

## FOLEY EXECUTIVE BRIEFING SERIES



# CHALLENGES FOR START-UPS AND YOUNG COMPANIES - ADDRESSING YOUR EXPOSURE



Presented by Thomas I. Elkind  
and J. Mark Waxman

©2009 Foley & Lardner LLP • Attorney Advertising • Prior results do not guarantee a similar outcome • Models used are not clients but may be representative of clients • 321 N. Clark Street, Suite 2800, Chicago, IL 60654 • 312.832.4500



## FOLEY EXECUTIVE BRIEFING SERIES

### Presented by

- Mark Waxman, Chair of Foley's Health Care Practice; and
- Thomas Elkind, Chair of Foley's Litigation and Intellectual Property Departments in Boston



## Liability and Risk Exposure Areas for Young Life Sciences Companies

- I. What Needs Protecting and How Do You Do It?
- II. Remedies Available Through Litigation

We begin with a cautionary tale . . . .



## I. What Needs Protecting and How Do You Do It?

- Protectable Assets
- The Value and Use of Written Agreements
- Diligence and Exposure
- Representations and Warranties
- Terminations and Exit Interviews



## Protecting Intellectual Capital

- Patents, Trade Secrets, Trademarks
- Know How
- Your People



- Patents and Trade Secrets
  - How to determine if a secret should be patented.
- A patent gives the inventor exclusive control of the invention by law for twenty years. Then it is publicly available for free to all.
- A patent requires the inventor to publicly disclose all material elements of the invention.
- A trade secret is, and is intended to remain, secret forever.
  - Coca Cola's Formula.



## What is a “trade secret?”

- “[A]nything tangible or intangible or electronically kept or stored, which constitutes, represents, evidences or records a secret scientific, technical, merchandising, production or management information, design, process, procedure, formula, invention or improvement.” G.L. c. 266, § 30.
- “A trade secret may consist of a formula, pattern, device or compilation of information which is used in one’s business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it.” Restatement of Torts § 757, comment b.
- Trade secrets include compilations of even public information used in a business if the “information is, as a result of a business’ efforts, combined in a unique way.” Picker International Corp. v. Imaging Equipment Services, Inc., 931 F. Supp. 18 38 (D. Mass. 1995).



## Trademarks

- Protecting trademarks is cheap and easy.
- Even if a trademark may not be necessary, it is a good idea to protect any mark you intend to use.



## Know How and Key People

- Know how is different than a trade secret.
  - There is value in having people who know how to do the work the company needs to do, even if they are not utilizing trade secrets.
  - People with know how can be experienced, low level workers, or highly trained and educated.
- Key people are generally executives, inventors, or highly trained workers.
- People with know how and other key people are intellectual capital that a company needs to safeguard.
- SAB members.



## The Employee's Right to His Knowledge

“[A]n employee upon terminating his employment may carry away and use the general skill or knowledge acquired during the course of the employment. . . The right (of an employee) to use (his) general knowledge, experience, memory and skill . . . promotes the public interest in labor mobility and the employee's freedom to practice his profession and in mitigating monopoly.”  
Dynamics Research Corp. v. Analytic Sciences Corp., 9 Mass. App. Ct. 254, 267-68 (1980).



## Breach of Fiduciary Duty

“An at-will employee may properly plan to go into competition with his employer and may take active steps to do so while still employed. . . . The general policy considerations are that at-will employees should be allowed to change employers freely and competition should be encouraged. If an employer wishes to restrict the post-employment competition activities of a key employee, it may seek that goal through a non-competition agreement.”

Augat, Inc. v. Aegis, Inc., 409 Mass. 165, 172 (1991)  
(citations omitted).



## The Value and Use of Written Agreements

- There are various types of written agreements that can be used to prevent key employees, directors, SAB members, consultants, and agents from misusing a Company’s intellectual capital, but there is no way to prevent them from leaving or dissociating from a company.
- What if there are no written agreements?
  - Fiduciary duties
  - Duties of loyalty
  - Common law rights of employers



- The Protection Tool Kit: Written Agreements
- Non-compete Agreements
  - Requirements – Time, Geographic, Restricted Activities
  - Legitimate Business Interests
  - Touchstone: Reasonableness
- Non-Disclosure Agreements
  - What it does and does not do: Trade secrets and confidential information
  - Inevitable Disclosure Doctrine
- Other Restrictive Covenants
  - Garden leave clauses/Notice Provisions
  - Non-solicitation (of employees or customers)
  - No-hire agreements
  - Forfeiture for competition



## Diligence and Exposure

- Checking ownership of Ideas and Assets Brought Into the Company
- Prior employment issues
- The Special Issues of Academic Personnel
  - Academic ownership policies
  - Steps to protect the company



## Releases, Waivers, Representations and Warranties

- From individuals and companies
- True “reps and warranties” and “best of personal knowledge” statements
- Releases and waivers (“if I have rights, I release and waive them”)
- Negotiating breach damages and remedies
  - If I breach, or what I said was not true, then I agree to –
    - Injunction
    - Forfeiture
    - Penalties (e.g., for violations of non-solicitation clauses)



## II. Remedies Available Through Litigation

- Theories of Relief
- Available Remedies
- Time and Cost of Litigation





## Theories of Relief

- Breach of non-competition agreement
- Breach of non-disclosure agreement
- Theft of trade secrets
- Tortious interference
- Unfair business practices – G.L. c. 93A



## Available Remedies

- Damages and Punitive Damages
- Declaratory Relief
- Injunctive Relief



## The importance of establishing the relationship between an inventor and the promoter of the invention

- City of Hope Nat. Med. Ctr. v. Genentech, 43 Cal.4<sup>th</sup> 375 (2008)
  - The issue: What determines whether there is a fiduciary relationship between an inventor and a company that markets the invention?



