

# Know your (intellectual property) rights

*The value of a transaction often resides in the intangible assets*

by Mark P. Kessler

**JUDGMENT CALL** Intellectual property due diligence is a vital and easily underperformed part of a complex business transaction, such as a merger or an acquisition. IP due diligence should be conducted to determine whether the IP rights held by the target company make the acquisition more attractive or create more problems than they would solve. Failure to conduct the proper intellectual property due diligence can be catastrophic.

Consider this cautionary tale: In 1998, **Volkswagen AG** purchased the Rolls Royce and Bentley automobile assets for almost \$800 million. The deal seemed to include all of the elements necessary to manufacture a Rolls Royce—the renowned plant, the designs and the machinery. Unfortunately, it was not determined until after the deal had closed that the IP assets did not include the right to use the Rolls Royce trademark, which was owned by **BMW AG** pursuant to a prior agreement. Volkswagen had acquired the technology and IP rights necessary to manufacture an automobile that looked exactly like a Rolls Royce. Volkswagen, however, was not permitted to identify the car as a Rolls Royce. Volkswagen’s mistake emphasizes the value of IP assets to the underlying business transaction and the fiduciary obligations the investors have to its shareholders.

There is no single way to undertake such a due diligence effort. However, certain basic steps must be considered

in every deal, including identifying and locating the IP assets, assessing the ownership of such assets, determining the scope of protection afforded by the IP assets, conducting a noninfringement investigation and evaluating the grant of any IP rights.

## Ownership

Ownership of the key IP assets should always be confirmed as part of any due diligence inquiry. Pursuant to U.S. law, ownership of a patent resides with the inventor(s) of the patent unless a legal obligation to assign the patents to a third party, such as an employer, exists. This practice differs from the rest of the world, in which patent applications are filed in the name of the company.

One should also check the target company’s employment agreements to confirm that employees have an affirmative duty to assign any inventions made during the course of their employment to the target company or even after the employment relationship has ended. It is also important to determine whether any other third parties may have an ownership interest in the target company’s patent estate.

For instance, if the target company was previously spun out of a university or research institution, the “parent” organization may have rights to the resulting patent estate. Similarly, if a product was developed pursuant to a research or collaboration agreement, the other party to the agreement may have rights to any patents resulting from the collaboration.

## Scope of Patent Protection

The claims of a patent define the scope of the patent protection. A due diligence inquiry should include a review of the claims of the target company’s issued patents to confirm that the products of the target company are covered by its patent estate. It is far more valuable to have a limited number of patents with claims that cover the commercialized product than to have numerous patents and applications that are not on point. Often embodiments of the target company’s technology fall outside the scope of issued patents. A weak patent portfolio can result in a reduction in the overall valuation of the target company, due to concern that competitors will copy such embodiments.

## Third-Party Patents

In evaluating patent rights, it is important to note that just because a product or process is patented does not mean it cannot infringe another patent owned by a third party. In fact, patented technologies can and often do infringe other patents. For example, if Company A owns a patent on a basic telephone and Company B owns a patent on a telephone dial, Company B cannot sell dial telephones unless it first obtains a license from Company A. A patent does not grant the patent owner the exclusive right to practice the invention. Rather, it grants the right to exclude others from making, using or selling the subject matter. As a result, due diligence should examine whether licenses from third parties are required for the company or its customers to use

the acquired company's technology.

Additional IP rights beyond patent issues often exist as well. For example, one should establish whether the Internet domain name used by the target company infringes any third parties' trademarks, trade names or logos. Due diligence should also be conducted on the target company's trademarks, trade

secrets and copyrights.

The value of IP rights often is the driving force in large-scale business transactions. A properly conducted IP due diligence will aid in the valuation of the proposed transaction and, in more severe cases, enable the buyer to make an informed decision on whether or not to revalue or terminate

the transaction. ■

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