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Technology Industry Newsletter

June 2016

From the Editor:

For technology companies seeking investment capital, the new SEC regulations on crowdfunding that went into effect on May 16, 2016 present new funding options by expanding the pool of investors beyond the traditional funding sources comprised of venture capital firms and angel investors. The new regulations permit the general public, including non-accredited investors, to use on-line crowdfunding platforms to invest in private companies. In addition, California has adopted new exemptions for finders in securities transactions, which may make it easier for early-stage companies to locate potential investors with the assistance of finders. Another significant development this year is the Defend Trade Secrets Act, which was signed into law on May 11, 2016, creating a federal cause of action for private entities to combat the misappropriation of trade secrets. A summary of these topics is included in this newsletter, along with other topics we hope you will find helpful.

Although venture capital firms and angel investors will continue to be an important resource for funding technology start-ups, total venture dollars deployed for start-ups in the first quarter of 2016 remained flat. Total deal count was down around 5% compared with the fourth quarter of 2015, and down by around 11% when compared to the first quarter of 2015. The competition is only getting stiffer for investor dollars, so giving a killer investor pitch is critical. In addition to building trust and connecting on a personal level with potential venture capital firms and angel investors, consider the following 10 Tips For Presenting to Investors:

1. Describe the problem and the opportunity by stating your compelling business idea in concise and convincing terms focusing on the market opportunity and your ability to create revenues and margins.
2. Articulate your solution to the problem.
3. Present a factual current status of the market, and focus on target customers with a willingness to pay for your product or service.
4. Share who has agreed to pay for the product or service by presenting specific customers who have provided credible evidence of willingness to make the purchase.
5. Describe the distribution channels for accessing customers.
6. Describe tangible major milestones that will be hit quickly that prove the proposition and indicate that you can address the market, allowing for a big-step-up in value.
7. Prepare impressive and interesting profiles of top team members with quick bullet points about their relevant past.
8. Present a chart outlining financial projections focusing on the last two quarters, the next two quarters and the next three years, and reflecting key metrics such as number of customers, revenue, product costs, gross margins, big expense lines, net income and cash flow.
9. Create a matrix of the competition with the variables that matter. Be specific about the top two or three competitors, and describe why you think you can beat them.
10. Outline a history of your achievements to date, and explain why your project fits into the strategies and investment portfolio of the investor's existing portfolio of companies.

To grab the attention of investors you need to tell a succinct and compelling story. Know your material and avoid reading the slide deck so you can present a sense of calm and control. Be prepared to be interrupted when presenting, be ready to answer questions directly, don't linger on the obvious, and stay out of the weeds when responding to questions. Above all, bring along your "passion" for your business to the pitch and artfully articulate your vision for your company.

Please feel free to pass our newsletter along to anyone who may be interested in the subject matter. We welcome you to reach out to our talented team of professionals should you have any questions or desire further input on any of the topics we have covered.

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Crowdfunding Update: Crowdfunding Regulations Are Now Effective!

Philip Schroeder

On May 16, 2016, Securities and Exchange Commission (SEC) regulations went into effect implementing Title III of the JOBS Act, which establishes an equity crowdfunding model involving non-accredited investors and an exemption from the requirement to register the issued securities with the SEC. To qualify for the exemption:

- The amount raised by the issuer may not exceed $1 million in any 12-month period (not including funds raised in offerings other than under the crowdfunding exemption);
- The crowdfunding offering must be conducted online through the online platform of a single intermediary that has registered as either a broker under the Securities Exchange Act of 1934 or as a funding portal under Title III and the regulations implementing Title III;
- The issuer may not advertise its crowdfunding offering except by way of notices that contain limited information with the intent that potential investors be directed to the intermediary's platform for more information; and
- Prior to commencing a Title III crowdfunding offering, the issuer must complete a Form C, which includes detailed financial and business disclosures about the issuer, file it with the SEC and make it available to the intermediary and the investors.

In addition, the Title III crowdfunding exemption (i) places limitations on the amounts that investors can invest in crowdfunding offerings, (ii) restricts the resale of securities for a period of one year except in certain limited circumstances, and (iii) requires the issuer to file annual reports with the SEC that contain similar information as required by Form C after the closing of the crowdfunding offering.

