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Intellectual Property in M&A Transactions

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Agenda

- Overview of IP/IT Rights
- Transaction Structure
- Due Diligence
 - Third-Party Agreements
 - Owned Intellectual Property
 - Third-Party IP Disputes
 - Information Technology
- Purchase Agreement
 - Representations and Warranties
 - Covenants and Other IP/IT Provisions
- Carve-out Considerations
- Ancillary Agreements

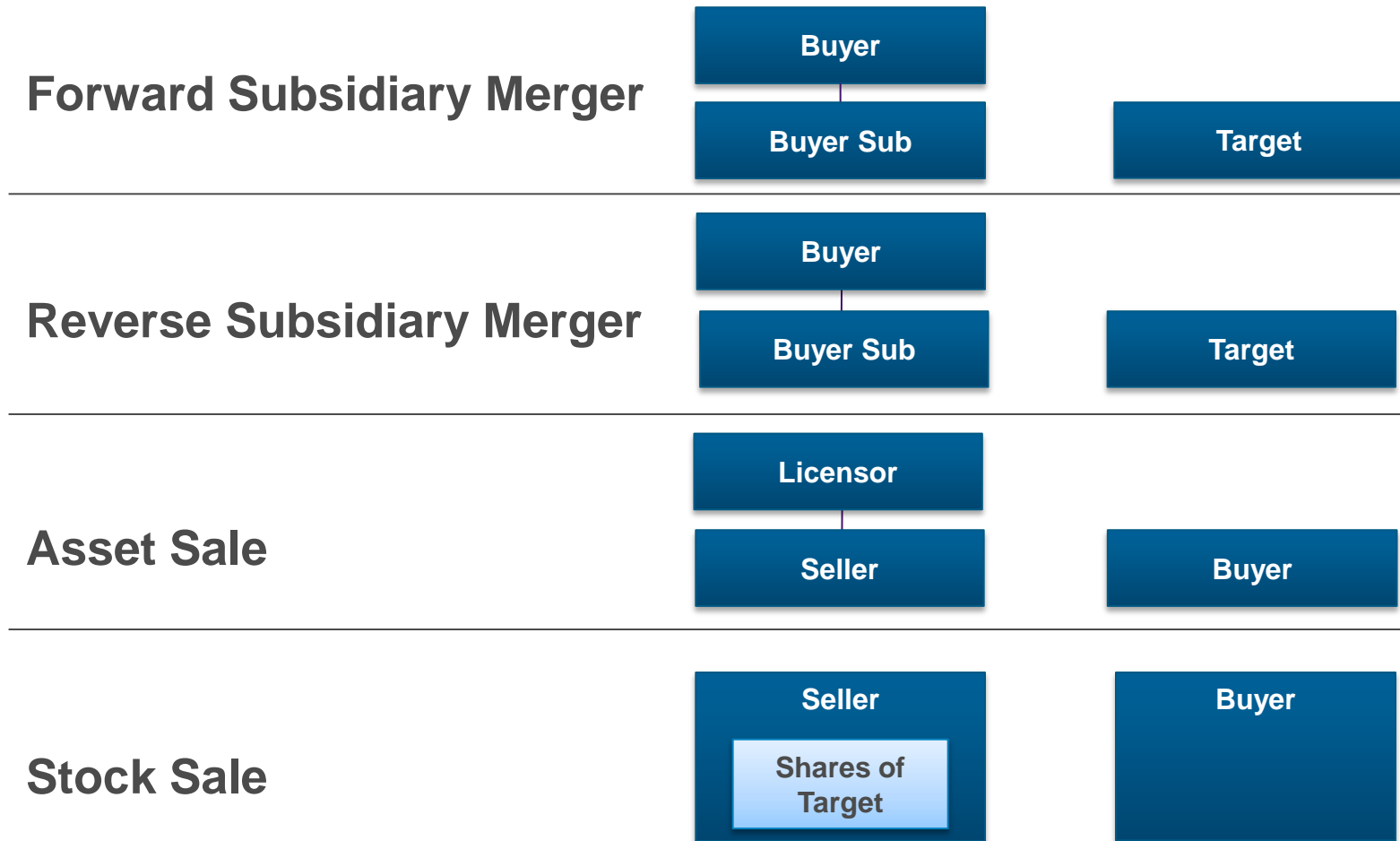
Intellectual Property and Information Technology

