

Technology

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Square's Lawsuit Settlement a Cautionary Tale for Tech Companies

The recent settlement of a major lawsuit against Square, the credit card processing company once valued at US\$6 billion (and now \$3 billion), is a cautionary tale as to why startups and their founders must build their business upon the strongest possible corporate and intellectual property foundation.

The lawsuit, brought by Robert Morley, a former colleague of Square's co-founders, was reported in Square's most recent financial statements to have been settled for US\$50 million.

The Lawsuit

In early 2014, Morley brought an action for claims including breach of fiduciary duty and patent infringement against Square and its co-founders, Jack Dorsey and James McKelvey. Morley sought damages and to be added as an owner of Square's patents.

Morley, a college professor and entrepreneur, alleged that he collaborated with Dorsey and McKelvey to design a system that accepted credit card payments through a mobile phone. In February 2009, Morley, Dorsey and McKelvey formed a joint venture to focus on their collaboration. Morley alleged that he then created the hardware that Square employed as its first credit card reader, and contributed his substantial knowledge of the credit card industry to the collaboration.

According to statements filed in the lawsuit, Dorsey and McKelvey redirected revenue from their joint venture with Morley to a separate company, which would eventually become Square. Although he participated in inventing and patenting the technology, Morley received no ownership interest in Square and was not compensated for the company's use of his work.

Avoiding Trouble Down the Road

When multiple parties work together to develop designs and prototypes for new products, the ownership of the intellectual property may come into question. One of the easiest ways to avoid or minimize the risk of disputes arising from the development of new products is for the collaborators to formally establish their relationship and ownership rights at the outset in a shareholders agreement and with properly documented intellectual property assignments.

It is often best for collaborators to incorporate a company through which to run their business. After incorporation, the founders can enter into a shareholders agreement to set out their rights and obligations with respect to the company. It is then integral to ensure the company establishes all of its ownership and intellectual property rights created in the course of collaboration by taking an assignment of the intellectual property. It is crucial that intellectual property rights and founder relationships are properly documented to minimize the potential for dispute between the collaborators.

The Morley, Dorsey and McKelvey lawsuit could have been avoided had the parties understood and clarified their interests and the ownership of the intellectual property from the outset.

Goodmans Tech Group

To assist clients in the technology sector, Goodmans brings together our acknowledged expertise in corporate/commercial, private equity, corporate finance, mergers and acquisitions, outsourcing, licensing, intellectual property, privacy, regulatory and media, tax, litigation, human resources, corporate restructuring and administrative law.

Goodmans was a pioneer for many of the contractual relationship formats that now exist in the information technology sector. We also have an extensive history of helping clients enforce their rights with regard to

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computer software issues and other business disputes. The members of our Technology Group teach internet and communications law at Canada's largest law school, are regular lecturers at technology industry events and legal conferences, and have published articles in the technology law field.

Goodmans continues to lead in the technology space and has recently partnered with The DMZ at Ryerson University. The DMZ is a leading business incubator (selected by BMI as the top-ranked university incubator in North America, and third in the world), which connects its startups with resources, customers, advisors, investors, and other entrepreneurs. Through this partnership, Goodmans will provide mentorship and networking opportunities to assist startups in maximizing their potential.

Please contact any member of our Technology Group for further information.