The Metropolitan Corporate Counsel®

www.metrocorpcounsel.com

Volume 13, No. 2 February 2005

Intellectual Property Aspects of Mergers & Acquisitions: What Every Attorney Should Know

By Jeanne Hamburg

Intellectual property ("IP") is often a corporation's biggest asset. Indeed, in the "new economy," brand names – that is, trademarks, service marks and trade names – are often as important as the goods and services in connection with which they are used in creating a competitive advantage. Sounds, smells, colors and product shape can all enjoy trademark protection. The patents which embody the inventions incorporated in a company's products are also critical in protecting the patent holder's rights to exclude others from marketing a particular product. The same is true of trade secrets associated with product formulations, business methods and the like. Additionally, even for businesses not in the entertainment, information or other traditional "copyright" industries, copyright can be an important tool for protecting marketing materials, advertising campaigns, web sites, databases, software and any original expression distributed digitally.

Thus, it should come as no surprise that IP often plays an important role in the sale or purchase of a business. Early assessment and consideration of all IP assets of a business (so called "due diligence") is critical in a number of respects.

Often early attention to the IP aspects of a transaction can actually result in the conclusion that the proposed transaction should be structured in a particular way or reconsidered. For example, if all or most of the IP owned by the corporate seller is not assignable as a result of the contracts vesting ownership in the seller, then a stock purchase, in which the assignability of the assets is not important, may be preferable to an asset purchase. In this case, both parties are protected: the seller is not forced to make representations about assignability that are impossible to meet, and the purchaser is not forced to assume the risk of claims of infringement or the inability to enforce IP rights arising from the ineffectual transfer of rights.

Another reason for due diligence is in making sure stated closing conditions are ones that are possible to meet. To illustrate, the closing conditions may include the requirement that third parties consent to transfer of the assets being acquired. If, during the due diligence process, a third party is identified whose consent is required to transfer rights in some important intangible, and that third party refuses to consent, then this closing "condition" will need to be reconsidered and an appropriate exception crafted.

What, then, should a company contemplating a sale or purchase where IP is one of the assets being transferred, consider during the due diligence process? The short answer is: "Anything that could materially affect the value of the client or its IP position." As a starting point, a company should take early stock of its IP and assure that it can transfer the rights it wishes to transfer. Then it should evaluate whether there are any limitations on its ability to transfer those rights. This may entail evaluating the likelihood of success of potential or actual claims and litigation. The litigation not brought by the client may be as important as the litigation that is brought since IP rights can be lost from lack of enforcement. It should also evaluate agreements material to the company's business that may be affected by change of control, agreements that may vest rights in intangibles, and company policies and practices.

The types of agreements that a typical corporation may need to have reviewed with respect to IP can be quite far-reaching. A partial list might include not only agreements granting rights under patent, trademark and copyright, such as transfers and licenses, but joint venture agreements, employment, consulting, independent contractor, supply, vendor, service and non-disclosure agreements. All of these agreements have the potential to touch upon IP owned or licensed by the company.

How, then, should a company that wishes to sell its business or some part of its business which includes IP assets go about conducting due diligence? Generally, it is advisable for the seller to pursue at least three different avenues: interviews, document (including agreement) review, and independent investigation. Initially, individuals within the company who have relevant information about the company's IP should be identified and questioned closely by counsel about their knowledge of relevant information and documents. They may also be able to identify others within the company who should be interviewed.

Because it ideally should be undertaken early on, long before a deal is memorialized in the purchase agreement, the process of personnel interviews may be somewhat complicated by the need for confidentiality. Particularly if the company is public (and there is some concern about effects of the news of a possible deal on the stock market), but even when it is privately held, there may be a need to avoid disruption of business and possible loss of personnel by too widely sharing the news of an impending sale, purchase or merger. It may be wise to have those employees who are interviewed sign non-disclosure agreements binding them to maintain the confi-

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dentiality of the proposed transaction.

Once personnel interviews are well under way, it will be important to review any forms of agreement and specific agreements that affect the company's IP rights and position. Potentially hundreds of agreements may be relevant and thus, for any given transaction, the task may be beyond the scope that can be accomplished by a single person. In that case, assembling a team which includes in-house and perhaps outside counsel, and may also include business people, is important. Early attention should be paid to formulating a "wish list" of all the documents the team wishes to review. Every member of the team should understand the context, purpose and key terms of the intended business deal. Additionally, the team leader(s) should establish a timeline for collecting and reviewing documents and a "data room" in which the documents can be centrally accessed. (It is likely that some or all of the contents of the data room, to the extent not privileged, will later be shared with opposing counsel as part of its due diligence.) Charts are often useful for summarizing key clauses of particular contracts. Charts can be organized by type of contract and contain information keyed to important clauses (e.g., assignability on change of control).

