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Valuing Intellectual Assets for M&A: The Evolution of Due Diligence

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CIP FORUM 2005
***Managing Intellectual Property
as a Core Business***
Goteborg, Sweden, May 22-25, 2005



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Alternative Deal Structures

Acquisitive (Transaction-based) -- Purchase/Sale of Entire Company

- Asset purchase – Liabilities usually not assumed
- Stock purchase – No change in corporate entity
- Merger -

Forward – Target merges into Acquirer and disappears

Forward Triangular – Target merges into Acquirer-Sub and disappears

Reverse Triangular – Acquirer-Sub merges into Target and
Target survives (at least for a while)

Merger of Equals (MOE)

More complex variants

Alternative Deal Structures (cont.)

Acquisitive (Transaction-based) - Purchase/Sale of Less than Entire Company

- Purchase of unincorporated division or business unit –
Asset-based, including IP
- Purchase of technology or product Line –
Asset-based, primarily IP

Alternative Deal Structures (cont.)

Collaborative (Relationship-based)

- Joint Venture - *Spin Out*

Without forming a Newco (contract-based)
With a Newco (investment-based)

- Co-development
- Co-marketing, Co-branding
- Other strategic alliance (e.g., IP pooling, consortia, standard-setting)

Primary IP Objectives

- **Acquisition/Divestiture of Entire Business –**

Identification of IP risk and allocation between Buyer and Seller (see below)

- **Acquisition/Divestiture of Business Unit, Product Line or Technology –**

Allocation of IP ownership and use rights between Buyer & Seller

- **Joint Venture –**

Allocation of IP ownership and use rights between each Partner's pre-existing and prospective (Non-JV) business activities and Joint Venture's business activities

IP Allocation Mechanisms

Forms of rights transfer to Buyer

- Full assignment
- Assignment with grant-back license –
 - Exclusive field-of-use grant-back
 - Non-exclusive grant-back
 - Grant back to improvements ??
- Assignment of joint ownership interest
 - With field-of-use restrictions
 - Without field of use restrictions

IP Allocation Mechanisms (cont.)

Forms of rights transfer to Buyer (cont.)

- Exclusive license –

Field-of-use limited

Term-limited (head-start)

- Sole license (exclusive with use reservation by Seller)
- Non-exclusive license
- Covenant not to sue–

Ordinarily personal, non-transferable

IP Allocation Mechanisms (cont.)

Example --

Acquisition/Divestiture of Business Unit, Product Line or Technology:

- Partition of ownership into Retained IP and Assigned IP

Much IP (particularly patents) will cover **both** business and/or technology transferred to Buyer and some/all of Seller's ongoing business/technology

- Forward license from Seller to Buyer on Retained IP –

Field-of-use vs. unrestricted

- Grant-back license to Assigned IP –

Field-of-use vs. unrestricted

- Joint IP ownership (assignment of undivided interest)

With contractual field-of-use partition
Without restrictions (not recommended)

IP Allocation Mechanisms (cont.)

Example --

Joint Venture/Spin-out - Technology and Associated IP Partitions

Background Technology/IP

Pre-existing; and
Developed during, but not pursuant to, JV

Foreground Technology/IP

Developed pursuant to JV
Jointly developed
Solely developed

Derivative Technology/IP

Subset of Foreground IP based exclusively (or
primarily) on one party's Background IP

IP Allocation Mechanisms (cont.)

Joint Venture Example (cont.)

JV Forms

JV Without a Newco (Contractual JV)

Licensing of JV Partners' Background IP to one another as necessary to accomplish the objectives of the JV

Licensing of Foreground IP to each JV Partner in carefully defined (and often non-competitive) fields-of-use.

IP Allocation Mechanisms (cont.)

Joint Venture Forms (cont.):

JV With a Newco (Investment JV) --

- Assignment of selected JV Partners' Background IP to Newco (or not)
- Exclusive (or non-exclusive) license of selected JV Partners' Background IP to Newco for use within Newco's defined field-of-use (usually royalty-free)
- Exclusive (or non-exclusive), royalty-bearing (or not) grant-back licenses of Newco-developed IP from Newco to JV Partners for use outside Newco's field-of-use (and often in mutually exclusive fields as between the Partners)

IP Allocation Mechanisms (cont.)

Joint Venture Forms (cont.):

Two-Stage JV

Interim (Pre-Newco) Phase – The Courtship

Exploration of feasibility and fit

Formation and operation of Newco

Wedded Bliss, but –

What happens to Interim IP if
Newco isn't formed?

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Acquisition of Entire Business - Risk Identification

Disclosure/Due Diligence

- IP Due Diligence Questionnaire & Document Request
- Document Review (the *Data Room*)
- Interviews
- Independent Investigation



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Acquisition of Entire Business - Risk Identification (cont.)

Risk Analysis

Third Party infringement claims/litigation

Restrictions on transfer (or loss) of licensed-in third party IP

Anti-assignment provisions

Requiring consent

Automatic termination of license

Application to Reverse Triangular Merger --

Does an RTM constitute assignment?

