IP Issue Spotting For M&A Deals

B. Delano Jordan is the founding Principal of Jordan Law LLC, in Chevy Chase, Maryland. He was previously with the Washington, D.C. office of intellectual property firm Kenyon & Kenyon, where his practice focused on the acquisition and enforcement of domestic and foreign patent rights in the electrical, wireless communications, and software fields. He has also worked for Intel as a Senior Patent Attorney, where he worked closely with business personnel, harvested invention disclosures, managed outside counsel in the preparation and prosecution of patent applications, and developed foreign filing strategies for the company's IP portfolio. Most recently, he was Counsel with Alston & Bird in the IP Litigation group. He can be reached at del@jordaniplaw.com.

Andrea Hence Evans is founder of the intellectual property law practice, The Law Firm of Andrea Hence Evans, LLC. Prior to founding the firm, she worked at the United States Patent and Trademark Office (USPTO) for five years as both a patent examiner and a trademark examining attorney. While working as a Trademark Examining Attorney, she examined all types of trademarks including design marks, word marks, Madrid applications, and configuration trademark applications to determine eligibility for registration on the Principal or Supplemental Register. Before working as a Trademark Examining Attorney, Ms. Evans began her career at the USPTO as a Patent Examiner. In that capacity, she examined patent applications in the electrical and mechanical engineering areas featuring printing, keyboards, and time-measuring devices. She researched prior art using USPTO automated tools to determine whether the applications complied with patent laws and rules such as novelty (Section 102) and obviousness (Section 103). She is extremely familiar with patent and trademark policies, procedures, and USPTO guidelines. She can be reached at andrea.evans@evansiplaw.com.

B. Delano Jordan and Andrea Hence Evans

The issues aren't hard to find if you know what to look for.

MERGER AND ACQUISITION (M&A) deals are commonplace and they function as an integral component of our modern economy. More and more often, these deals involve the transfer of intangible assets. Indeed, quickly identifying the different types of intellectual property (IP) involved in a proposed transaction and flagging the possible issues linked to the identified IP can be critical to negotiations over price as well as the decision to move forward at all. Given the significant amount of capital that can be at stake in IP-related deals — in 2006 AT&T reportedly acquired BellSouth for $72 billion — it is understandable that IP due diligence is rapidly gaining in importance. This article identifies practical techniques for spotting common IP issues for M&A deals against the backdrop of various IP court cases.

M&A IP OVERVIEW • M&A IP issue spotting is primarily a function of the type of deal, the parties involved, and the perspective of the issue spotter. For example, a portfolio acquisition in which one technology company acquires some or all of the intangible assets of another technology company may raise specific patent and trade secret concerns for the seller, whereas a business acquisition between a pair of media companies might lead to certain trademark and copyright issues for the purchaser. As this article touches on specific cases, the three primary areas of emphasis relate to ownership, the strength of the IP, and the potential for liability. While the central issue in the cases may not always focus on these areas, the importance of them to the case in question is undeniable.

OWNERSHIP • There is perhaps no better example of the age-old proverb cautioning against putting the cart before the horse than the attempted exercise of an intellectual property right that one does not own. While no due diligence review can be completely exhaustive, verification of the proper transfer of all appropriate rights should clearly be part of the vetting process. In *National Licensing Association, LLC v. Inland Joseph Fruit Company*, 361 F. Supp.2d 1244 (E.D. Wash. 2004), the plaintiff was a "collective enforcement"-type entity that had obtained the right to sue for infringement of various commercial nursery-related patents and trademarks without any other rights accompanying the transfer. The patent and trademark assignment agreements in question provided that the plaintiff was "exclusively assign[ed] all right, title, and interest to enforce any past, present or future state or federal tort claims for infringement…against any third party…." *Id.* at 1246. The defendant moved to dismiss the complaint pursuant to Fed. R. Civ. P. 12(b)(1), claiming that the plaintiff did not have sufficient standing to establish subject matter jurisdiction. *Id.* at 1246-47. The Court stated that without the additional transfer of any proprietary interests in the patent, the plaintiff was at most a bare licensee and had no authorization to sue or be joined in a patent infringement suit. *Id.* at 1253. The Court granted the defendants' motion to dismiss as to plaintiff's patent claims because the plaintiff did not have standing to sue in its own name or as co-plaintiff.

There is perhaps no better example of the age-old proverb cautioning against putting the cart before the horse than the attempted exercise of an intellectual property right that one does not own.