In addition to conducting personnel interviews and document review, counsel working on due diligence should not overlook independent investigation in uncovering potential areas of exposure; opposing counsel surely will pursue this avenue. Included among the documents and information counsel should seek out and review will be: U.S. and foreign patent, trademark and copyright rights and filings; information available through the U.S. Patent & Trademark Office and WIPO web sites; assignment records and maintenance fee/annuity records for patents; and commissioned Copyright Office searches with chain of title information and information on any security interest (e.g. lien). Additionally, counsel should carefully review UCC filings for security interests secured by IP; conduct Internet/news database searches and Westlaw/Lexis or other databases containing information with respect to litigations; prosecution files and assignment records; and if the company being acquired is public, SEC filings which include listings of material arrangements and contracts. Counsel may also want to examine errors and omissions insurance to see if any exposure potentially arising out of the transaction is covered or, if not, investigate whether errors and omissions insurance should be acquired for particularly large exposures.

Finally, counsel should prepare a report with an analysis of all the potential risks and areas of exposure brought on by the transaction. This will be critical in memorializing the results of the laborious personnel interview, document review and independent investigation process, and likely invaluable if, as often happens, months pass between due diligence and the time period when drafts of the purchase agreement actually circulate.

The next step is to focus on reducing the agreement to a writing that comprehensively addresses the IP issues while at the same time not unduly exposing either seller or buyer to risk.

The most significant provisions of the agreement from the IP attorney's perspective are: (1) definitions of assets and IP; (2) the scope of the transfer; and (3) representations and warranties. However, many other provisions of the agreement may touch on IP and it is important, even for counsel retained only for IP advice, to review the entire agreement to be sure nothing is missed.

That said, the representations and warranties, indemnification provisions, and disclosure schedules will often be the focus of the IP-related drafting. That is because the seller's (and purchaser's) exposure for IP-related damages will turn on the language in these sections. If a seller makes and then breaches that representation and warranty, typically it will be obligated to indemnify the purchaser for some or all monetary consequences of that breach. Worse yet, if the representation and warranty is intentionally misleading, the seller may be liable for fraud.

Disclosure schedules are also critical because typically the seller is not liable, unless the purchase agreement otherwise provides, for any monetary damages resulting from disclosed events. For example, if the seller discloses that a third party's consent for transfer of an important contract is required, and that third party withholds consent despite the seller's "reasonable best efforts" to secure such consent, the seller is typically not liable for monetary consequences of the refusal to provide consent.

Representations and warranties are often qualified by the disclosure schedules – that is the seller makes the representation of a certain fact "unless otherwise disclosed." Typical representations and warranties/disclosure schedules include: lists of all the IP the seller owns, has licensed from someone else and has licensed to someone else (often defined by reference to a disclosure schedule); the seller's representation that it hasn't given any IP or other rights away unless it's disclosed; a list of all transactions affecting IP; and the seller's representation that it owns or has acquired sufficient rights to exploit the works in the way it is doing so currently.

Additional representations and warranties include the seller's representation that it has good and marketable title; the seller's representation that there are no liens or judgments against the seller's IP; that 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; that seller has the right to use computer systems and software and to transfer such rights to the purchaser; that there are no pending, threatened claims against seller unless it discloses otherwise; that seller is not violating any third-party rights unless it so discloses; that no third party is violating any of seller's rights unless it so discloses; that there are no pending, threatened claims asserted by seller unless it discloses otherwise; that domain names and trademarks are still in full force and effect as of closing and that there are no pending or threatened challenges to domain names, opposition, cancellation, etc. as to trademarks; that contracts and rights thereunder are assignable; and that the seller owns rights to customer information, supplier information or other lists included in the IP assets being sold.

As counsel for the seller, you will want to qualify representations and disclose any vulnerabilities. As counsel for the purchaser, you will want to obtain the broadest, least-qualified representations and warranties and press for early review of the disclosure schedules and early commitment to a "final" draft of the schedules.

At the end of the day, thorough due diligence will inevitably lead to a contract which best protects the client and furthers the interests of both parties in a fair (and realistic) transaction. The importance of due diligence in the IP area should not be underestimated whenever any valuable intangibles change hands.

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