



IP Licensing Due Diligence That Creates Value
APEC Trading Ideas 2009

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This presentation is merely educational and does not constitute legal advice, and is not a substitute for consultation with professionals to get advice tailored to particular situations. This program focuses on U.S. laws and principles, which are likely to be different elsewhere.

INTELLECTUAL PROPERTY GROUP

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What is "Due Diligence"?

- Detailed investigation of acquisition / investment Target
- Covers key business and operations
- Team approach – across disciplines
 - Business
 - Financial
 - Technical
 - Legal
 - Corporate
 - IP
 - Employment/HR
 - Litigation
 - Tax

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Why "Due Diligence"?

- To aid in:
 - Determining the advisability of the transaction
 - Minimizing the risk of exposure for the target client
 - Formulating a proposal for the transaction
 - Structuring, negotiating and drafting representations and warranties that do not expose the client to risks and exposure identified during the process
- Determining if closing conditions can/will be met

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Reasons for Due Diligence

- Assess desirability of acquisition
 - Validate assumptions about Target strengths and weaknesses
 - Identify liabilities and potential liabilities
- Determine / confirm / adjust valuation
 - Establish reserves, charges and write-downs to be reflected on Target's closing balance sheet
- Use input to structure deal terms
 - Identify assets and liabilities that may be acquired
 - Representations & warranties and Target Disclosure Schedule
 - Pre- and post-closing covenants
 - Obligations to close

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Reasons for Due Diligence (cont'd)

- Risk allocation
 - Ensure adequate escrow to cover foreseeable claims
 - Define indemnity obligations
- Identify obstacles to the deal
 - Third-party consents
 - Intellectual Property infringement, etc.
- Determine measures to be taken in pre-closing planning and post-closing integration
 - Identify agreements to be amended or terminated
 - Identify bar dates for the filing of patent applications and the due dates for payment of patent maintenance and annuity fees
 - Assist in transition of target contracts to Acquiror legal team

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First Steps

- Legal Due Diligence Request List
- Business Due Diligence Request List
- IP Diligence Questionnaire

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Limitations on Due Diligence Review

- Review of available documents
 - Includes executed agreements
 - Target may resist creating due diligence – for example Acquiror not be able to obtain a comprehensive mapping of licensed Intellectual Property to Target products if such a summary does not already exist
- Interviews limited to Target personnel who are “over the wall”
- Due diligence review may be limited by fixed time frame

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IP Diligence

Identify the Key IP Assets of the Business and Focus On the Following Questions

- What Rights Does Target Have? [Inbound]
 - Ownership vs. License
- How Has It Been Exploited? [Outbound]
 - Customer, channel agreements
- How Has It Been Protected? [Protection]
 - Patent, copyright, trademark, trade secret protection
- Are There Risks To Value? [Risks]
 - Liens, litigation, clouds on title, questions of validity, non-transferability

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IP Diligence

- IP Questionnaires
 - Confirm IP chain of title
 - Use of third party / open source technology
- Interviews of Key Personnel
 - IP interviews help confirm chain of title
 - Confirms we receive consistent answers
- Physical Review of Items Embodying IP
 - Review of source code (trade secret issue)
 - Obtain and study allegedly infringing Target products

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IP Diligence - Inbound

- Identify Target core IP
 - Briefing from Acquiror business and technical teams
 - Target responses to the IP Questionnaire
- Identify all contributors to core Target IP
 - Employees, Consultants, Acquisitions, Joint Development, Inbound Licenses (including Open Source licenses), Patent Licenses or Cross-Licenses
- Identify what is owned vs. licensed
- Ensure license rights are adequate for Target's business as presently conducted and as proposed to be conducted by Acquiror
 - Discuss Acquiror plans for business with Acquiror business development team
- Patent Licenses
 - Will Target licenses cover Acquiror?
 - Will Acquiror licenses cover Target?

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IP Diligence - Outbound

- Identify all outbound agreements and rights granted and identify
 - Exclusive rights granted
 - Unfavorable terms
 - Other provisions inconsistent with Acquiror's standard models and practices
- Identify all obligations to be assumed by Acquiror and determine if any are inconsistent with Acquiror's plans for the business.
- Prioritize review of material agreements with input from business and financial teams
- Determine whether any Acquiror IP will be encumbered by Target agreements
 - Acquiror patent portfolio caught by cross-license?
- Source Code
 - Identify license rights granted by Target
 - Review source code escrow release triggers

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Contracts

- Review material contracts
- Is Target in default?
- Determine scope of Target's rights
- Determine scope of Target commitments & liabilities and any restrictions on Target's business
- "Most favored customer" clauses
- Exclusivity terms / Fields or scope of use for key rights
- Remaining term of key contracts
- Customer support obligations
- Is contract assignable?
 - Does transaction constitute an assignment?
 - Different assignment rules for IP licenses

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IP - Diligence - Protection

- Employment Agreements
 - Ensure proper Assignment of all types of IP
- Patents / Patent Applications
 - Is portfolio appropriate for company of age, size and technical scope of Target in terms of the number and type of patents?
 - Do patents appear competently prosecuted?
 - Any upcoming bar dates near Closing?
 - Patent marking issues?
 - USPTO and UCC searches for assignments, liens, and the like
 - Are all inventor assignments in place?

