

IP DUE DILIGENCE – Why? & How!



By

Vijay Pal Dalmia, Advocate

Head, Intellectual Property Laws Division

Partner, Vaish Associates Advocates

India

*Email: vpdalmia@vaishlaw.com

Mobile: +91 9810081079

What is a Due Diligence?

- A fact finding
 - “What are the facts”
- An assessment
 - “What do I think of this”
- A validation or corroboration
 - “Is this what I’m told it is”
 - “am I getting what I understand I should be getting”
- Types of due diligence
 - IP ownership and rights due diligence
 - patent position due diligence (validity and infringement)
 - scientific / technical due diligence



WHEN?

- Acquisition
- License agreement
- Assignment of IP
- Corporate merger
- Financing
- Takeover
- Tax Benefits
- Joint venture



WHY?

- To ascertain IPRs used in the business
- What is the value
 - Hence level of risk
- Who owns it
 - could I sue or could someone sue me?
- Better exploitation of IP
 - licensing in or out of technology
- Risk Minimisation



WHO?

- In case of all types of corporate ventures, both parties should undertake the due diligence.
- In case of licensing agreement
 - Both licensor and licensee.
 - Licensor, to ascertain the licensee's ability to pay the licensor or exploit the licensed IP
 - Licensee, to ensure that the licensor has the power to grant the license.
- Similarly, In case of assignment agreements, both the assignor and the assignee should conduct the due diligence on each other.



Purpose

- Primary Purpose
 - Determine value of IP assets
 - Typically in terms of competitive advantage
- Secondary Purposes
 - Subject matter itself
 - Clear chain of title/Ownership
 - Scope of rights
 - Territory
 - Validity of rights
 - Infringement concerns addressed/Freedom to Operate



Purpose

- Assessment and Minimization of Risk
- To ascertain that it can provide reps and warranties that Licensee will ask for
- To ascertain who are the beneficiaries of the license, or who is the Licensee/user (scope of the enterprise)
- Ensure third party contracts/licenses are being supervised and managed efficiently
- IP Policies and Procedures
- To ascertain Licensee's ability to pay/exploit
- To ensure technology is protected under foreign laws

Valuation of Intellectual Property

IP Audits should be conducted to ascertain the value of IPRs which are used in each department eg

- Manufacturing- patents, designs, trade secrets
- Research- patents, trade secrets
- Marketing- trademarks, copyright



Valuation of Intellectual Property

- Legal entitlements
- Other factors
- Use a qualified valuator



Diligence and Valuation

- Diligence information will assist in determining value of intellectual assets
- Determine value of intellectual assets in context of overall Target value
- Forcing Target to resolve diligence issues increases value of intellectual assets

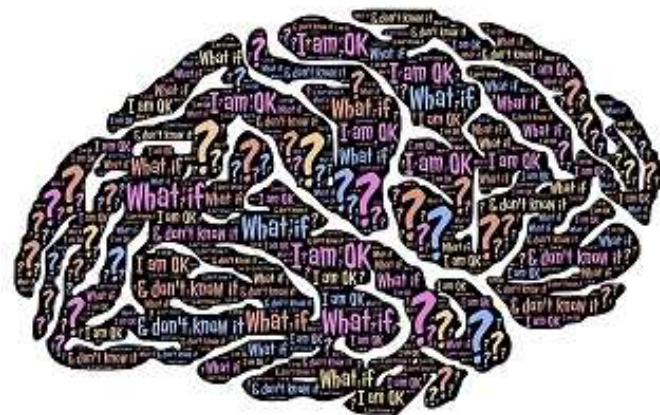
Competitive Advantage

- Product/Process Review
 - Existing
 - Pipeline
- Value Propositions
 - What provides competitive advantage (CA)
- Examine patents
 - CA covered by claims (pending and/or issued)
 - Ease of Design Around
 - What about design changes (drift)
- Patent Searches/Analysis



