Attorney-Client Privilege in IP Due Diligence: Preserving Confidential Communications in IP Asset Transfers

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Credits:

Intellectual Property Due Diligence in Corporate Transactions: Investment, Risk Assessment, Management, L.M. Brownlee (Thomson/West 2008)

The Attorney-Client Privileged and the Work-Product Doctrine, Fifth Ed., Edna S. Epstein (American Bar Ass'n 2007)

Hypothetical:

*Large Software Company (Buyer) wants to acquire large Internet Search Engine (Target). **

Buyer and Seller have agreed to begin Due Diligence.

Result will be a merger/acquisition or walk-away if the deal falls through

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** Any resemblance to actual companies and living persons is purely coincidental.*

How should Buyer and Target handle the following?

• Algorithm for targeted ads, database of demographics for profiled content delivery, lists of customers-users	• List of issued patents
• Unpublished patent applications	• Patent application files with attorney correspondence
• Published patent applications	• Draft patent applications
• New technology/inventions (disclosed, undisclosed)	• Noninfringement opinion
• Patentability report	• Clearance study (freedom-to-operate)
• Patent notice letter from third party	• Buyer's IP Due Diligence Report

Outline:

I. Information Sharing: To Do, Not to Do; If so, how much?; If so, when? (Steve Frank)

II. Protecting Privileged & Confidential Information during Due Diligence (Steve Schreiner)

III. Protection of Shared Information & Waiver (Steve Schreiner)

IV. What if the deal falls through? (Hope Mehlman)

What is Due Diligence?

- Buyer:

  - Fiduciary duty.
  - Investigation before investment.
  - Identify risks. Mitigate if possible.
  - Valuate.

- Seller: “Opening the books”.

- “Depends on whether you’re buying or selling”

  - Starting with Arms Length Negotiations . . .
  - Ending with Integrated Legal Entity, OR
  - Walk away . . .

What is Due Diligence? (cont'd)

- Exchange of information to evaluate Merits of the Deal for both sides.

- What information?

- "It Depends":

Need for Information & Risk Tolerance

v.

Risk of Waiver

IP Due Diligence scenarios:

- Share purchase/asset transfer/merger-acquisition
- Capital contribution/investment
- Joint venture
- Security pledge for loan
- IPO

Phases of the Deal:

1. MOU/Letter of Intent

   - often nonbinding
   - milestones
   - Proposed Transaction

2. Confidentiality Agreement/NDA/Common Interest

3. Due Diligence Requests

4. Transaction Closing

   - Asset Purchase Agreement
   - Merger Agreement

Scope of IP Due Diligence:

- Size of Deal
- Reps & Warranties
- Importance of IP to Target Co.
- Buyer to rely on Target's Opinions and risk waiver, OR
- Buyer develop independent opinions and avoid waiver.

IP Asset Types Subject to Due Diligence Request:

- Patents
- Trade secrets/confidential data
- Trademarks
- Domain names
- Copyrights
- Databases
- Semiconductor chip & mask works

Typical Due Diligence Request:

1. List of IP Assets (inventions, patents, TM's, TS's, etc.)
2. Ownership/encumbrances/validity (recordation, duty to assign for contractors/vendors maintenance, security interests, on-sale/bar issues)
3. Licenses In and Licenses Out (impact, adequacy)
4. Contracts with IP Clauses (ownership, indemnity, LoL)
5. IP Threats from Others (notice letters, suits, reexams)
6. Notices to Others (DJ risk, etc.)
7. Freedom-to-Operate/clearance
8. Third party infringement of T's IP (but laches, estoppel, etc.)
9. Reps & Warranties, exception schedules, IP policies
10. Valuation of T by B.

IP Due Diligence Risks to Target-Seller:

- Confidential information/trade secrets owned by T
- Confidential information of Third Parties held by T
- Waiver of Privileged/Work Product Documents & Communications

IP Due Diligence Risks to Buyer:

- Loss of Privilege Protection even if deal goes through
- MOTS allegations by T if deal falls through
- MOTS allegations by Third Parties if deal falls through

Guidelines for IP Due Diligence:

- Threshold question: Will T disclose protected materials to B?

- Assess **Need for Information v. Risk of Waiver**

- If not shared, consider impact on price via

  - B having to perform its own analysis (e.g., freedom-to-operate), or

  - B operating with incomplete information

- Assume if it's shared, protection will be waived:

  - Can B and T live with consequences?

Guidelines for IP Due Diligence (cont'd)

- Graduated Approach/Milestones: disclose unprotected documents first, protected documents later.

