

Intellectual Property Issues in Mergers, Acquisitions and Divestitures:



A Practical Guide for the Deal Lawyer

by Janet P. Peyton

The scene: you are a transactional lawyer and have been working on an acquisition for a number of months. The due diligence is complete, the reps, warranties and “baskets” have been negotiated, the schedules are being finalized, and you’ve begun to wonder what the deal toy will look like, when someone says: “By the way, we have this software that we really can’t operate without We’ll still be able to use it after closing, right?” Uh oh. You rationalize to yourself that surely the IT folks have listed this software on the material contracts schedule and it will just transfer with everything else, right? Wrong. The closing dinner reservations you just made may be a bit premature

Intellectual property transfers, and perhaps most notably software license transfers, have become a critical element in virtually every acquisition and divestiture transaction, yet often the intellectual property lawyer is not called into the deal until it is nearly complete. Unfortunately, many traditional business lawyers think of the IP lawyer's role in a deal as the provider of a quick once-over of the trademark representations and schedules within the final week before closing. In fact, the involvement of an intellectual property lawyer early in the due diligence process avoids the costs associated with ineffective transfers and re-licensing fees, not to mention infringement lawsuits. The following tips will help you keep your closing on schedule and your target business running while preparing for a transition of software licenses and other intellectual property in a merger, acquisition or divestiture.

Due Diligence

Software licenses. One of the most complex pieces of the IP due diligence puzzle relates to software licensing. In a deal of any size, it can take weeks, or even months, to identify all of the software, review the license agreements and make arrangements for assignments, as necessary. It is critical, therefore, to get started as soon as possible. The first step in the due diligence process is simply the identification of all of the software in use by or *for the benefit of* the target company and the review of the related license agreements. The only truly hassle-free software to transfer is off-the-shelf software (often called "shrink-wrap"). Shrink-wrap software is almost always transferable without the consent of the Licensor, as long as the whole package (CDs, instruction manuals, etc.) is transferred and the former owner retains no electronic copies. For all other types of software, however, the license agreement is likely to contain a non-assignment clause, or at least the requirement that notice be given to the licensor prior to any transfer.

Software license due diligence can only be accomplished with the help of experienced IT professionals. Once the deal is underway, it is important that a member of the target company's IT department be identified as a member of the transactional team, and that he or she fully understands the scope of the transaction. This person

may need some education about legal transfers, and it would be wise to initiate meetings early in the process between this individual and the IP lawyer on the deal, to develop a comprehensive game plan for the transaction. IT staff may be focused

of the software it uses, or which is used for its benefit, is licensed at the parent's level. Once the subsidiary is sold, it cannot continue to use software that is licensed to its former parent without violating the underlying software license.

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on the functional implications of the transaction—for example, how to technically transition from one parent company's mainframe to that of the new parent—but are not aware of the legal ramifications of the functional solutions they undertake. Here are some things to look for in connection with software license due diligence:

- *Non-assignment/change of control clauses.* Do not make the mistake of assuming that because your transaction is a stock deal, there will be no issue of software license transfers. In a simple stock acquisition, any software licenses that identify the target company itself as the licensee should remain intact. The licensed entity has not changed, but licenses sometimes contain express prohibitions on changes of control. In the context of a merger, the case law is inconsistent on whether or not these transactions would violate an anti-assignment clause in the license agreement. It is settled, however, that in an asset purchase, any software license transfers are assignments, and therefore would violate an anti-assignment clause. (See Elaine D. Ziff, *The Effect of Corporate Acquisitions on the Target Company's License Rights*, 57 Bus. Law. 767 (2002), for an excellent discussion of the effect of various transactional structures on licenses.)
- *Dependence on Parent's Software.* Another area of due diligence that is often overlooked is the dependence of the target company on software that is licensed to the parent. Many software licenses do permit use by affiliates or subsidiaries. If the target company is a subsidiary, it is likely that at least some

Identify which software will transfer and which software will need to be replaced (either through a new license directly to the target company, or by a migration onto the new parent's existing software).

