Structuring IP Provisions in Asset Purchase Agreements

Negotiating Scope of IP Assets, Representations and Warranties, Pre-Closing Covenants, and Ancillary IP Agreements

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Structuring IP Provisions in Asset Purchase Agreements

Strafford Webinar
May 31, 2016

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Key IP Considerations and Due Diligence
IP Implications of Transaction Structure

Stock Transaction

- Change in control of company
  - IP and other assets are not “sold” – title remains with the company
    - Contracting entity does not change
      - But watch for change of control provisions
  - Liabilities and claims remain with the company

- Buyer takes all assets and liabilities
  - Right to collect damages for past IP infringement
  - Liability for past infringement
IP Implications of Transaction Structure

**Asset Transaction**

- Identified assets are sold
  - Title to assets transfers to buyer at closing
    - Ancillary agreements
    - Contracting entity changes (consents)
  - Liabilities and claims do not automatically transfer to buyer

- Buyer takes only the identified assets and assumed liabilities

- Defining the scope of the transaction and identifying the assets within the scope is critical
Asset Transactions
Transaction Scope

- Typical transactions
  - Sale of patent or patent portfolio
  - Sale of all assets of company
  - Sale of a “Business”
    - Sell a particular business, but retain and continue to operate other businesses
      - Sell R&D assets that are no longer a strategic fit

- Define scope - then identify assets
Seller Due Diligence - Identify Assets
Business Sale

- Identify all IP assets that are relevant to the Business
  - Registered IP Assets
    • patent, trademark, copyright, designs, mask works, domain names
  - Unregistered IP Assets
    • trade secrets, copyrights, trademarks
  - IP contract rights
    • Licenses, options, MTAs, settlements, research agreements, etc.

- Are the IP assets within the scope of the sale?
  - All in scope assets will be sold to buyer
  - But, some might be relevant to sellers retained business
Seller Due Diligence
Defining “In Scope” IP Assets
Business Sale

- Seller should set the test to identify in scope IP assets before buyer due diligence begins
  - Exclusively related to the Business
  - Primarily used or held for use in the Business
  - Used or held for use in the Business

- In scope IP assets will be sold

- Ancillary agreements may be needed to complete the transaction by providing rights under additional IP
  - Buyer may need rights to IP that is out of scope
    - E.g., patents on platform technology
  - Seller may need a license back to in scope IP for use in the retained business
Due Diligence
Business Sale

- Identify Risk
- Mitigate Risk
- Allocate Risk in Transaction Documents
Due Diligence – Common IP Risks

- Record Title
- Encumbrances
- Lapsed Rights
- Co-ownership
- Disputes – Actual and Potential
- Transfer Restrictions
• Record title may not accurately show legal ownership
  – Mergers and internal transfers frequently are not recorded
  – Inventors may not have assigned to company
    • But local law or employment agreement may transfer title to company

• Often not practical to fix record title pre-closing

• Under some corporate structures Legal Title and Beneficial Title are with different corporate entities
  – Beneficial title is usually not recorded, but must be transferred
Due Diligence – Common IP Risks

Encumbrances & Lapsed Rights

- **Encumbrances**
  - Security interests, liens
  - Discharge is typically a closing condition

- **Lapsed Rights (and right that might lapse before or soon after closing)**
  - Allocate responsibility for any past due fees
  - Buyer typically is responsible for prosecution and maintenance immediately after closing
    - Transitional services may be needed
Due Diligence – Common IP Risks
Co-ownership

- In some countries a co-owner cannot assign or license his interest in the IP without consent of the other co-owner
  - Common in Europe and Asia
    - France – co-owner can assign his share, but other co-owner has a preemptive right to take the share

- Assignment or license may be invalid in absence of consent from the co-owner
  - Consent may be included in prior contracts – joint development agreements, etc.
Due Diligence – Common IP Risks
IP Disputes

- Actual and Potential Disputes are important
  - How material is the dispute to the Business
    - Ongoing litigation and threats
    - 3<sup>rd</sup> party infringers of IP that will be purchased
    - FTO risks

- Often have direct impact on valuation and deal structure
  - Lower up front payment with earn-out

- Risk allocation can be one of the most heavily negotiated issues
  - Reflected in IP representations and warranties, indemnity, and other provisions in transaction documents
Due Diligence – Common IP Risks
Transfer Restrictions

- Splitting patent families
  - US patents subject to terminal disclaimers only enforceable while commonly owned

- IP contracts
  - May not be able to assign or sublicense without consent of counter party
    - Prior consent may be limited to sale of all or substantially all off the business or assets to which the contract relates
    - Sublicense for activities done on behalf of licensee
  - Consent may be conditioned on payment or renegotiation
    - Will a sublicense substitute for an assignment
Translate due diligence results into the transaction documents

- Definitions of Business, purchased IP assets, assumed liabilities, IP contract rights, licensed IP rights and other definitions concerning the scope of the purchased IP assets and rights
- IP representations and warranties, including sufficiency warranty
- Pre-closing covenants and documents to be delivered at closing
- Ancillary agreements
- IP schedules
Structuring IP Provisions in Asset Purchase Agreements

Strafford Webinar

May 31, 2016

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Representations and Warranties
Assignments and Licenses
Pre-Closing Covenants
Preliminary Considerations

What Perspective?