One California decision says Yes

Default legal rules where license is silent

Patent – Non-exclusive vs. exclusive

Copyright and other IP licenses

Change-of-control provisions

Acquisition of Entire Business - Risk Identification (cont.)

Risk Analysis (cont.)

Encumbrances on owned IP

- Exclusive licenses out
- Non-exclusive licenses to competitors
- Covenants not to sue
- Settlement agreements
- Etc.

Real limitations on ability to conduct business vs.
permission (license transfer) costs.

Show-Stoppers and Deal-Breakers -

What is the appropriate materiality threshold?

Acquisition of Entire Business - Risk Allocation

Typical IP Reps. and Warranties

Ownership of or right-to-use designated IP

Valid title to scheduled Company-owned IP

Valid licenses to scheduled Third Party IP

No encumbrances -

on exploitation or use of IP

on conduct of business

as currently conducted

as contemplated

Validity & enforceability of Company-owned IP

Sufficiency of owned and licensed-in IP for conduct of business

Acquisition of Entire Business (cont.) - Risk Allocation (cont.)

Typical IP Reps. and Warranties (cont.)

Non-infringement of third party IP rights

- Patents
- Copyrights & Trade Secrets
- Trademarks & Domain Names
- Other IP

No pending or threatened third party IP claims

Agreements with employees and consultants re:

- Confidentiality of Company trade secrets
- Ownership of inventions/work product

Non-contravention of existing IP agreements

Non-impairment of existing IP

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Acquisition of Entire Business (cont.) - Risk Allocation (cont.)

Typical IP Reps. and Warranties (cont.)

Qualifiers

Knowledge (whose?, actual vs. constructive)
Materiality - Material vs. Material Adverse Effect (MAE)

“Bring-down” of reps at closing.

Closing conditions (exit options)

Indemnification for breach of R/Ws



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Acquisition of Entire Business (cont.) - Risk Allocation (cont.)

Effect of Breach of Reps & Warranties

Pre-Closing

Exit option (if Material/MAE)

Possible basis for price renegotiation (unusual)

Post-Closing (should reps survive?)

Money damages

Monetary caps and time limits

Who stands behind the R/W?

Seller's shareholders

Other guarantors

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Acquisition of Entire Business (cont.) - Risk Allocation (cont.)

Interplay between R/Ws and Disclosure

Exception Schedules (aka Disclosure Schedules)

Primary Negotiation Areas

Definition of “Knowledge” and “MAE” qualifiers and selective application to individual R/Ws

Inclusion vs. exclusion of selected disclosure items vis-à-vis Exception Schedules

Indemnity cap for breach of IP R/Ws (or not)



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Dawn of a New Era - Early Stage Consideration of IP in M&A

- Value Analysis as well as Risk Analysis
- Inclusion of IP analysis in *target selection* and *pricing* processes
- Assessment & valuation of technology (the old model)
vs. technology *and* IP (the new model)
- Strategic, as well as statistical, view of IP
- Increasing emphasis on substantive analysis of scope and validity of issued patents and pending patent applications

The Life Cycle of an M&A Transaction

<u>Stage</u>	<u>Drivers</u>
Business Case ID	Acquirer Strategic Planners
Target Selection	I-Bankers, Acquirer Mgmt.
Pricing	I-Bankers, CPAs, Co. Mgmt.

Contract Drafting	Lawyers
Diligence	Lawyers, Technical Teams
Closing	Lawyers, Co. Mgmt.
Post-Merger Integration	Acquirer Management

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A New Paradigm: The IP Investment Bank

Based on the fundamental premise that

IP is more than a bundle of legal rights

IP is an *asset class* that can be *traded* --

i.e., bought, sold, aggregated, subdivided, securitized, etc.

in many of the same way as other asset classes

such as real estate and corporate securities



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IP Investment Bank Services

- IP Brokerage --

Buy side - Targeted patent acquisition

Sell side - Sale of individual patent or portfolio

Primarily patents, but could be applied to know-how as well.

- IP M&A --

Corporate Transactions involving IP-Based Companies

e.g., Technology/IP Spin-Off (divestiture) or Spin-Out (Newco/JV)

Patent Aggregation

- IP-Backed Corporate Finance --

Sale and License Back

Use of IP as bridge loan collateral

Securitization of future IP royalty streams

- IP Development - outsourcing R&D



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IP Investment Banking Model vs. Assertion-based Patent Monetization Model

The assertion-based (aka “Troll”) patent monetization model is based on viewing a patent as --

an exclusionary legal right

Value proposition: zero sum game
“Pay us a royalty or we’ll sue!”

The IP investment banking model results from viewing IP as --

a commercial asset class (like real estate or corporate securities)

Value proposition: win-win
“We can both make money on this transaction.”



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Concluding Thought

***“When all you have is a hammer,
everything looks like a nail.”***

**Think creatively about monetizing IP assets -
talk to an IP investment banker.**