- *Transition Services.* Many deals provide for a transitional period, during which the former parent company agrees to provide certain services (almost always including IT-related services) to the target company while it migrates to the new parent's systems. It is critical that the software license agreements are reviewed and that the necessary consent is obtained from the software vendors prior to the commencement of any transition services. Virtually every software license prohibits use of the software by the licensee for the benefit of an unrelated third party, sometimes referred to as "service bureau" use. Companies with sophisticated contracts departments sometimes have negotiated terms into the license agreement that allow them the opportunity to provide transitional services for a former affiliate following a divestiture, but the vast majority do not have this kind of provision in their agreements. As a result, you (or the IP lawyer you have wisely brought in!) will need to approach these vendors for consent to perform the transitional services. Many vendors will grant a licensee the right to provide these types of services for a short period of time (60 or 90 days), but longer transitions may require more negotiation and, in some cases, payment of an additional license fee.

Traditional Intellectual Property—Trademarks, Copyrights, Patents and Trade Secrets

It is important to identify traditional intellectual property assets during due diligence. Typically, the seller will provide schedules of these assets and the buyer's counsel will engage an intellectual property lawyer to confirm the chain of title related to registrations at the Patent and Trademark Office. While this process is commonly used, it is only the bare minimum in terms of IP due diligence. Without more, IP assets can easily be overlooked, particularly those that are not registered with a federal agency. The following is a list of "traditional" intellectual property assets:

- **Trademarks.** Federal trademark registrations and applications can be identified or confirmed using the United States Patent and Trademark Office's free online database at www.uspto.gov. The database offers search logic in a number of fields, including owner name and address. The database is likely to reflect the name of the entity that first registered the mark, so if the company has a history of name changes and/or changes in ownership, information about prior corporate names can be helpful in identifying marks. Individual states also maintain their own trademark registries. They are searchable using a commercial trademark searching service like Thomson & Thomson (<http://www.Thomson-Thomson.com>) or Dialog (<http://www.dialog.com>).

The company may have acquired significant common law rights in trademarks or service marks that it has not registered or even applied for. Particularly in an asset deal, the trademark due diligence should include a review of representative samples of the company's marketing materials, packaging of goods, and Web site, to identify any common law trademarks that should be transferred to the buyer.

- **Copyrights.** Unfortunately, the databases available through the U.S. Copyright Office's Web site are not as easy to use as the trademark database maintained by the United States Patent and Trademark Office (USPTO). Copyright

registrations are searchable at the Web site of the Copyright Office (<http://www.loc.gov/copyright>), but it is complex and not recommend for an inexperienced searcher. Copyright registration databases are also available through Dialog, Westlaw and Lexis. The Copyright Office itself offers some searching services (for an hourly fee), but the turnaround time of 8 to 12 weeks is often prohibitive. Dialog and Westlaw are easier to use for owner searches, but given that these services typically operate on a per-minute fee basis, your client will be best served by engaging an experienced intellectual property lawyer or legal assistant to perform the search.

A company may also own copyrights that are not registered. Copyright arises upon the creation of an original work, as soon as it is fixed in a tangible medium. Therefore, a company may have many items protected by copyright that it has never registered with the Copyright Office. One type of copyright that is often overlooked is the copyright in software that was developed in-house. If the owner of the copyright in internally developed software will not be the surviving entity after closing, the copyright in the software must be assigned to the new entity. The *physical* transfer of the computers or CDs containing the software *does not affect an assignment of the underlying copyright*.