- **Patents:**
 - New and useful inventions
- **Trademarks:**
 - Brands and logos used to identify goods or services
- **Copyrights:**
 - Original works of authorship
- **Trade Secrets:**
 - Confidential information, know how, non-patented inventions
- **Non-US IP:**
 - Designs, database rights
- **Information Technology:**
 - Software, hardware, networks

IP/IT Due Diligence

- **IP/IT assets**
 - **IP/IT agreements**
 - **IP litigations/disputes**
- Identify IP-related risks that could affect value
 - Identify IP-related obstacles to consummating the transaction
 - Tailor Purchase Agreement to the facts
 - Buy-side due diligence can validate business reasons for the transaction
 - Sell-side due diligence allows Target/Seller to identify and resolve/mitigate issues prior to the transaction

Common M&A Transaction Forms



What Happens to a License Agreement in an M&A Transaction?

- **General rules:**

Transaction	Assignment?	Change of Control?
Asset Sale	Yes	N/A
Forward Merger	Yes (by operation of law)	Yes
Reverse Merger	Unsettled	Yes
Stock Sale	No	Yes

- **Confirm transferability of licenses for Target's in-licensed IP/IT**

- *SQL Solutions v. Oracle*, 1991 WL 626458 (N.D. Cal. Dec. 18, 1991), but see *Florey Inst. of Neuroscience & Mental Health v. Kleiner Perkins Caufield & Byers*, 2013 WL 5402093 (N.D. Cal. Sept. 26, 2013)
- *DBA Distribution Services v. All Source Freight*, 2012 WL 845929 (D.N.J. Mar. 13, 2012)
- *Meso Scale Diagnostics v. Roche*, 2011 WL 1348438 (Del. Ch. Apr. 8, 2011) and 62 A.3d 62 (Del. Ch. 2013)

- **Agreements silent on transfer**

IP/IT Agreements (continued)

- **Enterprise Agreements**
 - "Divested Entity" provisions
 - Is replacement agreement necessary?
- **Agreements soon due to expire or terminate**
 - Is renewal automatic or can a party terminate at will?
 - Potential uncertainty concerning ongoing rights may be material
- **Obligations that may apply to Buyer or its affiliates**
 - "Licensed IP" may be defined as "all IP [in a certain field] owned by licensor [i.e., Target] or any of its affiliates"

IP/IT Agreements (continued)

- **Bankruptcy considerations**
 - **Contractual restrictions on debtor-licensee's assignment typically are ineffective**
 - Look to "applicable non-bankruptcy law"
 - Same rules as if agreements were silent on transferability
 - **Debtor-licensor can unilaterally reject an unfavorable trademark license and terminate licensee's trademark rights**
 - *In re HQ Global Holdings, Inc.*, 290 B.R. 507 (Bankr. D. Del. 2003) and *In re Centura Software Corp.*, 281 B.R. 660 (Bankr. N.D. Cal. 2002)
 - Circuit split: Debtor's rejection is a breach that does not extinguish licensee's rights (*Sunbeam v. Chicago Am. Mfg.*, 686 F.3d 372 (7th Cir. 2012))
 - **U.S. Bankruptcy Code (Section 365(n)) protects other IP licensees**

IP/IT Agreements (continued)

- **Assignments of trademarks must include associated goodwill**
 - Failure to do so may be impermissible "assignment in gross"
 - Mark susceptible to third-party challenge for abandonment
- **Trademark licenses should include quality control provisions**
 - Target should be exercising appropriate quality control over licensees' uses of out-licensed marks
 - Failure to do so may reflect impermissible "naked license"
 - Mark susceptible to third-party challenge for abandonment

Owned IP: Issues Common to Patents, Trademarks and Copyrights

- **Schedules of federal, state, and foreign registrations and applications**
 - Patents, trademarks, copyrights, domain names
- **Items missing from or incorrectly included on Target's IP schedules**
 - Search U.S. and foreign public databases to confirm accuracy
 - Confirm the significance of IP schedules
 - Asset acquisitions: Define the scope of IP being transferred
 - Stock acquisitions: Ensure due diligence was thorough
 - Accuracy is less crucial in stock acquisitions because IP follows with control of Target by operation of law
- **Items due to expire or for which maintenance fees are due**
 - Key concern in asset acquisitions, where Buyer is responsible for maintaining IP portfolio immediately after Closing

Owned IP: Issues Common to Patents, Trademarks and Copyrights (continued)