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IP - Diligence – Protection - (cont'd)

- Copyright Registrations
 - Protects the expression, not the idea
 - Original works of authorship fixed in any tangible means of expression
 - Illustrative and not all-inclusive works of authorship include:
 - literary works, musical works (including any accompanying words; dramatic works (including any accompanying music); pantomimes and choreographic works; pictorial, graphic, and sculptural works; motion pictures and other audiovisual works; and sound recordings
 - Evaluate all work-for-hire agreements and contracts relating to consulting services and development work

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IP - Diligence – Protection - (cont'd)

- Trademark Registrations
 - A “trademark” is any word, name, symbol, device or combination thereof used by a manufacturer or merchant to identify its goods and distinguish them from goods made or sold by others. When used to identify services, it is a “service mark”
 - Currently, trademark rights arise only from actual use of a mark in connection with the sale of a product or service
 - Review all trademark licenses, not only through trademark license agreements but also through all other types of agreements that included trademark licenses, including for example, co-branding agreements and marketing and distribution agreements

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IP - Diligence – Protection - (cont'd)

■ Trade Names

- A “trade name” is the name used by a person or company in doing business. It is the company name and may or may not be the same as a trademark or service mark. If the company name is presented to the public, as most are, it symbolizes goodwill of the business and has value and may be protected
- Unlike trademarks, trade names are not federally registrable, but they may be protected by actions for unfair competition

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IP - Diligence – Protection - (cont'd)

■ Trade Secret Protection

- Technical and commercial information and know-how often may be protected as “trade secrets”
- Trade secrets may be protected against misappropriation indefinitely provided the information remains “secret.” Although absolute secrecy is not required, the company possessing trade secrets should take precautions to avoid unwarranted disclosure
- Use of NDAs by Target
- Prior disclosures of key trade secrets (*e.g.*, source code) by Target
- Any use of trade secrets of prior employer?

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IP - Diligence – Protection - (cont'd)

- Trade Secret Protection (cont'd)
 - Review and evaluate all relevant agreements including know-how licenses and technical assistance agreements

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IP Diligence Risks

- Litigation review
 - Review notices of claims / potential claims & related correspondence
 - Review infringement notices / offers to license IP & related correspondence
 - Review pleadings and briefs
 - Review insurance correspondence
 - Interview Target's litigation counsel
- Likelihood and amount of exposure
- Importance to Target's business
- Costs of prosecution/settling case
- Is litigation indicative of future patterns of liability associated with Target's business?

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IP Diligence – Risks (cont'd)

- Liens (UCC, U.S. Patent and Trademark Office, Copyright Office searches)
- Clouds on Title
- Questions of validity
- Non-Transferability

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Common Issues Found in IP Due Diligence

- Founders did not assign pre-incorporation IP into Target
- Inventions assigned to prior employer
- Material agreements with Acquiror competitors
- Notices of Patent infringement
- Use of Open Source Materials
- Review of Target source code – advantages and disadvantages

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Common Issues Found in IP Due Diligence

Avoid IP-related Mistakes: Common IP-related Mistakes Found During Diligence

- 1. Too late to file?
- 2. Legal scope too narrow?
- 3. Willfully infringing another's patents?
- 4. Pursuing IP in all appropriate jurisdictions
- 5. Relying solely on copyright protection for software
- 6. Unnecessary third party co-ownership rights in joint development projects
- 7. Impact of claim amendments
- 8. Are you underestimating importance of trade secrets and confidentiality?
- 9. Offshore licensing tax shelters
- 10. What are you spending to prosecute patents/strategize IP?

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Takeaways & Best Practice Considerations: Due Diligence Steps*

- Start Early
- Ask questions and demand answers
- Examine documents
- Check public records (such as UCC filings, Patent and Trademark Office filings, and Copyright Office)
- Obtain warranties and Indemnities (e.g., seller/licensor warrants; buyer or licensee – especially the licensee - warrants)
- Consider escrow (perhaps delayed payment until certain rights ripen)
- Obtain and record assignments of patents, trademarks, and copyrights

*R. J. Cole, Valuing IP Assets: The Legal Aspects, ICLE Spring 2002

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Takeaways & Best Practice Considerations

- Involve a multidisciplinary IP due diligence team early in the process
- IP due diligence team – business development expertise, technology/subject matter expertise, patent landscape/FTO expertise, & IP valuation expertise
- Prioritize key business objectives – understand the dynamic relationship between the documents and the core business
- Resolve important issues, mitigate risks (*i.e.*, structuring of the deal)
- International laws may impact the deal

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Takeaways & Best Practice Considerations

- Leverage IP intelligence, valuation and legal due diligence as early as possible as these factors influence targeting, pricing and deal structure
- How do IP assets match the business?
- IP due diligence involves numerous factors that must be specifically tailored to each transaction
- In today's economic environment, sound business advice is needed using value-driven transaction experts/advisers

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Questions/Comments?

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