## City of Hope v. Genentech, 43 Cal.4<sup>th</sup> 375 (2008)

- City of Hope argued a fiduciary relationship is established if 4 tests are met:
  - One party entrusts its interests to another;
  - The other has broad discretion;
  - The parties have asymmetrical access to information; and
  - One party is dependent on the other.



## **City of Hope v. Genentech, 43 Cal.4<sup>th</sup> 375 (2008)**

- The Court said this may not be enough.
- If the relationship does not involve agency, joint venture, or partnership, there may not be any fiduciary relationship.
- The high level of secrecy of the information provided may be a factor, but in itself is not enough to create a fiduciary relationship.



## **City of Hope v. Genentech, 43 Cal.4<sup>th</sup> 375 (2008)**

- “fiduciary obligations are not necessarily created when one party entrusts valuable intellectual property to another for commercial development in exchange for the payment of compensation contingent on commercial success.” quoting Wolf v. Superior Court, 107 Cal.App.4<sup>th</sup> 25 (2003).



## **City of Hope v. Genentech, 43 Cal.4<sup>th</sup> 375 (2008)**

- In City of Hope, the failure to establish that a fiduciary relationship existed cost the inventor \$200 million in punitive damages.
- City of Hope still recovered over \$300 million for breach of contract by Genentech.
  - Failure to properly account for royalties owed.



## **Avoiding the issue of Fiduciary Duty**

- The issue that the California Supreme Court decided in City of Hope need not be left to the courts to decide.
  - Proper drafting of a contract can make clear whether or not the parties expect a fiduciary relationship to exist.



## B. The Rules Change When Dealing with the Federal Government

- Madey v. Duke University, (USDC MDNC 2006)
  - The issue: How can an employer protect itself against inventor claims arising prior to joining the company?



## Madey v. Duke University, (USDC MDNC 2006)

- Dr. Madey was a professor hired by Duke to establish a laboratory.
- He helped obtain a federal research grant from the Navy.
- He later resigned in a dispute with Duke.
- He then claimed that Duke continued to make use of his patented inventions.
- Duke contended that it was entitled to do so because all uses were pursuant to the federal research grant.



## **Madey v. Duke University, (USDC MDNC 2006)**

- 28 USC Sec. 1498 says:
  - when a patented invention is used “for the government” and
  - With the “authorization and consent of the government”
  - The inventor’s sole recourse is to sue the government for a reasonable royalty.



## **Madey v. Duke University, (USDC MDNC 2006)**

- In Madey, Duke was able to use Section 1498 as an affirmative defense to Madey’s claim of patent infringement.
- The burden was on Duke to show the existence and intent of the government authorization, express or implied, and that the use of the invention falls within the scope of the government grant.



## **Madey v. Duke University, (USDC MDNC 2006)**

- Duke also tried to assert the Bayh/Dole Act, 35 USC Sec.200-212, as a defense to Madey's claims.
  - Bayh/Dole allows non-profit and small businesses to retain title to any invention developed by the contractor pursuant to a government contract. The courts have extended it to all businesses.
  - The government retains a non-exclusive, paid-up license in any inventions conceived or reduced to practice in the performance of federally funded research.
  - But, the "government license" defense may be raised only by the government – not by private parties such as Duke.



## **What is involved in Litigating these issues?**

- Once the governing law is identified, the facts become crucial, as in any litigation.
  - Juries are not prohibited from interpreting contracts where facts are in dispute and the credibility of witnesses is an issue.



## What is involved in Litigating these issues?

- For patent infringement, injunctive relief and damages are the usual remedies
  - The recent *ebay* Supreme Court case has limited the use of injunctions to cases where the injured party actually practices the invention, not just holds the patent.
  - Irreparable injury suffered; damages are inadequate to remedy the injury; balance of the equities, and public interest determine if an injunction will issue.
  - Multiple damages for breaches of fiduciary duty (City of Hope) and for patent infringement are also available.



## Time and Cost of Litigation

- Phases of Litigation (investigation, discovery, trial, etc.)
- A litigation chronology
- Are you ready for the counterclaim?





## A Litigation Chronology

- Litigation
  - Investigation
  - Commencement of Action
  - Preliminary Relief
  - Counterclaims
  - Discovery
    - paper
    - depositions
  - Experts
  - Markman hearing (patents)
  - Summary Judgment
  - Trial
  - Appeal
- Settlement
  - Negotiation
  - Mediation



## What is involved in Litigating these issues?

- Everyone knows that litigation is expensive and unpredictable.
  - In IP cases, experts can play a major role, and add to the cost.
  - In many cases, dealing with documents maintained through electronic discovery and years of correspondence and drawings relating to an invention can also drive up the cost.



## What is involved in Litigating these issues?

- Alternatives to litigation are available, but may not be better choices. These include:
  - Arbitration
  - Mini-trials
  - Jury-waived trials