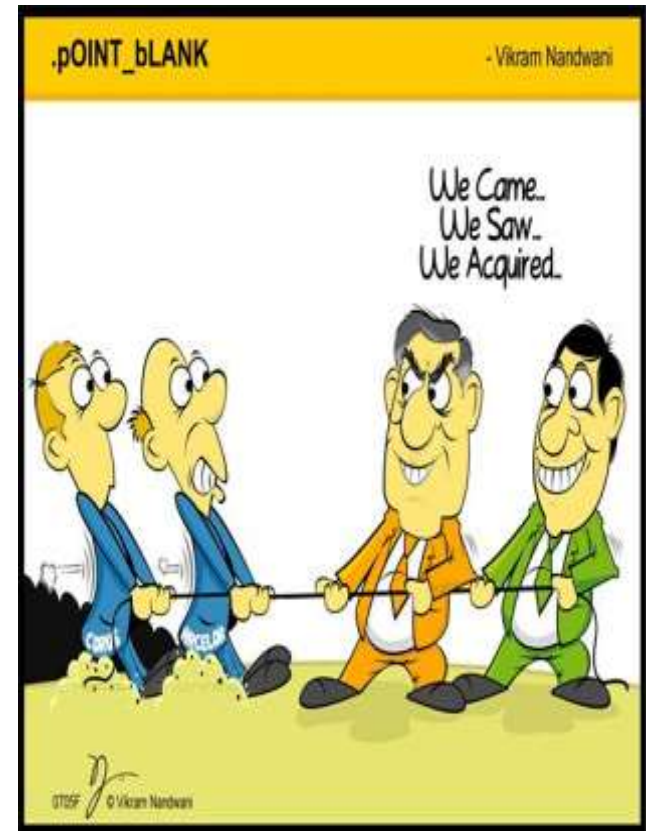
Due Diligence in M & A

- Identify all I.P. of target
- Confirm target's rights in the I.P.
- Confirm validity and enforceability of I.P. rights
- Identify intellectual capital not formally protected
- Identify relevant third-party I.P.
- Take curative steps to minimize risk
- The investigation of the assets and liabilities and the business undertaking



Due Diligence in M & A

- Why?
 - 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



THE ART OF CONDUCTING IP DUE DILIGENCE



- The owner of IP will want to disclose as little as possible during the discussion stage, especially concerning important inventions.
- The buyer of the IP will want to know as much as possible.
- The owner can have a due diligence room where the buyer can go and inspect all relevant documents, but may forbid the buyer to make copies of the same.
- This will help the buyer to ascertain the exact value of an IP.
- Eventually the party (buyer or owner) who is in a stronger bargaining position will decide the amount of information to be given for the due diligence.
- All information exchanged at this stage can be covered under a suitable confidentiality and non-disclosure agreement.

QUESTIONS TO BE CONSIDERED DURING IP DUE DILIGENCE

- Nature of the IP in question, i.e., whether it is a patent, trademark, copyright or design.
- How is the purported owner in possession of the IP, i.e., whether it has been assigned or licensed or whether it is being used in infringement of any third party rights.
- Status of the IP in foreign jurisdictions.
- Search of the relevant IP registries is a necessary step to be taken in this regard, but might be time consuming at least as far as foreign jurisdictions are



Factors

- Cost and time of conducting the due diligence
- Nature of the transaction
- Nature and value of the intellectual property
- Nature of the target's business
- Intended use of the intellectual property after the transaction



STEPS IN DUE DILIGENCE

- Identification of IP
- Information Gathering
- Analysis
- Documenting the Transaction



IDENTIFICATION



© 2017 Vaish Associates
Advocates. All rights reserved.

Understand the IP that Exists

- Registered intellectual property
- Unregistered intellectual property



© 2017 Vaish Associates
Advocates. All rights reserved.

Registered Intellectual Property

- Patents
- Trademarks
- Copyrights
- Industrial designs
- Domain names
- Integrated circuit topography
- Plant breeders' rights



Unregistered Intellectual Property

- Inventions
- Trademarks
- Copyright
- Trade secrets
- Goodwill
- Moral rights
- Personality rights



INFORMATION GATHERING



© 2017 Vaish Associates
Advocates. All rights reserved.

