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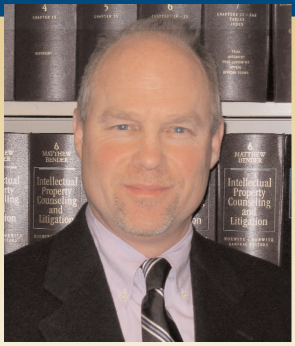

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What to Do When You are the Target of an Intellectual Property Due Diligence Investigation

The Spring 2009 issue of *BONEZONE* included an article entitled *"The Why, When and What of Intellectual Property Due Diligence Investigations"* that was written from the perspective of what a buyer, investor or licensee of technology should understand about intellectual property due diligence investigation. Like everything else in this world, there are always two sides to every story—and to every transaction. This article will look at an intellectual property due diligence investigation from the other side of the table: the seller's perspective, and what steps the seller or target entity can take to build value in their target intellectual property assets.

When one becomes a target of a due diligence investigation, the specifics of the proposed deal need to be fully understood. The seller needs to understand first what intellectual property is the focal point of the deal and second, how the proposed transaction is structured (i.e., an outright sale, license to use, equity investment). After these two initial questions are answered, the seller is in a better position to present a portfolio in the best light to the buyer to achieve the primary goal, which is maximized purchase price.

One of the most important steps a seller can take is the same one that every company that holds valuable intellectual property should take as a regular course of business, which is to organize their intellectual property portfolio in a manner that illustrates that the company has a prudent intellectual property protection and procurement strategy in place. This can be accomplished by first organizing the intellectual property into the various IP categories and then treating/protecting them accordingly.

For instance, for all existing trademarks, demonstrate that each trademark is routinely monitored to ensure that it is consistently being used in commerce with the corresponding goods/services, and that all renewal dates and other appropriate United States Patent and Trademark Office (USPTO) filings are properly calendared to avoid any inadvertent lapses that may lead to a trademark being cancelled or challenged. Further, a written trademark use policy should be in place to ensure company-wide compliance with the proper usage of the trademark when selling the related goods/services.

For copyrights, the seller should be able to show that the company has a policy in place to mark all works of authorship with the proper notation subsequent to when the work has been created. In addition, for each employment relationship, the company should have in place documents that clearly spell out that any works created during or at the direction of the company are works-made-for-hire and, therefore, are the property of the company. Further, the seller should have in place a policy for when and what creative works are registered with the United States Copyright Office. Having the seller's most important piece of literature or software program registered will be critical to maintaining the value in that work because of the eligibility for statutory damages and federal court jurisdiction in the event the work is ever infringed post-sale.

As for patents, the seller is best served by being able to show that a well-devised filing strategy was and is in place, and that inventions are adequately reviewed and evaluated before any filings take place. This may include a policy of procuring patentability and freedom to operate opinions from outside counsel. However, the seller can also build incredible value in their patent portfolio by being able to show a definitive filing strategy that focuses on certain product families or alternately, technology subject matter. This means that the seller should be in a position to show the buyer for either product families or technology families when parent patent applications were filed, what was the continuation and foreign filing strategy, how it is being carried out and how new invention developments will be addressed while adhering to the overall filing strategy.

Additionally, to further demonstrate value in one's patent portfolio, the seller should have in place policies that address

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how issued patents are policed and enforced. The seller should also be able to produce, if requested, the company's mandate for consistently marking all protected products with any relevant patent numbers or patent pending designations in order to preserve all available legal remedies.

Finally, the last IP category for which the seller must be in a position to demonstrate a set protection strategy relates to the company's trade secrets. Trade secrets are much different than any of the above discussed intellectual property categories, because these items/processes/formulas gain their economic value by being kept secret. The seller must use their best efforts to not disclose any trade secret to a prospective buyer before a memorandum of understanding and confidentiality or non-disclosure agreement (NDA) are in place. If such a trade secret is not home-grown and is licensed from a third party, then the seller will likely need to take an additional step to obtain permission from the licensor before any disclosure occurs, even with these two agreements in place. As trade secret protection is really the jurisdiction of individual states, it is difficult to provide uniform guidance on how best to show the buyer that the trade secret is really a protected trade secret. Generally, the seller should have in place several policies and procedures that evidence consistent steps that have been taken to keep the subject matter secret. Examples of these may include having all employees sign confidentiality agreements, storing the trade secret in a secure location, limiting access of company personnel to the trade secret, keeping the trade secret behind locked doors or in a secure building, and providing annual training on trade secrets to the employees.

