

Is Your Intellectual Property Portfolio Primed and Ready For A Financing Event?

By Joseph Capraro and Erik Saarmaa

A corporate lawyer must address a myriad of issues when called on to assist in a merger, acquisition or corporate financing transaction. If the company being acquired or financed has intellectual property assets, the first order of business should be to enlist the aid of IP counsel.

Although it is likely in transactions of this type that corporate counsel will experience some degree of sleep deficit, hopefully there will be fewer sleepless nights if an IP attorney is part of the due diligence team. Certain IP-related issues are readily dealt with by experienced corporate counsel. Frequently, however, corporate counsel lacks the time, specific IP legal expertise, or technology-specific knowledge required to identify and resolve issues involving intellectual property assets — issues that may significantly affect the valuation of the company involved in the corporate transaction.

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ROLE OF IP COUNSEL

If a fundamental corporate transaction is on the horizon, it pays to have an IP attorney evaluate the company's IP assets and then, as the transaction progresses, oversee the IP component of the due diligence process. Valuing and assessing the competitive strength of a technology company requires an in-depth understanding of the company's technology and intellectual property assets. This is the core expertise of IP counsel — to assess the strengths and weaknesses of the company's IP portfolio. Such an assessment gives corporate counsel — and the client — critical information regarding the company's asset value and strategic position in its industry, which is of benefit in connection with both pre-financing activities and the full-scale due diligence itself.

OVERVIEW OF DUE DILIGENCE

The types and scope of due diligence activities undertaken depends on a number of factors, including the size of the transaction, the size of the company being acquired or financed and the strategic importance of intellectual property assets in the company's business.

For example, the due diligence associated with a financing event for a large technology-driven company may involve review of an extensive IP portfolio spanning multiple geographic markets and technology areas.

The nature of the company's business is also a significant factor. In the case of a high technology company that relies heavily on patents, IP counsel may want to investigate competitor patents to ensure that the company has freedom to operate

with its technology relative to its competition. Or, if a company relies heavily on international sales, IP counsel will want to examine its IP portfolio in both domestic and foreign jurisdictions.

Market specific forces are also a determinant of the likely scope of the due diligence investigation. A company focused on developing or selling medical products often must deal with various forms of approval (eg, Food and Drug Administration regulatory approval) prior to selling or even testing its products, and IP counsel may be called upon for expertise in estimating the timelines and risks the company faces in satisfying regulatory approval requirements.

DUE DILIGENCE PROCESS

Even though the scope and variety of issues investigated during due diligence activities are often deal-dependant, there are activities that are common to most due diligence projects. The most common due diligence activities include an identification and assessment of the company's agreements, its IP portfolio, and any existing and potential litigation.

Agreements

In assessing the IP position of a company, IP counsel will review those agreements to which the company is a party that have intellectual property as a component. These may include, for example, license, manufacturing, supply, distribution, development, employee and consulting agreements. The key issue is an assessment of the company's rights and obligations with respect to intellectual property that has been licensed in from, or licensed out to, third parties. The agreements should be assessed as a whole, although the issues that tend to

require the greatest scrutiny include whether IP assets of the company have been transferred to another party; the scope and duration of licenses granted; whether the rights that have been granted are exclusive or non-exclusive; the field of use with respect to intellectual property licensed in or licensed out; the right to sublicense; events of termination; indemnification obligations; and the right to assign the agreement in the event of a sale of the company or change of control.

In addition, IP attorneys appreciate the nuances associated with international intellectual property laws that often complicate the review of otherwise standard agreements. For example, employment agreements between a U.S. company and a citizen of another country require special scrutiny with respect to IP rights. While a U.S. citizen in her employment agreement may effectively assign to her employer any and all rights to intellectual property created by the employee, countries like Germany require the employer to take additional subsequent steps to perfect its ownership interests. Specifically, under German law, an employed inventor is obligated to provide written notice to her employer immediately about any invention. The employer then must render a written declaration to the employee stating whether the employer will seek protection for the invention. If the employer states its intention to seek such protection, all rights to the invention pass to the employer upon delivery of the written declaration. Absent a written declaration, or in a case where the employer subsequently fails to seek patent protection, German law specifies that any rights in the invention remain with the employee, as if the invention had not been work-related.