A more detailed discussion of the offering exemption and requirements can be found in last quarter's Technology Industry Newsletter or by clicking here.

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New Exemptions for Finders in Securities Transactions

Mark Bonenfant

For early-stage companies seeking capital, finding potential investors can be difficult. For many companies, using a "finder," an individual or entity that identifies, introduces and negotiates with potential investors, to help locate potential investors may be critical. This is particularly true in situations where neither the company nor the size of the transaction attracts the interest of professional sources of capital.

Under federal securities laws it is unlawful for any broker or dealer to induce or attempt to induce the purchase or sale of any security unless such broker or dealer is registered with the SEC. A broker is any person engaged in the business of effecting transactions in securities for the account of others. This means any person who accepts transaction based compensation may have to comply with the licensing and registration requirements of federal law. State laws have similar regulatory schemes. For example, California law prohibits a person from "being engaged in the business of effecting transactions in securities" unless licensed as a broker-dealer.

No statutory guidance indicates what activities trigger the definition of a "broker-dealer. The use of finders has often resulted in inadvertent violations of broker-dealer licensing requirements. Guidance issued by the SEC, judicial decisions, and interpretive opinions have narrowly construed the scope of permissible activities in which a finder may engage. But, any person who accepts any form of compensation based on the success of a securities transaction risks acting as an unlicensed broker-dealer in violation of federal and state securities laws.

The same laws and regulations govern the activities of those persons whose business is introduction and assistance in consummation of merger and acquisition transactions.

Factors generally reviewed to determine whether a person is acting as a finder include: (i) participation in the solicitation, negotiation, or execution of the transaction; (ii) compensation based on the outcome or size of the transaction; (iii) otherwise engaging in the business of effecting securities transactions, and (iv) handling securities or investor funds. Routinely acting as a finder may in and of itself evidence of "engaging in business".

Companies and finders face risks if broker-dealer licensing requirements are not satisfied. For the company using an unregistered broker-dealer to assist with a sale of

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securities could create a rescission right in favor of the company's investors under federal and state law. Failing to disclose payments made to an unregistered broker-dealer in connection with a sale of securities could expose the company to potential liability for fraud. Companies that engage unregistered broker-dealers could also find themselves subject to SEC enforcement actions for aiding and abetting a violation of the broker-dealer regulations.

Finders are themselves subject to significant risks, including the risk of SEC sanctions. Specifically, a company could claim that its obligations to a finder under the finder's engagement agreement are void if the finder is acting in violation of the federal and state broker-dealer registration requirement. A company could rescind its engagement letter with the finder and the finder could be barred from collecting its fees. A finder's failure to disclose the fact that it is not registered as a broker-dealer could itself be characterized in regulatory enforcement proceedings or private litigation as a misleading omission that amounts to fraud on the company.

New California Legislation

In September 2015, the California legislature enacted Section 25206.1 of the California Corporate Code to provide an exemption from the broker-dealer licensing requirements in the state of California. A finder operating in California that meets the definition of "finder" and complies with the streamlined disclosure and other requirements of section 25206.1, will not be required to be licensed as a broker-dealer under California law, even if he or she receives transaction-based compensation.

The exemption is available only to natural persons, and only in connection with the introduction or referral of accredited investors to a company in relation to a transaction or a series of related transactions with an aggregate securities purchase price of $15 million or less.

The finder must limit his or her activities to introductions and referrals, and must not: (i) participate in negotiating any terms of the investment; (ii) advise any party regarding the investment; (iii) sell any securities owned by the finder as a part of the proposed investment; (iv) take custody of investor funds; (v) conduct due diligence in connection with the transaction; (vi) make disclosures to investors other than permitted disclosures; or (vii) knowingly receive compensation in connection with an offer or sale of securities that is not qualified or otherwise exempt from qualification.

Section 25206.1 requires that certain disclosures be made to the Department of Business Oversight (the "Department") and directly to the investors introduced by the finder that are less burdensome than the information required for a licensed broker-dealer. The finder must file an initial statement of information with the Department prior to engaging in any finder activity with the name and business address of the finder. A $300 filing fee is also required.