• Buyer v. Seller
• Deal Structure (technology transfer; JV; development; etc.)
• Industry & Special Concerns
• Materiality of IP

• What are the technology concerns & priorities?
• What issues were revealed in diligence that require special attention in the reps?
Primary IP Objectives in APAs

• Allocation of IP ownership and use rights between Buyer and Seller
• Identification and allocation of IP risk between Buyer and Seller
IP Allocation in an Asset Purchase

- IP divides into 3 categories:
  - Assigned
  - “Dual-use” (or “cross-over”), and
  - Retained

Dual Use IP is useful to both retained and sold products/businesses

- Divested business will receive title to Assigned IP
**IP Ownership**

*Rep:* Seller is the **sole and exclusive** owner of all right, title and interest in and to all Assigned IP [and Licensed ("dual-use") IP].

- Registered IP searches: USPTO, USCO and domain name registrars
- Confirm Registered IP that is purported to be owned is currently owned by that entity
- Examine chain of title
- Recorded security interests
- Special attention to IP that is material to deal value (e.g., Rolls Royce brand)
- In a divestiture transaction, make sure IP is at divested entity or will be divested at or prior to closing

### Default Law

- Patents: an invention is owned by the inventor unless expressly assigned to another (requires present assignment)
- Copyrights: owned by creator of the protectable work
  - Exception: limited work for hire doctrine
- Trademarks: A trademark is owned by the entity that uses the mark with its goods or services

### Are there agreements in place with every contractor or research partner?
- Assignment/license of IP to Company
- Joint ownership issues (US vs. foreign jurisdictions)
- Contamination / residual information

- **Form employee assignment agreement**
- **Variations from the form agreement**
- **Any employees have not signed the form agreement?**

**Company**

- **Acquisitions**
- **Joint Development / R&D**
- **Contractors**
- **Employees**
IP Licenses

Rep: Section X of the Disclosure Schedules sets forth a true and complete list of all Contracts pursuant to which (i) Seller receives a license, covenant not to sue or other right under any third party IP that is used in the Business, or (ii) Seller grants to any third party any license, covenant not to sue or other right under any Assigned IP [or Licensed IP].

- Grant rights under IP of Affiliates?
- Identity of counterparty
- Scope of rights granted:
  - What IP is licensed?
  - Exclusive? In what fields?
  - Licensed products and services
  - License term
- Sublicensing rights
- Royalties/payment obligations
- Terminable by counterparty as a result of transaction?
- Government funding:
  - March-in rights
  - US manufacturing requirement

- Materiality of license to Business
- Scope of licensed products and services
- Covers products/services of Affiliates?
- Territorial limitations
- License term
  - E.g., upcoming expiration for a key license
- Non-compete
- Survival upon change of control
- Terminable by counterparty as a result of transaction?
- Assignment
  - Default rule for non-exclusive IP licenses is that they are not assignable absent express language to the contrary
- Royalties/payment obligations
- Commercially-available replacement
**Non-infringement of Third Party IP**

*Rep:* The conduct of the Business as presently conducted, and as conducted in the [three (3) year] period prior to the date of this Agreement, does not and did not infringe, misappropriate or otherwise violate any IP of any third Person.

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**Pending litigation**
- Subject matter of the action and materiality
- Damages / risk of injunction
- Work-around

**Threatened litigation**
- Assertions of infringement from third parties
- Cease and desist letters
- Invitations to take a license

**IP proceedings**
- Opposition / cancellation proceedings
- Post issuance proceedings under AIA

This rep, as formulated above, *may not* pick up infringement upon commercialization and sale of a product that is under development, or infringement of a product that is sold in one country (e.g., US) but has not yet been sold in another (e.g., EU).
Non-infringement of Third Party IP

• Variations
  • *Forward-Looking:* A representation that the operation of the Business *does not infringe* would not, without more, protect a Buyer where a product in development *had not yet been sold* against infringements upon “sale” of products.
    • Especially important for new technologies, new uses, or use in new jurisdictions
  • *Downstream Infringement:* “Operation of business” rep may not capture customer infringement.
  • *Gap Filling:* Proper definition of “Product” can help fill the gaps left by a simple representation of non-infringement for operation of a business.

• Sellers seek to qualify
  • Knowledge/MAE
  • Materiality
IP Sufficiency

*Rep:* The purchased assets include all IP **used in or necessary for** the conduct of the Business **as presently conducted** [and as currently planned to be conducted].

