701 Merging & Acquiring IP

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Irene Kosturakis

Irene Kosturakis is chief intellectual property counsel at BMC Software, Inc., where she is responsible for all intellectual property matters for the company, including patent acquisition, development and maintenance of the patent and trademark portfolios, patent litigation, copyrights, property transactions, and industry standards-setting efforts.

Ms. Kosturakis came to BMC with many years of experience handling intellectual property issues at Hewlett-Packard and Compaq. At HP, she performed in the role of IP transactions attorney, including mergers and acquisitions for the business unit she supported. While at Compaq, she went through the two largest IT industry mergers at the time: Compaq/Digital and HP/Compaq.

She is a president-elect of ACC's Houston Chapter and an adjunct professor at South Texas College of Law. She is the chairperson of the State Bar's business law section e-commerce committee. In that capacity, Irene assisted in the State's passage of the Uniform Electronic Transactions Act during the 2001st legislative session. She is currently assisting with a proposed spam law for Texas and the review of the current revised draft of UCC Article 2 on Sales. Irene is also a member of the American Intellectual Property Lawyers Association and the Houston Intellectual Property Lawyers Association.

Ms. Kosturakis has a B.A. of from the University of Texas at El Paso. She also has a M.A. of Law from the University of Houston, a J.D. from South Texas College of Law, and a Masters of Science in Civil Engineering from the University of Houston.

Taraneh Maghame

Taraneh Maghamé is vice president, emerging technologies counsel at Tessera, Inc. in San Jose, California. Her responsibilities include advising company management regarding various IP and patent-related issues, including issues relating to M&A, patent licensing, and litigation. She is also responsible for IP due diligence and strategic IP counseling relating to development and acquisition of IP assets.

Ms. Maghamé came to Tessera from Hewlett-Packard Company, where she was senior counsel in its intellectual property group. At Hewlett-Packard, her practice focused on IP licensing and transactions as well as patent dispute and litigation management. Before the merger between Hewlett-Packard and Compaq Computer Corporation, Ms. Maghamé was responsible for managing all IP litigation for Compaq. Prior to joining Compaq, Ms. Maghamé was associated with the law firms of Brobeck, Phleger & Harrison in Palo Alto and Perkins Coie in Seattle, where she specialized in intellectual property litigation, licensing, and counseling.

Ms. Maghamé is an active member of ACC and currently serves as secretary of the Intellectual Property Committee.

She is a graduate of Georgetown University Law Center.

D.C. Toedt III

D. C. Toedt III was formerly vice president, general counsel, and secretary of BindView Corporation, a Nasdaq-traded software company in Houston; he left in last spring in conjunction with the company's acquisition by Symantec Corporation, one of the largest software companies in the world. As of this past spring he is taking a sabbatical to develop an open-source compendium of common contract clauses, along with Web-based technology to speed up the initial legal review of routine contracts.

Before going in-house with BindView, a long-time client, Mr. Toedt was a shareholder and member of the policy committee of Arnold, White & Durkee, one of the nation's largest intellectual property law firms (now Howrey LLP). He is the author of numerous software-related patents, as well as a one-volume treatise, The Law and Business of Computer Software (West Group). Between college and law school he served as a nuclear propulsion trained surface warfare officer in the U.S. Navy.

Mr. Toedt served as a member of the governing council of the ABA Section of Intellectual Property Law. He was the principal drafter of the Section's Model Software Licensing Provisions project. He is a frequent CLE speaker and is active in church and community matters.

Mr. Toedt received a B.A. with high honors, from the University of Texas at Austin, and his J.D. from the same institution, where he served on the editorial board of the Texas Law Review.

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Publications

Reprints
How to Secure Licenses You Pay For, *Mergers & Acquisitions, The Dealmaker's Journal*
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Don't assume that the target's IP licenses automatically go with the deal. Legal conflicts and deal formats can get in the way.

Deal lawyers who only occasionally work on technology company acquisitions sometimes incorrectly assume that the seller's intellectual property (IP) licenses vest in the buyer.

Typically, state merger statutes provide that the seller's rights and obligations under its contracts are automatically assumed by the surviving entity at closing, and lawyers and theirclients may believe that these laws apply without question to the seller's license agreements. However, principles of equity and federal IP law and policy may override state merger laws, and the surviving entity in a merger may not have the right to exploit the seller's licenses.

