Research Paper Management

Patent Due Diligence for Technology Based Enterprises in Merger and Acquistion

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ABSTRACT

The areas of intellectual property include patents, trademarks, copy¬right, trade secrets and industrial designs. All forms of intellectual property have to be evaluated to mitigate the corporate risks in mergers and acquisitions (M & A). Due Diligence analysis is imperative for evaluating all aspects of a potential merger or acquisition. If a due diligence review is being conducted on behalf of the acquirer, the resource gathering procedure, including that relating to intellectual property, is a means of discovering as much as possible about the status of the acquiree. Intellectual property, especially patents, form the profits source in corporate transactions. This paper focuses on the patent due diligence in M & A and its mechanics and considerations.

Keywords : Patents, Due Diligence, Merger and Acquisition, Intellectual Property Rights

Introduction

Reports from the Federal Reserve's data indicate that, the non financial sectors in United States had accrued $1.93 trillion in cash and other liquid assets representing 7.4% of total assets of company-the largest since 43 years. With these surplus reserves, these companies would be looking forward invest in new technology or acquire other companies to enhance growth. The growth in technology companies are determined by the value of intangible assets or the intellectual property portfolio the target company possess. Hence it becomes appropriate to conduct due diligence of intellectual property to determine the true value of intellectual assets.

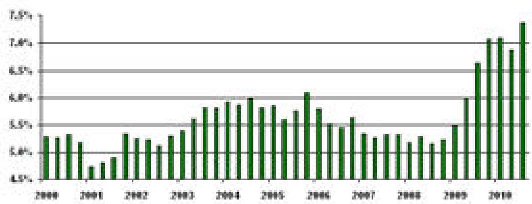

Figure 1- Corporate cash percentage of reserves; Source-Federal Reserve, 2011

Due diligence refers to the procedure of accessing the issues values and risks associated with corporate transactions. This process is vital in many corporate transactions such as M and A, new ventures, licenses, initial public offerings and litigation.

Patent due diligence:

Patent due diligence is an investigation about a patent. Due diligence is often done prior to acquisition, so that the potential purchaser knows more about the asset that they are acquiring. The four major areas of patent due diligence can be undermined as below:

- Ownership and Control of Target Company Intellectual Property
- Structure of the Proposed Transaction
- Recognition of Strategic Value of the acquirer's IP
- Target (and Acquiring) Company Exposure to Liability from Intellectual Property of Others

Review of patent portfolio:

The preliminary step in the patent due diligence is the review of patent portfolio which includes these steps

(a) Obtain Expiration dates and renewal fee records of issued patents in different foreign and domestic jurisdictions.
(b) Obtain the patent inventory of granted patents and pending patent applications or drafted ones, which includes subsidiary of target company or affiliated of the IP holding company.
(c) Obtain invention disclosures that have been submitted but that haven't been filed.
(d) Verify all members of patent family are included in the patent portfolio.
(e) Due Diligence Team should build its own patent inventory of public or commercial databases as a cross ensure on the Target Company list.
(f) Examine the scope transferability duration of licensee/ licensor

After examining the ownership and control of intellectual property patent portfolio, the next process of due diligence in M & A is examined

Structure of the Proposed Transaction:

In a transaction structured as the purchase of assets, only those tangible and intangible assets and liabilities specifically listed in the agreement are transferred. In this case assessment of any omitted patent family should be evaluated and distinguished.

Other due diligence issues that requires paramount consideration are:

(a) Evaluation of foreign patents to ascertain, whether assignments to the Target Company were properly drafted, executed and filed.
(b) Review of license agreements to ascertain whether they are assignable with or without consent of the other parties.

Recognize Strategic Value of the Acquiree's IP:

The primary objective of due diligence team is to ascertain value of acquiree's patent portfolio and its market exclusivity with regard to acquirer's business

The basic analysis of acquiree's patent portfolio with regard to its product and services has to be organized.

However, there are ways to investigate acquiree's patent portfolio, which include:

- Due diligence team should identify titles/abstracts of highly cited patents and make an assessment of their relevancy to the products/services/lines of business of acquiree
- If the quality of the Claims in the Patents is low then the overall strategic worth of the portfolio might be limited. This can be accomplished through manual analysis, or with larger portfolios, by leveraging portfolio claims assessments driven by expert systems.

STRONGER PORTFOLIO

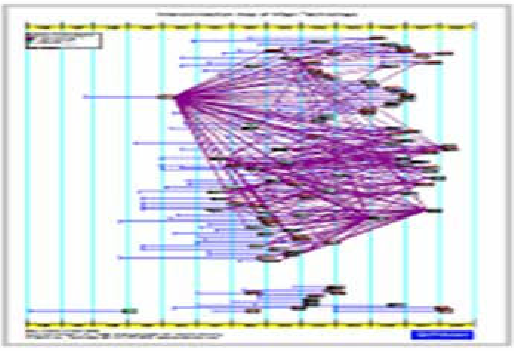

Figure 2: Portfolio Analysis, Source- Author's creation

- **Citation Clustering:**

Patent mapping software helps to visualize cross cite of patents against other patents. Prior art evidences a cohesive patenting strategy in which new features and extensions to a core invention are protected over time, creating a exclusive patent right against competitors.

WEAKER PORTFOLIO

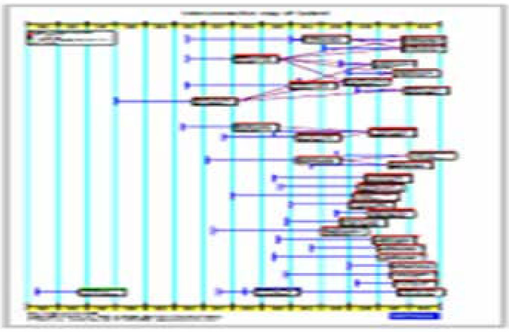

Figure 3: Portfolio Analysis, Source- Author's creation

- **Patent Family Size :**

Determines the strength of patent family and its technology/ products with regard to the acquiree. Also establishes the proportion of portfolio that are in patent families that contain more than one member

- **Expired Patents:**

Patents that have expired six years ago may still sue for damages accrued through expiration, subject to statute of limitations and equitable defenses.

Litigation

All forms of litigation documents/infringements notices should be examined and scrutinized. Also the litigation/claims against the target company, such as cease and desist letters from the company should be recognized. Copy of settlement agreements/releases/indemnification agreements should be taken into consideration. All license offers received should also be identified to scrutinize potential future claims or licensing opportunities.

Recent due diligence issues in Mergers and Acquisitions in United States:

Observations

United States patents have a predictable value for the product, practice the method and restrict competitors from doing same. Assessing the true value of the patent is complex task. Currently, Federal Circuit law requires a patentee seeking indemnity, to draw very specific claim, around the invention is, its improvement over the prior art, and limit the other licenses, can be viewed as comparable analysis. The reasonably high reversal rate for patent cases makes them both more exclusive and less conventional in outcomes.

Licenses to Patents

Licenses to patents are essential to a company. But Target Company may have weak licensing options. Smaller companies may have negotiated for less due to more bargaining power of larger corporations. The converse might also be true. A license will not automatically extend to a purchaser of a licensee or to the acquired trade of a licensee, but may give the parties an option to license other operations at the same price. Moreover, if the idea is to expand merge the operations, whether a lump sum was paid or a running royalty is due. Many aspects have to be considered and requisite due diligence has to be conducted before licensing patents.

Conclusion:

A due diligence review of an intellectual property patent portfolio can facilitate an acquirer to evaluate more precisely the inherent risks associated with an investment in a company and enhance the likelihood of a successful, economically rewarding outcome.

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