

# Identifying Value and Risks in the IP-Driven Deal

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## The IP-Driven Deal

An IP-driven deal means a technology deal focused on intellectual property such as a patent portfolio. However, even a non-technology transaction may involve important intellectual property assets. Business executives recognize the importance of capturing all the potential value of a transaction. A KPMG study found that over 80% of mergers failed to produce any business benefit in terms of shareholder value. IP due diligence, done early and done right, goes a long way toward extracting incremental value, managing risks and facilitating post-deal integration.

## Identifying the IP

Identifying the target's IP is the first step in valuing IP, which includes a range of intangible assets such as patents, trademarks, copyrights, trade secrets and know-how. IP lawyers systematically collect due diligence information to identify the target company's IP. Due diligence focuses on patents and patent applications that purport to cover the company's primary revenue-driving technology, and trademark registrations and filings on the company's trademarks, service marks and trade dress. IP also depends on an effective retention program for key employees who may possess the know-how necessary to run the business and integrate technology and operations.

## Identifying Risks

### Ownership risks

IP lawyers do not presume that a company owns the IP used in its business. As a rule in patent law, absent any written agreement, an inventor owns the patent or patent application, and in copyright law, an author owns the work product. Therefore, if an inventor or author

is an independent contractor rather than an employee of the company, further due diligence is warranted. If a government entity or a university is in the picture, IP ownership almost always resides in the government entity or university absent a written agreement to the contrary.

*Example—tech start-up:* A cautionary example involves an employee at a tech start-up. In the employment agreement, where prompted, the employee briefly identified certain technology he had developed on his own prior to employment at the company. The company failed to follow up on this note at the time. The employee subsequently refused to assign patent applications to the company on the basis that his independently developed technology was incorporated into the invention. When the company was being acquired, the ownership of certain key patent applications came into question, and the company was forced to make additional payments to secure his signatures.

## Infringement risks

Because of the complexity of the potential disputes and the high cost of litigation, the words “IP infringement” strike fear in many business executives. Although the parties cannot entirely eliminate the risk of infringement, proper IP due diligence can at least identify where the risks lie and how these risks may be allocated between the parties.

Due diligence can also assess whether the target company adheres to proper IP practices, such as incorporating routine patent and trademark clearance searches and freedom-to-operate analyses when launching a new product under a new trademark. Verification plays a crucial role in the case of patents, as the owner of a patented technology may not have the right to practice the invention if it infringes the rights of another patent holder. Evaluating the risks of infringement requires effective lines of communication between the IP lawyers and the deal team.

## Risk of invalidity

The target company's key IP merits an initial review to spot any obvious invalidity. For example, a patent may be invalid for a number of reasons, including improper inventorship, public disclosure of the invention more than one year before filing of the patent application, offer for sale more than one year before filing of the patent application, failure to disclose material prior art to the U.S. Patent and Trademark Office during the pendency of the patent application, improper payment of government fees under small entity status, and other irregularities. Omissions or missteps in the patent process are often incurable and result in an invalid and unenforceable patent worth nothing.

*Example—foreign patents:* Although the U.S. patent laws provide for a one-year grace period to file a patent application after initial public disclosure, most foreign countries do not. Therefore, if the acquiring company seeks to develop a key market in a foreign country, due diligence should focus on patent validity in that jurisdiction.

## Maintaining IP

An IP portfolio is a living thing that requires nurturing. IP due diligence should assess whether the portfolio has been neglected or cared for; appropriate procedures vary depending on the type of IP. For example:

*Patents:* Pending patent and trademark applications require timely responses to usher them through the U.S. Patent and Trademark Office. Issued patents require periodic maintenance fee payments to avoid abandonment. Knowledge about patent infringement without appropriate enforcement action may render the patent unenforceable.

*Trademarks:* Trademarks require continued proper usage and enforcement to avoid loss of trademark rights. Third-party trademark registration filing and use requires diligence monitoring to protect the trademark rights. Further, if there are licensees under a trademark, the license agreement must provide for quality control to protect the trademark.

*Domain names:* Domain name registration must be kept current.

*Trade secrets:* The company should put in place guidelines and reasonable security precautions to protect trade secrets.

## Protecting Essential Technology

*Patents:* Drilling down into the due diligence requires a detailed analysis of the IP portfolio. A company may believe that its essential technology is patented and thus protected, but in fact the patents may have serious deficiencies. For example, the patent claim language may not cover the most valuable aspects of the technology. Inadequate claim language may result from miscommunication between the patent attorney and the inventors, or the technology may have morphed or been improved after the filing of the patent application. Patent claims may also have overly narrow scope, allowing competitors to design around them easily. Problems with the wording of patent claims can render them difficult or impossible to enforce.

