

January 20, 2009

# IP Due Diligence: Even More Critical in a Troubled Economy

By *JON MAKI*

*Sheppard Mullin Richter & Hampton LLP*

Pick up any newspaper or trade journal and you will see the news of mergers and acquisitions, particularly in biotechnology and high-technology industries where venture capital is tight and the IPO window has been closed for some time. Cash is king, and those who have it are looking to acquire companies with strong pipelines, intellectual property portfolios and/or strategic positioning. But just because a company can be acquired for less than it was worth a short time ago doesn't mean that thorough IP due diligence isn't necessary to avoid costly mistakes down the road.

The upfront costs of such a review outweigh the risk of finding a deal-breaking issue only after the deal is done. Thus, a detailed investigation into IP asset scope and ownership is particularly critical for risk assessment in M&A transactions. Properly conducted IP due diligence will present information that is essential in assessing value, price and structure of a potential acquisition. IP due diligence is not just for the buyer; seller-side due diligence can locate key IP assets to be retained and attractively position companies for potential investors/acquirers.

Certain tips and best practices promote a thorough but efficient IP due diligence review.

1. Establish the goals and the anticipated transaction. How IP due diligence is conducted often depends on the deal in question. Clear goals help both the buyer and

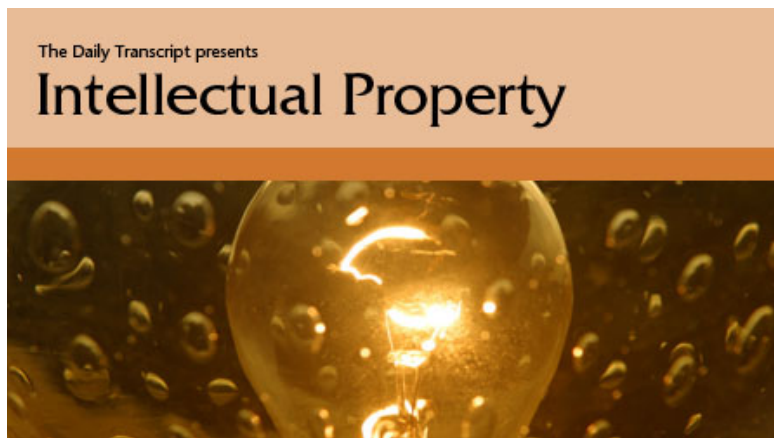
seller best prepare and complete IP due diligence, even if the results sometimes change the structure of the deal.

2. Establish a timeline and budget. An experienced professional will know how much can be accomplished and how deep the review can go based on timeline/budget so that an appropriate search strategy and team can be employed. A flexible approach to the methodology, sources searched, people interviewed, and form of report can be tailored to fit time and budgetary constraints.

Anticipating and securing records beforehand avoids rush charges and downtime. Regular (telephonic or Web) meetings are a cost-effective way to address potential issues before the final report, which itself may require significant effort depending on the results.

3. Establish record keeping procedures for the due diligence. Given the current financial climate, good organization before, during and after the review is essential to efficiently completing the task. A checklist is a must but properly assigning and tracking tasks is paramount. Recording what searches took place, the results and who reviewed what ensure completion without duplication.

4. Establish a multi-disciplinary team. A team of IP professionals with patent litigation, prosecution and licensing expertise as well as trademark and trade secret experience may be necessary to most effectively assess



an IP portfolio. Not every IP lawyer has experience in each of these areas, each of which can pose significant risks to a deal.

5. Establish the rights necessary for the deal to get done. Determine what the buyer needs to complete the transaction and, if applicable, clearly set forth any IP assets in which the seller is retaining rights. Some critical components that must be evaluated and addressed include:

*Ownership issues:* This can be as simple as inspecting the chain of title documentation. But a prudent buyer may also want to see any agreements conveying to or acquiring rights from third parties and conduct interviews regarding collaboration, consulting and employment agreements that can affect ownership and inventorship. Prudent sellers will have this documentation readily available and be able to explain the deals, policies and procedures that governed their creation.

*Freedom to operate (FTO):* The seller may be in the best position to explain the legal roadblocks and hurdles to commercializing a product based on the seller's IP rights, but independent analysis of the known blocking patents must be done. Depending on time and budget constraints, independent FTO searches are frequently employed. Products made in accordance with strong patents can still sometimes be blocked by others' patent rights. But exercise caution in disclosing opinions of counsel because the attorney-client privilege could be waived in a purely business transaction in which the community of interest doctrine does not apply. For products or services nearing the marketplace, trademark and

other commercial IP rights must also be cleared, and trademark descriptions that cover products that were never made or sold can be problematic.

*Strength of the IP:* An experienced IP attorney needs to assess the scope, validity and enforceability of the seller's IP assets. The seller may be able to point to particular strengths and weaknesses in its patents and applications, but the disclosures must be still evaluated for the basic requirements of written description, enablement and best mode. Similarly, what was or wasn't disclosed to the Patent Office can raise potential inequitable conduct issues requiring an understanding of what the seller knew at the time of filing. If the seller relies on trade secrets, efforts to maintain confidentiality should be evaluated.

In sum, IP due diligence is even more critical and valuable in a troubled economy because parties can less afford a costly mistake. Buyers are wise to independently assess the value and risks of the IP assets they are acquiring, and sellers can clearly benefit by making themselves more attractive for potential suitors. An experienced IP attorney can assist either side of the transaction by identifying key areas, focusing the budget and performing the necessary steps in a cost-effective manner.

*Maki is an attorney in Sheppard Mullin's San Diego/Del Mar office and a member of the Intellectual Property practice group. His practice focuses on all areas of IP law including patent, trademark and trade secret litigation, patent prosecution and transactional work such as due diligence and license agreements.*