  - **What** Privileged docs to disclose? **When**?

- Example: (1) Publicly available docs, then (2) Confidential docs of T, then (3) Confidential docs of 3rd Party, then (4) Privileged docs.

- Consider piecemeal sharing of Privileged materials, e.g.:

  - Provide list of patents considered in Freedom-to-Operate (FTO) opinion, but not opinion itself.

  - Describe methodology of FTO to satisfy outside IP DD counsel without disclosing actual opinion.

Guidelines for IP Due Diligence (cont'd)

- If Privileged docs shared, exchange between outside counsel (avoids discovery on executives if waiver found).

- Execute Confidentiality Agreement/Common Interest Agreement prior to sharing protected documents:

  - Handling procedures. What to share? Who can access? Final disposition?

  - Specify common interests, purpose of disclosures.

  - **Research your jurisdiction on Common Interest.**

- Preserve confidentiality via Data Room with restricted access: **Who needs to access protected docs ("need to know" threshold)?**

Guidelines for IP Due Diligence (cont'd)

- Avoid sharing protected documents if conversation between IP counsel addresses B's needs

When is Privilege Waived in Due Diligence?

- **Learning by Repetition: "Research your jurisdiction on Common Interest."**
- Assume worst case that there will be waiver.
- Whether there is waiver depends on:
  - Regional law & specific facts
  - Nature of common interests in the subject matter
  - Existence of Written CI Agreement (not dispositive)
  - Compliance with handling procedures to restrict disclosure.

How to safeguard information during Due Diligence?

- Confidentiality Agreements/Nondisclosure Agreements
  - Trade secrets, proprietary data of T
  - Trade secrets, proprietary data of Third Parties
  - Handling procedures, limited access, data room
- Trade secrets:
  1. independent economic value, not generally known
  2. reasonable efforts to maintain secrecy
- Confidentiality Agreement/NDA should demonstrate "reasonable efforts"

Refresher on Attorney-Client Privilege:

- Definition: (1) Communication between (2) client and attorney (or agents of either) (3) expected to be confidential (4) for purpose of seeking or rendering legal advice, and (5) not for purposes of crime or fraud.

- "Encourages full and frank communications between attorneys and their clients . . . to protect not only the giving of professional advice . . . but also the giving of information to the lawyer to enable him to give sound and informed advice". See Upjohn Co. v. United States, 449 U.S. 383 (1981).

- A-C Privilege has existed for centuries going back to Roman times.

Attorney-Client Privilege (cont'd)

- Covers substance of communication, not underlying facts.
- Descends to successors-in-interest, such as corporate successors.
- May extend to communication between A and Former Employees
- Pre-discharge privileged matters
- Continuing duty to corporation from code of conduct, employment agreement, inventor assignment
- The fact of the communication/surrounding circumstances (e.g., VP Smith spoke to AGC Esquire in NYC on 8/28/08) usually not protected.

Attorney-Client Privilege (cont'd)

- Acting as "mere conduit" for facts or documents does not invest them with privilege.

- Routing A-C communications (reporting letters, etc.) are unprotected as they do not involve legal advice.

Refresher on Work Product Immunity:

- Definition:

  (1) Materials, things and information

  (2) prepared in anticipation of litigation, reflecting

  (3) mental impressions, conclusions, opinions or legal theories of counsel.

- First recognized in Hickman v. Taylor, 329 U.S. 495 (1947).

- Materials by non-attorneys prepared at attorney's request.

Work Product Immunity (cont'd)

- Not a privilege, not absolution protection:
  - Non-opinion work product (trial preparation materials)
    - qualified protection, overcome if substantial need and unavailable
  - Opinion work product
    - absolution protection, mental impressions, theories, etc.
- Protected items must be prepared anticipating litigation, not ordinary course of business

Common Interest Agreements:

- "Joint defense", "common interest"

  - Exception to waiver rule from disclosure to third party.

  - Extends privilege for communications between parties having "community of interest."

- Purpose to allow parties with common interest to secure and share legal advice.

- Early case: Duplan Corp. v. Deering Milliken, 397 F.Supp. 1146 (D.S.C. 1974) (common interest privilege recognized where "identical legal interests with respect to subject matter of the communication".)

Common Interest Agreements (cont'd)

- Need not be common litigation interest (co-Defs), can be "common legal interest".
  - May exist even though parties have some adverse interests on other subjects (co-Defs with cross-claim).
  - Should be common legal interest, not mere common commercial interest.
- But some courts have a restrictive view of CI:
  - May need to be identical legal interest without any adversity.

