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Employers Beware – IT Intellectual Property Ownership, Employees And Contractors

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Adequate protection of a business' intellectual property is not only valuable for income accrual through successful exploitation, but can also be a key indicator of the business' management performance, can add to the value of the business for the purpose of mergers or acquisitions, and may be used as security for loan or equity finance.

It is a common practise for businesses to engage employees or independent

contractors to develop their information technology (IT) and information systems (IS) which often become valuable assets of the business. Equally it is a common assumption that payment for the development of their IT means that they will necessarily own the intellectual property rights subsisting in it. However under Australian intellectual property laws ownership of intellectual property is not always

synonymous with the creation, payment of consideration or commissioning of it.

Whilst today the term intellectual property encompasses numerous legal rights including the exclusive rights associated with copyright, patents, designs, trade marks, circuit layouts, confidential information, trade secrets and know-how this article has been confined to an overview of the ownership issues that may arise in

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relation to copyright, patent and designs protection in light of the more common forms of IT developed by businesses including their software and website development.

Copyright

When a business engages an employee or an independent contractor to develop its IT to increase its business capabilities or for subsequent sale it is expected that the developed IT will become the property of the business and that they will own the right to reproduce it.

However the general principle running through intellectual property law that the author or inventor is the owner of the intellectual property means that the assumption 'I paid for it therefore I own it' does not always ring true.

For example in *Avtex Airservices Pty Ltd & Ors v. Bartsch and Ors* (1992)¹ the operators of a flight school wanted to establish a school teaching flying theory. The first and second Respondents were engaged to help establish the flight school and proposed a computer assisted interactive class learning system to later become known as the ACE System. The first Applicant paid the majority of the expenses of setting up the course although some money was obtained from student fees. An aspect of the ACE System was a software program. There were never any discussions between the Applicants and the Respondents regarding ownership of copyright in the system including the software. When the relationship between the Applicants and the Respondents soured the question of ownership of copyright of the system became an issue. Despite the Court recognising that the money for the development of the program was ultimately paid for by the Applicants it found copyright ownership vested in an independent contractor engaged by one of the Respondents to develop the program.

The general rule under section 35(2) of the *Copyright Act* 1968 (Cth) is that the author of a work is the owner of any copyright subsisting in it. In the copyright context the author is the person who first put the work into material form, such as the person who

first developed the source code of a computer program.

This rule applies to "works", defined by the Copyright Act to include literary, dramatic, musical and artistic works such as reports, compositions, software or sketches of logos. Taking software and web pages as examples, copyright subsists in the source code of a software program which has been recognised by Australian courts as a literary work and copyright may subsist in a business' website on a number of levels, including the layout and design of the website and in the images and icons used on the web page as artistic works, and in the source or html code of the website or in databases accessed via the web page as literary works.

Employees

The general rule that the author is the first owner of the work is however subject to exceptions including section 35(6) of the Copyright Act that provides where 'a work is made by the author in pursuance of the terms of his or her employment by another person under a contract of service that other person is the owner'.

In most cases the copyright in a work which is created in the source of a person's employment will be the property of their employer. Not infrequently however disputes arise when it is unclear whether an employee is working pursuant to a contract of or for service and whether the work is created within the scope of the contract of employment.

Contracts of or for Service

Generally employees over whom a business has direction and control as to the manner in which they carry out their work will be employed pursuant to a contract of service. However for employees who exercise a greater amount of skill such as a computer software programmer the control test becomes less significant as the employer cannot always control the manner in which the task is done. In *Stephenson Jordan & Harrison Ltd v. MacDonald & Evans* (1951)² Denning LJ considered that instead a key determination was whether an employee is an integral part of a

business or is only an accessory to it.

In the case of *Redrock Holdings Pty Ltd and Hotline Communications Ltd v. Adam Hinkley* [2001]³ ("the Hotline Case") the defendant, Mr Hinkley, submitted that he retained copyright in software programs he developed on the basis that he was not an employee because he was not subject to Redrock Holdings Pty Ltd's ("Redrock") control and direction. The court said legal authority to control is no longer the sole determining factor, particularly where a person exercises a high degree of professional skill and expertise in the performance of their duties. Referring to Denning LJ's test Harper J considered that the defendant had been an integral part of the business. The court also found that evidence of fixed salary, the deduction of group tax, the completion of an ATO employees declaration form, annual, sick and long service leave entitlements, superannuation contributions and the provision of tools and equipment pointed towards a contract of service.