When determining whether the assignments provided the plaintiffs standing to sue for trademark infringement, the court turned to case law and the Lanham Act sections 32 and 43. In particular, section 32 of the Lanham Act grants the "registrant" of a mark standing to assert a claim of trademark infringement. *Id.* at 1256 (citing 15 U.S.C. §1114(1)). The Act further defines registrant as including the registrant and its "legal representatives, predecessors, successors and assigns." *Id.* at 1254 (citing 15 U.S.C. §1127). Since the plaintiff was neither the registrant nor its legal representative, the court held that the plaintiff had no ownership interest in the mark and could not sue pursuant to section 32(1) of the Lanham Act. *Id.* The court also reasoned that unlike section 32(1), which grants a right of action to the registrant of a trademark, section 43(a) permits "any person who believes that he or she is likely to be damaged" by the proscribed conduct to bring a civil action. *Id.* (citing 15 U.S.C. §1125(a)). The plaintiff must show that it has a commercial interest in the allegedly misused mark that is "likely to be damaged." *Id.* (citing *Waits v. Frito-Lay, Inc.*, 978 F.2d 1093, 1109 (9th Cir.1992)). The Court concluded that the plaintiff had no reasonable interest to be protected under the Lanham Act and without a protectable interest, plaintiff also lacked standing to bring its Lanham Act claim under section 43(a). *Id.* at 1257.

Thus, *National Licensing* serves as a cautionary tale to non-practicing entities that may be primarily focused on enforcement of intellectual property rights — any assignment agreements including the right to sue for patent and trademark infringement without any other rights accompanying the transfer should be analyzed in detail to determine the true nature and extent of the assignee's IP rights.

It is also imperative to review all copyrights that may be involved in a deal to ensure that they are properly protected as well as to ensure that all license agreements, if any, are adequate. Issues such as whether additional licenses need to be purchased for multiple users in particular should be examined. In *Netbula, LLC v. BindView Development Corp.*, 516 F. Supp. 2d 1137 (N.D. Cal. 2007), the defendants included a primary software company and the target software company with which it had merged. In the course of conducting due diligence, the primary company discovered software in the target company's software product that was possibly owned by the plaintiff. *Id.* at 1141. The target company had previously acquired a third party company that, prior to its acquisition by the target company, had purchased one user development license from the plaintiff. *Id.* at 1142. The target company continued to develop and sell the third party's software after its acquisition of the third party. *Id.* When the target company could not locate a license agreement from the plaintiff, the target company communicated with the plaintiff regarding the purchase of necessary licenses, if any. *Id.* The plaintiff responded with a request that the target company provide a royalty report. *Id.* at 1143. The primary company eventually merged with the target company and, when the terms of the license were not agreed upon, the plaintiff filed suit against the target company, the primary company and the individual owner of the target company, (collectively the "defendants") for copyright infringement under 17 U.S.C. section 101 et seq. arising from the defendants' unauthorized copying of the plaintiff's software. *Id.* at 1141. The plaintiffs also asserted claims under California Civil Code and California law, and the defendants filed a motion for summary judgment as to copyright infringement. *Id.* at 1141-42.

Was Succession To License An Assignment Or Transfer Of Rights?

Upon review of the defendant's motion for summary judgment for copyright infringement, first, the court discussed whether the primary company's and the target company's succession to the third party's license constituted an assignment or transfer of rights. *Id.* at 1148. When acquiring a corporation that has previously merged, a review of the corporation's license agreements may present an issue of whether the "original" license agreements owned by the corporation would be considered an assignment or a transfer of rights if acquired and whether state law or federal law will govern if this issue is disputed. The target company contended that its acquisition of the third-party company did not constitute an assignment of the license under state law and that, alternatively, the plaintiff had no evidence that the license between it and the third party company was non-assignable. *Id.* at 1147. The plaintiff argued that federal law preempts state law and that a transfer of rights is no less a transfer just because it occurs by operation of law in a corporate merger.

The parties could not locate a copy of the license, so the Court did not resolve the issue of whether the law regarding the original license agreement would consider the mergers (target-third party and primary-target) to constitute a transfer or assignment of the third party's license. The court did articulate, however, that it would appear that the state law governing the original license agreement, rather than the state law that governs the merger agreement, would apply to determine whether a transfer or an assignment occurred. *Id.* at 1149. The court granted summary judgment as to the copyright infringement claim since the plaintiff did not have evidence from which a jury could find an essential element of the copyright infringement claim – namely than an unlawful transfer or assignment occurred. *Id.* at 1150.

What Was The Scope Of The License Agreement?

Secondly, when reviewing the defendant's motion for summary judgment for copyright infringement, the court discussed the scope of the license agreement between the third-party company and the plaintiff. *Id*. The court pointed out the Ninth Circuit's observation that "a copyright owner who grants a nonexclusive license to use his copyrighted material waives his right to sue the licensee for copyright infringement and can sue only for breach of contract. If, however, a license is limited in scope and the licensee acts outside the scope, the licensor can bring an action for copyright infringement." *Id*. (citing *Sun Microsystems, Inc. v. Microsoft Corp.,* 188 F. 3d 1115, 1121-22 (9th Cir. 1999)). The court articulated that because the existence of the license agreement was not at issue, the plaintiffs must prove that the defendants exceeded the scope of the license. *Id*. at 1151. The court found that the plaintiff had not met that burden. *Id.*

Some Lessons From *Netbula*

Netbula therefore provides a basis for a number of valuable IP issue spotting techniques. For example, any evidence that proper records of all intellectual property transactions have not been maintained should be a catalyst for further investigation. At least, a written copy of any license agreements should be retrievable upon request. In addition, when conducting due diligence, the scope of any license agreements should be crystal clear.

