

Seven Key Steps When Thinking About IP Due Diligence in Corporate Transactions

Article

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Intellectual Property (IP) assets play an increasingly significant role in corporate transactions — small and large — and the importance of involving IP counsel, particularly on the buyer's deal team, cannot be overstated.

All too often, corporate attorneys overlook IP issues as they focus on financial statements and tax implications, and assume that general representations and warranties provide adequate protection. However, representations and warranties only provide the buyer with recourse for damages, which may be limited by the seller's ability to pay, and which are only awarded after lengthy and expensive litigation. Representations and warranties cannot remedy the real problem that arises from lack of due diligence, namely, that the buyer cannot claim title to the asset they bargained for. It is much better for the buyer to confirm valid chain of title and no encumbrances on the target IP prior to closing the transaction.

Here are seven key issues to think about:

1. **Identify the IP Portfolio**

First, a list of all IP assets owned or used by the target should be requested. This should include traditional IP assets, such as registered and unregistered (i.e. common law) trademarks, trademark applications, patents, patent applications, registered and unregistered copyrights, as well as non-traditional IP assets, such as fictitious name (DBA) filings, domain names, social media accounts, software, trade secrets, proprietary technology and processes, customer lists, territory rights, publicity rights, and the like.

2. **Verify Ownership, Status, and Chain of Title**

Each asset should be reviewed to verify ownership and status of the IP. For registered IP, the proper registry should be reviewed to ensure that the IP is registered in the seller's name, there are no gaps in the chain of title, there are no recorded security interests against the IP, and all maintenance fees and requirements have been satisfied to ensure the registration is active. Significant maintenance fees that are coming

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due and costs that must be incurred to record transfers of the IP should also be considered.

For both registered and unregistered IP, the sources of each asset should be verified and documents should be requested showing transfer of title, including work-for-hire, invention assignment and non-disclosure agreements with all key personnel, contractors, and service providers that participated in the development of the IP.

3. **Evaluate Proposed Use and Scope of IP**

Throughout the diligence process, the buyer's proposed use of the IP should be evaluated to ensure the IP allows for that use. Trademark goods and services classifications should be reviewed to confirm they cover the anticipated use; patents should be reviewed for scope, validity and enforceability; and freedom-to-operate analyses should be considered to discover infringement concerns. If the buyer has plans to expand geographically, jurisdictional concerns should be explored to determine whether the IP can be used in the proposed jurisdiction and whether the jurisdiction is a "first-to-use" or "first-to-file" jurisdiction.

4. **Review Agreements for IP-Related Issues**

All key agreements — not just IP-specific agreements — should be reviewed for IP-related issues, as they arise in numerous contexts such as license agreements, development agreements, consultant agreements, settlement agreements, endorsement agreements, manufacturing agreements, distribution agreements, collaboration agreements, and more. Anti-assignment or change-of-control clauses, exclusivity, restrictions on scope of use, restrictive covenants, rights of first refusal, rights to infringement indemnification, and impact of governing law provisions on the foregoing (among others) should all be investigated.

5. **Consider IP Protection and Enforcement Strategy**

Protection and enforcement strategy can have a major impact on the strength and value of the IP and should be reviewed to discover weaknesses. Information should be obtained regarding active and prior disputes, knowledge of competitive or infringing IP, subscriptions to trademark monitoring services, cease and desist letters, quality monitoring protocols for any licensee products, and practices for marking IP with appropriate markings (®, ©, patent numbers).

6. **Don't Ignore Foreign Assets**

Almost all transactions these days include a foreign component. It is important to remember that title, validity and enforceability of IP assets are subject to the law in each separate jurisdiction in which the asset is registered or is used, and may vary dramatically from country to country. A common mistake is overlooking the foreign assets, assuming that assignment of the U.S. asset carries forward into other jurisdictions. It does not. Failing to conduct due diligence on foreign IP assets can be a costly mistake. IP assets often become abandoned for the owner's failure to attend to administrative duties such as filing annual annuity fees, or failing to file required proof of continued use in commerce.

7. **Engage Qualified Counsel to Limit Exposure**

It is virtually impossible to cover all the aspects related to properly conducting due diligence on IP assets in a short article. The markets are too varied, and the subject matter is simply too complex. It is best to engage qualified counsel early in the acquisition process in order to verify that the IP assets are actually transferable as the buyer expects. Failure to do so could result in a bad transaction that cannot be unwound. The results could be catastrophic to the buyer, and could expose the buyer's executive management team to significant liability to investors.

The above list is representative and not exhaustive. Each transaction, and each market, may have specific IP or other regulatory "ownership" paradigms that must be subjected to due diligence (e.g., Supplement Type Certificates, or STCs, in the aviation industry; ownership of 510k clearance for medical devices; etc.).

Of course, no amount of diligence can combat a seller's fraudulent concealment of information, but the IP due diligence process should, at a minimum, include the steps described above in order to discover issues prior to closing.