Information Gathering- What

- Anything that could materially affect the value of the client or its IP position:
- Examples:
 - Potential or actual litigations that could result in exposure
 - Agreements material to the company's business that may be affected by change of control
- Specifically
 - IP portfolio
 - Company policies and practices
 - Types of agreements
 - Provisions in agreements
 - Litigation/arbitration/mediation
 - Claims/threats of infringement

Information Gathering- How

- Checklist
 - Letter requesting documents
 - Data Room
- Independent Investigations
 - PTO, Copyright Office
- Interviews
- Site Investigations



Site Investigations

- Intellectual property management practices
 - identification
 - protection
 - commercialization
- Infringement mitigation practices
- Identify intellectual property used by target
 - locate relevant documents
 - review of operations and products and services



ANALYSIS



© 2017 Vaish Associates
Advocates. All rights reserved.

Important Areas of Concern

- Ownership
- Licensing
- Infringement



Ownership



- Verify ownership
 - Assignment records
 - Recordation
 - Subsequent conveyances/contracts (not recorded?)
 - Chain of Title
 - Corporate name changes
 - Mergers
 - Holding Company v. Operating Companies
- Search public archives and cross-reference
- Unreleased security interests
 - Should be released?

Ancillary to Ownership

- Inventorship
 - Ensure comfort level with inventors named on patents
 - If Target is a university spin-out or other start-up, interview inventors
- Government Rights
 - If government sponsored technology
 - If government market
 - Ensure proper notice and reporting to government if applicable

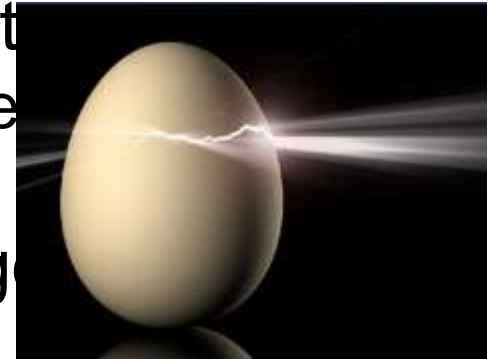
IP Licenses

- Review Target's IP licenses
 - Exclusive v. non-exclusive
 - Field of Use restrictions
 - Who owns Improvements
 - Who enforces rights
 - Licensors necessary party
 - Term
 - Any unusual provisions
 - Make sure licenses are assignable
 - If silent and non-exclusive, default is not assignable
- If “no assignment” clause
 - Consider stock deal (without dissolving target afterwards), or
- Get permission
- If not important to deal, don't necessarily let it drive the form of the deal