- **Recorded and unreleased security interests**
 - May reflect existing lien or simple failure to record release
- **Abandoned or expired items**
 - Revival may be possible after failure to pay fees
 - Damages can be recovered for pre-expiration infringement
- **Chain of title issues**
 - Affiliate owner
 - Employee or consultant owner
 - Other third party owner
- **IP developed using government/university/military resources or as part of a standards-setting organization or patent pool**
 - Arrangements often restrict transfer, mandate an approach to exploitation, or require licensing, joint ownership, or other mandated sharing of proprietary rights with third parties

Owned IP: Trademark and Domain Name Issues

- Identify unregistered (common law) marks
 - Reviewing websites, and marketing and promotional materials may help identify Target's unregistered marks
 - Geographic or product gaps in IP portfolio could signify validity or infringement concerns
 - Trademark clearance searches may have influenced decision to forego applications
- Only entities based in countries that are members of the Madrid Protocol or Madrid Agreement may own international trademark registrations and national extensions
- Some jurisdiction-specific domains only can be owned by/assigned to persons or entities based in the applicable jurisdiction
 - Examples: European Union (.eu), Canada (.ca), Germany (.de)

Owned IP: Copyright Issues

- Registration of material copyrights
 - For copyrighted works created in the U.S., registration is required to sue for infringement under the U.S. Copyright Act
 - Statutory damages available if work is registered before the infringement commences or within three months of publication
- Material copyrighted works previously assigned to Target
 - Author/creator retains irrevocable right to terminate any assignment within a five-year window beginning 35 years after the assignment
 - 56 years from the date of copyright for pre-1978 assignments
 - Does not apply to “works made for hire”
- Compliance with DMCA "safe harbor" provisions (if website permits user-posted content)

Employee/Contractor Agreements

- **Invention assignment and confidentiality agreements**
 - Present transfer of rights ("hereby assign") vs. promise to transfer ("will assign")
 - "Work for hire" only applies to certain copyrights, not all IP
 - When prepared by a contractor, software code not a work made for hire
 - Inadequate confidentiality measures could threaten proprietary status of trade secrets
 - Confidentiality obligations should be perpetual for trade secrets
 - Some states will not enforce perpetual confidentiality obligations for non-trade secret information

Intellectual Property Disputes

- **Infringement, misappropriation and dilution litigations involving Target, an affiliate or a key licensee/licensor**
 - Industry-wide or "patent troll" infringement litigations
 - Enforcement actions and material failures to enforce
- **Administrative actions**
 - Office actions, oppositions, cancellations, re-examinations, interferences
- **Domain name arbitrations**
 - UDRP proceedings
- **"Cease and desist" and "invitation to license" letters**
 - Action by either party imminent or required?
 - Possibility of declaratory judgment action

Intellectual Property Disputes (continued)

- Search for active matters in online databases
- Materiality of dispute; worst-case scenario
- Availability of alternatives in case of injunction
- Potential costs and indemnification obligations
- Likelihood of settlement
- Management time
- Loss of revenue from licensees
- Buyer's relationship to the adverse party – help or hindrance?
- Possibility of parallel actions in foreign countries
- Opinions of counsel regarding merits of claim or validity of third-party IP
 - Require special treatment in diligence process (delay disclosure; specific NDA identifying parties' common interest; avoid placing in data room)
- "Freedom to Operate" analysis

Information Technology

- No material malfunctions
- Operate in accordance with specifications
- No malware
- No unauthorized access
- Open source issues
- Source code escrow issues

Information Technology (continued)

- **Data protection policies and practices**
 - Collection and protection of personal information
 - Compliance with Massachusetts data protection statute
 - "General" rules in EU
 - Compliance with stated data protection policies and applicable law
 - Compliance with Payment Card Industry Data Security Standard (PCI DSS)
 - Change of control may trigger notice obligations in website privacy policy concerning transfer of personal information
 - Local counsel should provide guidance for cross-border data transfer
 - Obtain appropriate protection in Purchase Agreement
 - Complexity of overlapping state, federal and non-U.S. data protection laws and regulations makes it difficult to confirm through M&A due diligence whether Target is in compliance

Purchase Agreement: Key IP/IT Representations

- Schedule of IP
- Sufficiency of IP/IT Assets
- Ownership of IP / Right to Use
- No Liens or Encumbrances
- Validity and Enforceability
- Non-Infringement
- Confidential Information / Employee Matters
- Effect of the Transaction
- Company IP Agreements
- No IT Malfunctions / Viruses / Unauthorized Access
- Accuracy / Completeness of Source Code
- Open Source
- Data Privacy and Protection
- DMCA
- Research and Development