The form of the merger and the terms of the license agreements will influence the outcome. Deal lawyers also have to be aware that if the surviving company competes directly with the company that granted the license, there may be snags in getting the licenses to go with the deal.

Because licenses are often among the target's most valuable assets, especially in technology industries, a wrong decision on which principle governs the transfer could frustrate the objectives of the deal and deny the buyer use of the licenses.

A particularly surprising example of the problems that can arise in technology deals emerged from a 1991 decision in SQL Solutions v. Oracle, which is precedent in the states of California and Washington, where many tech firms are located. Briefly, a federal district court ruled that a transfer of a license to a buyer breached its anti-assignment clause, which generally prevents a change in who holds the license unless the licensor consents.

SQL has not been overturned or reversed, and courts in other jurisdictions have referred favorably to the decision, thus potentially widening its impact. Because SQL and other case law establish a precedent at odds with the conventional wisdom often held by M&A professionals, this article reviews the issues raised in some of those cases and provides a basic framework for analyzing how to handle licenses in mergers and acquisitions.

Deals can be structured in three ways: purchase of assets, purchase of stock, or statutory merger.

In an asset deal involving technology companies, the buyer usually wants to include the seller's licenses among the assets being acquired. If the licenses contain anti-assignment or change-of-control provisions, the buyer's lawyers normally request that the seller obtain consents from the licensors or IP owners to permit the acquirer to obtain and use the licenses. In a purchase of stock, the buyer's lawyers typically would not ask for the consent of the licensors or the IP owners unless the terms of a particular license agreement require that consent.

Also impacting the outcome is whether the merger is "forward" or "reverse." In a forward merger, the seller merges into the buyer, which survives. In a reverse merger, the buyer merges into the seller, and the seller is the surviving entity.

Regardless of the applicable state merger statutes, courts may view a forward merger as a "transfer" of the license requiring consent of the licensor because the surviving entity is different from the seller. Unless the license expressly permits transfers of the license to third parties, most lawyers would exercise caution and obtain the licensor's consent to make sure that the license remains with the surviving entity. With the reverse merger, lawyers usually believe that the seller's licensors should not object to the survivor's continued exercise of the rights because the seller is the surviving entity.

Federal IP law impact

There are three categories of IP under federal law - patents, copyrights, and trademarks. In general, patent law protects new and useful inventions and awards monopolies for those inventions for a limited period of time. Copyright law protects original works of authorship and expression, such as literary and artistic works, and prevents others from reproducing or distributing the works. Trademark law protects symbols, slogans, and other images that identify goods and services of a specific producer or service provider.

Because of the supremacy clause of the U.S. Constitution, federal law and policy prevail if there is any conflict with state law. Thus, federal IP law and the federal policy of protecting the interests of IP owners and fostering technological innovation may supersede state merger statutes. As a result, the seller's licenses may not vest in the surviving entity in a forward or reverse merger.

Owners of patents, copyrights, or trademarks may grant a third party certain rights in a specific patent, copyrighted work, or trademark by entering into a license agreement. Broadly speaking, there are two types of licenses - exclusive and nonexclusive. Because a typical exclusive license can be granted to only one licensee, federal laws treat an exclusive patent or copyright license as equivalent to ownership of the patent or copyright.

The general rule to keep in mind is that exclusive patent or copyright licenses, particularly those where the licensor does not reserve any of its rights, are freely transferable without the consent of the licensor, unless the agreement expressly requires such consent. However, the general rule for nonexclusive patent or copyright licenses, having more than one licensee, is that they are not transferable without the consent of the licensor, unless the agreement expressly permits transfer or assignment. This is also the rule even if the nonexclusive license agreement is silent on whether it can be assigned.

Because of the "historic kinship" between patent and copyright law and because nonexclusive patent and copyright licenses raise more issues of transferability than other types of licenses, we will focus on nonexclusive patent and copyright licenses.

Trademark licenses, exclusive or nonexclusive, are in a separate category because they generally require the trademark registrant's consent to transfer the license. Unlike patent and copyright law, federal trademark law does not equate exclusive trademark licenses with ownership of the registered trademark. Because of the unique and complex nature of trademark licenses, and because trademark licenses are not always at issue in technology deals, trademark licenses in mergers are beyond the scope of this article.