Along with having its intellectual property portfolio organized, the seller can also build value in the transaction by having all associated documents aligned and available for review, if requested. The seller should have administrative materials segregated into two categories: confidential attorney/client privileged materials or attorney/work products, and non-privileged and non-confidential materials. Further, depending upon the number of buyers, the seller must determine early in the process what documents they want to make available and what need to be held back, mainly so as to not waive any attached privilege or confidential standing. This process is very delicate, as the seller does not want to give the impression that information is being hidden or withheld from the buyer.

At the point that the seller is fully aware of what intellectual property is the subject of the transaction, and the form of the transaction, the seller and buyer should immediately enter into a Mutual Confidentiality Agreement or NDA that provides for a definitive time period for the exchange of information. In addition to the NDA, it is advisable that a Memorandum of Understanding (MOU) or a non-binding term sheet be negotiated. The MOU will usually spell out specific details of the deal structure and provide preliminary financial terms, including earnout payments and royalty schedules for the seller to evaluate. Following the completion and signing of these two documents, the seller is now in the position to more fully disclose and allow the intellectual property portfolio to undergo a thorough due diligence investigation.

Focusing initially on the patent portion of the portfolio, the seller should be prepared to discuss with the buyer, whether any patentability or freedom-to-operate evaluations or opinions have been undertaken. In addition to having such related opinions, it would be wise for the seller to also have an excellent knowledge base on the competitive landscape of their products and technology and be able to communicate this expertise to the buyer. In this regard, the seller should have previously performed a complete comparison of its products to the competition and identified any problem areas that may be raised by the buyer, with corresponding solutions if necessary. The seller must be very careful as to the extent of discussing technical details and conclusions contained in any corresponding attorney-generated written patentability or freedom-to-operate opinions in order to avoid waiving any attorney/client privilege.

The seller should take great care in trying to avoid any inadvertent waiver of the attorney/client privilege, as it relates to not only these written opinions, but also other intellectual property portfolio-related communications between the seller and attorneys. Unfortunately, the law regarding waiver and its avoidance when participating in due diligence investigations is not entirely clear and, further, is inconsistent from court to court. An exception to such a waiver does exist if the seller and the buyer share a "common legal interest." This exception is also referred to as the "Common Interest Doctrine." Most courts require that the interest in common be a "legal" (i.e., defending a lawsuit) rather than a commercial one (i.e., purchase and sale of assets), in order to trigger the doctrine. As a preliminary matter, before the seller decides to turn over any privileged materials, research on how local courts have interpreted the "Common Interest Doctrine" should be performed. The courts may have a very restrictive or expansive view of the doctrine, which should then dictate what and how the contents of the privileged documents are shared.

Sellers may protect themselves from waiving any attorney/client privilege by taking a gradual approach to disclosing information, only providing public, non-privileged

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data such as the prior art reviewed in preparation of any of the desired opinions. This would allow the buyer's attorney to review the prior art and formulate his own conclusions without having to look at the seller's attorneys' work product. A further suggestion would be to agree to disclose, post-closing, the privileged documents and provide for some representation and warranty within the transactional documents, that allow for some remedy in the event the buyer discovers in these opinions—information that materially impacts the value of the deal. Additionally, a common interest agreement could be entered into between the buyer and seller that clearly recites the common legal interest, the privileged information that is to be shared, a specific time frame for reviewing the information, who will review the information and the mandatory return of all shared information. It should be emphasized that this common interest agreement does not replace or supersede the previously signed NDA, but only supplements it in the attempt by the seller to not waive the attorney/client privilege when sharing confidential and privileged documents. Please understand that even entering into such an agreement will not guarantee non-wavier of any cloak of privilege as this determination will ultimately rest with the court, if challenged.

