

INTELLECTUAL PROPERTY 2021 EXPERT GUIDE

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Best practices in IP due diligence for M&A transactions and investments

By Yuval Marcus & Jordan Garner

Intellectual property (“IP”) has become an increasingly important driver of M&A transactions and investments in technology companies. IP is particularly significant in transactions involving medical, life-science and biotechnology companies, which rely heavily on patents and other proprietary information. While most target companies will tout their patents as key assets that justify the purchase price, a buyer/investor’s insight into the scope, validity and term of such assets is critical to understanding whether the target company’s patents, in fact, provide the value claimed by the target. An acquirer or investor will also benefit from an assessment of whether the target company has exposure to patent infringement claims after the transaction closes. To gain a meaningful understanding of the IP assets and potential IP threats involved in the transaction, it is essential to conduct IP due diligence.

Each IP diligence is tailored to the business objectives of the investor, their risk tolerance, and the time horizon. A debt investor with a short investment time period may have different concerns than an acquirer seeking to add a business unit. Regardless of the particulars of the transaction, at the most basic level, IP diligence should include confirmation that the IP assets are in fact owned by the target company and that none of the patents have ex-

pired due to the non-payment of maintenance fees. This simple review, however, only scratches the surface and does not provide the buyer/investor with meaningful insight that will enable it to determine whether to proceed with the transaction or perhaps to seek a reduction in the asking price. A comprehensive IP due diligence analysis, however, will probe how and why the target’s IP portfolio was developed, enable the buyer/investor to effectively understand and evaluate the scope of the IP protection and assess IP risks inherent in the contemplated acquisition or investment.

The most effective IP diligence is customised for the particular concerns of the buyer/investor. The following are some of the questions to be answered as part of an IP due diligence analysis:

- Does the target company have a coherent patent prosecution strategy?
 - ◊ Has the target obtained patent protection for its key products and innovations?
 - ◊ Does its patent portfolio act as a barrier to entry to the target’s competitors?
 - Are the target’s patents well-drafted such that a competitor cannot easily design around them?

- Are the patents too broad and subject to invalidity challenges?
- ◊ Is there adequate geographic coverage in countries where significant sales are made and in countries of manufacture?
- How likely is it that the target will be sued for patent infringement?
 - ◊ Has the target conducted a freedom to operate analysis?
 - ◊ If so, has it identified any significant threats?
 - ◊ Do the target’s infringement risk conclusions withstand scrutiny?
- Does the target license in any of the technology it needs to be able to commercialise its products?
 - ◊ If so, would an acquisition enable the licensor to terminate the license?
 - ◊ Are there any other limitations on the licenses?
- What is the company’s IP litigation history?
 - ◊ What is the target’s tolerance for litigation risk?
 - ◊ Has it asserted IP rights (IPRs) against third parties?
 - ◊ Has it been sued for IP infringement?
 - ◊ Are there any pending threats of IP infringement?
 - ◊ Are there third parties currently infringing the company’s IP?

To obtain answers to these and other related questions, our firm has developed an enhanced IP due diligence process. We recommend the following steps:

Step 1: Determine the scope of the diligence

To streamline the approach, it is important to understand the business factors that underlie the acquisition or investment decision. If the investment is premised on significant future revenue streams from a new product launch, for example, the IP diligence should, at a minimum, closely examine the IP risks associated with the new product line. Similarly, if the target is selling an existing product that has been on the market for several years but expanding the geographic scope of its sales, it will be beneficial to understand the IP landscape in the new sales jurisdictions. Once the key business drivers of the transaction are understood, the IP diligence can be focused on the most relevant aspects of the target’s IP protections.

Step 2: Request and review the target company’s IP assets and related documents

After the scope of the diligence has been determined, typically we request that the target provide documents that relate to the

company’s IP assets. At a minimum, the following documents should be requested and reviewed:

- A complete list of issued patents and pending patent applications;
- Assignments from individual inventors to the company;
- Technical documents relating to key products covered by the patent portfolio;
- All IP agreements including license agreements; and
- A complete list of all pending IP lawsuits, and copies of assertion letters and settlement agreements.

Based on our review of these documents, we generally can form an initial impression of whether the company has an IP strategy that makes sense and will have identified potential red flags that could have an impact on moving forward with the transaction.

Step 3: Interview company IP counsel

A seasoned IP attorney can learn a tremendous amount of information during a call with the target company’s IP counsel. Usually, our approach is to start by requesting an overview of the company’s IP strategy and the process for capturing invention disclosures and making determinations on what inventions warrant the filing of a patent application. We then drill down on specific patents and products to gain an understanding of the company’s approach to what it views to be its most valuable IP assets. We also ask questions based on our review of the documents provided, such as explanations regarding why certain licenses were entered into by the company and the company’s tolerance for risk in connection with IP disputes.