Transfers in forward mergers

The threshold issue in analyzing nonexclusive patent and copyright licenses in a merger is whether a "transfer" or "assignment" of the license has occurred. Unlike reverse mergers, the surviving entity in a forward merger is not the same entity as the seller. Accordingly, courts are likely to find a "transfer" or "assignment" of the seller's licenses to the surviving entity in a forward merger. To be safe, M&A lawyers should obtain the licensor's consent to ensure that the seller's licenses will extend to the surviving entity, unless the nonexclusive patent or copyright license specifically permits free transfer or assignment of the license.

In PPG Industries v. Guardian, the Sixth Circuit U.S. Court of Appeals enforced an anti-assignment provision in a nonexclusive patent license agreement in a forward merger, even though applicable state merger statutes provided that rights and assets of the constituent companies vest in the surviving corporation. At issue in the case was a cross-licensing arrangement between PPG Industries Inc. and Permaglass Inc. under which PPG granted to Permaglass a nonexclusive license to use two patents. The agreement stated that "the license granted by PPG to Permaglass hereunder shall be personal to Permaglass and non-assignable except with the consent of PPG first obtained in writing." It also specified that the license was "nontransferable."

Several years later, Guardian Industries Inc. acquired Permaglass. After the merger, PPG sued Guardian for patent infringement. PPG alleged that the license that it granted to Permaglass was not transferable to Guardian in the forward merger, despite the applicable state merger statute.

The federal district court held for Guardian, ruling that the company acquired and succeeded to Permaglass' rights under the cross-licensing arrangement. The Sixth Circuit reversed the lower court, declaring that, "[i]t has long been held by federal courts that agreements granting patent licenses are personal and not assignable unless expressly made so." The appeals court noted that the intent of PPG and Permaglass was to make the license agreement nontransferable. If they intended the license to be transferable in a merger, the opinion continued, they would have specifically excepted mergers in the anti-assignment provision of agreement.

One of the facts that influenced the Sixth Circuit's decision was that the surviving company in the forward merger was Guardian, a glass manufacturer that directly competes with PPG.

Hidden traps in reverse mergers

Many M&A practitioners believe that if the seller survives the merger, no "transfer" or "assignment" of the seller's agreements has occurred and the rights in those agreements should be unaffected. This common understanding may stem from the similarity of reverse mergers to stock sales, in which the seller continues to exist as an independent corporate entity. However, if the buyer or the surviving entity is a direct competitor of the seller, a court may find that a "transfer" or "assignment" of the license violates the rule against transferability of licenses and the anti-assignment provision, even in a reverse merger.

In SQL Solutions, a district court in California held that a nonexclusive copyright license was "transferred" to the surviving entity in a reverse triangular merger and that the "transfer" resulted in a breach of the anti-assignment provision in the license agreement. The agreement was executed in 1987 when Oracle Corp. licensed D&N Systems to use its software. The agreement limited the use of Oracle's software solely to D&N and contained an anti-assignment clause that required Oracle's written consent for D&N to "assign" or "transfer" the license to a third party.

In 1990, Sybase Inc., an Oracle competitor, acquired D&N in a reverse triangular merger. D&N was the surviving company in the merger but changed its name to SQL Solutions. Oracle terminated the license agreement, claiming a material breach of the anti-assignment clause. In response, SQL insisted that it took the license under the state merger statute, not by "transfer" of the license, and it sought specific performance of the Oracle license agreement.

The district court in California held for Oracle, reasoning that the license indeed was "transferred" and that the "transfer" violated the anti-assignment clause. The ruling said Oracle's consent was needed for SQL to exercise the license rights originally granted to D&N, even though the relevant merger statutes provided that the surviving company automatically succeeds to the merged entity's rights and assets and the surviving entity remained the same company as the original licensee.

Particularly noteworthy is that Sybase used a reverse triangular merger structure to acquire D&N. The court apparently was following a precedent established by the California Supreme Court in Trubowitch v. Riverbank Canning Co., which articulated the rule, "If an assignment results merely from a change in the legal form of ownership of a business, its validity depends upon whether it affects the interests of the parties protected by the non-assignability of the contract."