Sufficiency / Right to Use

- **Will the Target continue to have all IP and IT rights, assets and services necessary to operate the Business immediately after Closing?**
 - Particularly important in asset sales and carve-outs; sufficiency representation is commonly based on:
 - Transferred Owned IP/IT Assets
 - IP/IT licensed to Target pursuant to Transferred Target IP/IT Agreements
 - Ancillary license agreements between Buyer and Seller
 - Transition Services Agreement between Buyer and Seller
 - Seller should ensure no inconsistency with general sufficiency of assets rep

Non-Infringement: Allocating Risk

- **Who bears the risk of unasserted third-party infringement claims?**
 - **Buyer's position**
 - Seller is in better position to identify, assess and mitigate
 - Buyer may be a more attractive target
 - Deeper pockets?
 - Relationship to potential claimants?
 - Need for 6-year "look-back"
 - Address both threatened claims (cease and desist letters) and "invitations to license," which may be precursors to claims

Non-Infringement: Allocating Risk

- **Seller's position**

- Risk of doing business
- Impossible to assess infringement risk with 100% certainty
- Qualify warranties by knowledge and/or materiality
 - Potential compromise: knowledge-qualify solely with respect to patents / NPE patents
- Avoid "back door" non-infringement warranties
 - *In re Paragon Trade Brands*, 324 B.R. 797 (Bankr. N.D.Ga. 2002)
 - "The representations and warranties set forth in this Section are the only representations and warranties made by Seller in this Agreement with respect to any activity that constitutes, or otherwise concerning, infringement, misappropriation or other violation of Intellectual Property."

Effect of the Transaction

- These representations primarily address the risk of:
 - Licenses and other encumbrances that do not mature until Target is sold
 - Broad out-licenses or other obligations of Target that bind Target "and its affiliates"
 - After Closing, Buyer and its affiliates typically become Target's affiliates
- As license agreements have become more complex and sophisticated, these provisions are becoming part of Buyer's core set of representations
- Seller may seek to qualify these representations to its knowledge or limit to an agreed level of materiality

Purchase Agreement: Covenants and Other Provisions

- **Covenants and other IP/IT provisions**
 - Interim operating covenants
 - IP filings and portfolio management
 - Asset sale provisions
 - Closing deliveries
 - Third-party consents
 - Carve-out Considerations
 - Licenses in Purchase Agreement or as Ancillary Agreement?
 - Non-assignment provisions (SQL disclaimer)

Carve-out Considerations

- **Transferred intellectual property**
 - "Primarily used" vs. "Exclusively used"
 - Transitional assistance
- **Dual-use intellectual property**
 - License to divested entity
 - Scope of license
 - Restrictions on Transfer
 - Grant-back license
 - Relationship to non-compete
 - Ability to sublicense

Carve-out Considerations

- **Encumbrances on assigned IP**
 - Seller Cross-licenses
 - Seller Out-licenses
 - Exclusive vs. non-exclusive
 - Inventor remuneration
- **Trademark issues**
 - Treatment of composite marks and domain names
 - Transitional trademark license
- **Wrong pockets clause**
 - Grant of license vs. obligation to grant license
 - Often subject to a time limit (e.g., 6-24 months)

Ancillary IP Agreements

- **Transitional trademark license**
 - "Existing stock" vs. ongoing operation of business
 - Exceptions: Fair use? Reference to historical use?
 - Typically separate agreements if term longer than 120 days
- **Patent and copyright licenses**
 - Often perpetual, subject to non-compete and field limitations
- **Assignments of registrations and applications**
 - Master assignment (at closing)
 - Jurisdiction-specific assignments (post-closing)
 - Coordinate with local counsel on requirements for recording
 - Seller should obligate Buyer to record within agreed time period
- **Domain name assignments**
 - "Further assurances" to coordinate transfer with registrar

Relevant Practical Law Resources

- [Practice Note, Intellectual Property: Stock Purchases and Mergers](#)
- [Practice Note, Intellectual Property: Asset Purchases](#)
- [IP Due Diligence Issues in M&A Transactions Checklist](#)
- [IP Licenses: Restrictions on Assignment and Change of Control Flowchart](#)

The Speakers



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