- **Patents.** Due diligence regarding patents is complicated. A patent application must be filed in the name of the individual inventor(s)—it cannot be filed in the name of a corporate owner. For this reason, although patent applications can be (and often are) later assigned to a corporate owner, searching in the online database of the USPTO is not usually an effective method of identifying patents owned by a particular company. Assignments will only appear in the USPTO database if the assignment was made *before* the patent issued (i.e. while the application was still pending). To further complicate matters, provisional applications are not public record, nor are pending applications unless, and until, they are published. Furthermore, if the applicant elects not to file any foreign applications, it can request that the USPTO keep the application secret throughout its pendency (to maintain

U.S. trade secret status.) So, the free online patent database (available at the USPTO Web site) is simply not useful for due diligence purposes. As with copyright searches, thoroughly search the patents owned by a particular entity using a law firm with a patent practice or by engaging an outside patent searching service.

You cannot absolutely verify ownership of a pending or provisional patent application until the patent issues. For this reason, you must have adequate representations and warranties relating to ownership in the document governing the transfer.

A patent is essentially the right to a monopoly on the invention for a fixed period of time; therefore, it is important that the purchaser or merging party determine the remaining life of each patent during due diligence. Once you have an accurate list of the patents owned by a corporation involved in an acquisition or merger, it is important to take note of what *types* of patents are to be transferred (i.e. utility, design or plant) and their respective filing dates and issuance dates, to determine the remaining life of each patent. Different types of patents have different "life spans." For example, utility patents filed on or after June 8, 1995, have a 20-year life, calculated from the date the application was *filed*. Design patents, on the other hand, have a 14-year life, calculated from the date the patent was *issued*. Consult a patent attorney on any transaction involving patents.

- **Trade Secrets.** Due diligence can be tricky when the assets involved are trade secrets—held in confidence by the company claiming ownership. Its value to the owner lies in the competitive advantage it gives the owner by remaining secret. The extent to which trade secrets are divulged during due diligence is negotiated on a case-by-case basis, but no disclosure should be permitted without the parties first having executed an appropriate non-disclosure agreement. Disclosure should be made to individuals on a need-to-know basis.

The “Forgotten” Intellectual Property Assets

In addition to software licenses and the other “traditional” types of intellectual property, the technology era has brought new types of intellectual property that may not be listed on standard “deal checklist” (particularly if it was developed before the mid-1990s.) Here are some types of assets that are often overlooked:

- *Domain Names.* Most practitioners are aware that domain names are valuable assets that need to be protected and properly transferred (or excluded, as the case may be) in corporate transactions. The primary domain name used by a company for its Web site may not be the only one it owns. Many companies purchase duplicative and/or similar domain names either for future use or to prevent their purchase by a competitor or disgruntled employee. It is important to conduct a WHOIS or similar search to identify all domain names owned by the target company and/or its parent, to develop an appropriate schedule of the domain names to be transferred. The schedule should not only identify the domain names, but also the company through which the name was registered, because each registrar has its own procedures (and fee structure) for recording name changes and effecting transfers.
- *IP Addresses and ASNs.* In this context, “IP” stands for “Internet Protocol” rather than “Intellectual Property.” Internet Protocol is a set of rules that govern communication over the Internet. Internet Protocol addresses (or “IP” addresses) are the eight-digit codes that identify users on a network, and are an essential element in the routing of traffic on the Internet. A company’s IP address is actually an allocation of space (i.e. multiple addresses) on the Internet, and is a valuable asset, particularly if the company has a substantial allocation. The American Registry for Internet Numbers, or ARIN, is the nonprofit entity that assigns IP addresses and allocates space within North America, South America and the Caribbean. ARIN is also responsible for assigning Autonomous System Numbers or ASNs. ASNs function like an Internet address, but for a *group* of Internet Protocol networks that

adhere to a single routing policy. This may sound like computer gobbledegook to the transactional lawyer, but you don’t need to fully understand it to know enough to ask the IT folks at the company to think about it. Put it on your checklist, and ask the IT contact person on the deal to consider whether or not a

If an outside contractor created the Web site, did the company obtain a copyright assignment from the developer and any independent contractor photographers or graphic artists whose work is included on the site?

transfer or name change with ARIN will be necessary. As is the case with domain names, if the maintenance fees for IP addresses and/or ASNs are not paid (because the contact information, company address, etc., are out of date as the result of the sale, merger, or other transaction) these assets can be put in jeopardy, and that can have devastating effects on the functionality of the company’s computer networks.