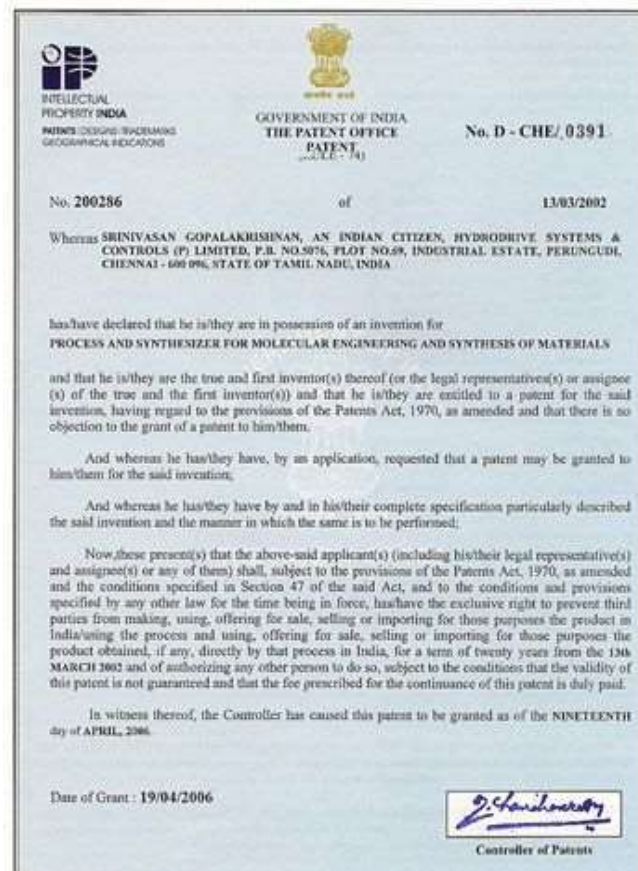
Infringement Concerns

- More relevant for early stage Target
 - Freedom To Use Opinions of Counsel
 - Reps/Warranties
- Search Quality versus Project Budget
 - Can get very expensive
 - As with most things, the more thorough, the more expensive
 - File History Reviews
 - Opinions
 - Territory searched (U.S., Europe, Asia, etc...)
- Consider design changes contemplated
 - How blocked in will you be?
- Deal Breaker



Patent Analysis

- Identify all patent assets
 - Patents, pending applications, abandoned applications and patents, licenses
 - National and foreign
 - Current and previous companies
 - Owner /Assignor/ Assignee licensee / licensor



Patent Analysis

- Searches
 - patent number
 - owner
 - target
 - related companies
 - key employee or principal
 - inventors
 - interests recorded against title
 - provincial personal property registry



Patent Analysis

- Confirm Status of Patent Assets
 - Confirm term including extensions
 - Confirm payment of maintenance fees and annuities
 - Confirm status of applications (published, dates for action)
- Claims analysis
 - scope of the claims
- Validity analysis
- Infringement analysis
- Patentability analysis



Patent Analysis

- Confirm Nature of Rights
 - Review assignments / license agreements
 - Review ownership issues
 - Review employment agreements, joint development agreements, government contracts
 - Analyze conception records
 - Laboratory notebooks, R&D memos
 - Identify blocking patents (right to use v. exclude)

Patent Analysis

- Confirm Nature of Rights
 - Identify products (target and third-party) covered by patents
 - Confirm marking
 - Review prior art search and disclosure practice
 - Consider updated prior art search
 - Target's assessment of rights / value

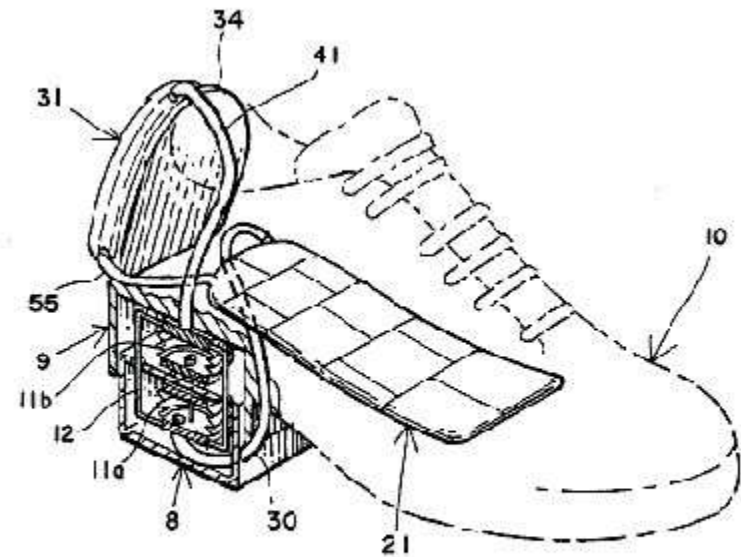


FIG. 2

Patent Analysis

- Confirm Nature of Rights
 - Review offensive actions against third parties
 - Resolution
 - Estoppel issues
 - Reasonable royalty issues
 - Confidentiality
 - Term



Patent Analysis

- Analyze defensive trespass issues
 - Review all legal opinions (freedom to operate, non-infringement, invalidity)
 - Identify all past, present and future I.P. litigation
 - Review closed cases
 - Review pending cases
 - Review notice letters
 - Consider whether additional legal opinions are merited

Trademark Analysis

- Identify all Trademarks
 - Registered, Unregistered, pending applications, abandoned applications
 - National and foreign
 - Current and previous companies
 - Owner / Assignee/Assignor/licensor



