

THE DAILY RECORD

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IP FRONTIERS

Introduction to IP due diligence

Are you buying or selling a patent, deciding whether to invest in a start-up technology company or contemplating entering into a license arrangement with another company?

If so, you likely will be subject to an IP due diligence investigation, generally performed to scrutinize the assets that are the target of a proposed transaction.

What is involved from both a buyer's perspective? The seller's?

The purchase

Buyers engage in IP due diligence investigations simply to ensure they actually will be getting what they pay for. Usually this is accomplished by closely examining all aspects of the subject intellectual property. Specifically, details of the target trademarks, copyrights, trade secrets and patents must be examined. Doing so also enables a buyer to gain unique insight via the IP as to the inherent value of the research and development activities of the target company, including what technology is in development and past protection strategies. Both are extremely helpful to establishing the appropriate value of the transaction.

Due diligence investigations also are very useful in identifying and exposing overvalued intellectual property assets. A target company may value certain proprietary software at a high amount, for instance, yet upon further review, a buyer may learn that no patent applications were filed, or the software was not registered with the U.S. Copyright Office. Such actions — or lack thereof — on the part of the seller likely will decrease an asset's value significantly due to the lack of protection and enforceability without a patent and/or copyright registration.

The ability to assess the risk of the IP assets is another key reason for a buyer to perform a due diligence investigation. Many potential risks pertaining to the target IP portfolio should be reviewed, including:

- whether patents actually cover the products or technology that they are supposed to;
- whether the patents or trademarks are valid and enforceable; and,
- whether the seller actually owns or has the ability to transfer the IP in its portfolio.

Another risk that may be identified and assessed during an investigation is the existence of ongoing or threatened litigation involving the target IP. Litigation involving intellectual property is extremely

costly and may span several disciplines, including infringement and validity actions, antitrust and employment matters. Buying into a lawsuit could negate the entire value of the transaction.

Buyers should initiate an IP due diligence investigation as soon as possible to determine accurately the true value of the transaction and obtain critical supplemental information to allow them to investigate other, associated risks. What specific tasks should be performed during an investigation are likely to vary depending on the type of assets being purchased, the allocated investigation budget and the time by which the investigation must be completed.

If a buyer's primary goal is to purchase or to be able to sell the target company's products, then the investigation likely will focus on a freedom-to-operate or clearance review to determine whether a third party's patents may impact or even prohibit the buyer from being able to make, use or sell the products.

If the transaction focuses on the target company's intellectual property assets — which may include issued patents, pending applications and registered trademarks and copyrights — a different type of search and review typically is used in order to determine the overall strength and enforceability of the assets. This can be accomplished by examining previously issued patents

and trademarks to determine the scope of their protections, as well as the extent of the descriptions of goods for trademarks.

The claims of the seller's key patents should be examined in detail to determine whether they are valid and enforceable given the prior art patents found in the search, and to confirm that they actually cover the associated products included in the purchase.

Buyers also should confirm that a seller actually owns or has the authority to transfer the titles of the IP assets. It is important to identify the inventors and/or creators of the work and to ensure proper assignments have been signed and recorded. In addition, any inventor or target company obligations involving the IP to third parties through a pre-existing license arrangement, research, merger and acquisition or joint venture agreement must be reviewed. Every buyer wants to avoid the trap of purchasing an IP asset only to discover later that the seller did not have the right to sell, or that someone else — such as a secured creditor or lienholder — actually owns it.

The sale

On the seller's side of the transaction, a whole new perspective emerges.



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Sellers or targets of due diligence investigations have one goal: Increase the value of the IP portfolio. How that is achieved usually depends on how organized the seller and the target IP portfolio is.

A good first step is for the seller to have all of their intellectual property assets broken out into categories — patents, trademarks, copyrights and trade secrets. Next, a seller must demonstrate (for each category) the corporate filing and protection policies, portfolio enforcement strategies and ownership determination protocols used. Sellers are well advised to establish and consistently follow guidelines and policies that address the distinct nuances of the categories listed.

In addition to organizing and breaking down a portfolio, sellers also may build value by having all corresponding administrative documents aligned and available for review. Sellers should carefully segregate the documents into attorney-client privileged and non-privileged materials. It also is critical that sellers have a binding and comprehensive non-disclosure agreement in place before any documents are exchanged with a potential buyer, which will provide sufficient protection in the event that a transaction never materializes.

All documents requested by a buyer should be reviewed carefully before they are turned over. The freedom-to-operate or clearance opinions regarding the target products are almost uniformly requested and provide credible value to a portfolio. Special care must be taken not to inadvertently waive any attached privilege to those valuable opinions by freely handing over documents or discussing attorney advice contained in an opinion.

Sellers must take extra precautions to protect the integrity of opinion documents, and should not share their conclusions, but also should be able to explain to a buyer that the examined products are clear of any infringement dangers.

A buyer most likely will want to evaluate the scope, validity and enforceability of the seller's key patents. The best protocol is to have all corresponding file histories as well as relevant internal research and development records available for review.

In special circumstances, a sellers may want to make the inventors available for controlled in-person interviews with buyers. Sellers should have all records concerning payment of patent maintenance fees and trademark renewal fees available, along with any documents related to foreign patent and trademark filings in a way that will allow a buyer to evaluate quickly where and when foreign patents and trademarks were filed and/or issued.

Sellers make available all up-to-date documentation relating to IP asset ownership, with copies of all corresponding assignments for inventors, authors and creators. Any related employment and independent contractor agreements that disclose the ownership obligations of the target intellectual property should be made available as well.

Finally, sellers should be aware of the need to demonstrate the status of any related litigation or post-grant challenges regarding the target assets. Sellers who can show conclusively that a portfolio's assets never have been challenged — or have weathered challenges intact — can bring instant peace of mind to a buyer, and possibly increase significantly the value to the buyer.

The key for any seller going through an IP due diligence investigation is keeping the portfolio and all supporting documentation up to date and organized in way that will facilitate the process and address any and all questions from buyers adequately.

If one is ever involved in a major business transaction, licensing arrangement or investment, then it is highly likely that they also will be engaged in a due diligence investigation. On both sides of the table, the ultimate goal is to establish the fair market price for an IP portfolio and mitigate risk. Buyers and sellers both must remember that getting there may be difficult, so care must be taken to ensure that time and capital are allocated adequately, to ensure the most comprehensive investigation possible.

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