The result of the distinction is that if the employee is not working pursuant to a contract of service then the general rule will apply, and the business may lose the fruits of its investment.

Is the work made pursuant to that Contract of Service?

For an employee's copyright to vest in an employer section 35(6) of the Copyright Act further requires that work be made pursuant to the employee's terms of employment. Little judicial guidance is given to determining when a work is made 'pursuant to the terms of employment' however this will generally involve an examination of the employee's duties and whether the work resulted from the employee performing those duties.

In the *Hotline Case*⁴ Redrock claimed copyright ownership in software programs developed by Adam Hinkley. In relation to one of the programs named Hotline the court found that Mr Hinkley retained ownership of copyright. The court accepted his evidence that Hotline was his own project carried out without any direction from his employer

Redrock and without their knowledge, and although he worked at it while at the premises of Redrock he only did so when he had no specific tasks. Redrock was unable to produce sufficient evidence that Mr Hinkley had developed the program during working hours and the court was not satisfied by evidence that Mr Hinkley had to develop a PC version of the program because that was all that he had at work.

Redrock nevertheless retained copyright ownership in a program named App Warrior (AW) upon which Hotline was dependent. The program was originally conceived and developed by Hinkley to impress his prospective employer. However, because the software that he had developed using the program whilst employed by Redrock was functionally and critically dependant on the program, and the program had been developed from what the court described as an embryonic form at Redrock the court found that Redrock owned the copyright. Expert evidence had also shown that the majority of the further development of the program occurred between 9:30am and 7pm on weekdays.

This case demonstrates how in the absence of a specific agreement ownership of copyright can become confused and an employer will not always be automatically entitled to ownership of copyright in works produced by their employees.

Independent Contractors

The general rule applies to independent contractors with limited exceptions that include commissioned photographs, portraits and engravings and works created by or under the direction or control of the Crown. Further the position under the Copyright Act is that an assignment of copyright (whether total or partial) does not have effect unless it is in writing signed by or on behalf of the assignor. Therefore in the absence of a specific agreement copyright in works created by independent contractors will remain in their hands.

Returning to the above examples where a small business has engaged an

independent contractor to develop its software program this means that in the absence of express contractual terms regarding ownership the business will not own copyright in the program including the right to reproduce it. Although the commissioning of the development of the program might give rise to a licence to use it or other equitable rights difficulties will arise where the company subsequently seeks to sell the program for this will involve an infringement of the developer's rights.

The difficulties faced by a business in relation to its website will arise where aspects of the website created by the contractor (which may include the layout and design of the website, images and icons used on the web page, the source or html code of the website or in databases accessed via the web page) are sufficiently original to attract copyright protection and not assigned to the business. In the absence of suitable agreement conferring ownership the contractor will own the relevant copyrights and be free to use those aspects on another webpage and assign/licence them to competitors.

Contracts of and for services should therefore be checked to ensure that they contain appropriately worded and clear assignment clauses.

Patents

Although patents are less commonly relied upon for protection of a business' software because of the associated expense and difficulties that can be faced in obtaining them, including due requirements of novelty and inventiveness, effective software patent protection can be more effective than copyright protection because of its ability to protect the idea per se behind a program.

Unlike the Copyright Act there is no provision in the *Patents Act* 1990 entitling employers to rights in the inventions of their employees. Employers obtain patents for inventions created by their employees on the basis that they are entitled to have the patent assigned to them. In the absence of an express term as to

ownership in a contract of employment a term will be implied by law entitling an employer to an employee's invention so long as it arrived in the ordinary course of the duties the employee is engaged to perform.⁵ Thus when determining an employer's entitlement it becomes again necessary to determine whether the employment relationship suggests that the invention concerned was made in the ordinary course of employment.