The court in SQL applied the Trubowitch test and concluded that:

- The reverse merger constituted a change of legal form of ownership, and
- Oracle, the party protected by the anti-assignment clause, would suffer "adverse impact" if the license was held by SQL, an Oracle competitor.

The SQL court's reliance on Trubowitch and other cases in California to uphold the proposition that "transfers" and "assignments" of licenses do occur in a reverse merger is somewhat troubling because none of the prior cases even involved reverse mergers. Perhaps the only case that directly supports the court's conclusion in SQL is Koppers Coal & Transportation Co. v. United States.

In Koppers Coal, the Third Circuit U.S. Court of Appeals affirmed a district court's ruling that certain assets of a merging corporation did "transfer" to the surviving corporation. It rejected the notion that "the underlying assets of the constituent corporations are taken up into the resultant corporation precisely as specks of dust floating in drops of water are taken up into a single merged drop."

The Third Circuit concluded that the "transfer" of assets to the surviving company did not occur by operation of the state merger statute, but by the "voluntary act and participation" of the constituent corporations, and dismissed the argument that no "transfer" occurred in a merger as "metaphysical." Nevertheless, the applicability of Koppers Coal to a reverse merger is questionable. Unlike the SQL deal, the Koppers Coal merger was a forward merger, and the issue involved stamp taxes on transferred stock certificates, not a license.

SQL has been widely criticized by M&A practitioners but has not been reversed or overturned and has been followed or cited in other cases, although none of those cases involves reverse mergers. However, the issues raised in the cases grappling with the interplay between state merger statutes and federal IP law are not insignificant and may become increasingly important as more technology firms become acquisition targets. After all, federal IP law and a policy of encouraging innovation and rewarding creation of new technology are compelling and have been memorialized in the U.S. Constitution.

Decisions such as SQL should not be disregarded as outliers. In fact, some of the same issues of equity can arise in a non-technology merger. In a case involving an exclusive distribution agreement for hair care products, the Seventh Circuit U.S. Court of Appeals engaged in a heated debate over whether the agreement should be assumed by the buyer in a forward merger when the agreement was silent on assignment.

In that case - Sally Beauty Co. v. Nexxus Products Co. - the majority opinion was based on the Uniform Commercial Code rule that a party to a contract may assign and delegate the rights and obligations under a contract unless the other party has a "substantial interest in having his original promissor perform or control the acts required by the contract." The Seventh Circuit held that the exclusive distribution agreement between Nexxus and Best Barber & Beauty Supply Co., the original parties to the contract, should not continue in Sally Beauty, a wholly owned subsidiary of Alberto-Culver Co., a direct competitor to Nexxus, even though Sally Beauty presumably succeeded to the rights under the distribution agreement when it acquired Best.

Even Judge Richard Posner, a well-known proponent of free-market economics, wrote in his dissenting opinion that although "a change of corporate form, including a merger, does not in and of itself affect contractual rights and obligations," the key question is "whether, as a matter of fact, a change in business form is likely to impair performance of the contract." Because Posner wrote in his dissenting opinion that the merger did not "hurt" the manufacturer granting the distribution rights, he concluded that the distribution agreement should remain with the surviving entity.

Navigating tricky terrain

Dealmakers should not make the simple assumption that the seller's licenses will automatically vest in the surviving entity if authorized by state merger statutes, even if the deal is structured as a reverse merger. Equitable considerations such as "adverse impact" on the licensor may be the overriding factor in determining whether the license vests in the surviving entity in a forward or reverse merger. In addition, because of possible federal preemption, policies inherent in the federal IP laws may prevail over the state merger laws.

At a minimum, M&A lawyers should look for the following factors in their analyses of licenses in mergers:

- Law that governs the license agreement;
- Type of IP being licensed;
- Whether the license is exclusive or nonexclusive;

- Exact language in the license agreement, especially the license granting provision, the anti-assignment clause, and provisions regarding a change of control of the licensee;
- Whether the buyer or the surviving company is in direct competition with the licensor; and
- Any other potential "adverse impact" on the licensor.