An annual renewal statement must be filed including an affirmative representation by the finder that the finder has complied with and will continue to comply with the conditions of section 25206.1(a) and will not engaged in certain illegal securities activities, and, that the finder has obtained a written agreement with each investor with respect to each transaction in which the finder has participated in the prior twelve months. A $275 filing fee is required for each renewal statement.

The finder must make certain written disclosures directly to each investor it introduces to the company concurrent with that introduction. This written disclosure must be in the form of a written agreement between the investor, the finder, and the issuer and include: (i) the type and amount of compensation payable to the finder; (ii) a statement that the finder is not providing advice to the company or to any person introduced or referred by the finder to a company as to the value of the securities or as to the advisability of investing in, purchasing, or selling the securities; (iii) disclosure as to whether the finder is also an owner, directly or indirectly, of the securities being offered or sold; (iv) disclosure of any actual or potential conflict of interest in connection with the finder's activities related to the transaction, and (v) a statement that the parties to the agreement have the right to pursue any available remedies at law or otherwise for any breach of the agreement. The investor must represent that the investor is an accredited investor and that the investor knowingly consents to the payment of the described compensation.

Section 25206.1 also requires that the finder maintain a copy of all disclosure items and other records relating to any transaction in which the finder receives compensation for a period of five years.

Section 25206.1 is only available for California transactions and does not provide any relief from the federal requirements. Therefore the issues raised in this article will continue to be applicable. Persons who find themselves faced with possible broker-dealer licensing violations should review their circumstances with experienced legal counsel.

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Defend Trade Secrets Act (DTSA) Signed Into Law

Philip Nulud

On May 11, 2016, President Obama signed into law the Defend Trade Secrets Act ("DTSA"). The DTSA creates a federal cause of action for private entities to combat the misappropriation of trade secrets.

The DTSA has been heralded as one of the largest developments in intellectual property law in many years. By creating a federal private right of action, it brings both uniformity in the law and access to the federal courts for trade secret holders.

As its name implies, a trade secret is a form of intellectual property that by its nature is not disclosed. A trade secret, in a broad sense, is confidential information that provides one with a competitive advantage. It differs from patents and copyrights in that it does not have a certain term in which it expires, and unlike patents, trademarks or copyrights, it is not examined or reviewed by any governmental authority.

Trade secrets can range from formulas and algorithms to manufacturing processes and customer lists. The most famous example is the secret formula for Coca-Cola®. Another example of a trade secret is a search algorithm for online search engines such as one Google® may employ. Typically, something is considered a trade secret if it derives economic value from not being known to the public or to competitors, and reasonable measures are taken to protect its secrecy.

Prior to the DTSA, if a trade secret was misappropriated, the only way to enforce it was through an action in state court. Individual states have developed their own statutes to protect against the misappropriation of trade secrets. Most states have closely tracked the Uniform Trade Secrets Act ("UTSA"), but there are still significant differences in the laws of various states. While the DTSA has many similarities to the UTSA, such as the three year statute of limitations, the DTSA has a number of important distinctions.

The DTSA provides for the recovery of actual damages, restitution, injunctive relief, exemplary damages up to two times actual damages and attorney's fees as remedies for the misappropriation of a trade secret. However, the most important remedy it provides, that was not available until the DTSA, is an ex parte order, in "extraordinary circumstances," for the "seizure of property necessary to prevent the propagation or dissemination of the trade secret that is the subject of the action" (S.1890(2)(A)(i) 2016).

Another important procedural item that the DTSA includes, or more appropriately does not include, that varies from state trade secret laws and the UTSA is the absence of any requirement to identify the claimed trade secret as a prerequisite to the plaintiff's right to discovery. Unlike patents, trademarks and copyrights, which can be readily identified, a trade secret would lose its protected status if it is identified. The application of this will be rather interesting as the case law surrounding this legislation develops. There is a possibility that it can be used unscrupulously by a plaintiff—they can vaguely allege a trade secret, take broad discovery and then narrow down their claims based on such responses. Only time will tell with regard to how the federal courts handle such matters.