*Trademarks:* As a corollary on the trademark side, trademark registrations of the target company may not fully cover the acquirer's intended uses and markets.

*IP due diligence:* After closing, the acquiring company may use the diligence results to correct IP deficiencies and shore up the portfolio.

## Identifying Any Prior Agreements That Limit or Take Away IP Rights

*Transfer of IP:* The IP due diligence seeks to determine whether the target company's IP rights are freely transferable. One often-cited example of due-diligence-gone-wrong is the Rolls-Royce Motors deal in 1998, when Volkswagen outbid BMW in the purchase of Rolls-Royce Motors. However, a prior stipulation in the Rolls-Royce ownership documents required that Rolls-Royce plc, the aero-engine maker, would retain the essential Rolls-Royce trademarks if the automotive division were sold. Rolls-Royce plc chose to license the trademarks not to Volkswagen but to BMW. As a result of the prior agreement, Volkswagen could make the cars, but could not brand the cars with the famous Rolls-Royce name and logo.

*Open source software:* A survey conducted in 2008 found that 85% of companies used open source software. If the target company develops software and incorporates open source software into its software code, then the company's IP rights in the software code are likely subject to an open source license. Due diligence can identify the software code subject to the open source license and the flavor of open source license at issue.

## IP and M&A

The KPMG M&A study identified due diligence as one of three key activities of successful acquirers that had a tangible impact on financial benefits from the deal. Synergy evaluation and integration planning also delivered financial benefits. Hidden value—and hidden costs—from IP assets can determine whether or not a deal yields positive shareholder value. A due diligence briefing by the IP lawyers can provide the deal team with important information on IP, including:

- The range of IP assets that drive revenue, and key employees with know-how,
  - Risks associated with IP assets and the target's historical practices related to IP,
  - Potential deficiencies in maintaining the IP portfolio, and whether any material IP assets have been neglected or lost,
  - Adequacy of patent protection and trademark registration, and
  - Any prior agreements that limit or take away IP rights central to the deal.
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## A Modern IP Practice

Andrews Kurth has a seasoned intellectual property practice dedicated to ensuring our clients' IP assets, business brands and global presence are consistently, strategically and effectively managed, protected and enforced. But gone are the days when intellectual property was left to mad scientists, lone inventors and disparate IT departments. Today, intellectual property not only commands a place at the corporate table, but often serves as a driver of innovation, growth and corporate strategy. That is why Andrews Kurth has patently positioned our IP team at the intersection of business and technology. We are bringing IP out of its technical comfort zone and into the business environment in which it exists. We look beyond the portfolio and see the possibilities.

The Andrews Kurth Intellectual Property Practice has:

- More than 20 full-time IP attorneys with a combined 300 years of experience.
- In the past decade, filed more than 700 patent and trademark applications on behalf of our clients and successfully represented clients in disputes in front of federal and state courts, the U.S. Patent and Trademark Office and in international tribunals.
- A comprehensive cross-border IP practice concentrated in Asian markets, including China and Taiwan, addressing both inbound and outbound matters.
- Consistently ranked Band 1 in the Technology: Corporate & Commercial category for leading Texas firms since 2007 in *Chambers USA: America's Leading Lawyers for Business*.

- A team of IP lawyers in which many hold technical and/or scientific degrees and have legal, technical and commercial experience as IP trial lawyers and appellate advocates; in-house IP counsel; business executives; patent examiners; engineers and scientists.

Now that is straight talk about intellectual property. For more information about Andrews Kurth's Intellectual Property Practice, or to learn more about our IP attorneys, please visit our website at [www.andrewskurth.com/practices-IntellectualProperty.html](http://www.andrewskurth.com/practices-IntellectualProperty.html).



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Wei Wei is a Partner in the Intellectual Property section of the Dallas office. Wei Wei focuses on the procurement, licensing and enforcement of intellectual property, including patents, copyright, trademarks and trade secrets of high tech clients. She also works closely with clients on patent reexaminations and legal opinions related to patent infringement, validity, freedom-to-operate, clearance and other issues. She works with clients ranging from Fortune 100 companies to solo inventors to secure and protect their patent rights. She received her J.D. in 1993 from Southern Methodist University Dedman School of Law and her B.S. in 1986 in Computer Engineering from the University of Illinois at Urbana-Champaign.



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