Patents, Trademarks, Copyright, and Trade Secrets

Perhaps the most critical due diligence task involves a review of the IP portfolio — including the company's patented and patentable inventions, trademarks and service marks, copyrighted materials and trade secrets. At a bare minimum, due diligence investigation of a company's IP portfolio should include determining whether the company has proper title to all items in the IP portfolio, and has paid all required maintenance/renewal fees to ensure that issued patents and pending patent applications, and registered trademarks, service marks, domain names, mask works and copyrights are

valid, subsisting and in full force and effect. Deficiencies identified in either case can impact the value of the portfolio and/or necessitate costly and time-consuming activities by the company prior to the financing event to remedy the deficiency. In some extreme cases, a payment deficiency can have a draconian result rendering a patent permanently abandoned, thereby eliminating all rights otherwise afforded by the patent.

Ensuring that a company has proper title to its intellectual property and that its intellectual property rights are in full force and effect, and have not been abandoned, is, of course, a critical component of IP due diligence. Ultimately, though, the value of an IP portfolio depends on the substantive content of the portfolio. In the case of patents, the value of a patent portfolio lies in the breadth and scope of the patent claims, whether patents cover the company's products, and to what extent the patent provides the company with the right to exclude or limit competition by third parties. These types of portfolio assessments require a specific knowledge of patent law and the underlying technology, both of which are within the province of IP counsel.

While company employees and managers may have general familiarity with the patent positions of their competitors, IP counsel brings an in-depth perspective to this issue. IP counsel, for example, will make a judgment on whether it would be desirable to conduct a "freedom to operate" study as part of due diligence. Such a study involves assessing the scope and coverage of patents assigned to third parties, sometimes even if they relate only generally to the company's business. In this manner, a proper assessment of third party patents provides insight into whether there are barriers to the company's making or selling its products or the company's customers using those products.

In assessing the strength and value of an IP portfolio, it is important to consider not only whether competitors have blocking IP rights, but also whether potential customers have such rights as well. The issue is that a customer may assert its rights against the customer's competitors and thereby potentially limit the company's market penetration. Further, the customer also could use its IP rights as leverage against the company to seek favorable pricing or other concessions in exchange for non-assertion of its rights.

The due diligence process may also provide valuable insight and guidance for directing future IP strategy. A thorough review of the portfolio may identify gaps (*eg*, areas of the business that are relatively unprotected) and weaknesses (*eg*, areas of the IP portfolio where broader protection may be sought). In some instances, gaps or weaknesses identified during pre-financing due diligence activities can be minimized or eliminated. For example, IP counsel can quickly file additional patent applications on new patentable subject matter to fill the gaps or file continuation patent applications that more broadly claim inventions that were the subject of earlier patent applications to remedy weaknesses in the patent portfolio.

Existing and Potential Litigation

Active or threatened IP litigation may have a material impact on the company and is thus a critical area of focus during due diligence. IP counsel can help assess the merits of claims that have been asserted against the company and, equally important, the merits of claims the company has asserted against third parties alleged to infringe. In a patent infringement case, for example, in which the company is a plaintiff, the patent itself is at stake. In such a case the defendant will undoubtedly raise defenses of invalidity and/or unenforceability and thus the continued viability of the patent as an asset of the company is at risk. For both offensive and defensive litigation, therefore, it is important for corporate counsel to obtain the perspective of an IP attorney.

CONCLUSION

If your client is acquiring or financing a company with significant IP assets, or if your client is the target in such a transaction, get IP counsel on board! The skills and expertise offered by an IP attorney complement those of corporate counsel and facilitate a thorough analysis of the costs, benefits and risks involved in a financing event or other fundamental corporate transaction.