Common Interest Agreements (cont'd)

- May be limited to where common interest is a common litigation interest, not mere common legal interest.

Bottom Line:

- Regional law varies
- CI may/may not apply in asset negotiation/due diligence context.

Preferred Approach is Formalized CIA Agreement:

- Document common interests & documents shared in furtherance of CI.

- Obligation of confidentiality

Privacy concerns and confidentiality of personally identifiable private information:

- Significant concern for financial institutions

- Identity theft, Privacy Act

- Avoid sharing if feasible

- Redaction/dummy data where feasible

- Special handling, access, & destruction procedures

Other considerations for protecting information:

- Third party consultants/experts to limit transmission of information from T to B

- Written versus Verbal communication of privileged information

Waiver of Common Interest/Privilege/Work Product:

- Privilege generally construed narrowly because it impedes search for truth.

- Issues of privilege and waiver are procedural issues controlled by regional circuit law, not the Federal Circuit. See In re Pioneer Hi-Bred Int'l, Inc., 238 F.3d 1370 (Fed. Cir. 2001) (in patent cases, substantive law controlled by Federal Circuit; procedural matters controlled by regional circuits).

- Generally, privilege is waived if voluntary disclosure of materials to third party.

Waiver of Privilege/Work Product (cont'd)

- Intentional disclosure (express waiver)

  - can lead to subject matter waiver on subject of communication.

- Inadvertent disclosure:

  - may lead to waiver unless considered involuntary, unintentional.

  - usually limited to disclosed communication only, not general subject matter waiver.

Court Treatment of Common Interest: Expansive View

- Hewlett-Packard v. Bausch & Lomb, 115 F.R.D. 308 (NDCA 1987): No waiver where seller of division disclosed patent opinion letter. Confidentiality protected. Policy to keep efficient M&A market, not chill deals. But see Nidec below.

- Rayman v. American Charter, 148 F.R.D. 647 (D. NB 1993): No waiver for sharing of information as part of merger.

- Tenneco Packaging v. S.C. Johnson, 1999 WL 754748 (ND Ill. 1999): Seller's disclosure of infringement opinion from attorney during Asset Purchase Agreement not a waiver. Limited disclosure and NDA.

Court Treatment of Common Interest: Expansive View (cont'd)

- Britesmile v. Discus Dental, 2004 WL 2271589 (NDCA 2004): CI upheld where seller disclosed noninfringement opinions and patentability opinion to buyer Discus.

- In re Regents of California, 101 F.3d 1386 (Fed. Cir. 1996): CI protection for communications between licensor/applicant U-Cal and exclusive licensee Eli Lilly on prosecution of patents.

Court Treatment of Common Interest: Restrictive View

- Bank Brussels v. Credit Lyonnaise, 160 F.R.D. 437 (SDNY 1995): CI protection only if common legal, not commercial, interest. General concern about litigation in sufficient. Must be more than "merely concurrent legal interests". Disclosure must be in course of "formulating a common legal strategy."

- Libby Glass v. Oneida, 197 F.R.D. 342 (ND OH 1999): Oneida's disclosure of noninfringement opinion to concerned mfr was a waiver. Lack of confidentiality critical.

Court Treatment of Common Interest: Restrictive View (cont'd)

- Katz v. AT&T, 191 F.R.D. 433 (EDPA 2000): Katz disclosure of opinion to potential exclusive licensee MCI was a waiver. Must be identical legal, not commercial, interests. Relationship during arms-length negotiations was adversarial, not common.

- Blanchard v. Edgemark Financial,192 F.R.D. 233 (ND Ill. 2000): Threat of lawsuit imperiling merger leading to exchange of privileged documents was not CI protected. Mere common commercial/financial interest.

- United States v. Duke Energy, 2003 U.S. Dist. LEXIS 6134 (MD NC 2003): No CI privilege unless common legal interest is based on contemplated litigation.

Court Treatment of Common Interest: Restrictive View (cont'd)

- In re Santa Fe Int'l, 272 F.3d 705 (5th Cir. 2001): No joint privilege for class action by oil drillers unless "palpable threat of litigation."

- Nidec v. Victor, 249 F.R.D. 575 (NDCA 2007): Broad HP decision on CI limited to combination/merger of parties, not mere majority stock purchase transaction. HP also limited to common interest based on anticipated joint litigation, not general business interest in purchase transaction.

What if the Deal Falls Through?

- Handling/destruction/return as per agreements.
- Confirm proper disposal of all documents shared.
- Need-to-know and controlled release mitigates risk.

QUESTIONS?

THANK YOU

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