the entire development cost outright, it would be unusual for it to be asked to pay an additional royalty to use or resell the work product. However, if resale of the work product requires the use or distribution of pre-existing or underlying technology that belongs to the Developer, it would not be unusual for the Client to pay a royalty with respect to those uses and sales.

It should be noted that in some arrangements the opposite occurs: Though the Client has been

persuaded that the Developer should own the IP Rights, because the Client has paid a high cost for development services the Developer is required to pay a royalty to the Client as the Developer uses and distributes the work product. Often there is a cap on such payments, for example, the Client can recover no more than it paid originally, perhaps with an additional “kicker” to give the Client some upside.

III. CLIENT OWNS, DEVELOPER LICENSES

If the Developer is merely implementing the Client’s ideas, designs and specifications, if the work product is just a particular arrangement of the Developer’s own tools and designs (and not the tools or designs themselves), if the cost is substantial, if the Client has significant leverage, or if the Developer is just not concerned, the parties may agree that the Client will be deemed the owner of the work product and associated IP Rights.

Depending on the circumstances, the Developer may either have certain rights (licenses back) to the IP Rights, or may have no rights in the IP Rights. In all cases, but especially if the Developer will not be granted rights in the IP Rights, the Developer must be extremely careful that the contract cannot be construed as either depriving it of its existing intellectual property rights, or as limiting its ability to use freely any newly acquired skills or know-how of general applicability in its business.

If the Developer will be granted a license back to all or parts of the work product under the relevant IP Rights, then it must be concerned with most of the same issues discussed above regarding the Client’s licenses. To recap these issues, from the Developer’s perspective:

Exclusivity. It is unlikely the Developer can argue for a significant exclusivity, since that would probably be inconsistent with the Client’s goals in hiring the Developer in the first place. Still, it may be possible for the Developer to be granted limited exclusivity, for example, to use

the work product to furnish development services to third parties (often provided that these other customers are not competitors of the Client).

Assignability; sublicensability. Because intellectual property licenses may be deemed personal in nature, the Developer will want it stated that it may assign the licensed IP Rights to affiliates, acquirers and successors, and perhaps sublicense the same in appropriate circumstances.

Scope. The scope of the Developer’s license will depend greatly on what the work product is and how the Developer will be allowed to reuse the work product. Often the Developer will be granted rights to exploit the work product in a wide variety of ways, provided they do not compete with the Client’s contemplated uses.

To emphasize a critical point (from the Developer’s perspective), the Developer must not (due to poor drafting or otherwise) grant the Client ownership rights in the Developer’s pre-existing technology used to create the work product or incorporated into it. If the Developer is compelled to assign such rights to the Client, it should probably insist on a broad license back of all such transferred technology so that it can use this technology for future work.

Term. The Developer would probably prefer a perpetual and irrevocable license to practice the licensed IP Rights. This is particularly critical if the work product and associated IP Rights are in a core area of the Developer’s business. However, the Developer may need to concede termination rights for certain material breaches, such as misuse of the licensed IP Rights and bankruptcy.

Territory. Similar issues may arise concerning where the Developer can do whatever it is being authorized to do. If the Developer is receiving only a right to use the IP Rights in providing development services to others, the Client will likely be unconcerned where they are exercised and thus may allow them to be worldwide

(unless the Client intends to do competitive development work itself). In contrast, if the Developer is licensed to sell products that incorporate the work product, and perhaps sublicense these rights to others, the Client may limit the licensed territories to prevent the Developer and its sublicensees from selling in direct competition with the Client and its distributors.

Royalty. If the Client paid a lot of money for the work product, or if it is simply a savvy negotiator, it may demand payback from revenues generated by the Developer's licensed uses.

IV. CLIENT AND DEVELOPER CO-OWN

An option that is probably not used as often as it should be is joint ownership of the work product and IP Rights. Provided the drafter of the contract understands how this concept operates in intellectual property law, joint ownership could be the ideal compromise.

The advantages of co-ownership include the following: (1) each party can claim (partial) title and ownership rights in the work product and IP Rights; (2) other than contractual restrictions the parties agree upon, each party knows that it can do whatever it wants to do with these new developments (except have exclusive ownership and control); and (3) neither party needs to worry that it may lose its rights in the event of breach (no matter how egregious) or bankruptcy.

Probably the main disadvantages are: (1) neither party can maintain exclusive control, or grant to third parties exclusive rights in, the work product or IP Rights (unless the co-owners agree to this by contract); (2) if the agreement establishing co-ownership is not drafted properly, the parties may have obligations to each other that they did not contemplate (see below); and (3) if the contract is not well drafted, the parties may not have certain controls and protections they assumed exist (see below).

As an example of potential pitfall (2), consider the following difference between patent co-ownership and copyright co-ownership. Under patent law, each co-owner can exercise its rights in the patent (including granting non-exclusive patent licenses) wholly independent of the other co-owner. Under copyright law, each co-owner may exercise its rights (including granting non-exclusive copyright licenses), but is obligated to account to the other co-owner for its share of the profits earned from such exploitation. Thus, if a co-owner of IP Rights in a software product (or other work product protected, at least in part, by copyright) wishes to avoid having to pay a portion of its revenues to the other co-owner, the agreement establishing co-ownership should be clear that this party (or, assuming reciprocity, neither party) is required to account to the other party for, or pay the other any portion of, the revenues it earns from exploiting the work product or IP Rights.

As an example of potential pitfall (3) above, consider that all rights in a trade secret can be lost if the owner publicizes the secret to the world. Thus, if part of the value inherent in the work product and associated IP Rights stems from its confidential nature, the agreement establishing co-ownership must bind the parties to respect the confidentiality of their co-owned creation; otherwise either can cause the value to be lost or diminished by disclosing the trade secret to third parties without restrictions.

V. CONCLUSION

Sometimes a party truly requires sole and exclusive ownership in work products it pays others to create for it, or that it is paid by others to create. However, often a party's needs can be met by something less than sole ownership, such as joint ownership of all or a part of the creation, or a license that is tailored to the party's real needs. When contracting for development services, whether on the side of the Developer or the Client, be sure to know your client's real needs so that the negotiation will not run aground on needless posturing or unnecessary demands for title and ownership.