

### **Intellectual Property Issues in Mergers and Acquisitions Deals**

A potential merger or acquisition of a target company must include a thorough investigation of the target company. (See our July 2009 newsletter on Due Diligence, available at <http://www.morganlewis.com/mandaprimers>.) A critical part of this investigation is the review of the target's intellectual property assets and all agreements the target has entered into relating to such IP assets.

The following are some of the important issues that need to be addressed in an IP due diligence investigation.

#### **Ownership and Sufficiency**

An important aspect of the due diligence process is confirming the target company owns, or has valid licenses for, all intellectual property and technology that is used in the target company's business. This is done in two ways. First, by reviewing documents relating to ownership of registered intellectual property, and the agreements with third parties pursuant to which the target company is granted the right to use such third parties' intellectual property or technology. Second, by obtaining representations and warranties from the target company in the acquisition documents.

A secondary issue is confirming that not only does the target company have the right to use all intellectual property and technology used in its business, but that all intellectual property and technology currently in the target company's possession is all the intellectual property and technology necessary for the target company to conduct its business as currently conducted and as proposed to be conducted. If the target company will need to obtain a license to use third-party technology or intellectual property, this should be disclosed.

#### **Infringement**

There are two basic types of intellectual property infringement cases to concern the buyer when acquiring any company. The first is infringement by the target company of a third party's intellectual property rights. Intellectual property infringement litigation, and particularly patent infringement litigation, is very expensive and can take many years to resolve. While few companies outside of the biotechnology arena regularly conduct extensive patent searches to determine whether they have freedom to operate without fear of infringement suits, the target company should disclose any potential infringement it is aware of. This includes any letters the target company may have received from potential licensors, and any noninfringement opinion letters the target company may have obtained from patent counsel.

The second type is infringement of the target company's intellectual property by third parties. While the decision whether to bring an infringement claim is generally within the target company's discretion, knowing whether the target company is aware of third-party infringement is useful in determining the value of the target company's intellectual property assets. In addition, having a strong patent portfolio can be helpful as a shield against infringement suits by third parties against the target company.

### **Intellectual Property Agreements**

Intellectual property agreements can present a number of significant issues, and therefore should be reviewed carefully as part of the due diligence process. For agreements pursuant to which the target company receives a license to use a third party's intellectual property or technology, the acquiring company should confirm that the scope of the license is broad enough to cover all current and anticipated future uses of the licensed intellectual property or technology (including the right to make modifications, if applicable), contains reasonable indemnification provisions (ideally with those obligations excluded from any limitations on the licensor's potential liability), and contains ownership provisions allocating ownership of any permitted modifications.

For agreements pursuant to which the target company grants a license to a third party to use the target company's intellectual property and/or technology, the acquiring company should confirm that the scope of the license is narrowly drafted so that only those rights needed by the licensee are granted, the indemnification provision, if any, is limited to a small number of jurisdictions (e.g., United States patents vs. worldwide patents), the indemnification provisions and other significant obligations of the target company are limited by an appropriate limitation of liability, the target company's ownership of its intellectual property and/or technology is clearly stated, and the licensee is obligated to maintain the confidentiality of the target company's intellectual property and technology. Further, the acquiring company should ensure that such agreements do not include definitions or other terms that could grant to the licensee rights in the acquiring company's products or intellectual property.

### **Restrictive Covenants**

The acquiring company should review all technology-related contracts entered into by the target company to determine whether any restrictive covenants have been agreed to by the target company. These covenants can include grants of exclusive rights and agreements not to pursue a particular product or field of use. A grant of exclusive rights can take a number of forms, including an exclusive license or the appointment of an exclusive distributor or reseller in a particular territory or for a group of products.

### **Royalty Obligations**

The acquiring company should determine whether any royalties, commissions, honoraria or similar fees are required to be paid by the target company in order to continue the development and sale of the target company's products, and whether any such fees would have to be paid as a result of the consummation of the contemplated transaction. While it is common for a company to have some ongoing payment obligation with respect to third-party technology included in the company's products, the amount and duration of royalty obligations should be determined and taken into account when determining the value of the target company's products.

### **Source Code**

The possession of source code for all software distributed by the target company is critical to the target company's ability to maintain and evolve its software products. This is also true for any third-party software incorporated by the target company into its products if the target company will need to make modifications to such third-party software in order to do the integration and develop bug fixes. If the target company does not have possession of source code for third-party software, the acquiring company should review the license agreement applicable to such third-party software to ensure the third-party licensor is obligated to provide support to the target

company and its customers. The acquiring company should also confirm whether any source code for the target company's products has been provided to any third party, whether to an escrow agent or directly to a third-party licensee.

### **Open Source Software**

Open source software is widely used by a variety of companies, both in the form of tools and programs used by the company in its internal business operations, and as part of or incorporated in the company's products. The manner in which open source software is used, and the open source license governing its use, can have a significant impact on the target company's software. Therefore, the target company should provide a complete and accurate listing of all open source software used by the target company, copies of all applicable licenses, and a description of how such open source software is used.

### **Registered Intellectual Property**

The intellectual property due diligence process should include a review of materials relating to the target company's registered intellectual property, including patents and patent applications, copyright registrations, trademarks and trademark applications, and internet domain names. The acquiring company should request a list of all of the target company's registered intellectual property, and documents evidencing the target company's ownership of all items on such list. The acquiring company will want to confirm the target company is the owner of record for all such items.

### **Employee Issues**

In the absence of a contract, ownership of inventions (whether or not patentable) initially vests in the inventor. Therefore, the acquiring company should confirm that all of the target company's employees and contractors have executed written agreements assigning ownership of all intellectual property and technology developed by those parties to the target company. In certain limited circumstances, a license from the employee or contractor to the target company may be sufficient, though those cases should be carefully reviewed prior to a determination of sufficiency.

If you have any questions, please feel free to contact us.

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