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Intellectual Property Strategies for the Software Seller

by Author Craig McCrohon
Holland & Knight LLP

For many software companies, intellectual property just happens. Programmers write code. Sales staff find customers. Executives book revenues. The company may have a sales strategy and a long-range view of technology, but the *legal* protection of its intellectual property becomes an after-thought—a strategic orphan.

Big mistake. Companies that do not identify risks early, if not immediately, pay dearly when the day comes when a potential buyer or investor tries valuing the core asset—software. The strategy need not be poetry. Nor must it harmonize every syllable of the business plan. However, the software protection regime must be more than a three-line checklist of patent filing deadlines, or the occasional piece of hate mail threatening to sue over pilfered computer code.

Developer Versus Consultant

Most software firms are part developer and part consultant. Each company must recognize which trait dominates. Developers need strong stand-alone licenses and sometimes a patent; consulting-oriented firms require solid engagement agreements and cross licensing deals. Along with all the other competing demands, the executives must juggle the mindset of lawyer, developer, and business executive.

A pure development shop can afford to delegate the “legalese,” and focus on technology. The easy-to-forget contractual terms and conditions weigh less on the daily demands of these firms. However, the firm that tilts toward advising, not selling code, needs an elegant agreement that untangles the various deliverables and identifies who owns what. Legal prose—no matter how unreadable—reigns supreme.

Total Cost of Ownership

Beware the hidden costs of patent. Although an initial cost of a patent may be as little as $10,0000 to $15,0000, the “total cost of ownership” of the patent is much, much higher. First, the patent owner must invest in monitoring the marketplace for possible infringers. Courts have held that patent holders who sleep on their rights and permit free sales of infringing products, have relinquished their rights to enforce the patent. Second, once a developer catches the infringer, the patent holder must invest the time and money to file a lawsuit (or present a credible case) to stop the infringement. The costs of this phase can dwarf the price of the initial filing.

In the right situation, the nature of the product of the business strategy justifies feeding the patent monster. For example, some firms aim for applications with long shelf lives. Perhaps the software they sell depends less on the ever-changing chip market or communications equipment makers. If the software publisher can establish standards, then the market will change less frequently. If the software depends on the installation of thousands of units, such as the Microsoft operating system, then users can less easily replace the system with that of a competitor.

Patents protect big-ticket items that companies can sell year after year. Unlike patented drugs or heavy equipment, software buyers can instantly upgrade and sell their programs. The three- to four-year average patent prosecution period is simply too slow for software sold in a competitive and volatile market. Also, without a protection during the period between the filing of the patent and the issuance of the patent, others can market the idea with impunity. Note that, in many cases, after only 18 months from the filing, the Patent and Trademark Office will post the application on the internet, available to every Napster-trained software pirate.

Avoiding Patent Overkill for One-Hit Wonders

Some programs must constantly be updated – not only to accommodate behind-the-scenes changes in software and embedded code, but also to adapt to user demands. The more complex, large, expensive, and customized the software, then the more developers should opt for trade secret protection over the patent. A software program providing a fundamental function, such as an operating system or basic utility, will likely enjoy a longer commercial life than a niche application product.

In such a situation, the long-term patent poorly fits the short-term product. The trade secret is simply the general right of a company to profit from a non-public idea or program. Confidentiality agreements and strict security practices are the instruments that protect the trade secret. With patents, the government grants a monopoly over the innovation in exchange for disclosure by the inventor. However, for trade secrets, disclosure equals disaster. Companies must scrupulously require everyone - employees, directors and contractors—to sign confidentiality agreements. Firms should prohibit employees from competing with the company. In addition, anything the employee invents should belong to the company. Limited variations of these themes may be appropriate for independent contractors. With trade secret law, the emphasis is always on the secret. If established companies have an arsenal of patents, lax adherence to these practices can be tolerated; with no strong patent program, however, the company must absolutely keep these agreements, establish rules limiting access, and mark copies of items as confidential.

Where to Protect the Expensive Stuff

The more expensive the software development, the more formal the intellectual property protection. If the software required massive amounts of development by highly trained engineers, then the costs and delay of a patent may well be worthwhile. Thus, companies should patent the expensive stuff that took years to develop; on the other hand, new code

assembled over a cold pizza after a frantic weekend warrants only trade secret and copyright protection.

Local Versus International

The more international the product, the more formal the copyright and patent protection. For products distributed beyond the United States, developers often lose control over secrecy. Domestic licenses depend on the enforceability of obligations to limit copying, avoid reverse engineering, and maintain confidentiality. Software is at the mercy of users in distant lands with exotic laws and a disregarded and disrespected legal system. Intellectual property is considered no more proprietary than drinking water. Patents, however, with a more uniform set of international standards, have a better chance than trade secrets of being honored by local officials. In contrast, international law defers to local customs and rules regarding trade secrets, thus increasing the inconsistency and unpredictability of this body of law between two legal systems.

Have a Plan: Stay Small, Be Acquired, or Go Public

The grander the vision of the future, the more likely the intellectual property will warrant protection as a patent or registered copyright. Large acquirers of smaller innovative software developers will demand a more formal protection program. Just as companies must behave like publicly-held firms three years before an initial public offering, the intellectual property strategy should reflect the longer-term objectives of the company. If the owners of the firm intend to remain independent or forsake outside investors, then an expensive and inefficient patent program makes little sense. The risks of an informal intellectual property protection program are similar to that of a farmer owning the fields he plows: If no sale or financing of the property is expected in the near term, then an imperfection in title will make little difference. Try selling the farm, or getting a mortgage, then even a minor issue can become a major problem.

In the end, coordinating the legal strategy need not be a perfectly harmonized plan. However, companies with better organized programs and a general concept of the types of protections needed will more likely maximize the financial reward they deserve as the software matures into a popular product.

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Craig McCrohon is a partner in the international law firm of Holland & Knight. You may contact Craig through the Holland & Knight web site at www.hklaw.com.

