IP Due Diligence

Whatever the technology, IP can form a significant intangible asset for a company. In addition to legally protecting the company's products and activities from being copied by competitors, IP can generate revenue through licensing or sales, it can protect market share and increase return on a company's R&D investment. IP therefore plays a vital role in establishing the value of a company. When looking to invest in a company that holds IP, a good understanding is needed, not only of what IP a company holds, but how that IP adds value to the company. IP is not just a matter of numbers: the strengths and weaknesses of each IP right need to be understood to be able to evaluate the portfolio as a whole. And an ability to assess these strengths and weaknesses in a timely manner is crucial.

We discuss here how a company's IP can be assessed in a due diligence process, as well as some common misconceptions about IP that are frequently encountered.

Due Diligence: Establishing the IP Rights

An IP due diligence investigation firstly needs to determine all of the registered IP rights and unregistered IP rights that a company may have. Patents are generally the most valuable right as they provide the strongest protection, preventing others from using a company's invention. Trade marks also play a key role. Many companies rely heavily on the goodwill associated with their brands – Coca Cola, Apple and Nike being just a few of the many examples. For these companies, protecting the respect afforded to the brand via a trade mark is vital. However, other lesser-known types of IP, such as know-how for protecting trade secrets where no patent is in place, copyright for protecting software and database right for protecting databases, are also becoming increasingly important.

Most companies now develop their own software and providing a service to customers through an App is commonplace. Software may be protected by copyright. Unlike patents and trade marks, where a company needs to apply to register their rights, copyright is an IP right that can arise automatically. Copyright protection for software depends on the circumstances, in particular whether or not open source software has been used, so careful consideration is needed of what rights apply.

The service sector is increasingly reliant on information, and details of customers and other data that has been compiled in company databases can have significant value. Many companies also invest heavily in compiling databases of historical and real time data in order to provide services such as automatic trading, situation monitoring and AI. These valuable resources may be protected by database right, another right which can arise automatically.

Due Diligence: Assessing the IP

IP due diligence, though, is much more than a simple audit of what IP is held. An IP due diligence report provided by an IP expert will also assess the strengths and weaknesses of the IP and provide a clear assessment of the IP that is understandable by non-IP experts.

First and foremost it is important to establish that the company owns all of its IP. Patents cover inventions which initially belong to the inventor(s). Although in the UK rights will automatically transfer to the company that employs the inventors, complications can arise if inventions were the result of collaboration, as is often the case. Also, different ownership considerations apply to different types of IP, so this needs proper consideration.

The validity of the IP and the risk of any successful validity attack by third parties also needs to be considered. Questions such as the geographical scope of the IP portfolio and the ability to enforce the IP might well be important – IP rights which do not cover the key intended markets may be problematic.

For patents, it is important to understand the underlying technology – does the patent cover the product that is being developed or sold by the company and will it do so for future developments? How easily will third parties be able to work around any patents? A patent may effectively cover a company's own product and be able to withstand any attack on its validity, but this is no guarantee it will protect the company's market position: the patent also needs to cover the types of modifications to the product that competitors might make.

Common Misconceptions

Unfortunately, misconceptions around IP abound and can lead to mis-understanding of the true value of an IP portfolio. Here are five common ones:

"We have a patent, so we have the right to exploit our invention." – Many companies have false expectations of what their IP rights allow. In fact, IP only provides the right to stop others from doing something – it does not provide the right to do something. It is necessary for companies to perform freedom-to-operate (FTO) investigations to determine if there are rights of other parties that could prevent their activities.

"We have worldwide patent protection for our idea." – This type of statement is often not correct. Whilst it is possible to apply for a patent application via an international treaty (the Patent Cooperation Treaty), this does not lead to a "worldwide patent", but needs to be converted into separate national or regional patents in the countries of interest. In fact, the cost of filing and maintaining a patent family in a large number of countries is normally only an option for companies with large IP budgets and for patent protection to be sought in every available country is extremely rare.

"Our patent provides us with a monopoly for our company's

product" – Whether this is correct or not will depend on the exact wording of the patent. An IP expert will need to analyse the claims of the patent to determine if the scope of protection is appropriate for preventing competitors from designing round the patent. And this may need to be done country by country as the scope of protection provided by patents in different countries in a patent family may vary. Care also needs to be taken to look at what a patent ultimately protects once it is granted. It is all too easy for companies to lose sight of IP when changes are made to product design during development: it may be that a patent does not actually cover the product it was intended to protect.

"We have not applied for any patents because it is not possible to obtain a patent for a computer program" – Many opportunities are lost because of this misconception. The European Patent Office alone grants thousands patents a year for computer programs.

"Now we have a patent, it will be easy for us to keep our competitors off the market" – Enforcing IP rights is often a complex business. There are significant costs and risks associated with litigation. Settling a dispute, with a licensing or other agreements, is normally the preferred option with suing a competitor for infringement of an IP right being a last resort.

These are just a few of the reasons why a company's IP may not be what the company, or a potential investor in the company, thinks it is. Many companies are not fully aware of what IP they have, nor how they can use their IP to maximise their company value. In fact, many companies are these days carrying out their own IP review at regular intervals, or at least in advance of any investment process, in order to try and resolve these issues at an early stage.

Conclusion

IP is an increasingly important asset for companies in a wide range of technologies and its correct understanding and management should not be undervalued. Investigating the value of this asset through a diligence process which assesses strengths and limitations is a critical part of the investment process.

Companies may not want to wait for a due diligence round to see where these strengths and limitations lie. An early IP review can improve a company's understanding of its IP and help it to put an appropriate IP strategy in place. Any company with an appropriate and correctly managed IP strategy will be well prepared for the IP due diligence investigations that potential investors are likely to perform.

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