



Getting Intellectual Property Due Diligence Right

Intellectual Property





CHEAT SHEET

- ***Inventor information.*** Ascertain all inventors by name, status and legal entity, as well as dates and locations of their inventions.
- ***Contract information.*** For each IP asset, ascertain the contract that assigned or provided the rights to the target company.
- ***Comprehensive search.*** Conduct a title search of all patents, copyrights, domain names, mask works and trademarks in each country where the IP assets are registered.
- ***Compare the results.*** Determine if the IP registrations reflect where and how business is actually being done.

Intellectual property (IP) is the “lifeblood” of many of today’s global corporations that view IP acquisition and licensing as a primary growth strategy. The lawyers who run these transactions can add significant value to their corporate clients. Those that fail to understand the challenges will not see positive results. Those who address issues in advance can avoid potential disaster. The strategy and process for due diligence regarding such transactions is critical. Its execution provides both significant opportunity and significant risk for in-house counsel. “Getting it right” is the only option.

In-house counsel involvement in the due diligence process for IP analysis

No best practice intellectual property due diligence process can be completed by simply “quitclaiming” it to outside counsel. This is because intellectual property and its use are closely tied to the business’ success after the merger or acquisition. Frequently, we have seen in-house counsel outsource intellectual property due diligence to outside counsel because of a perceived lack of internal expertise. While the value of outside counsel’s technical expertise is important, it should never overshadow the significant and essential value in-house counsel brings to the transaction because you are more familiar with the business than any outside counsel.

In this article, we draw from hundreds of due diligence processes in intellectual property that have been undertaken in both multi-hundred-million dollar transactions and day-to-day operations. Through this experience, it is easy to conclude that, while intellectual property is a specialized subject matter giving rise to unique issues, it is essentially the same as any other asset being examined for acquisition. The same foundational questions apply to IP as any other asset examined for purchase:

1. Is the asset legally clear for unencumbered title transfer?
2. What is the legal quality and strength of the rights to the asset?
3. What are the limitations of the legal rights to the asset in the jurisdictions where the asset is desired to be used?
4. Is the asset desirable for your client commercially given the extent of those rights?
5. Is the asset and the legal rights ascribed to it going to meet your client’s commercial objectives post-acquisition?

The answers to questions one through three can be done by outside counsel who have technical

expertise in intellectual property laws in the jurisdictions where the transactions are taking place. Questions four and five, however, are so integrally tied to your client's business objectives, that they are best suited to be addressed by you, the in-house counsel.

Intellectual property due diligence is not a closed technical process with a single outcome. It is a moving, dynamic and systematic activity that forms a frequently critical part of an in-house counsel's role in an M&A transaction. To quitclaim this responsibility to outside counsel and then await the results will not only result in increased transaction costs, but will also prevent your client from receiving the integrated business and legal analysis needed.

Intellectual property due diligence processes reflect corporate internal innovation management. The value lies in not just what the asset is, but also in how it is being used commercially, and how that use can be expanded over time. As such, a strong due diligence process for IP takes into account not just "what is," but also "what can be" in terms of potential expansion of rights into other uses and legal jurisdictions. For this reason, this strategic and business-focused analysis requires an intimate knowledge of your client's existing business and as well as where this business may seek to expand in the future. This explains why outsourcing the entire intellectual property due diligence process to outside counsel is rarely fruitful. Frequently parties do not realize that technical legal knowledge of intellectual property law and how that law impacts a particular asset is very different from articulating how your client's intellectual property can be commercially exploited. The latter skill set is critically needed during the due diligence process.

In-house IP due diligence best practices

The best practice process for conducting due diligence for any form of intellectual property transaction is straightforward and systematic. Following such a system will create a complete data set for analysis by you and your business.

At the end of each step, a "deficiency list" can be created as well as a satisfactory list for each intellectual property asset that is broken out by country. We have outlined a system below to help in-house counsel walk through a step-by-step review in order to access the right data as early as possible and to analyze and provide input to determine if the company should continue or move away from the transaction completely. This type of step-by-step process reduces costs and creates efficiencies. It also informs the transaction structure and pricing of the deal, which brings tremendous value to the company in any transaction where a significant portion of the transaction value may be intellectual property.

Even in a heavily technology-based transaction, limiting an analysis to merely patents may be misleading as the value of many patents lies in associated intellectual property assets such as trade secrets in related improvements, copyright in public explanatory materials, know-how in manufacturing processes and the value of associated brands. In some transactions, the brands may hold the majority of the prospective value, along with associated domain names.