The existence of non-standard or unusual terms to patent transfers may also be a clue that certain ownership pitfalls lie ahead. In *Digeo v. Audible,* 505 F.3d 1362 (Fed. Cir. 2007), for example, the plaintiff was a communication technology company that purchased the patent in question "as is" at a bankruptcy estate sale. Upon asserting the patent against an accused infringer, the patent holder learned that the patent lacked legal title due to fraudulent conduct on the part of the inventors during execution of the declaration and assignment paperwork. *Id*. at 1366. In fact, the central issue in the case, which was voluntarily dismissed with prejudice by the patent holder, was whether the district court's refusal to award the defendant attorney fees and additional discovery was proper. *Id*. at 1366-67. Although the court ultimately held that there was no clear error in the district court's finding that the case was not exceptional and that there was no abuse of discretion in the denial of additional discovery, the case highlights the potentially dire consequences of failing to acknowledge and investigate non-standard terms involved in the transfer of IP.

STRENGTH OF THE IP • The strength of a given IP depends at least in part on the type of IP involved. For example, the strength of a trade secret is usually dependent upon the measures taken to keep the underlying information secret and the commercial value of the information to the owner of the trade secret. See, Uniform Trade Secrets Act section 1 (1985). Patents, trademarks and copyrights likewise have their own unique aspects with regard to the strength of the IP involved. In particular, a patent's strength is typically a function of its validity in view of the known prior art, the breadth of the claims, and the likely interpretation of the claim terms, wherein each of these aspects is directly related to the prosecution history of the patent.

For example, in *Immunocept v. Fulbright,* 504 F.3d 1281 (Fed. Cir. 2007), the patent holder entered into negotiations with a subsidiary of a third-party company as part of an investment deal. During the course of due diligence, the third-party company's patent attorneys discovered that the patent had been amended during prosecution to use the transition phrase "consisting of," which the court characterized as a fatal flaw from a claim scope standpoint. *Id*. at 1283. In fact, the subsidiary terminated discussions with the patentee as a result of discovering the flaw. While the central issue in the case was whether the statute of limitations had expired with regard to a malpractice claim against the prosecuting attorneys, it is clear from this case that identification of certain patent claim amendments can have a determinative impact on the strength of a patent and ultimately the attractiveness of a proposed investment.

POTENTIAL LIABILITY • A sometimes overlooked aspect of M&A transactions involving IP is the potential for added exposure to allegations of infringement and other obligations. In particular, acquiring a business may result in the purchaser engaging in activities such as the use of new technology that may infringe the patent rights of others or the use of marks that might be accused of trademark infringement. Absent effective IP issue-spotting, these unexpected allegations could be disruptive to the underlying business and add an unacceptable level of risk to the business venture.

For example, identifying the existence of trade secrets can be important, particularly in situations involving patented technology, in which trade secret protection may be overlooked. For example, in *Forest Labs, Inc. v. Pillsbury Company*, 452 F.2d 621 (7th Cir. 1971), the defendant was accused of misappropriating the plaintiff's trade secret for packaging sweetener tablets, wherein the process was ultimately patented by the plaintiff. The plaintiff had confidentially communicated the trade secret to a third party company whose assets were later acquired by the defendant. *Id.* at 625. Subsequent to the acquisition, the defendant began using the packaging process that was the subject of the trade secret with knowledge that the process was subject to confidentiality constraints. *Id.* at 626. After citing the general rule for trade secret misappropriation liability, the court considered whether the defendant qualified for an exception to the rule on the grounds that it had in good faith paid value for the secret. *Id.* The court found that the record did not show that the defendant paid anything specifically for the trade secret and that the defendant was therefore liable for trade secret misappropriation. *Id.* at 626-627.

CONCLUSION • Thus, whether it's a cursory review of assignments and licenses to identify potential ownership concerns, a patent file history review to uncover the true strength of the IP, or a simple inquiry about the existence of trade secret obligations surrounding a technology-based deal to avoid exposure problems, a number of readily identifiable issues can and should be addressed in most IP-related M&A transactions. Other issues such as antitrust, standard-setting organization licensing obligations, previous litigation of the IP, maintenance fee payment, foreign counterpart IP, and a wide variety of other considerations may also factor into the M&A due diligence assessment.