- Likely includes a non-infringement rep, unless expressly disclaimed
- Could capture IP that is not used in the business, but is “necessary” (e.g., in-licenses necessary for ongoing product development)
IP Sufficiency

• Critical rep for Buyers in asset purchase transactions
  • Operation of the Business after closing
  • Identify “missing” IP assets and necessary third party consents

• Sellers seek to qualify
  • Knowledge/MAE
  • Materiality
Other Considerations

• Scope of reps depends on industry and how material IP is to overall value or competitive position
  • Encumbrances on IP
  • Trade Secrets
  • Open Source Software
  • Listing of Transferred Software and IT Assets
  • Development
  • Employee Assignment
  • Possession / Ownership / Security of Source Code
  • Government Funding
  • Standards Organizations
  • Condition of IT Assets
Assignments and Licenses

• Registered Assigned IP subject to short form assignments for recordation with the applicable IP office

• Non-registered Assigned IP transfers through the purchase and assignment provisions in the APA
  • Separate documentation not required

• Licenses to Seller Retained IP
  • Necessary [or useful] to conduct the Business
  • Patent portfolio license limited to Business field of use
  • Software license (object and source code)
  • Transitional trademark license
Pre-Closing Covenants

• Also called interim operating covenants

• Protects the assets and value of the Business between signing and closing
  • Continue operation of the Business in the ordinary course consistent with past practice
  • Prohibition on selling, encumbering or otherwise disposing of Business assets, including IP
  • Continue to diligently prosecute and maintain registered Assigned IP [and Licensed IP]
  • Carve-outs for ordinary course events typical (e.g., granting non-exclusive licenses to customers)
Pre-Closing Covenants

• Sample pre-closing IP covenant:

Seller shall not without the prior written consent of Buyer (which consent shall not be unreasonably withheld, conditioned or delayed):
sell, assign, license or otherwise transfer or dispose of any Assigned IP [or Licensed IP], except (i) for IP licenses granted in the ordinary course of business consistent with past practice, (ii) pursuant to obligations in Contracts to which Seller is a party and that were made available to Buyer and in effect prior to the date of this Agreement, or (iii) abandonment of any Registered Assigned IP [or Registered Licensed IP] at the end of the applicable statutory term or upon any final rejection during prosecution, and, with respect to any pending application that is not material to the Business, any abandonment in the ordinary course of business consistent with past practice.
IP Provisions in Asset Purchase Agreements

Pre-Closing Covenants and Ancillary IP Agreements

May 31, 2016

Presented by Jessica N. Cohen  jessica.cohen@skadden.com
Section 1

Pre-closing covenants
Why are pre-closing covenants useful?

- Help solve issues without holding up signing

- Allow for handling sensitive IP issues that parties do not feel comfortable with until they have a deal

- Typically incorporated by reference into the closing conditions

- Typically uncapped liability for failure to perform
Examples of pre-closing covenants related to IP

- Interim operating covenants

- Obtaining consents for the transfer of IP licenses or the use of licensed IP in any post-closing arrangements

- Restructuring IP ownership to consolidate in an acquired entity

- Updating record title to IP applications and registrations

- Release of stray liens recorded against IP applications and registrations

- Disclosure of sensitive IP (formulas, source code) to allow for Buyer evaluation

- Negotiate ancillary agreements related to IP

- Establishing a steering committee to address IP transition matters
Section 1

Ancillary IP Agreements
Examples of Ancillary IP Agreements

- Trademark License Agreement
- Patent License Agreement
- Technology License Agreement
- Trademark Co-existence Agreement
Post-Closing Covenant v. Ancillary IP Agreement

Issues to Consider When Choosing Between a Post-Closing Covenant and an Ancillary IP Agreement

• Level of complexity; ongoing obligations
• Term
• Disclosure issues
• Remedies
• Assignment
• Governing law; cross-border issues
• And, finally, how much time do you have?
  – Term sheets + pre-closing covenant
Ancillary IP Agreements – Common Themes

Consider the following when preparing an Ancillary IP Agreement

• Does the agreement need to be truly standalone?
  - Perpetual terms
  - Disclosure issues
• Is there any separate compensation?
• Should there be separate/additional reps?
• Should there be a separate liability scheme?
• To what extent should the agreement be assignable?
Trademark License Agreements

• **Scope of the License**
  - Existing materials; existing uses; new uses

• **Different Terms for Different Uses**
  - Electronic uses
  - Tools and dies
  - Regulatory restrictions
  - Logo use for road shows
  - Signage

• **Quality Control**
  - Tied to scope

• **Phase-out Rights**
Patent License Agreements

- Versus covenants not to sue
- Scope of the Licensed Patents
  - Specifically identified patents v. catch-all
- Scope of the License
  - Exclusive in a field v. non-exclusive
  - Acquired business v. natural extensions v. all fields
- Enforcement Rights
- Maintenance Obligations
  - Consider right of first refusal
- Term
Trademark Co-existence Agreements

- Territory v. Field of Use (or both)
- Right of First Refusal
- Cooperation on Prosecution and Enforcement
- Cross-border Issues
- Reputational Issues and Public Announcements
- Domain Names
- Confusion Not Likely
- Term (including abandonment)