"Deal critical" intellectual property is often missed in due diligence in two ways. First, the legal strength and scope of legal rights being acquired is misunderstood. Or, wrong assumptions about the

legal ability to commercially expand the use of the intellectual property are made. These problems can be resolved by in-house counsel ensuring that the commercial desires of your client's business, both now and in the future, are articulated prior to the completion of the transaction. This permits a proper analysis of whether the legal rights to the intellectual property at issue do, or can be expanded legally, to match your client's commercial plans.

Due diligence in intellectual property acquisitions should not be limited to M&A transactions. Instead, this due diligence should be part of regular business practices. We recently received a call from a general counsel requesting strategic assistance. His client's director of marketing had purchased an advertising campaign for seven figures without any clearance work being done on the marks, slogans or trade dress created. Moreover, no work for hire documents had been executed to transfer the copyright and other intellectual property rights to the client in the campaign. The campaign was scheduled to launch on television the following week.

As a team, we worked to clear the rights we could, and then developed a risk abatement strategy to address rights that could not be cleared. Assignments and indemnifications were drafted to address the gaps and risks, some of which the agency and the related network refused to sign. While the client was able to abate most of the risks through limiting the use of the creative, the campaign did not achieve its commercial objectives and the director of marketing did not remain in his position with the client. Prior due diligence and proactive searching and clearance could have completely eliminated these problems for the client.

Moreover, by going through the correct due-diligence review, it may be discovered that the true value of the transaction may not be in the form of a patent, copyright or trademark at all, but rather some innovation that is as yet unprotected, or intellectual property in the form of a developed trade secret. Accordingly, any intellectual property due diligence needs to examine all actual and potential forms of intellectual property in any possible country or jurisdiction.

The following steps reflect best practices and would be appropriate for public or private companies:

1. Ascertain the scope of the intellectual property assets, the subject of the potential transaction and their potential categories for legal protection, patent, trade secret, etc. applicable for each country at issue.
2. Ascertain how they came to be assets, by internal creation by employees, external creation by the target, acquisition, license, joint-development or otherwise, and ascertain all inventors/creators of the same by name, status and legal entity as well as dates and locations of creation.
3. Ascertain the contract for each asset that assigned or provided the rights to the target; i.e., employment agreements with no shop rights clauses and non-competes with employees, work for hire and assignment provisions for the Target, clear transfer of title for acquisitions, etc. and review the same to determine what contractual rights the target may have to the intellectual property assets at issue.
4. For those intellectual property assets that still appear to be potentially owned by the target after evaluating the above information, conduct a title search of all registerable intellectual property such as patents, copyrights, domain names, mask works, and trademarks with the respective government offices in each country where the assets are registered, looking not only for complete chains of title on the record but also registered encumbrances and financial

-
- liens (in the United States, also conduct a UCC1 search in each state where the target is doing business for encumbered intellectual property), and request from the target any financing documents that may include an encumbrance on the intellectual property at issue.
5. Compare the results of the search with the target's business operations to determine if the intellectual property assets being offered for sale address the actual business operations of the target in each country of operation (i.e., Do the intellectual property registrations and their scope reflect where and how business is actually being done?).
 6. Compare the technology of the target with the patents and patent claims issued to cover it, and determine if the patents address an aspect of the technology which provides a comparative advantage in the market or if the value of the technology lies outside of the patent protection (i.e., trade secret, copyright, etc.).
 7. For any registered intellectual property deemed valuable, conduct a review of the file wrappers for the prosecution of the registered intellectual property to determine if the prosecution appears correct at the requisite government office, and that there is sufficient evidence in the record, or available, to support all claims made in the prosecution.
 8. Request and review any prior opinions of counsel provided to the target regarding any intellectual property or any searches of any intellectual property that was made.
 9. Request and review any demand letters or litigation sent, initiated by, received or responded to by the target relating to any intellectual property.
 10. Ascertain what, if any, policing or enforcement systems are in place or were conducted regarding any intellectual property of the target in any country where the target does business.
 11. For those assets determined to be of critical value, either request an opinion from the target's counsel addressing the validity of the patent or trademark in question (and this will need to be done on a country-by-country basis with counsel for each country) or retain counsel to render an opinion regarding the validity of the patent or trademark in question.
 12. An alternative to having the activities conducted in no. 11 above, and relying upon such representations, is to conduct searches to determine the validity of the intellectual property without reference to the target or requiring an opinion, but rather a fact gathering and risk assessment process internally. This does not afford legal protection and may create risk through knowledge if the transaction proceeds and you are aware of potential infringement by the target, and create laches issues if you become aware of third party infringers of the target's intellectual property and decide not to act promptly post-acquisition, but it may provide critical information that would halt the transaction proceeding.
 13. For patents and trademarks that are determined to be of critical value, conduct searches to determine if the scope of protection afforded by the registered intellectual property will allow them to be commercially useful to expand into the areas in commerce contemplated post-acquisition, both on a country-by-country basis, and regarding the subject matter of the protection (i.e., Will the scope of the registered protection cover the existing and anticipated uses?).
 14. Craft language in the acquisition document to address the issues found above and ensure that any representations made by the target or their counsel in the above process are reflected in the final documents as material.

