

THE IMPORTANCE OF INTELLECTUAL PROPERTY DUE DILIGENCE

Intellectual property is an intangible creation of the human mind, usually expressed or translated into a tangible form that is assigned certain rights of property. Most creations, resulting from human endeavours in the various fields of art, literature, science and technology, constitute Intellectual Property. Intellectual Property rights are a bundle of exclusive rights over creations of the mind, both artistic and commercial. These rights are usually limited to non-rival goods, that is, goods which can be used or enjoyed by many people simultaneously, the use of which by one person does not exclude its use by another. Since non-rival goods may be used by many simultaneously (produced at zero marginal cost in economic terms), producers would have no incentive to create such work. Thus, the establishment of Intellectual property represents a trade-off, to balance the interests of society in the creation of non-rival goods (by encouraging their production) with the problem of monopoly power.

A due diligence review is important for evaluating all aspects of a potential merger or acquisition. If a due diligence review is being conducted on behalf of the buyer, the information-gathering process, including that relating to intellectual property, is a means of discovering as much as possible about the status of the target. A comprehensive and thorough IP due diligence requires significantly more than merely compiling a list of the company's registrations and other IP assets. Not only must the strength of the company's IP rights in the marketplace be assessed, but also the strength of its competitors' rights. While every IP due diligence must be tailored to meet the particular business situation, certain basic steps should always be considered. The first step is to understand the company's basic products and services. This includes not only understanding the current product and service offerings of the business, but also an understanding of projected products and services. The second step is identifying the intellectual property which corresponds to such products or services. Once such IP has been identified, an inventory must be taken of the company's intellectual property rights, usually set forth in a detailed schedule. Special emphasis should be placed on the form of IP which is crucial to a specific aspect of a company's business, e.g. trade secrets or confidential information may be the most important issue for some emerging technologies. Naturally, all forms of intellectual property should be carefully listed, including patents, trademarks, copyrights, trade secrets/know-how and any other agreements affecting IP.

Intellectual Property due diligence generally provides vital information specific to future benefits, economic life and ownership rights and the limitations of the assets all of which affect its final value. Therefore, due diligence is a prerequisite to the valuation process, regardless of the methodology used. Intellectual Property diligence is the process of investigation of a party's ownership, right to use, and right to stop others from using the Intellectual Property rights involved in a sale or merger. The nature of the transaction and the rights being acquired will determine the extent and focus of the due diligence review. It should also evaluate agreements material to the company's business that may be affected by change of control, agreements that may vest rights in intangibles and company policies and practices.

Pre-due diligence Formality:

The legal basis for due diligence often starts in the form of a letter of intent or memorandum of understanding and commonly regulates the due diligence process. A Confidentiality Agreement between the buyer and the target Company is one of necessity and both should ensure that it is carefully drafted and includes the scheduling, modus operandi and deadlines, with due emphasis on Attorney Client privilege.

Preliminary Assessment:

The target Company should make a preliminary assessment of the current status of its intellectual property portfolio and management, including:

- Current holdings and their status
- Goals for the portfolio
- Historical and perspective investment in Intellectual Property

While every effort should be made to ensure that a thorough due diligence occurs in the time available, all parties must recognize and make allowance for the fact that there is no such thing as a perfect due diligence in relation to intellectual property. Relevant materiality signposts should therefore be established that are both quantitative and qualitative.