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The Crucial Role of Patent Due Diligence in Mergers & Acquisitions: Spotting Patent Litigation Risks Before Closing a Deal

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In today's rapidly evolving business landscape, mergers and acquisitions ("M&A") remain a common strategic priority for companies aiming to grow, innovate, or strengthen their market position. However, the complexity of these transactions necessitates meticulous preparation and due diligence. Patent due diligence is a critical component of the intellectual property ("IP") due diligence process in M&A deals, particularly for tech centric businesses. Overlooking this step can lead to substantial legal and financial repercussions post-transaction.

Understanding Patent Due Diligence

IP due diligence involves comprehensive review of the IP assets of the target company to assess their value, validity, ownership, and potential risks associated with them. Patents often represent significant assets in the overall value of a business. Therefore, a meticulous review will likely need to be conducted to understand the rights essential to the business being acquired and ensure that they are free of encumbrances or vulnerabilities that could hinder future use or lead to disputes.

The process typically includes:

- Identifying the IP Portfolio: cataloging all patents and other IP (e.g., trademarks, copyrights, and trade secrets) owned by the target company. This step includes verifying ownership and identifying any licenses or agreements that might affect the value or transferability of these assets.
- Assessing Patent Validity and Scope: evaluating whether the patents have been properly obtained, maintained, are enforceable, and align with the subject matter of the acquirer's business strategy.
- Evaluating Patent Rights Transfer: ensuring that the transfer of rights upon acquisition is clear and that no third-party claims, liens, or existing licensing

obligations create unforeseen hurdles.

- Identifying Potential Infringement Risks: investigating whether the target company is infringing any third-party patents, which could lead to costly litigation or settlements after the acquisition.

The Importance of Serious Patent Review

An in-depth patent due diligence process is essential because failure to uncover potential risks can have significant consequences. Issues uncovered post-transaction—such as unresolved patent disputes or previously overlooked competitor patents—can lead to costly product modifications, product delays, or the abandonment of key business strategies altogether.

For instance, a company might underestimate the impact of ongoing or impending patent litigation, only to face a costly legal battle shortly after finalizing the deal. Similarly, discovering post-acquisition that key patents were improperly assigned, unenforceable, or restricted by prior licensing agreements can undermine the value of the transaction. For example, in *Whitewater W. Indus., Ltd. v. Alleshouse*, a successor company successfully argued in District Court that an ex-employee of the predecessor company was required to assign three patents to the successor company. *Id*. at 1046-47. The Federal Circuit, vacating the lower court's decision, disagreed and held that the assignment provision in the ex-employee's employment contract was void under California law and as a result, the ex-employee was under no assignment duty. *Id*. at 1059. Additionally, and more recently, in *Core Optical Techs., LLC v. Nokia Corp.*, the Federal Circuit vacated the District Court's decision finding a valid employee assignment and found that an exception in an employment contract meant an invention created by an employee during employment was not assigned to the employer. *Id*. at 1272. As such, the ownership interest of the patent remained with the employee. *Id*. These examples underscore the critical necessity of conducting thorough patent due diligence.

Evaluation of Potential Ownership Issues

One frequent complication in M&A transactions is unclear patent ownership—particularly when companies have collaborated on innovations. If joint development agreements, employment contracts, or assignment records are incomplete or ambiguous, ownership disputes can arise. Without proper documentation and agreements in place, acquirers face restrictive conditions that could inhibit their ability to effectively and strategically utilize valuable assets. The process involves a review of patent assignments, employee invention agreements, and any third-party licenses or encumbrances. Any gaps in the chain of title or ambiguities in agreements can lead to ownership disputes, potentially impacting the value and enforceability of the patents post-transaction.

To prevent such disputes, acquirers must ensure that patent assignments are properly executed and recorded, employee and contractor agreements clarify that all inventions belong to the company with proper present assignment language, and joint development agreements clearly define each party’s rights.

Mitigating Risk

To effectively mitigate risks associated with patent due diligence, companies should adopt a proactive and structured approach. This includes engaging experienced legal advisors who specialize in patents and M&A transactions. Conducting robust audits of the target’s patent portfolio, including (1) rigorous searches for existing patents, (2) analyzing claim coverage and geographic protections, (3) ensuring proper compliance with legal and regulatory requirements, (4) performing freedom to operate analyses and (5) assessing the future trajectory of the current portfolio, may be essential to uncover potential liabilities. Furthermore, integrating patent considerations into the broader risk assessment process during the due diligence phase allows acquirers to identify and address vulnerabilities early on. By anticipating potential challenges and implementing robust risk mitigation strategies, companies can streamline the integration process and enhance the overall success of the merger or acquisition.

Patent due diligence is not merely a checkbox item in the M&A process; it is integral to the overall success of the transaction. By prioritizing a careful and comprehensive patent review, companies can safeguard their interests and ensure that their strategic M&A activities contribute positively to their long-term growth and stability.

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