The above difficulties may be avoided by way of an express term in the employment contract whereby the employee promises to assign to the employer any rights in future inventions. Where however an employee is not engaged to invent in a specific field, then the results of some inventions may still accrue to the employee. Upon first consideration a broader clause applying to all inventions created by an employee may overcome this difficulty however clauses purporting to give employers ownership of inventions manufactured whether or not in the course of employment have been construed strictly against them as an unreasonable restraint of trade.⁶

Independent Contractors

The position with respect to independent contractors is again clear. In the absence of a valid and binding agreement that clearly states that the engaging business will own the invention then ownership rests with the inventor and the business will lose the fruits of its investment.

Designs

Unlike copyright and patent protection, the payment of consideration for the creation of a design in the presence of an agreement does favour ownership by the business regardless of the relationship between the commissioner and the designer.

The starting point for ownership of designs is similar to that of copyright. Section 19(1) of the *Designs Act* 1906 provides that the owner of the unregistered design is the author of the design. The author of the design is defined by the *Designs Act* as the

person whose mind conceives the relevant shape, configuration, pattern or ornamentation. The position in respect of employees is similar to that of the Copyright Act. Section 19(3) of the Designs Act states 'where a design is made by a person in the course of his employment with an employer, the employer is the owner of the design'. Although the Designs Act does not draw on the distinction between a contract of service or a contract for service the assessment again turns on whether the work is created by an employee or an independent contractor and whether it was made within the scope of employment.

The position for independent contractors is however different to that of copyright and patent ownership for the Designs Act vests ownership of commissioned designs in the commissioner. Section 19(2) of the Designs Act essentially provides that where an agreement for valuable consideration is entered for the creation of the design the

commissioner will own the design. The Designs Act is silent as to whether the agreement must be in writing. Therefore as long as there is an agreement between the business and designer together with payment of consideration for the design then the business will own the design regardless of the absence of express contractual provisions as to ownership.

Conclusion

In order to ensure that your business owns the intellectual properties of its employees and independent contractors the following check list sets out the more important points that should be covered or considered.

1. Check that all agreements with employees and/or independent contractors are carefully drafted and that all intellectual property rights are assigned to the business.
2. Ensure that the business obtains appropriate warranties as to ownership of any intellectual property developed by external

contractors and that there is no "embedded" intellectual property that may restrict your future use or ownership.

3. Ensure that the business maintains an appropriate intellectual property register and that its intellectual property is regularly audited for ownership purposes.
4. Ensure that where a business is engaging "employees" for the purposes of creation of intellectual property that they are being engaged pursuant to a contract of service.

1 23 IPR 269

2 69 RPC 10

3 50 IPR 565

4 *Redrock Holdings Pty Ltd and Hotline Communications Ltd v. Adam Hinkley* [2001] 50 IPR 565.

5 see *Sterling Engineering Co Ltd v. Patchett* [1955] AC 534.

6 see for example *Electrolux Ltd v. Hudson* [1977] FSR 312.

Purposeful availment required for US jurisdiction

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On 27 January 2003, the United States Court of Appeals for the Third Circuit ruled that a court may not exercise specific personal jurisdiction over a website operator outside the jurisdiction unless there is evidence that the operator purposely availed itself of conducting activity in the forum state.¹

The US companies, Toys "R" Us Inc and Geoffrey Inc (Toys), claimed that two Spanish companies, Step Two SA and Imaginarium Net SL (Step Two), had used their internet websites to engage in trademark infringement, unfair competition, misuse of the trademark notice symbol and unlawful cybersquatting. Toys owned a network

of Imaginarium stores selling educational toys and games, a number of Imaginarium trademarks, and the domain names, www.imaginarium.com, registered in 1995, and www.imaginarium.net, which was registered in April 1999 and offered Imaginarium merchandise for sale.

Step Two owned 165 stores operating under the name Imaginarium in Spain and nine other countries, with the same façade and logo, and similar merchandise, as Toys' stores. Step Two did not operate any stores in the US, nor did it have any US bank accounts or employees. Step Two first registered the Imaginarium mark in

Spain in 1991, and subsequently registered the mark in several other countries where its stores were located. In 1996, Step Two registered the domain name www.imaginarium.es. In June 1999, two additional domain names, www.imaginariumworld.com and www.imaginarium-world.com, were registered, followed by www.imaginariumnet.com, www.imaginariumnet.net and www.imaginariumnet.org in May 2000. In February 2001, four of the Step Two websites allowed customers to purchase merchandise online.

The District Court denied Toys' jurisdictional discovery request and