The DTSA also brings up employment issues in that it provides immunity to whistleblowers who disclose trade secrets to government officials, in confidence, "for the purpose of reporting or investigating a suspected violation of law." 18 U.S.C. § 1833(b)(1)(A)(ii). Employers must now give notice of that immunity "in any contract or agreement with an employee that governs the use of a trade secret." Otherwise, if that notice is not provided, an employer cannot recover from the employee punitive damages or attorney's fees that may otherwise have be available to it under the DTSA.

By opening the doors of the federal courts and providing new remedies to prevent disclosure of trade secrets, the DTSA will be a valuable tool for businesses that own and seek to protect valuable trade secrets. Companies should evaluate their policies and enforcement options in light of it.

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Congressional Stalemate Persists over Air Traffic Control Privatization as FAA Reauthorization Deadline Approaches

Paul Fraidenburgh

The integration of cutting-edge aviation technology such as commercial drones and the modernization of our national airspace system are just a couple of the pressing aviation issues hanging in the balance this summer as Congress seeks common ground on FAA Reauthorization legislation.

With the July 15, 2016 expiration of the current Federal Aviation Administration (FAA) authorization legislation rapidly approaching, congressional disagreement over a plan to privatize Air Traffic Control is preventing bicameral endorsement of a path forward.

On April 19, 2016, the Senate passed its *Federal Aviation Administration (FAA) Reauthorization* legislation by an overwhelming margin of 95-3 (initially introduced as S. 2658 and later merged into H.R. 636). The Senate's FAA legislation would reauthorize FAA programs through September 2017, and would focus billions of dollars and government resources on some of the most pressing aviation issues including the promotion of widespread commercial drone operations, bolstering airport security, and adding new safety systems in private aircraft. However, the Senate's FAA Reauthorization legislation is arguably more notable for what it would not do than for what it would do. Namely, it would not privatize Air Traffic Control.

In the House of Representatives, the pending *Aviation Innovation, Reform, and Reauthorization Act of 2016* would completely overhaul domestic Air Traffic Control operations by moving the operations out of the FAA to a non-profit corporation. If successful, the House bill would place approximately 38,000 Air Traffic Control employees, and the management of the safest national airspace system in the world, in the hands of a private corporation.

Though the Senate and House bills share many commonalities, each passing day without congressional consensus brings mounting fears that the current efforts to modernize American aviation will devolve into an endless string of short-term extensions. The July 15 deadline has industry insiders calling for the House to adopt the Senate's more measured approach to reauthorization and to table the Air Traffic Control overhaul until 2017.

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Website Design Can Affect the Enforceability of Terms of Use

Matthew Lubniewski

Good website and app design is not just about aesthetic preference. The typography, layout, and user experience of your website and app can determine whether your terms of use and privacy policy are enforceable.

What is a "Wrap" Agreement?

Online agreements are often referred to as click-wrap or browse-wrap agreements. The "-wrap" part of their names is a throwback to shrink-wrap agreements. Shrink-wrap agreements are software licenses that are hidden inside a shrink-wrapped box. How can a customer be bound to an agreement they cannot see at the time of purchase? In general terms, a shrink-wrap agreement is enforceable if the buyer had an opportunity to review the terms of the agreement before deciding whether to use the software and the terms of the agreement are not otherwise objectionable "on grounds applicable to contracts in general" (e.g., if the agreement contains an unconscionable term). *ProCD, Inc., v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

Courts have applied the ideas from shrink-wrap agreement cases to so-called click-wrap and browse-wrap agreements that appear on websites, rather than in a product's physical packaging. Click-wrap agreements are entered into by clicking a button or checking a box to manifest assent to the terms of an agreement. Browse-wrap agreements are entered into by browsing a website after having the opportunity to read the terms of use for that website.

Are "-Wrap" Agreements Enforceable?