OUTLINE FOR INTELLECTUAL PROPERTY DUE DILIGENCE IN AN ACQUISITION TRANSACTION

This outline is intended to help those who will be directing due diligence efforts on intellectual property and intellectual property-related issues in an acquisition transaction. It assumes the goal of such a due diligence is to provide the acquiror with as much information as possible about the target company. In this manner the acquiror may assess the potential risks and rewards of the transaction carefully, and then reflect this assessment in the offered price and terms, as well as the price and terms the acquiror is actually willing to accept.

I. Patents and inventions

A. Identify patents and inventions owned

1. All U.S. patents unexpired or expired within the last 6 years (statute of limitations for recovering damages for past infringements)

2. All unexpired foreign patents

3. All U.S. and foreign pending patent applications, including continuations, continuations-in-part, divisionals and the like

4. All other identified inventions (for example, those identified in written invention disclosures)

B. Evaluate patents and inventions owned

1. Title
   a. Origin of invention
   b. State and chain of title
   c. Liens or encumbrances
   d. Potential claims by others of ownership, co-ownership or other right to use invention based on financial or substantive contribution to its development, contract rights or otherwise

2. Validity, Enforceability and Scope
   a. Adjudications
   b. Written opinions
   c. Allegations or correspondence to or from third parties
   d. Newly-discovered prior art or other issues tending to bring validity into question, and any action taken in connection therewith
   e. Identify all agreements in which any of the patents or inventions were licensed to a third party in any respect; then

check the terms of these license agreements for possible patent misuse (potentially rendering patent unenforceable)

3. Remaining term of identified patents

4. Status, prognosis and PTO due dates for all pending patent applications, as well as the identity of attorney(s) handling the cases and the nature of their standing orders

5. Maintenance fee payment records for identified patents

6. Importance of identified patents and inventions to competitive position of the company

7. Potential of the identified patents and inventions for producing licensing income

8. Events that might forever bar filing for patent protection in the U.S. of a foreign country
   a. Invention was used for profit or in public more than one year ago in the U.S.
   b. Invention was offered for sale by or to anyone in the U.S. more than one year ago
   c. Invention was described in a writing which was made available to the interested public anywhere in the world more than one year ago
   d. Invention was claimed in a foreign patent that issued more than one year ago, or that was filed more than one year ago and has already issued
   e. Any disclosure at all before U.S. filing may bar a foreign filing
   f. Invention was abandoned

C. Identify inventions not owned but used in a material way in the operation of the company's business

D. Evaluate inventions used but not owned

1. Nature of right to use

2. Limitations on use rights

3. Assignability of use rights

4. Payment required for use rights

5. Payment required for assignment of use rights

6. Potential duration of use rights and restrictions

7. Conditions that could trigger a reversion or loss of use rights

8. Importance of use rights to the competitive position of the company

E. Evaluate other issues relating to patents in general

1. Possibilities of or actual knowledge that current or planned activities will infringe the patent of another
   a. Infringement searches
   b. Others in the industry being sued
   c. "Invitations" to take a license or "notifications" of patents
   d. Noninfringement opinions

2. Actual or threatened patent litigation

II. Trademarks

A. Identify trademarks owned

1. All trademarks, service marks, tradenames and trade dress adopted and used by the company anywhere in the world, registered or not

2. All state, federal and foreign registrations pertaining to any of the above

3. All pending applications for registration pertaining to any of the above

4. All pending intent-to-use applications for registration of marks

B. Evaluate identified owned marks

1. Ownership
   a. Origin of mark
   b. State and chain of title as to registrations
   c. Liens or encumbrances
   d. Potential claims by others of ownership, co-ownership or other right to use mark based on prior use, financial or substantive contribution to its development, contract or otherwise

2. Any senior users

a. Geographical scope of senior user rights
b. Substantive scope of senior user rights

3. Records of payment and due dates for renewal fees and declarations of continued use

4. Current uses of the mark as compared to goods and services listed in registration

5. Any evidence of abandonment of the mark
 a. Assignment without good will
 b. Licensing mark without retaining right to control nature and quality of goods
 c. Non-use of mark for 2 years or more

