Tips for investors and inventors

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Earlier this year, the Victorian Supreme Court handed down its decision in *Redrock Holdings Pty Limited and Hotline Communications Ltd & Ors v Hinkley & Ors.*[1] This article looks at some commonsense lessons that investors and inventors can learn from the circumstances and outcome of this case.

The class library

In 1995, teenager Adam Hinkley created a class library of functions of about 12,000 lines of code for the Mac platform (which other software could reference in order to perform those functions). Hinkley dropped out of school and was interviewed for a position as a programmer for A2B Telecommunications Pty Ltd (later, Redrock Holdings Pty Ltd (**Redrock**)). Prior to the interview, Redrock sent Hinkley a copy of a Windows version of a proprietary Redrock product and asked him to develop a Mac version. He used his own proprietary source code to do so and demonstrated the Mac product for Redrock at the interview.

Redrock offered Hinkley a job as a programmer. Hinkley assumed that the intellectual property rights in the class library would remain with him, because he created the initial version before he started employment with Redrock. During his working life, he created products for Redrock that relied heavily upon the class library.

Investors: *When Redrock asked Hinkley to develop a product and disclosed proprietary information, Redrock should at least have had Hinkley under a non-disclosure agreement to protect the source code to their existing proprietary product and an agreement to specify who owned the intellectual property rights in the Hinkley developed product.*

Inventors: *Make sure before you create work for another person that both of you agree in writing about the basis on which you are creating it.*

He also continued to develop, revise and transform the class library, so that it was much longer and quite different from the version he had created prior to starting work for Redrock (the **AW class library**). He carried out work on the AW class library both during working hours and outside working hours. He also created and developed new software for himself (called **Hotline**), although some of such work allegedly took place during working hours. Hotline also depended on the AW class library.

During the court case expert evidence was called to establish how much had been developed during and outside of working hours. The court found that the bulk of the AW class library work had in fact been done during Hinkley's employment at Redrock and thus, the copyright in the class library vested in Redrock, not Hinkley. The court found, however, that Hinkley was the owner of the copyright in the Hotline software. By private settlement before this case was heard, the copyright in the class library held by Redrock was transferred from Redrock to another company, Hotline Communications Limited.

Investors: *In employment agreements, state clearly that what employees create during the course of their employment belong to the employer – whether done during standard working hours or not.*

If employing creative people for creative positions, request that they clearly identify in writing to the employer creative works that they have created before starting employment, which they want to continue to own.

Explain in the employment agreement that if they use those works to create new things, or modify those works, in the course of employment, the intellectual property rights in those modified works and new creations will belong to the employer.

Inventors: *If you, as a creative person, intend to create works that might otherwise be fairly regarded as belonging to your employer, tell your employer that, (1) you're interested in working on a separate project for yourself; (2) you won't work on it during the course of your employment; and (3) whether you would be interested in licensing the results to the employer.*

Hotline Communications

The Hotline software was designed to allow a transfer of a file that had been interrupted by a dropped internet connection to be resumed without loss of the previously downloaded material, and it also sped up the file transfer. The product also allowed users to make their personal computers function like a server and enable other users to upload and download files from it, while chatting to other users by internet relay chat. According to internet reports at the time, when Hotline really took off, it had roughly 1.5 million users.

When Hinkley travelled to Canada ostensibly on holiday in September 1997, he actually negotiated a new venture with three young Canadians, who were interested in the Hotline software and had two individual backers. The Canadians incorporated a company, Hotline Communications Limited, to commercialise the Hotline software. A shareholders agreement was proposed, whereby in return for a majority of the shares, Hinkley would assign his interest in the Hotline software and part of the AW class library. While the judgment reports that the Canadians

suggested Hinkley obtain legal advice, he did not do so.

At the time Hinkley visited Canada in September 1997, only $50,000 had been invested. In a representation later held by the court to be fraudulent, Hinkley was told that if he signed the shareholders agreement, the two individual backers would invest another $500,000. In fact, no such sum was available.

Hinkley argued that he entered into the shareholders agreement on the basis of that representation and that he would have been 'generous' in assigning the intellectual property rights in the Hotline system to Hotline Communications Limited for an investment of only $50,000.