The above processes can be undertaken mainly with in-house resources, or in conjunction with outside assistance and members of both the legal department and the client team at issue. Outside counsel costs and internal costs and time can be closely managed if the process is properly undertaken in the order outlined. By following the above steps in order, the critical problems around most intellectual property based transactions will be identified early in the due diligence process. Thus, resources are not wasted and risks can be minimized in the process.

Early in my career, I was tasked with “finding out what wasn’t there” in an IP-heavy multi-national acquisition where our client was the potential buyer. After laboring for several days to try to understand what was needed, I ventured out of the conference room and sheepishly asked the general counsel exactly what he wanted again. He sighed and said, “Compare a list of the countries where the target company is doing business with a list of the registered intellectual property they have in each such country. Then make a note of any places where they do not have registrations for intellectual property that they are using in their business.”

Emboldened, I returned to my task with gusto even though the Internet did not exist at the time. After two weeks of very long days, I emerged triumphantly with a list that showed those countries where the target company had business operations or sales but limited or zero registered intellectual property protection. My general counsel took the list, read through it quickly, and said, “Good, we will now lower the offering price by \$25 million because the target has not secured its key assets in many of its major global markets. While this gap creates risks for our client, we have the opportunity to reduce the deal price. Now go figure out how to fill those gaps and come up with a process, timeline, risk analysis and approximate budget.”

I set to work again and came back with the data requested along with a figure of several hundred thousand dollars to complete it. The deal closed at a substantial discount, larger than \$25 million, and we immediately set to work closing the gaps in intellectual property protection identified. The general counsel understood intellectual property processes, value and negotiation strategy. Our client was the beneficiary on the deal and I learned these foundation concepts that have been with me for my legal career.

The typical acquisition agreement has broad representations and warranties for intellectual property. We have set forth below portions of the suggested language from the American Bar Association’s Model Asset Purchase Agreement:

- (a) The term “Intellectual Property Assets” means all intellectual property owned or licensed (as licensor or licensee) by Seller in which Seller has a proprietary interest, including:
 - (i) Seller’s name, all assumed fictional business names, trade names, registered and unregistered trademarks, service marks and applications (collectively, “Marks”);
 - (ii) all patents, patent applications and inventions and discoveries that may be patentable (collectively, “Patents”);
 - (iii) all registered and unregistered copyrights in both published works and unpublished works (collectively, “Copyrights”);
 - (iv) all rights in mask works;
 - (v) all know-how, trade secrets, confidential or proprietary information, customer lists, Software, technical information, data, process technology, plans, drawings and blue prints (collectively, “Trade Secrets”); and

(vi) all rights in internet web sites and internet domain names presently used by Seller (collectively "Net Names").

(b) Part 3.25(b) contains a complete and accurate list and summary description, including any royalties paid or received by Seller, and Seller has delivered to Buyer accurate and complete copies, of all Seller Contracts relating to the Intellectual Property Assets, except for any license implied by the sale of a product and perpetual, paid-up licenses for commonly available Software programs with a value of less than \$_____ under which Seller is the licensee. There are no outstanding and, to Seller's Knowledge, no threatened disputes or disagreements with respect to any such Contract.

(c)(i) Except as set forth in Part 3.25(c), the Intellectual Property Assets are all those necessary for the operation of Seller's business as it is currently conducted. Seller is the owner or licensee of all right, title and interest in and to each of the Intellectual Property Assets, free and clear of all Encumbrances, and has the right to use without payment to a Third Party all of the Intellectual Property Assets, other than in respect of licenses listed in Part 3.25(c).