6. Importance of identified marks to the competitive position of the company

C. Identify marks not owned but used in a material way in the operation of the company's business

D. Evaluate marks used but not owned

1. Nature of right to use

2. Limitations on use rights

3. Assignability of use rights

4. Payment required for use rights

5. Payment required for assignment of use rights

6. Potential duration of use rights and restrictions

7. Conditions that could trigger a reversion or loss of use rights

8. Importance of use rights to the competitive position of the company

E. Evaluate other issues relating to trademarks in general

1. Any third-party complaints pertaining to the company's use of marks, names or trade dress, including actual or threatened trademark litigation

with them from their previous employers; if so, identify materials, especially those used in creation of the work

5. Review circumstances surrounding the creation of the works for potential ownership problems:
 a. Nature of the work
 b. When and where work was made, with whose equipment, under whose sponsorship and supervision, for what purpose
 c. Written agreements with consultants
 d. Written employee agreements

6. Agreements with any known joint authors or co-owners

C. With regard to all copyrightable works claimed to be owned, evaluate importance of the work to the competitive position of the company

D. Investigate viability and exploitation of owned and licensed copyrightable works

1. Licensing agreements
 a. Enforceability
 b. Exclusivity
 c. Scope of licenses granted
 d. Term of licenses granted
 e. Support obligations
 f. Indemnity obligations
 g. Anti-competitive provisions capable of supporting "copyright misuse" claims

2. Income produced and income potential

3. Instances of possible loss of copyright protection due to improper publication or use of copyrightable works

E. Identify copyrighted works used but not owned

1. Nature of right to use

2. Limitations on use rights

3. Assignability of use rights

4. Payment required for use rights

e. Labeling of information as "confidential" or "proprietary"
f. Employee entrance and exit interviews
g. Policies related to handling of trade secrets furnished by third parties
h. Periodic communications to employees regarding importance of non-disclosure and confidentiality

3. All circumstances, confidential or not, in which any of the company's trade secret(s) were disclosed to a third party

4. Any agreements (such as consulting agreements or disclosure-for-consideration agreements) with third parties relating to trade secrets or know-how
a. Continuing training obligations
b. Continued availability of key personnel
c. Limitations on use rights
d. Assignability of use rights
e. Payment required for use rights
f. Payment required for assignment of use rights
g. Potential duration of use rights and restrictions
h. Indemnity obligations
i. Conditions that could trigger a reversion or loss of use rights
j. Importance of use rights to the competitive position of the company

B. Evaluate the importance of trade secrets claimed to be owned to the competitive position of the company

C. Establish whether there is any actual or threatened litigation by third parties against the company relating to trade secrets

D. Establish whether the company is aware of any unauthorized disclosures or misappropriations of its trade secrets

V. Employees and Consultants

A. Identify key employees

1. Current employees

2. Former employees

B. Did any of the company's inventors conceive his or her idea while working for a former employer?

C. Did any of the company's founders or employees take proprietary documents, samples, or other materials with him or her from a former job?

D. Does the company compete with an inventor's former employer?

E. Did two or more of the company's founders work for the same former employer?

F. Have any current or former employees ever asserted or threatened to assert rights against the company relating to its technology or intellectual property?

G. Identify all agreements between the company and its consultants and key employees, and evaluate

1. Confidentiality

2. Assignment of ownership of inventions, trade secrets and copyrights, if applicable

3. Continued employment

4. Covenant not to compete

VI. Miscellaneous

A. Was any of the company's technology development funded in whole or part by outside sources?

B. Does the company engage in foreign sales?

C. Investigate possible problems with export controls relating to technical data.

D. Do any of the company's products or services trace their origins to patient tissue or fluid samples? If so, investigate patient consent.

CONSIDERATIONS IN VALUATION OF THE DEAL BASED ON TARGET'S IP

Taraneh Maghame
VP, Emerging Technologies Counsel
Tessera, Inc.

Encumbered IP

- Early assessment regarding encumbrances on IP
  - Jointly-developed IP
  - Jointly-owned patents
  - Licenses – exclusive or non-exclusive
  - Pending or threatened claims
  - Cross-licenses
  - Assignability of IP or Licenses

Third Party IP

- Is IP essential to target's business?
- Terms and conditions of licenses
- Ability of 3d party to terminate rights
- Assignability of rights and obligations
- Possibility of renegotiation
- Conflicts with acquirer's existing portfolio or licenses

Valuation of IP

- Is the deal IP-driven?
- Depending on purpose of acquisition or merger, may need to begin very early on
  - Before engaging target, based on public records
  - Retention of experts
- Valuation of IP as part of determining price and negotiating deal

Patent Analysis

- Breadth and scope of patents
- Strength of patents
- Third party patents
- Added value to acquirer's existing portfolio

Caution: Keep in mind potential "tainting" issue if the deal doesn't go through!

