10 Key Intellectual Property Issues for M&A Deals

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HIGHLIGHTS:

- Intellectual property (IP) assets often constitute the most significant component of technology sector businesses. As a result, IP legal issues are of crucial importance in merger and acquisition transactions.
- There are several key issues that should be addressed in pre-transaction IP due diligence, as well as IP terms and conditions in technology sector purchase agreements.

Intellectual property (IP) issues are increasingly important factors in merger and acquisition (M&A) transactions. Of the various industry sector transactions included in recent American Bar Association (ABA) Business Law Section M&A Deal Points Studies, technology sector transactions consistently rank at or near the top. Because IP assets often constitute the most significant component of technology sector businesses, IP legal issues are of crucial importance in these transactions. Key issues that should be addressed in pre-transaction IP due diligence, as well as IP terms and conditions in technology sector purchase agreements, include the following:

1. Identify the IP
The scope of IP assets obviously will depend on the nature of the particular business, and IP assets exist in a variety of formats, but most significant IP assets are comprised of registered patents, trademarks and copyrights, as well as software, trade secrets, internet domains and technology licenses. Identification of what IP is important or necessary in the target's business will include an assessment and categorization of what IP is owned, used and licensed in or out by the target. Once the relevant IP is identified, acquirors, investors and their advisors can evaluate IP operational risks and determine how to best address them before consummating the transaction.

2. Ownership of IP
To determine ownership of registered patents, trademarks and copyrights, a good starting point is to search the registration databases of the U.S. Patent and Trademark Office (USPTO) and the U.S. Copyright Office. However, IP law includes some subtle variations from traditional property ownership principles that may not be apparent from ownership searches. For example, if a patent is registered in the name of multiple co-inventors, each co-inventor has separate rights to grant licenses and receive royalties. A complex ownership question also may arise if the target is a business unit or division within a family of affiliated companies, and technology is shared among the affiliates. In such cases, an intercompany license and/or transition services agreement may be needed. Ownership rights of employees, agents and independent contractors also must be addressed.

3. Employee and Contractor Rights
IP laws recognize ownership rights of individual inventors and authors, so if a company's IP is developed by individual employees, agents or contractors, the parties need to resolve those ownership rights in the transaction process. Generally, without an express assignment, an employee inventor retains ownership of patent rights unless the employee was employed to create the specific invention or the invention was

otherwise within the scope of employment. For works of authorship and software, the copyright law "work for hire" doctrine may operate to vest title in the employer to the extent the work was created by the employee within his or her scope of employment. To ensure clarity and avoid potential disputes, the best practice is to obtain IP assignments from all employees, agents and contractors who have contributed to the development of the target's IP, including patent assignments from all employees and agents who are co-inventors and copyright assignments from all co-authors. As to independent contractors who have contributed to inventions or works of authorship, the terms of relevant independent contractor agreements should be reviewed to assess any potentially unresolved contractor IP rights.

4. Liens and Encumbrances
With the increasing prominence of IP as a balance sheet asset, it is common for lenders to include IP as collateral in secured debt financing. Thus, a buyer needs to determine if the target has granted liens on specific IP assets, including liens on patents, trademarks and copyrights, software, internet domain names, etc. There are complex IP lien perfection rules, and due diligence regarding IP liens is multifaceted. In addition to conducting lien searches of the USPTO and U.S. Copyright Office databases, state level Uniform Commercial Code (UCC) lien searches should be conducted in relevant state UCC lien databases pursuant to Article 9 of the UCC.

5. Licensed IP
Even if it is clear that a target company is the owner of an IP asset free and clear of liens, the IP asset still may be the subject of third-party rights pursuant to a license granted by the IP owner. Alternatively, there may exist crucial IP assets being used by a target company that it does not own, but are available under license from a third party. In either case, a buyer must pay close attention to the relevant license agreement terms to determine the respective rights, obligations and terms of use regarding the licensed IP. Key issues often addressed in IP licenses include duration, royalties and fees, scope of use, exclusivity, territorial limits, sublicense rights, rights to enhancements and improvements, and assignability.

6. License Assignability
The law with respect to assignments of IP licenses is different in some respects from general contract law regarding assignments. Under the contract law of most states, in the absence of express restrictions agreed to by the parties, contracts are assignable without the requirement for consent. Thus, it is often assumed that if a contract is silent as to assignability, the courts will uphold an assignment. However, due to the strong deference in IP law to the rights of registered patent and copyright owners, federal case law generally provides that patent and copyright licenses are not assignable without the consent of the licensor, unless the terms of the license agreement expressly provide otherwise. Consequently, in the M&A diligence process, the buyer needs to assess the transferability of the target's licenses to determine if any third-party consents are necessary.

7. Infringement
Even if the USPTO has issued a patent or trademark, and even if it is established that a party holds clear title to such IP, it is possible that a third party could own IP rights that are infringed by the issued patent or trademark, so a buyer still needs to consider whether the target IP infringes any rights of third parties. Similarly, it is possible that a third party may be infringing the target's IP. A buyer can partially address this risk via standard "non-infringement" representations, warranties and indemnification in the purchase agreement, but the risk of a post-closing IP infringement dispute may still remain. Steps that can be taken in the diligence process to reduce this risk include assessment of any prior infringement claims, as well as

analysis of the merits of any prior demand letters, cease/desist letters or invitations to license. If the target assets include a specific registered patent or trademark that is of particular importance or value, the buyer may consider retaining IP legal counsel to perform a pre-closing infringement analysis and to provide a formal legal opinion as to its conclusions.

8. IP Validity
Even if there is no evident infringement risk, another potential concern, particularly with patents, is whether the IP was "validly issued." For example, it is possible that during the original patent application process, an important component of "prior art" was not considered by the USPTO. If so, the validity of the issued patent subsequently could be challenged on the basis that the "prior art" was not appropriately considered in the initial application process. If a patent is a key asset in a proposed transaction, this concern may warrant retention of a professional search firm to conduct a prior art search, or retention of IP legal counsel to perform a validity analysis and to provide a validity opinion. Even if this level of diligence is pursued, there still may be no absolute certainty on the validity question without a judicial determination. For critical registered patents and trademarks, another matter to consider is whether all necessary government maintenance fees have been paid and whether all renewal filings have been made in order to avoid expiration or lapse of registration.

9. Open Source Software
If a buyer is seeking to acquire exclusive rights to use and/or license a particular software product, the buyer should attempt to determine if the software includes any "open source" components. A list of open source software is available online. As a condition of using open source code, the user must comply with the applicable open source license terms. The Free Software Foundation may seek to prosecute violations. If target assets incorporate open source components, the entire software package may be subject to free use rights. Parties can take various actions in order to identify open source software issues with particular software, including software audits by independent experts and code scanning by service providers.

10. Transfer Documents/Filings and Trademark Assignments
Upon consummation of an assignment and transfer of registered IP, assignment filings should be made with the applicable IP registrar to evidence the transfer (the USPTO for patents and trademarks, and the U.S. Copyright Office for registered copyrights). Internet domain name filings also should be made with the applicable domain name registrars. Note that for a trademark assignment to be valid, the "goodwill of the business" related to the trademark must be assigned along with the trademark. The concept underlying this requirement is that a trademark should not have inherent value apart from the product or service associated with the trademark. Thus, appropriate language should be included in a trademark assignment including transfer of the goodwill related to the assigned trademark.

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