(ii) Except as set forth in Part 3.25(c), all former and current employees of Seller have executed written Contracts with Seller that assign to Seller all rights to any inventions, improvements, discoveries or information relating to the business of Seller.

(d)(i) Part 3.25(d) contains a complete and accurate list and summary description of all Patents.

(ii) All of the issued Patents are currently in compliance with formal legal requirements (including payment of filing, examination and maintenance fees and proofs of working or use), are valid and enforceable, and are not subject to any maintenance fees or taxes or actions falling due within ninety (90) days after the Closing Date.

(iii) No Patent has been or is now involved in any interference, reissue, reexamination, or opposition Proceeding. To Seller's Knowledge, there is no potentially interfering patent or patent application of any Third Party.

(iv) Except as set forth in Part 3.25 (d), (A) no Patent is infringed or, to Seller's Knowledge, has been challenged or threatened in any way and (B) none of the products manufactured or sold, nor any process or know-how used, by Seller infringes or is alleged to infringe any patent or other proprietary right of any other Person.

(v) All products made, used or sold under the Patents have been marked with the proper patent notice.

(e)(i) Part 3.25(e) contains a complete and accurate list and summary description of all Marks.

(ii) All Marks have been registered with the United States Patent and Trademark Office, are currently in compliance with all formal Legal Requirements (including the timely post-registration filing of affidavits of use and incontestability and renewal applications), are valid and enforceable and are not subject to any maintenance fees or taxes or actions falling due within ninety (90) days after the Closing Date.

(iii) No Mark has been or is now involved in any opposition, invalidation or cancellation Proceeding and, to Seller's Knowledge, no such action is threatened with respect to any of the Marks.

(iv) To Seller's Knowledge, there is no potentially interfering trademark or trademark application of any other Person.

(v) No Mark is infringed or, to Seller's Knowledge, has been challenged or threatened in any way. None of the Marks used by Seller infringes or is alleged to infringe any trade name, trademark or service mark of any other Person.

(vi) All products and materials containing a Mark bear the proper federal registration notice where permitted by law.

(f)(i) Part 3.25(f) contains a complete and accurate list and summary description of all Copyrights.

(ii) All of the registered Copyrights are currently in compliance with formal Legal Requirements, are valid and enforceable, and are not subject to any maintenance fees or taxes or actions falling due within ninety (90) days after the date of Closing.

(iii) No Copyright is infringed or, to Seller's Knowledge, has been challenged or threatened in any way. None of the subject matter of any of the Copyrights infringes or is alleged to infringe any copyright of any Third Party or is a derivative work based upon the work of any other Person.

(iv) All works encompassed by the Copyrights have been marked with the proper copyright notice.

(g)(i) With respect to each Trade Secret, the documentation relating to such Trade Secret is current, accurate and sufficient in detail and content to identify and explain it and to allow its full and proper use without reliance on the knowledge or memory of any individual.

(ii) Seller has taken all reasonable precautions to protect the secrecy, confidentiality and value of all Trade Secrets (including the enforcement by Seller of a policy requiring each employee or contractor to execute proprietary information and confidentiality agreements substantially in Seller's standard form, and all current and former employees and contractors of Seller have executed such an agreement).

(iii) Seller has good title to and an absolute right to use the Trade Secrets. The Trade Secrets are not part of the public knowledge or literature and, to Seller's Knowledge, have not been used, divulged or appropriated either for the benefit of any Person (other than Seller) or to the detriment of Seller. No Trade Secret is subject to any adverse claim or has been challenged or threatened in any way or infringes any intellectual property right of any other Person.

(h)(i) Part 3.25(h) contains a complete and accurate list and summary description of all Net Names.

(ii) All Net Names have been registered in the name of Seller and are in compliance with all formal Legal Requirements.

(iii) No Net Name has been or is now involved in any dispute, opposition, invalidation or cancellation Proceeding and, to Seller's Knowledge, no such action is threatened with respect to any Net Name.

(iv) To Seller's Knowledge, there is no domain name application pending of any other person which would or would potentially interfere with or infringe any Net Name.

(v) No Net Name is infringed or, to Seller's Knowledge, has been challenged, interfered with or threatened in any way. No Net Name infringes, interferes with or is alleged to interfere with or infringe the trademark, copyright or domain name of any other Person.

These representations and warranties are asking the target to specifically identify the intellectual property being purchased. You can then verify the target's information by using the approach this article suggests. You should also confirm whether the target has insurance to protect itself in the event of infringement. Proper due diligence (plus insurance as a backup) is the only way to protect your client from known and unknown problems.

