

# THE EVOLVING ROLE OF INTELLECTUAL PROPERTY ANALYSIS IN M&A TRANSACTIONS

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*M&A Due Diligence - Maximizing the Odds of Success*

Incremental Advantage

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# Evolution of the Role of IP in M&A Decisions

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First Generation -

IP as a *Risk Factor* - Identification and allocation of IP-related risk

Second Generation -

IP as a *Value Driver* - Integrating IP into the deal pricing calculus

Third Generation -

IP as a *Deal Driver* - Target selection based (at least in part) on IP

# Alternative Deal Structures

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Divestive –

- Sale of entire business

Assets –

Liabilities usually not assumed

Stock –

No change in corporate entity

# Alternative Deal Structures (cont.)

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Divestive (cont.) –

- Spin out

Unincorporated division or business unit –  
Asset-based, IP included

Technology assets or product line –  
Asset-based, IP essential

IP only –  
Formation of independent licensing entity

Spin-out vs. Spin-off –  
Divestive (cash-out) vs. participatory (equity)

# Alternative Deal Structures (cont.)

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Aggregative –

- Merger

Forward – Target merges into Buyer and disappears

Forward Triangular –

Target merges into Buyer-Sub and disappears

Reverse Triangular –

Buyer-Sub merges into Target and  
Target survives (at least for a while)

Merger of equals (MOE)

More complex variants

## Alternative Deal Structures (cont.)

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### Collaborative –

- Joint Venture

Without forming a Newco (contract-based)  
With a Newco (investment-based)

- Co-development
- Co-marketing, Co-branding
- Other strategic alliance  
(e.g., IP pooling, consortia, standard-setting)

# Primary IP Objectives

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Acquisition of entire business –

Identification of IP risk and allocation between Buyer and Seller

Acquisition of business unit, product line, technology or IP assets –

Allocation of IP ownership and use rights between Buyer & Seller

Joint Venture –

Allocation of IP ownership and use rights between each Partner's pre-existing and prospective (Non-JV) business activities and Joint Venture's business activities

# IP Allocation Mechanisms

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## Forms of rights transfer to Buyer

- Full assignment
- Assignment with grant-back license –
  - Exclusive field-of-use grant-back
  - Non-exclusive grant-back (with or without field of use restriction)
  - Grant back to improvements ??
- Assignment of joint ownership interest –
  - With or without contractual field-of-use restrictions
- Exclusive license –
  - Field-of-use (application) limited
  - Term-limited (head-start)
  - Territory limited
- Sole license (exclusive with use reservation by Seller)
- Non-exclusive license
- Covenant not to sue–
  - Ordinarily personal, non-transferable
  - Explicit inclusion of customers and other TPBs

## IP Allocation Mechanisms (cont.)

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*Example 1: Acquisition of business unit, product line or technology*

Partition of ownership into Retained IP and Assigned IP –

Much IP (particularly patents) will cover **both** business and/or technology transferred to Buyer and some/all of Seller's ongoing business/technology

Forward license from Seller to Buyer on Retained IP –

Field-of-use vs. unrestricted

Grant-back license to Assigned IP –

Field-of-use vs. unrestricted

Joint IP ownership (assignment of undivided interest)

With contractual field-of-use partition  
Without restrictions (not recommended)

## IP Allocation Mechanisms (cont.)

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### *Example 2: Joint Venture - Technology and associated IP partitions*

- Background Technology/IP

Pre-existing; and  
Developed during, but not pursuant to, JV

- Foreground Technology/IP

Developed pursuant to JV

Jointly developed  
Solely developed

- Derivative Technology/IP

Subset of Foreground IP based exclusively (or primarily) on one party's Background IP

## IP Allocation Mechanisms (cont.)

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### Joint Venture Types –

- JV Without a Newco (Contractual JV)

Licensing of JV Partners' Background IP to one another as necessary to accomplish the objectives of the JV

License-back of Foreground IP to each JV Partner in carefully defined (and often non-competitive) fields-of-use.

## IP Allocation Mechanisms (cont.)

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### Joint Venture Types (cont.) –

- JV With a Newco (Investment JV)

Assignment of selected JV Partners' Background IP to Newco (or not)

Exclusive (or non-exclusive) license of selected JV Partners' Background IP to Newco for use within Newco's defined field-of-use (usually royalty-free)

Exclusive (or non-exclusive), royalty-bearing (or not) grant-back licenses of Newco-developed IP from Newco to JV Partners for use outside Newco's field-of-use (and often in mutually exclusive fields as between the Partners)

## IP Allocation Mechanisms (cont.)

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Joint Venture Types (cont.) –

- Two-Stage JV

Interim (Pre-Newco) Phase – Courtship

Exploration of feasibility and fit

Formation and operation of Newco - Marriage

Wedded Bliss, but –

What happens to Interim IP if  
Newco isn't formed?