If done properly, yes. Although there are few cases exploring the enforceability of click-wrap agreements (browse-wrap agreements are discussed below), the prevailing view is that click-wrap agreements will be upheld if users are given reasonable notice of the terms of the agreement and manifest their assent to the agreement. *Feldman v. Google, Inc.*, 513 F.Supp.2d 229, 236 (E.D. Pa. 2007). A big takeaway from *Feldman* is that the enforceability of online contracts relies on basic contract principles (i.e., whether the user knew the terms of the agreement and whether the user manifested their assent to the terms of the agreement). In *Feldman*, the user was required to create an account by visiting a website that immediately displayed a scrollable text box containing the agreement with a "prominent admonition in boldface to read the terms and conditions carefully." *Id*. at 237. The agreement was not hidden at the bottom of the page or behind a series of hyperlinks. The user was then required to take "affirmative action and click the 'Yes, I agree to the above terms and conditions' button" in order to proceed in the registration process. *Id*. at 237. The court upheld Google's agreement because the user was

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given reasonable notice of the agreement and the user manifested his assent to its terms with the click-through mechanism.

Google's success in *Feldman* is contrasted with Netscape's failure in a 2002 case from New York. *Specht v. Netscape Communications Corp.*, 306 F.3d 17 (2d Cir. N.Y. 2002). In *Specht*, the court refused to uphold an arbitration provision contained in an agreement that was hidden behind a hyperlink that appeared in a "submerged" part of Netscape's website. The agreement said that when the user clicked a download icon on the Netscape's website it was entering into the hyperlinked software license. The court found that the user did not have reasonable notice of the terms of the agreement when it clicked the download icon. The mechanism that Netscape was attempting to use to manifest the user's assent to the agreement (i.e., the clicking of the download icon) was not physically close enough or related enough to the terms of the agreement for the clicking to actually manifest the user's assent. The *Specht* case can be viewed as both a browse-wrap and click-wrap case due to the download icon's lack of proximity to the related agreement.

Browse-wrap agreements are looked at with more skepticism than click-wrap agreements. If a user visits a website or loads a mobile app but is not required to affirmatively accept the applicable terms of service, how can a company bind the user to those terms of service? Courts generally look to whether a user has "actual or constructive knowledge of a website's terms and conditions." *Nguyen v. Barnes & Noble Inc.*, 763 F.3d 1171, 1176 (9th Cir. 2014)(quoting *Van Tassell v. United Mktg. Grp., LLC*, 795 F.Supp.2d. 770, 790 (N.D. Ill. 2011)). If the user did not have actual knowledge about the browse-wrap agreement, courts will next look to whether the design of the website to which the agreement applies would put a "reasonably prudent user on inquiry notice of the terms of the contract." *Nguyen* at 1177 (citing Specht, 306 F.3d at 30-31). In *Nguyen*, the court found that the design of Barnes & Noble's website was such that a reasonably prudent user would not be on inquiry notice of the terms of use that were hyperlinked on the website, despite appearing on every page the user viewed and even being in close proximity to the buttons the user had to click to checkout and complete a purchase. The analysis of whether a user has constructive notice of a browse-wrap agreement and its terms takes into account the visual design, typography, and user experience of the website. Is the link to the agreement in a jumble of 15 other links? Is it in 8 point light gray typeface on a medium gray background at the bottom of the webpage? Is the website designed in a way that the user could complete a sale without ever needing to scroll to the part of the page with the link to the agreement? The answers to these questions should be no if you hope to enforce your browse-wrap agreement.

Strategies for Strengthening Enforceability

Use click-wrap agreements instead of browse-wrap agreements. While requiring users to click "I Accept" does not guarantee that your online agreements will be enforceable, requiring users to affirmatively manifest their assent to the terms of your online agreements is certainly better than hoping they find and read the agreements. If you operate an e-commerce website or app, consider requiring users to consent to your terms of use and privacy policy at checkout. The cases show that you may not be able to rely on online agreements that are merely hyperlinked at the bottom of a webpage, especially if they contain provisions like class action or jury trial waivers.

Make design choices that make your terms of use and privacy policy easy to find. If you are asking users to enter into a click-wrap agreement, consider placing the agreement in a scrollable text box that is immediately above the "I Accept" button or check box so your users can easily read the agreement. Use typography that calls attention to your agreements, instead of obscuring them.

If you do decide to use a browse-wrap agreement, consider posting banners indicating to users that their continued use of your website or app constitutes consent to your terms of use and privacy policy. Since the cases on browse-wrap agreements focus in part on whether there is actual notice of the terms of the agreement, using banners or other announcement features may make it more likely that your users will have actual notice of the agreement. Consider using a landing page that discloses the terms of use and privacy policy before a user can access your main webpage.