Effect of Licenses on Valuation

- How will acquirer use IP?
  - Freedom to operate
  - Defensive use
  - Offensive use
- How is use affected by licenses granted by target?
  - Who are licensees?
  - Exclusive vs. non-exclusive licenses
  - Royalty-bearing licenses
  - Cross-licenses

WHAT IP LAWYERS NEED
TO KNOW ABOUT
M&A DEAL STRUCTURES

D. C. Toedt III

Key Documents w/ IP Implications

- Pre-negotiation NDA
- Merger agreement – IP reps and warranties
- Disclosure letter – crucial
- Empl. contracts / separation agrmts
- Seller: Review buyer's prior M&A agreements in SEC filings

Key Document: Pre-Negotiation NDA

- Fact of negotiations is confidential
- Term
- Authorized contact people
- Outsiders – investment bankers, CPAs, attys
- Insider-trading prohibition
- Archive copies retained by outside counsel
- SEC disclosure rqmts as exceptions
- Freedom of action clause
- See www.pactix.com for clause examples

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Key Document: Merger Agreement

- IP-related reps and warranties
- Covenants to run business in ordinary course
  - No licenses, deals, etc., except in OCOB
  - Buyer may want approval of IP filings, R2OA
- Material adverse change ("MAC") clause
- "Absence of material changes" clause

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Key Document: Merger Agreement – IP Reps and Warranties

- Pure IP matters – e.g.:
  -
  - No infringement
- Open-source software
- Litigation status (pending / potential)
- Compliance w/ laws

Key Document: Disclosure Letter

- Like a very thorough business questionnaire
- Must list all agreed exceptions to seller's reps and warranties
  - Buyer can walk away if R&W breached
  - *Some* R&W have materiality qualifiers
- Comprehensive lists of patents, registrations, licenses, etc.

Other Key Documents

- Letter of intent (LOI)
  - No-shop clause; break-up fee
- Board minutes to show *process*
- Fairness opinion – bankers do it
- Hart-Scott-Rodino filing
  - Beware “gun-jumping” – bad news
- SEC filings

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Deal Structures

- Taxable vs. tax-free
  - "Triangular" merger - buyer sets up subsidiary, which merges w/ target
- Asset sale vs. stock sale
- Consideration – cash; stock; mix of both
- Stock as consideration:
  - Valuation questions
  - Lock-up risks

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Deal Structures – Asset Sale

- Good for Buyer
  - Buyer gets step-up in tax basis of assets
  - Liabilities stay w/ Seller (maybe)
  - But assignment filings can be complicated
- May not be so great for Seller
  - Seller's tax basis affected by past depreciation
  - Seller's gain / loss may be taxed at different rates
  - Warranties may survive closing – escrow of proceeds
- Often used to sell small private companies, or to sell off line of business / division

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Deal Structures – Stock Sale

- Simple paperwork after approvals received
- Good for Seller
  - Capital-gain treatment on stock
  - Liabilities go w/ sold company
- Standard deal type for public companies
- Put a division into a subsidiary, sell it off

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PRE-DEAL HANDLING OF
POST-DEAL ISSUES

William Hwang
Patent Counsel
Microsoft Corporation

Risk Mitigation

- Consider effect of acquisition on
  - NDAs
  - Assignability of contracts and licenses
  - Confidentiality clauses

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Risk Mitigation

- Must have retention agreements for
  - key employees
  - Inventors
- Consider non-compete agreements as part of deal
  - Enforcement issues
- Consider talking to key customers before closing to get them on board

Risk Mitigation

- Integration
  - Consider how to integrate and keep sales force
    - Retention of target's sales force
    - Integration of target's sales force
  - Have technology integration plan
  - Relocation issues
  - Address company cultural differences upfront