# Acquisition of Entire Business – Risk Identification

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## Disclosure/Due Diligence –

- IP Due Diligence Request
- Document Review
- Interviews
- Independent Investigation

## Acquisition of Entire Business – IP Risk Factors

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- Third Party IP infringement claims/litigation - asserted and prospective
- Lack of - or inability to locate - IP assignment agreements for key creative employees and consultants/contractors
- Potential termination of inbound license(s) for critical technology
- Potential compulsory royalty-free licensing of proprietary software due to “contamination” by combining with open source software
- Potential compulsory RAND licensing of patents due to participation in standard setting organizations
- Potential loss of trade secrets due to absence of NDAs and/or inadequate internal security

## Acquisition of Entire Business – IP Risk Factors (cont.)

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- Restrictions on transfer of target's in-licensed IP to acquiror
  - Anti-assignment provisions
    - Requiring consent
    - Automatic termination of license
    - Application to Reverse Triangular Merger --
      - Does an RTM constitute assignment?
    - Default legal rules where license is silent
      - Patent – Non-exclusive vs. exclusive
      - Copyright and other IP licenses
  - Change-of-control provisions
- Leakage of acquiror's pre-existing IP to third parties via target's license agreements

## Acquisition of Entire Business – IP Risk Factors (cont.)

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- Encumbrances on Target's IP
  - Exclusive licenses out
  - Non-exclusive licenses to competitors
  - Covenants not to sue
  - Settlement agreements
  - Etc.
- Real limitations on ability to conduct business vs. permission (license transfer) costs.
- Show-Stoppers and Deal-Breakers -
- What is the appropriate materiality threshold?

# Acquisition of Entire Business – IP Risk Allocation

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## Typical IP Reps. and Warranties –

- Ownership of or right-to-use designated IP

Valid title to scheduled Company-owned IP

Valid licenses to scheduled Third Party IP

No encumbrances -

on exploitation or use of IP

on conduct of business

as currently conducted

as contemplated

- Validity & enforceability of Company-owned IP
- Sufficiency of owned and licensed-in IP for conduct of business

## Acquisition of Entire Business – IP Risk Allocation (cont.)

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### Typical IP Reps. and Warranties (cont.) –

- Non-infringement of third party IP rights

Patents

Copyrights & Trade Secrets

Trademarks & Domain Names

Other IP

- No pending or threatened third party IP claims
- Agreements with employees and consultants re:

Confidentiality of Company trade secrets

Ownership of inventions/work product

- Non-contravention of existing IP agreements
- Non-impairment of existing IP

## Acquisition of Entire Business – IP Risk Allocation (cont.)

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### Typical IP Reps. and Warranties (cont.) –

- Qualifiers

Knowledge (whose?, actual vs. constructive, duty to inquire)

Materiality - Material vs. MAE (Material Adverse Effect)

- “Bring-down” of reps at closing.
- Accuracy of IP reps as a Closing Condition (exit option)
- Indemnification cap for breach of IP reps
- Post-closing escrow for breach of IP reps - how much and how long?

# Acquisition of Entire Business – Risk Allocation (cont.)

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Effect of Breach of IP Reps & Warranties –

Pre-Closing

Exit option (if breach is material or causes a MAE )  
aggregation of individual breaches to get to MAE?

Possible basis for price renegotiation (unusual for IP)

Post-Closing (should reps survive and if so, for how long?)

Money damages

Monetary caps and time limits

Who stands behind the reps?  
Seller's shareholders  
Other guarantors

# Acquisition of Entire Business – Risk Allocation (cont.)

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Interplay between Reps and Disclosure –

Exception Schedules (aka Disclosure Schedules)

Primary Negotiation Areas –

Definition of *knowledge*, *materiality*, and *MAE* qualifiers and selective application to individual reps

Inclusion vs. exclusion of selected disclosure items vis-à-vis Exception Schedules

# The New Deal – Early Stage (Pre-Pricing) Consideration of IP

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- Value Analysis as well as Risk Analysis
- Inclusion of IP analysis by investment banks in target selection and pricing processes
- Assessment & valuation of technology (the old model) vs. technology *and* IP (the new model)
- Strategic, as well as statistical, view of IP
- Increasing emphasis on substantive analysis of scope and validity of issued patents and pending patent applications
- The role of the CIPO in the M&A process