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Keep Your Exposure To Real Estate Low—Sublease

Manuel Fishman

Start-ups are always confronted with how much space to lease and for how long, and whether a landlord is going to approve their credit (and discover the start-up has no real credit, given the burn rate). Coupled with this is the inherent desire to limit exposure to real estate—meaning the cost to build out space, the longer term required for a direct lease, and the risk that you have taken down too much space or taken down too little space, or have picked the wrong location. While incubators may be good for some companies, it offers little in the way of privacy and there is an inherent cost in the stock warrants that the incubator may require.

The alternative is the "sublease." A sublease is a lease, and the company, as a "subtenant", has the same obligations that a tenant has under a lease. The only difference is that the subtenant's landlord (usually referred to as a "sublandlord") is itself a tenant under a "master lease"—or a direct lease with the owner of the building—and you, the subtenant, generally have to assume all the obligations of your sublandlord under the master lease. At first blush, that makes it seem even more burdensome—not only do you, the subtenant, have obligation to your landlord under the terms of your sublease, but because your landlord is also a tenant under a lease, you have to assume the obligations of your landlord, as the tenant under the master lease. In actuality, these obligations are simply the normal obligations you would have to assume under any lease. And the benefit to you, the start-up, is that you are leasing space that is already built out, and in most cases you get to use the furniture and kitchen that is already there, and you get to use the fiber and voice and data infrastructure that is already there. All at a large savings to you. Why? Because in most cases you are subleasing excess space from another company—a company that may be further along in its life cycle than your start-up, and that has excess space, and is willing to sublease the space for a cost that is less than the market rent that you would pay if you enter into a direct lease with a landlord. And since your landlord has already sunk the money into its furniture and equipment, it is only trying to recapture a fraction of that cost from you, the subtenant.

In addition, while credit is always important, your landlord, the subtenant, is usually going to scrutinize your credit to a lesser extent than a direct landlord. Why? Because it is incentivized to cover its obligation under a larger lease—under which it is already responsible and is willing to take a bit more risk than a landlord in the business of renting space. Finally, sublease terms come in a variety of flavors—there is much more flexibility in a sublease than the standard 3 or 5 year term that a landlord is willing to offer. The reason is simply that tenants decide to sublease for a variety of reasons at different stages in their lease and therefore the available periods of occupancy are much greater in the sublease market than in the direct lease market.

Yes, there are issues to consider in a sublease—the biggest risk is that you, the start-up subtenant are at the mercy of your landlord's performance under the master lease. In other words, if you only sublease a portion of your sublandlord' s premises, and your sublandlord, as the tenant under the master lease, defaults under that master lease—your sublease is at risk and can be terminated. While there are some legal strategies that can be adopted that minimize this risk, those are not common place. Therefore, taking over an entire lease—as a subtenant—is sometimes preferable, unless you can get comfortable with the creditworthiness of your sublandlord.

Getting direct contact with the master landlord—the owner of the building, can also be difficult, because the owner of the building—the master landlord—is not in contract with you, the subtenant. His contract is with your landlord, as the tenant. Again, there are legal strategies that can be put in place and those are generally much more effective and common place.

Lastly, remember that in the large majority of cases, a sublease requires the consent of the "master landlord"—so your landlord, who is a tenant under a master lease, is obligated by the terms of the master lease to get the master landlord's consent, and that consent is an important pre-condition to the effectiveness of the sublease. In most cases, the lease governing your landlord's occupancy of the premises will provide that the master landlord will not unreasonably withhold consent to a sublease.

The bottom line is that a sublease is common for start-ups, and the legal strategies that can be put in place can minimize many risks that are inherent in the sublease structure. A sublease is a worthwhile alternative to a direct lease and does reduce a company's exposure to real estate. Subleasing can present the right opportunity for your company, and real estate brokers get a commission just like in a lease, and there is usually a letter of intent that sets out the general terms of the sublease, just as in a lease. We recommend that you have a lawyer review the master lease before you enter into the sublease, and have a lawyer draw up the sublease document. Attorneys in the Firm's real estate group are expert in these types of transactions.