Step 4: Analysis and conclusions

Typically, by the end of the call with the target’s IP counsel, we will have identified any areas of particular concern and have a good understanding of whether the target company’s approach to protecting and enforcing its IP assets is sound. We then take a deep dive into the patent portfolio to evaluate, among other things, whether the patents cover the company’s commercial products. Patent documents define the technology and scope of protection afforded to the patent owner, but the process of obtaining a patent can change or influence its scope. Thus, to provide deep insight into the patent assets, it is advantageous to have a robust understanding of the patenting process and how that process can impact the validity, scope and even the term of a patent asset. As a team of patent prosecutors and litigators, we utilise our patent prosecution expertise to evaluate the patent claims of key patents and compare those claims with the target’s company’s technical product specifications and make determinations as to whether

pending applications are likely to issue with meaningful protection. Our extensive litigation background enables us to assess the likelihood of success of potential claims, defences and strategies that the target has developed to mitigate infringement risk. Likewise, we also assess the strength and validity of the patent claims as written and the likelihood that they would survive a challenge either in a patent infringement lawsuit in federal court or in an IPR in the United States Patent and Trademark Office.

In addition, we examine and assess whether there are any clauses in the company's license agreements that could jeopardise the company's ability to make, use or sell its commercial products. For example, would an acquisition trigger the ability of a licensor to terminate a license for a key technology component of the company's products. Lastly, we conduct a freedom to operate analysis by reviewing relevant prior art so that we can assess the likelihood that the target company will subject to possible liability for patent infringement. To the extent that we uncover potential red flags during the course of our review, we immediately bring them to the attention of our client. In some cases, the target company is then required to explain why the perceived problem is not a serious concern or resolve the issue to the buyer's satisfaction. Once we have completed our review, we memorialise our findings in a memorandum for our client.

Throughout the diligence process, we work closely with corporate or in-house counsel so that issues raised during our IP diligence are addressed appropriately in the purchase or investment documents. As part of this collaboration, we often assist with drafting and/or negotiating key IP provisions of the purchase or investment documents.

Conclusion

When considering an acquisition or investment in a technology or life sciences company, it is critical to understand the value of the target company's IP assets as well as the IP risks associated with proceeding with the purchase of, or investment in, the target company. A comprehensive IP due diligence analysis is an essential tool to provide invaluable insight and potentially help avoid unfavourable acquisition or investment decisions.

Yuval H. Marcus is a Partner and the Chair of the Litigation Practice Group at Leason Ellis, a boutique IP law firm that has been

ranked among the top IP law firms in New York. With more than 25 years' experience litigating intellectual property disputes in federal courts throughout the country, he implements a practical, business driven, results-oriented approach for his clients in all types of IP disputes, including patent, trademark, trade dress, copyright and false advertising matters.

With a litigator's perspective, Yuval also conducts IP due diligence on behalf of investors and companies relating to investments and M&A transactions (totalling more than \$1 billion), including in connection with life sciences and medical technology companies. Yuval helps buy-side clients evaluate and understand the IP litigation risks inherent in each investment or acquisition opportunity.

Yuval frequently lectures and publishes articles on many intellectual property topics and has been selected to the New York Metro Super Lawyers in the category of Intellectual Property Litigation from 2011 to the present. He has also been recognised by World Trademark Review and IAM Magazine, most recently in the 2020 WTR 1000 and the 2020 IAM Patent 1000.

Jordan Garner is a Partner at Leason Ellis, a boutique IP law firm that has been ranked among the top IP law firms in New York. With over 15 years' experience as a patent prosecutor, Jordan builds, evaluates and manages intellectual property portfolios for clients in diverse fields including medical device technology, bioinformatics, pharmaceuticals, spectrophotometry and computer software. Jordan also counsels clients and provides strategic advice in connection with Hatch-Waxman and Paragraph IV certification matters. His practical approach focuses on the client's technology and how best to craft IP protections that fit into their overall business objectives.

Jordan conducts IP due diligence on behalf of investors and companies relating to investments, debt and alternative financing arrangements and M&A transactions (totalling more than \$1 billion), including in connection with life sciences and medical technology companies. Utilising his hands-on patent prosecution experience, Jordan enables clients to evaluate and understand the scope and strength of the patents and other IP assets that form the basis for the investment or acquisition opportunity. Jordan frequently lectures on intellectual property topics, both in the United States and in Asia. He has previously been mentioned in New York Metro Super Lawyers.