Trademark Analysis

- Searches
 - trademark
 - Owner
 - target
 - related company
 - predecessor company
 - interests recorded against title
 - provincial personal property registry



Trademark Analysis

- Geographical Extent
- Infringement analysis
- Registrability review
- Validity analysis
- Use review
 - different trademark
 - different wares and services
 - statutory use



Trademark Analysis

- Assignments in proper order
- Renewals timely filed
- Opposition/cancellation proceedings
- Classes
- Third party use
- Policing/Licensing
- Protests
- No encumbrances/liens



Copyright Analysis

- Searches
 - title
 - owner
 - security interest
 - author



Copyright Analysis

- Identify all Copyrights
 - Registered and pending applications,
 - Not Registered
 - Commissioned
 - Owner / Assignee/Assignor/licensee / licensor
 - Date of First Publication
 - Term



Copyright Analysis

- Ownership
- Scope of Rights (exclusive, non-exclusive)
- Registrations in Proper Order
- Rights Transferable
- Assignments in proper order
- Licensing
- Moral rights
- Grants Effective
- No encumbrances/liens



Industrial Designs Analysis

- Identify all Industrial Designs
 - Registered, pending applications, abandoned applications and licenses
 - National and foreign
 - Current and previous companies
 - Owner /Assignor/
Assignee licensee /
licensor



Industrial Designs Analysis

- Confirm Status of Industrial Design
 - Confirm term including extensions
 - Confirm payment of maintenance fees and annuities
 - Confirm status of applications (published, dates for action)
- Claims analysis
 - scope of the claims
- Validity analysis
- Infringement analysis



Domain Names Analysis

- Review registration records
- Verification of record owners
- Service agreement
- Assignments in proper order
- Status of registration and renewal
- Domain names which contain a significant trademark
 - are they registered
 - who owns them



Trade Secret Analysis

- Analyze substantive trade secret
- Analyze ownership/development issues
- Analyze confidentiality practices
 - Employment agreements
 - Non-disclosure agreements
 - Use of “Confidential” markings
 - Notice to employees of confidential nature
 - Practices for dissemination of information
 - Security precautions



Litigation Analysis

- Review copies of all cease and desist or demand letters
- Assess risks, exposure of actual and threatened litigation:
 - Indemnification (both ways)
 - Worst case scenario if client is defendant: Effect on business
 - Likelihood of success
- Review *all settlement agreements* concerning IP
- The claim not brought by the client may be as important as the one brought by or against the client



DOCUMENTING THE TRANSACTION



© 2017 Vaish Associates
Advocates. All rights reserved.

DOCUMENTING THE TRANSACTION

DRAFTING TIPS

- Relevant Sections of Purchase Agreement:
 - Definitions
 - Assets
 - Intellectual Property
 - Scope of Transfer
 - Representations and Warranties



DOCUMENTING THE TRANSACTION

DRAFTING TIPS

- Some typical representations and warranties:
 - Here are some lists of all the IP seller owns, has licensed from someone else and has licensed to someone else (see disclosure schedule)
 - Seller hasn't given any IP or rights away unless it's disclosed
 - Seller owns or has acquired sufficient rights to exploit the works in the way it is doing so currently
 - Good and marketable title
 - No liens or judgments



DOCUMENTING THE TRANSACTION

DRAFTING TIPS



- More Reps and Warranties:
 - All registrations and applications to government entities with respect to IP are valid and in full force and effect and all registration and renewal fees due up to closing are paid.
 - Right to use computer systems and software
 - No pending, threatened claims against seller unless disclosed
 - Seller not violating any third party rights unless disclosed
 - Third party not violating any Seller's rights unless disclosed