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This article originally appeared in Inside Counsel Magazine

Including Trade Secrets in a Patent Application: Strategies and Caveats

Isaac Zaghi

Companies often grapple with the difficult decision of how to protect their innovations: apply for a patent or maintain a trade secret. This decision typically hinges on many factors. Significant factors include the state of the technology, competitive landscape, and merits of succeeding at the Patent Office. Companies may also treat their intellectual property differently based on their economic circumstances and respective business models. Fortunately, in some limited instances, the company may delay this decision, at least for a period of time, by keeping their patent application confidential until it issues.

A company may consider using a patent portfolio to protect its market space, create a licensing strategy, add tangible assets, and defend against other portfolios, among other strategic business concerns. For instance, an independent solo inventor often lacks the capital to develop the technology and will therefore look to sell or license the intellectual property. This entity therefore needs a tangible asset that can be licensed and to prevent an acquirer from simply taking the idea. Start-ups may pursue a patent to protect their core technology, carve out new space in a particular industry, or bolster their intellectual property portfolio to increase valuation. Similarly, large corporations may file patent applications to protect improvements to existing products, as well as for defensive purposes. In particularly litigious industries, companies will develop or acquire a patent portfolio as ammunition to defend against infringement claims from competitors. A perfect example of dueling portfolios is the Apple and Samsung patent disputes over their mobile phones. Therefore, this option is available for technology, methods of manufacturing, and processes that are innovative, and where the company has the funds to prosecute an application to obtain protection for 20 years from filing.

On the other hand, maintaining an invention as a trade secret can be a viable strategy as well. For start-ups and large corporations, maintaining secrecy of an invention can be very lucrative. If a company creates sufficient safeguards to protect its secrets, then the protection can be maintained indefinitely. The classic example here is the secret formulation of Coca Cola®. Therefore, this option is available for technology, methods of manufacturing, processes, and other company information that can be kept a secret through sufficient company policies and safeguards.

In certain circumstances, both options are viable. However, such a strategy is very nuanced and requires sufficient preparation prior to execution. This is because patent applications automatically publish 18 months from the earliest filing date associated with the application. Thus, upon publication, any trade secret status of the confidential information in the application is lost. To make matters worse, in some cases, the disclosure of a general combination (e.g. formula of a compound) may destroy secrecy of a specific ratio within the broader range, even if the narrow ratio had not been explicitly disclosed. Therefore, segregating the trade secret information from a patent disclosure is treacherous.

However, a company may strategically consider disclosing trade secret information in a patent application to buy time to make the decision between patent protection or trade secret protection. A patent application may be held confidential during its examination if it is filed with a non-publication request. But this comes with several caveats. The biggest restriction on this strategy is that it is limited to the United States. A foreign patent application cannot be filed while the non-publication request is pending. Other restrictions include the timing of the request, as well as providing notice to the patent office of certain activities.

As such, a company that is not interested in pursuing a patent in another country may include trade secrets within a patent application and file it with a non-publication request to “test the waters.” If the application is ultimately granted, the patent will publish and the secrecy is destroyed. But the company has presumably now protected the idea in the form of a patent. If the case is ultimately unsuccessful, or the company decides not to continue prosecuting the application, it can be abandoned. Since the application has not been published, the disclosure remains secret. Here, the intellectual property in the form of a trade secret is retained.

There are some tradeoffs, however, to employing this strategy. A published patent application serves as constructive notice and may allow the patentee to accrue reasonable royalties for infringement as of the date of publication. Therefore, not publishing the application could mean foregoing the royalties accumulated between the dates of publication and patenting. Since the application can be pending several years before it is patented, the amount or royalties in this period can be substantial. Further, if an application is not published, it cannot serve as prior art against another application. Therefore, the non-published patent application will not be used as prior art against competitor patents until it issues. In a heavily patented and competitive technical area, a published application can be useful at blocking efforts of competitors.

Companies faced with the decision of protecting their ideas in the form of a patent or a trade secret may benefit from filing an application with a non-publication request. However, anyone contemplating this strategy should seek advice from counsel.

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Buchalter Nemer is a full-service business law firm that has been teaming with clients for over six decades, providing legal counsel at all stages of their growth and evolution, and helping them meet the many legal challenges and decisions they face.

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