The buyer in performing due diligence will likely want to evaluate the scope, validity and enforceability of the issued patents and pending applications. The seller can best prepare for such requests by having any file histories available as well as internal records, including lab books and other research and development materials. Additionally, to avoid failure to disclose challenges, it is prudent for the seller to have available copies of all Information Disclosure Certifications that have been filed with the USPTO for issued patents and pending patent applications as well as proof that all maintenance fees and annuities have been kept current for all issued patents. Please also note, the seller should be prepared to provide proof that the appropriate continued use affidavits and renewal fees are up-to-date for any existing trademarks. All documents relating to foreign filings of patents should also be available and provided in a manner that allows the buyer to easily track in what countries applications have been filed or patents issued in, and whether any pending PCT applications that have not entered the national stage exist. Further, the seller should be prepared if the buyer wants to conduct in-person interviews with the inventors of key technology to investigate issues surrounding patentability or validity of key patents. With regards to other categories of intellectual property, including trademarks and copyrights, the seller should have available for review the corresponding prosecution file histories for the trademarks and registration applications with deposit materials for any copyrights that may be the subject of the due diligence investigation.

The seller is well advised to have all documentation relating to intellectual property ownership updated. There have been many deals scuttled when a buyer has discovered that all ownership rights do not reside with the seller. The seller should be prepared to provide copies of all assignments between the inventors, authors or creators and the selling company. Documents evidencing the recordation of these assignments should also be available for review. Special care must be taken with any foreign-based inventions or intellectual property first filed abroad, as the ownership determination is different from that of the U.S. Most foreign inventions immediately become the property of the employee's company as a matter of law, wherein for the U.S., initially title always rests with the inventor.

Employment and independent contractor agreements that detail who owns the intellectual property created during the terms of such agreements should be available for review. Focus must be paid as to whether the employee or contractor has been retained on a work-for-hire basis or actually retains ownership interest. It is advisable for the seller to take precautions and redact any non-deal related information, including compensation terms, from any agreements before allowing the buyer to review so as to protect the privacy of the subject employees and contractors. In the event any of the intellectual property that is part of the portfolio has been licensed from a third party (including a university), then great care needs to be taken to ensure that the seller actually has the rights to sublicense or retain any new inventive developments that have evolved from the licensed technology. Close attention should also be paid to ensure that the seller has not exclusively licensed key technology out of the portfolio that may impact the overall value to the deal. Again, the seller will need to redact non-essential information, including financial terms, from any reviewed license agreements. Lastly, the seller must be able to document to the buyer any continuing obligations resulting from outside funding, including federal government grants that may negatively impact the seller's ownership rights and ability to transfer title or license the IP.

Several other types of documents and information that the seller needs to be conscious of that may impact the value of the intellectual property portfolio include any IP related litigation filings or post-issuance challenges within the USPTO. Such challenges may take the form of reexamination requests or interference proceedings for patents, and cancellation proceedings for trademarks. The seller need not only be prepared to discuss any pending litigation proceedings (i.e., infringement lawsuits), but also any sent or received cease and desist letters relating to patent, trademark or copyright usage. In the event the target intellectual property relates to technology that is subject to governmental oversight, any documents relating to the agency approval, disapproval or corresponding validation/clinical studies should be ready for examination. These documents may include FDA 510(k) or PMMA filings and/or European CE Mark applications. Any documents relating to liens, UCC filings or recorded security interests that encumber the target intellectual property assets must also be made available for inspection.

Finally, the seller may consider providing to the buyer certain in-house policies that are in place that could aid in demonstrating enhanced intrinsic value of the intellectual property portfolio. Such policies may relate to inventor publication rights, record retention, lab book requirements, R&D invention disclosure requirements and trade secret protection procedures.

In conclusion, the target of an intellectual property due diligence investigation is best served when their portfolio and all supporting documentation are up to date and in good order. The seller, in order to speed the review process, may be tempted to just openly provide all requested materials without a proper NDA and other legal protection in place. Such action must be avoided at all costs as this could significantly impact the value of the transaction as well as the seller's ability to continue to operate the business in the future, should the deal not come to fruition.

As always, the readers of this article are reminded that the information provided within is not intended to be interpreted as legal advice. The contents of this article are only being provided to educate and assist the reader in various aspects of intellectual property due diligence investigations.

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