However, the court held that there was in fact no reliance and Hinkley was merely doing 'what had to be done if his hopes for the product which he had created were to be realised'. The court also held that 'Mr Hinkley ought immediately to have wondered what it was that (the individual backers) would receive for their $500,000. It could not be the Hotline software, because Hotline Communications owned ... the rights to that. It could only have been shares in the company – the usual quid pro quo for an investment of that kind.' The court also held that 'there is nothing improbable or unfair about the "deal" to which he agreed'.

Investors: *If the other party to the deal doesn't have experience, suggest that an advisor be retained, to avoid an argument that you have behaved unconscionably. Remember that a shareholders agreement governs an ongoing – not a one-off – relationship and you will be dealing with the other party for some time to come.*

Inventors: *Read carefully any agreement that you are asked to sign. If you have assumptions about how certain things will be dealt with, make sure that the agreement reflects your assumptions and that the other party understands them. If you don't understand something, or if you don't have experience or qualifications in law or finance or a specialist area which may have bearing on the agreement, get assistance. While it may seem like a significant outlay of money for little tangible result, it's better than being at the end of a lawsuit brought by an angry investor – or another inventor.*

Copyright issues

The assignment of the intellectual property rights in the Hotline software referred to 'Intellectual Properties consisting of all telecommunications and programming protocols and software applications (Hotline and AW Class Libraries) developed and being developed for the Internet by him (Hinkley)'. Hinkley argued that the loose phrase 'developed and being developed for the Internet' was in fact a restriction of what intellectual property rights were assigned and that he had retained the intellectual property rights relating to the use of the AW class library and the Hotline software for other purposes, such as company intranets.

The court found that the way in which the parties, and in particular Hinkley, promoted to the public that the Hotline software had functionality beyond the internet, was consistent only with a conclusion that the assignment of copyright was unqualified. Consequently, it was held that the shareholders agreement effectively assigned the entirety of Hinkley's interest in the Hotline software and the AW class library to Hotline Communications.

Whether you are an investor or an inventor, be careful about how you describe what you are assigning to make sure you only include what you think you are including. It is not unusual to refer to particular software specifications or even to deposit code to achieve such a result.

Breach of employment contract

Once the negotiations between Hinkley and Hotline Communications Limited were completed, he resigned from Redrock by email while still in Canada, without notice, and without leaving a copy of the source code of the AW class library.

As a result, Redrock was unable to update the source code of the AW class library as required to maintain Redrock's products and service its clients. The court held that Hinkley's sudden departure and failure to properly hand over to Redrock to enable it to understand the suite of code in the situation where he was the only Redrock employee with Mac skills was a breach of his contractual obligations to Redrock.

In March 1998, Hinkley suddenly returned to Australia. He deleted software from Hotline Communications Limited's computers, encrypted remaining software and shut down its website. While he sent a copy of the source code to Hotline Communications Limited, he did so in an encrypted (and therefore unusable) fashion.

Hinkley then developed the Paradox class library, which the court found reproduced a substantial part of the AW class library and thus infringed Hotline Communications Limited's copyright.

Investors: *Make sure that employees are properly supervised and are aware of and comply with company policy.*

Inventors: *Leave well. Give your employer the period of notice that you have agreed to give under your employment contract.*

If you are the only responsible employee for a particular project, document what you are doing, how you are doing it and where you are up to. If you have your own software that you have created on your own time which you would like to use on a particular project, tell your employer that you would like to use it, ask that you be appropriately compensated, get your employer's agreement in writing. If this is not possible then do not use it.

Seek to hand over responsibility for any projects that you have been working on to an accountable fellow employee with the knowledge of your employer. Use common sense - don't

take proprietary information that may belong to a previous employer to a new employer or seek to use it for yourself, even if you created it in the first place.

Implications for investors and inventors

The issues discussed above are just some of the many that may be faced by young inventors seeking to raise funds on the basis of their creative powers – and by the investors who are seeking to bring from those creative powers some commercial benefit. Creative people want to exploit the rights in the work that they independently create and to continue to create more works. However, investors expect to see some return for the use made of their funds, usually by ownership of the intellectual property on which the venture is founded. Unless the creator and the investor discuss how this can be achieved, neither the creator's goal, nor the investor's, may ever be fully realised.

A court case in Ontario, Canada, determined that Mr Hinkley's shareholding in Hotline Communications Limited should be cancelled. In the court case brought in Victoria, judgment on costs has been reserved.

[1] Redrock Holdings Pty Ltd & Hotline Communications Ltd & Ors v Hinkley [2001] VSC 91 (4 April 2001)

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A light lunch will be provided