Risk Mitigation

- Post-closing tools
  - Reps and warranties
  - Indemnification
  - Holdbacks

Risk Mitigation

- Taint
  - Open source analysis
    - Use 3rd party open source analysis service
    - Obtain indemnification, reps and warranties
    - Obtain holdback provision
  - Use outside counsel or 3rd party expert to analyze source code.
  - Have NDAs and strict need-to-know procedures

Risk Mitigation

- 3rd Party Landscape Analysis
  - Acquirer may become a potential target when acquisition announced
  - Consider possible litigation options
    - Prepare counterclaims
    - Consider cross-licenses
  - Consider having target complete license, if that is an option, prior to closing

Risk Mitigation

- Notice Letters
  - Obtain opinion of acquirer's counsel
    - Consider NOT having opinion of counsel rendered by target company's counsel prior to closing
  - Obtain indemnification provision
  - Obtain holdback provision
  - Have target obtain a broad license prior to closing
  - Consider risk of taint and being put on notice

Risk Mitigation

- Litigation
  - Conduct due diligence on case strength
  - Consider performance of current OC
  - Consider changing counsel
  - Obtain indemnification provision
  - Obtain holdback provision
  - Have target settle prior to closing
  - Consider possibility of taint and being put on notice

CREATING SYNERGY OUT OF MERGER CHAOS:

INTEGRATING THE PATENT PORTFOLIOS AND PATENT DEVELOPMENT ACTIVITIES OF MERGED COMPANIES

Irene Kosturakis
Chief Intellectual Property Counsel
BMC Software, Inc.

Securing the Patent Files

- Inventory the files
- Identify which files are handled by outside counsel and which are handled by in-house counsel
- Secure all files handled by local in-house counsel who will not be retained
- If location where files are physically housed is being closed, transfer files to a secure location

Handle Critical Matters

- Identify from docketing system or files what office actions require responses and what notices of allowance must be paid
- For files that were being handled by in-house counsel not retained, commission local counsel to handle files in process
  - Office Actions handled immediately
  - Avoids inadvertent abandonment
  - Avoids extra fees for extensions for time

Realizing the Value of the Acquired Patent Portfolio

- Understand the Patents and the Technology
- Identify significant patents
- Consider businesses units and synergies
- Prune the portfolio
  - Save maintenance fees
  - Licensing or sale opportunities (for non-core technologies)
- Review of portfolio
  - Consider it in light of the new owner's strategy and corporate goals

Unifying Patent Development Activities

- Unify Patent Activities between existing and new members of the department
  - Limits confusion
  - Brings all staff up to speed
  - Allows advantage of new ideas on how to do things better
- Communicate expectations to outside counsel

ACC's 2006 Annual Meeting: The Road to Effective Leadership October 23-25, Manchester Grand Hyatt

Unifying Systems Used in Patent Development

- Unify systems
  - Saves money in training on two systems
- Docketing Software
  - Consistency in collection of data and docketing processes
  - Port over data from legacy system to new system
- Case reference numbers
- Matter Management Software

Using Outside Counsel Effectively

- Merge outside counsel lists with a thought to pruning
  - Saves resources in managing too many firms
- Interview new outside counsel
- Review arrangements, e.g., rates
  - Some arrangements must be honored
- Cut list of outside counsel
  - Seek the best among outside counsel
  - May have overlapping counsel, both domestic and foreign
  - Conflicts may have been created
  - Retain existing counsel with expertise in acquired technology
  - Consider political concerns

Harmonize Outside Counsel Procedures

- Outside Counsel Procedures for patent acquisition result in consistency, uniformity, and efficiency
  - Explain responsibilities
  - Define expectations
  - Desired claiming techniques
  - Timing of responses
  - Invoicing
  - Level of interaction between outside counsel and inventors

Updating Title to the Patent Assets

- Assignment of cases domestic and foreign
  - Whether to change assignee?
  - Why change assignee?
  - Costs involved
  - Time involved
  - Consider having a single trusted foreign associate handle it in ROW

ACC Association of Corporate Counsel

Going Forward

- Handle invention disclosures pending at closing
- Get to know new inventors
  - Reassure that invention disclosures will be handled promptly
  - Interview to capture all inventions that have not been documented
  - Encourage continued inventing
- Perform Training
  - Patent processes, procedures, and forms
  - Inventor recognition/incentive policies and programs