Conclusion

Due diligence involving intellectual property is not merely a technical legal process. As a best practice, it is integrated completely into your client's business processes and analysis. Once integrated, one of the client's most valuable assets can then be protected and preserved.

[Sean Collin](#)

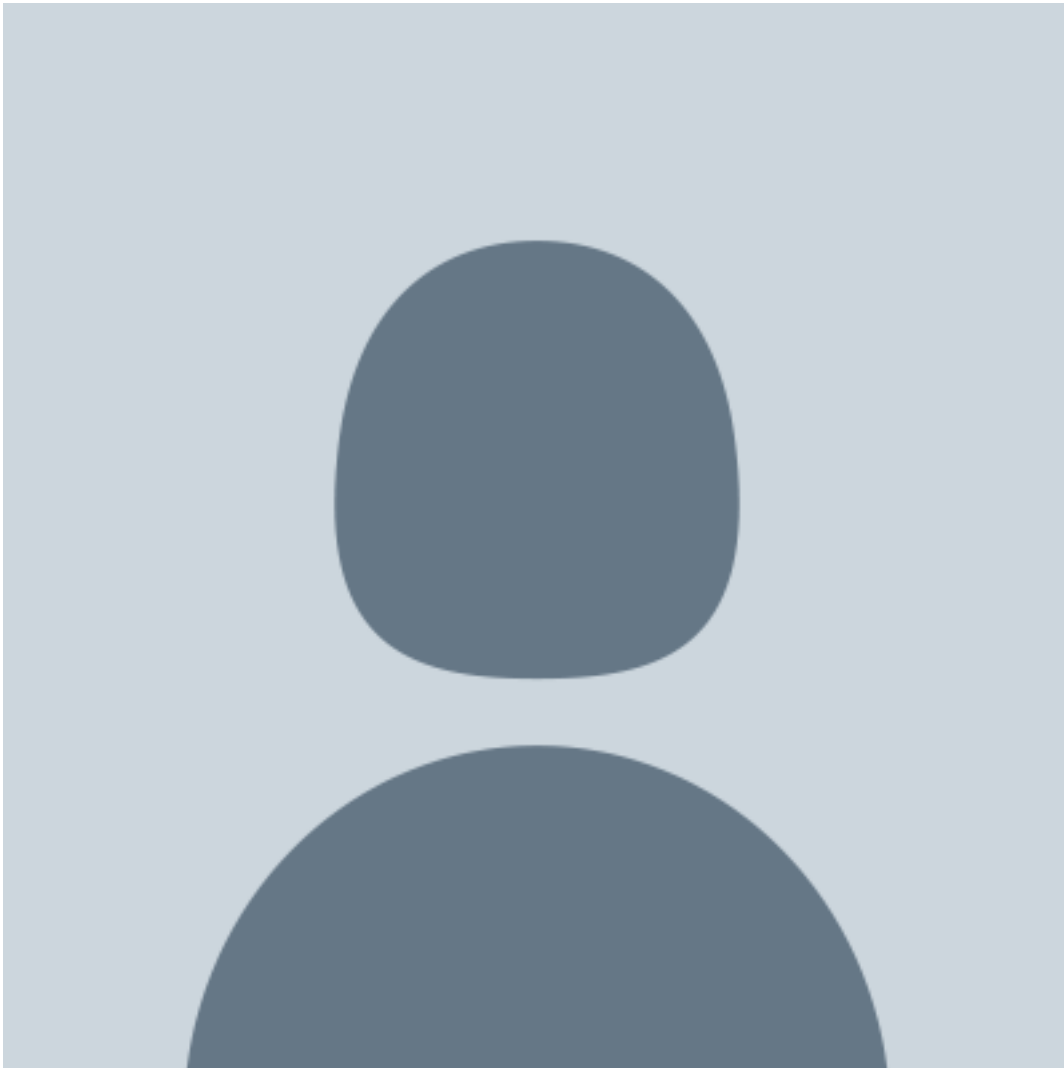


Founder and CEO

IPWatch Systems Corporation

Sean Collin is the founder and CEO of IPWatch Systems Corporation.

[Conrad C. Pitts](#)



Chairman and General Counsel

IPWatch Systems

IPWatch Systems is an SAAS software solutions provider to the legal and intellectual property industries. Prior to accepting this position he has worked for the last three decades in national and global M&A as counsel.