- *Associations and Industry Group Memberships.* Many times it does not occur to anyone at the target company to mention trade associations or other industry group memberships when asked to prepare schedules of their intellectual property assets. In fact, the existence of a membership itself is probably more accurately characterized as a simple contract, but often these contracts will not make it onto the material contracts schedule because the associated fees are relatively low. The intellectual property schedule can be an appropriate place for these to appear because membership in trade associations often involves intellectual property. Membership may encompass the right to access Web-based databases or software or may entitle the member to use a trademark or service mark indicating membership, etc.
- *Web site Content.* The text, graphics and other content of the corporate Web site are all protected by copyright, and any transfer of the business that includes the

Web site should include an assignment in all of the copyrights associated with the Web site. It is also relevant to note exactly what rights the target company has in the content materials in the first place. If an outside contractor created the Web site, did the company obtain a copyright assignment from the

developer and any independent contractor photographers or graphic artists whose work is included on the site? Verify what rights the target company *has* in the content before attempting an assignment.

Doing The Deal: Transfer Documents and Schedules

Once the due diligence is complete, the next step is to ensure that the deal documents accurately and effectively transfer the intellectual property assets. Although effective assignment language can be built into the larger purchase agreement, it is advisable to use short assignment documents that function as appendices or “Related Agreements” to the main agreement. With assignment of registered trademarks, copyrights or patents, you will need to record a copy of the relevant assignment document with the USPTO or the Copyright Office, respectively, and there are a myriad of reasons why you won’t want to record the entire purchase agreement. A separate assignment document also makes coordination with the IP attorney easier, particularly if you are using outside counsel for the IP portion of the deal. Whether you use a separate assignment document or fold the assignment into the main agreement, you will need to attach an appropriate schedule to it. The following are some simple checklists for the content of the IP schedules:

Trademark Schedules. For registered marks or pending applications the schedule should contain, at a minimum:

1. The mark itself (word, design, etc.)
2. The serial number. (U.S. Serial numbers have eight digits)
3. The registration number, if any (U.S. registration numbers can have six or seven digits, depending on the age of the registration. If it is a state registration, or a foreign registration, the number of digits will vary. Be sure to identify the state or country itself for all non-federal registrations.)
4. The filing date
5. The registration date, if any

It is also useful, but not necessary, to include:

6. The goods and/or services covered by the application/registration

For common law marks, the schedule should include:

1. The mark itself (word, design, etc.)
2. The goods and/or services sold under the mark
3. The date of first use of the mark in commerce, if known

Copyright Schedules. These can be somewhat less straightforward than trademark schedules, but if the copyrights have been registered with the U.S. Copyright Office, the schedule should identify:

1. The copyright registration number
2. The title of the work
3. The author's name

For works that are not registered (like internally developed software), the schedule should include as much information as possible to clearly identify the works. In cases where the volume of the material being transferred is relatively small, it can be useful simply to attach a copy of the work itself. Keep in mind that if the seller wants to retain the right to use the software or other materials, it may be more appropriate to grant the buyer a license, rather than assigning away all rights in the work. As an alternative, the parties might

agree to an assignment to the buyer, with a license-back to the seller.

Patent Schedules. Patent schedules should include:

1. Patent number
2. Filing date of application
3. Issuance date of patent
4. Type of patent (i.e. utility, design, or plant)

Trade Secrets. Typically, trade secrets are not listed and identified on a schedule. Their transfer can be accomplished by a broad statement in the purchase agreement. For the transfer of particular trade secrets that are easily identified without disclosing the trade secret itself, a schedule listing such description may be appropriate, (i.e., “the recipe for Coca-Cola.”)