DOCUMENTING THE TRANSACTION

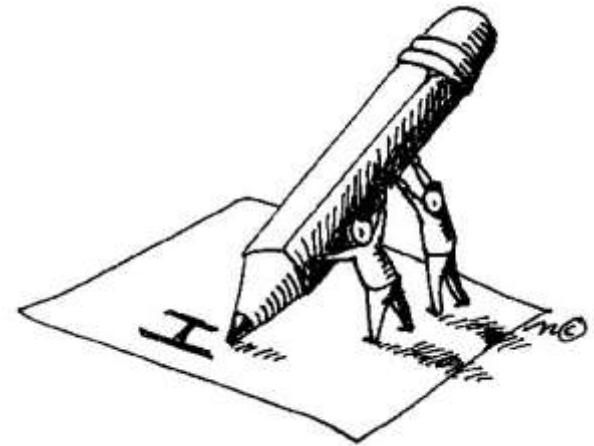
DRAFTING TIPS

- Yet MORE typical reps and warranties:
 - Domain names and trademarks are still in full force and effect as of closing and no pending or threatened challenge to domain names, opposition, cancellation, etc. as to trademarks
 - Assignability of contracts, rights thereunder
 - Owns rights to customer information, supplier information or other lists included in the IP assets being sold

DOCUMENTING THE TRANSACTION

DRAFTING TIPS

- Qualifying reps and warranties:
 - As to time period
 - As to materiality
 - As to seller's business
 - As to particular agreements' effect on the seller's business "taken as a whole", or "Individually"
- Disclose, disclose, disclose!



DOCUMENTING THE TRANSACTION DISCLOSURE SCHEDULES

- You have discovered that a number of the contracts you've reviewed, in particular the software development agreements and licenses, contain a requirement that your client obtain a consent to their assignment to a third party.
- How do you recommend that the agreement deal with this?
 - Disclosure schedules
 - Itemize all the contracts
 - Seller will exercise “reasonable best efforts” to obtain consents



Legal Due Diligence - Encumbrances

- Is there anything that detracts from the ability to make deals freely with this IP?
 - Is there a security interest granted over the IP ?
 - Mortgage
 - Charge
 - Is there a joint owner ?
 - Patents: one owner cannot assign without the consent of the other (except US)
 - Copyright: all copyright holders must act jointly, neither can act alone
 - Does someone have an option over the IP
 - Does someone have a right of first refusal
 - Is there an obligation to manufacture in a particular country or state ?
 - Does the owner have an obligation of confidentiality



Defective Due Diligence

- Possible adverse impact:
 - Discovery of a joint owner that has inflated commercial expectations and puts your capital raising or deal at risk
 - Non-Renewal of trademark
 - Delays in capital raising or deal
 - Financial terms renegotiated by assignee / investor / licensee given the risks of discovered and previously undisclosed defects
 - Know-how not transferred



Goddard Cartoon ©

Advantages of Due diligence



- Economic life of property
- Lifecycle of technology
- Nature of property - how is it used
- Legal protection of property
- Tax benefits
- Forecast of revenue and operating profits attributable to property
- Level of research and development needed to maintain property
- Cost of developing competing property

Advantages of Due diligence

- Any restrictions on exploitation
- Logical extension of property for other uses
- Extent of brand loyalty
- Extent of investment needed for property to become commercially viable
- Analysis of key people associated with property
- Extent of functional and/or technological obsolescence (e.g. software to hardware)
- Transferability of property
- Dependency on raw materials used by the property



Duties of an active IP Owner

- **IP Owner should undertake its own due diligence as part of preparing IP for a capital raising or deal**
 - Discover its own defects
 - Plug them up first
- **Prepare**
 - **IP & Contracts Map**
 - Identifies every inventor
 - Identifies every link in the chain of ownership and rights
 - Employee to Employer
 - Assignment or license from collaborator
 - Assignment from student
 - Ownership provisions in an MTA
 - Assignment from a contractor
 - Demonstrates that the IP Owner has the ownership (or rights) to deal with the IP in the deal proposed





Vijay Pal Dalmia, Advocate

Intellectual Property Laws Division

Vaish Associates Advocates

New Delhi | Mumbai | Bengaluru

Celebrating 45 years of professional excellence

IPR & IT Laws Practice Division

1st, 9th & 11th Floors | Mohan Dev Building | 13, Tolstoy Marg | New Delhi 110001 (India)

Phone: +91 11 42492532 (Direct)

Mobile: +91 9810081079

www.vaishlaw.com

email:- vpdalmia@vaishlaw.com