

INTELLECTUAL PROPERTY

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UNDERSTANDING IP LITIGATION RISKS IN M&A TRANSACTIONS AND INVESTMENTS

By Yuval Marcus & Jordan Garner

When evaluating a potential investment in, or acquisition of, a technology or life sciences company, one very important consideration is the risk that a third party will commence litigation against the target company alleging infringement of intellectual property (IP) rights. Similarly, if the target company is already engaged in litigation with respect to a key product line, evaluating the likelihood of an unfavourable outcome is vital to the investment decision.

In addition to monetary damages, a significant remedy available to a prevailing plaintiff in patent infringement cases is injunctive relief which prohibits that target company from selling its products. Further, in certain cases, a third party may obtain a preliminary injunction which disrupts the target company's ability to sell its products during the pendency of the lawsuit. If the target company's revenue stream is disrupted due to an adverse outcome in IP litigation, the underlying rationale for the investment or acquisition decision may no longer make sense. Understanding the likelihood that the target company will be sued for infringement of IP rights and, if a suit has commenced, whether it is likely to prevail, is critical to a successful investment or acquisition. An analysis of IP litigation risks should be included as part of the IP due diligence of the target company.



Utilising freedom to operate studies

One way to gain insight into the risk of possible patent infringement is for diligence counsel to conduct freedom to operate (FTO) studies. There are several steps to a FTO analysis. First, it is crucial to have a thorough comprehension of how the target's key products operate. This can be achieved by carefully reviewing the technical specifications of the products and interviewing technical personnel to identify those features of the products that are driving the target's revenue. Next, a search of U.S. and/or foreign patent databases can be conducted or commissioned. The aim of a patent database search is to identify those live and enforceable patents that have claims that could potentially be asserted against the target's products. Once the searches have been completed, carefully review the patents disclosed to determine whether there are patents that pose an infringement risk (i.e., there is at least one patent claim where each element is found in the target's products). Then, rank the patents based on how much of a risk each patent poses, taking into consideration many factors, such as:

- Who owns the patent?
- Is the patent owner a direct competitor of the target company?
- Is the patent owner a large or small company?
- How litigious is the patent owner?
- Has the patent been asserted in litigation against any third parties?
- Do companies in the target company's industry often litigate patent disputes?
- Is the patent likely to survive patentability challenges?
- Has the validity of the patent been challenged in court or the USPTO?
- How long have the target company's products been in the marketplace?

For the most problematic patents, after taking all of the various factors into consideration, diligence counsel should reach an educated conclusion as to: (i) the likelihood that the patent owners would assert their patents against the target company; and (ii) the

strength of the target company's defences to any patent infringement claims asserted.

Analysing pending litigation

In some situations, the target company is already a party to patent litigation. When the target company is a defendant in a pending litigation, diligence counsel has additional information available to aid in an evaluation of the merits of the lawsuit. At a minimum, diligence counsel should carefully review:

- Court pleadings and related documents;
- The asserted patents and their file histories;
- Technical documents relating to the target company's products;
- The litigation history of the asserted patents;
- Chain of title documents; and
- Information about the judge assigned to the case including prior decisions in similar cases.

Based on a review of the foregoing documents and information, diligence counsel can make determinations with respect to possible adverse outcomes, the strength of the patent claims, and possible defences.

Evaluating the likelihood of injunctive relief

Separately, diligence counsel should ascertain whether there any basis for entry of a preliminary injunction. While preliminary injunctions are not commonplace in patent cases, in certain cases they may be granted. Among the data points to take into account are: (i) how long the target company's products have been in the market; (ii) potential harm to the patent owner as a result of the sale of the target company's products; (iii) whether the target company has acted in bad faith; (iv) the judge's track record for granting preliminary injunctive relief; and (v) whether the patent owner and/or its counsel have taken aggressive positions in patent cases in the past. Balancing each piece of information, diligence counsel should be able to reach a conclusion as to whether a preliminary injunction is a likely result in that particular case.

Considering the implications of past litigation

In addition, it is important for diligence counsel to understand how any prior IP dispute was resolved. If target was involved in a prior IP dispute and there was a settlement, settlement documents should be scrutinised to determine what obligations survive and may have an impact on future business plans. For example, a settlement may include a cross-license to particular technology in a specific field or geographic area.

Conclusion

Whether the litigation risk is identified through a FTO review, or based on pending or past patent litigation, it is highly recommended that diligence counsel speak with the target company's IP counsel and enquire about the nature of the claims, the company's position with respect to the litigation risk, and the strength of its defences. Based on information learned during that conversation in combination with a review of the relevant litigation documents, diligence counsel should be able to provide an informed opinion of the IP litigation risks inherent in the proposed transaction.



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 litigating intellectual property disputes in federal courts throughout the country, he implements a practical, business driven, results-orientated 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 (totaling 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 2021 WTR 1000 and the 2021 IAM Patent 1000.



Jordan G. Garner is a partner and Co-Chair of the Patent Practice Group at Leason Ellis, an IP boutique law firm that has been ranked among the best IP firms in New York. Jordan works with individuals, start-ups and established companies to obtain patents and to manage their patent portfolios, from acquisition through enforcement or monetization.

Jordan excels at managing the IP aspects of complex financial transactions that involve a heavy IP component. During his time at Leason Ellis, Jordan has provided advice and IP diligence expertise on financial deals totaling more than a billion dollars. In providing IP diligence services, Jordan routinely works with venture capital, private equity and commercial law firms to assess IP risks and devise timely and effective solutions. He also provides opinions on patentability and patent infringement as well as trade secret misappropriation.

Jordan enjoys teaching and speaking on IP law and can often be found giving presentations in China, Japan and New York about various aspects of patent law. He has been listed in New York Super Lawyers, and The Business Council of Westchester Rising Stars 40 Under 40.



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