Other Intellectual Property. Consider incorporating a “miscellaneous” intellectual property schedule, to capture domain names, IP addresses and other intellectual property that does not fall neatly into a traditional category.

Software Transfer Documents and Schedules. In a transaction requiring the assignment of software licenses from one entity to another, some form of assignment and assumption agreement is often used to accomplish the transfer. Prior to closing, the IP lawyer should work with the IT business contact to obtain the necessary consent to assign and to deliver any required notices to the software licensors, so that these licenses may be assigned to the buyer (or surviving entity, in a merger.) In some deals, however, there may be software licenses for which consent to assign could not be obtained. Although this software will not be transferred, consider including a schedule that lists any such software and describes which party will bear the responsibility and the cost of obtaining a new license for the proper entity. Finally, in the event that the transaction will incorporate any kind of transitional services to be performed by the seller post-closing, a schedule of all of the relevant software to be used in those services should be attached as an addendum to the agreement governing the services, and the seller's counsel should ensure that the appropriate consent has been obtained from the licensors of the

software to permit this type of “service bureau” use.

The Aftermath

You made it through closing, the deal toy is on your shelf, and you're ready to put the transaction behind you and re-establish your relationship with your family (or your golf pro.) Don't take a breather quite yet—there are still a number of clean-up items relating to the intellectual property transfers that cannot be completed until after closing. Here is a short checklist to run through (or hand-off to your IP attorney) before you head out to the links:

Recordation of Assignments. All of the assignment documents relating to registered trademarks, registered copyrights and patents must be recorded at the USPTO or the Copyright Office, as appropriate.

Domain Name Transfers. Although you may have completed much of the paperwork in advance, do not file the domain name transfer forms until after closing. Record each transfer with the registrar of the domain name. For example, if some of the domain names were registered through Network Solutions and others through Register.com, you must transfer each through its respective registrar.

IP Addresses and ASNs. Like domain names, although the document evidencing the intent to transfer between the buyer and seller will be signed at closing, the actual transfer will not take place until the registry (ARIN) approves it. For transfers of IP addresses or ASNs, ARIN requires that an authenticated copy of the instrument affecting the transfer be submitted, and reserves the right to require an inventory of all assets utilized by the requesting party in maintaining and using the Internet Protocol space and a list of any customers of the registered party that used portions of the assigned space. ARIN's transfer policy gives it much discretion to re-allocate IP addresses if, in its judgment, the new entity does not require the same amount of space as the prior owner. It is important to involve the appropriate technical business people in the transfer process, to minimize the impact of any re-allocation.

Software. Although most of the communications with the licensors should have occurred prior to closing (obtaining

consents to assign, etc.), there may be some vendors requiring notice that the transaction has taken place. Additionally, to the extent that consents for limited transitional service bureau use of software were obtained, these vendors require notice of the date the transaction took place, to track the 60- or 90-day time period that the consent was intended to cover.

What If the Deal Has Already Closed?

Most of the transfer-related issues discussed above can be dealt with post-closing; it just may be more expensive. To the extent that trademark, patent or copyright assignments have yet to be recorded, it's not too late. There is no time limit on these recordings, and often it is not until due diligence for the next deal begins, that the parties discover the need for recordation of prior transfers. So, go ahead and clean up the record now, and save yourself some trouble later. If software licenses were assigned without consent, the remedy, of course, is to come clean with the vendor. Although in theory, the worst-case scenario is a copyright infringement claim against the company using the software, in reality, the vendor probably is not interested in burning its bridges with a new customer who may purchase additional licenses and, of course, pay those maintenance fees that keep software companies running. The real downside to straightening this out after the fact is that once you are out of compliance with the license, you have much less leverage to argue against a substantial transfer fee or possibly a new license fee for the software that is in use. Still, if you are forthright with the vendor in bringing this licensing "oversight" to their attention, your good intentions may be rewarded with a reasonable transfer fee. The moral of this story is—start early on your IP issues, so that you won't pay later. 🍷



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