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TRASKBRITT Intellectual Property Attorneys

A primer on patent due diligence

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The areas of intellectual property include patents, trademarks, copyright, trade secrets and industrial designs. While all intellectual property must be analysed in any due diligence evaluation, this article will generally outline the mechanics and considerations for conducting a patent due diligence. 'Due diligence' refers to the process of assessing the issues, value, and risks associated with a business transaction. This process is a critical precursor in many business transactions, such as mergers, acquisitions, new ventures, licences, initial public offerings, and litigation.

Very generally, a patent carries the right to exclude others from making, using or selling an invention in the country in which it is granted. In order to obtain a patent, a patent application must be filed with the appropriate national government patent office in each country where protection is sought (e.g., United States, Japan, Europe, etc.). Each country has its own requirements in relation to patentable subject matter, as well as unique requirements for filing and obtaining a patent, such as usefulness, adequate written description, enablement, novelty, and nonobviousness. In most countries, the term of a patent is 20 years from the date of filing of the patent application (or the earliest date from which priority to another patent application is claimed).

The scope of patent protection is defined by the 'claims' of a patent, which are located at the end of the patent in numbered paragraphs. Claims that are narrow in scope can be easier to design around, allowing competitors to design competing product so as to not fall within the scope of the patent. Claims that are broad in scope and are valid may not be easily designed around, forcing a competitor to obtain a licence from the patent owner, sell alternative products, or face a potential patent infringement lawsuit.

In order to properly initiate a patent due diligence, a patent attorney needs a basic understanding of the business, the structure of the deal, and the business goals, which include a detailed understanding of the technology, products, formulations, and/or manufacturing processes.

Patent portfolio matrix: An initial step in the due diligence process requires preparation of a patent portfolio list, which includes itemisation of the target company's US and foreign granted patents and its patent applications, both utility and design. Various records at the applicable patent office can be searched. A search by owner (as listed in many foreign countries) or assignee (US) can identify patents and patent applications that are in the name of the target company. A search by key employee, researcher, or principal of the target company can identify patents that are of key value to the relevant industry, but that may not have been recorded in the name of the target company. The patent database can also provide information on the names of individual inventors. These patents can then be reviewed to determine whether or not the invention relates to the business of the target company and the acquiring company. A list of any inbound and outbound licences should be added to the list. Once a preliminary list is compiled, it is prudent to also assess the company's procedures for identifying patentable inventions and designs and for ensuring that applications are timely filed. A review that these procedures are followed and are appropriate and effective for timely submission of inventions to the appropriate patent office should be conducted.

Ownership records: Records for all patents and applications should also be checked for proper listing of the target company as owner. This includes confirming that the company has recorded assignments (where applicable) for all US and foreign patents and patent applications. One should determine whether the company has assigned or granted rights to, or security interests against, any patents or patent applications. Patent maintenance and annuity fee records should be reviewed to verify active status of patents. Patents that are expired and/or unenforceable should be clearly identified. For any US patents of special interest, assignment records from the US Patent and Trademark Office (USPTO) can be obtained. Local counsel can be retained to confirm ownership and clear title to foreign patents.

A search should be conducted for any patents and patent applications in the names of key personnel, contractors, and principal product development, research, or regulatory consultants to ensure that they were assigned or licensed to the company. Agreements for inventors, employees, consultants, contractors, officers, and principal product development, research, or regulatory consultants should be reviewed to confirm that the agreements include obligations to assign US and foreign rights to the target company. Copies of all licences should be obtained to ensure that the licensor had the right to transfer the technology, and that the licences allow for sublicence or sale to the purchasing company. Searches should be conducted on related companies to determine what, if any, patents and patent applications are owned by a related company. This may identify inventions that are of interest to the target company's business and which are not owned by the target company. The records at the patent office can also be searched to determine whether or not any interests have been recorded against title to a patent or patent application. For example, interests such as licences and security interests may have been registered against a patent. Such records are available from some, but not all, patent offices in various countries. Compensation due inventors pursuant to national law (e.g., DE or UK) should be identified.

Litigation/infringement notices: Any existing litigation documents, opposition documents, and infringement notices to or from the target company should be reviewed and analysed. Any correspondence from the target company accusing others of infringing its patents and/or offering licences under the company's patents should be obtained from the target company and reviewed. An analysis to determine whether any matters justify further negotiations and/or litigation can also be performed. Any actual or threatened litigation/claims against the company, such as 'cease and desist' letters, should be identified. All licence offers made to the company should also be located to analyse potential future claims or licensing opportunities. The current status of any ongoing proceedings or negotiations should be identified and verified. Copies of any settlement agreements and releases should be obtained from the target company and analysed. Any existing covenants not to sue or indemnification agreements should also be analysed.

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Freedom to operate: Freedom-to-operate searches and analysis for the target company's products and processes should be performed. Such searches can be very involved and expensive. If cost becomes an issue, at a minimum, a patent search limited to core technologies and products is recommended. If available, the results of patentability and right-to-use searches conducted or commissioned by the target company should be reviewed. Consider whether to obtain corresponding formal legal opinions for problematic patents and applications.

An infringement analysis can be conducted to determine if the current and/or proposed activities of the target company infringe any third party patents. Where the activities of the target company are diverse or broad in nature, certain key activities and technologies can be identified for this type of analysis to limit the scope and cost of the analysis. If it is determined that some key technologies of the target infringe on third party rights, the target may be required to stop using those technologies or engage in designing around the patent claims.

Patent validity/claim analysis review: An analysis can be performed to assess the validity of a patent. Although a patent has been granted, it does not guarantee that it is valid. For example, prior art may have existed at the time of the patent application that describes the invention and which may invalidate the patent. The validity of a patent can be challenged in numerous ways (e.g., anticipation, obviousness, lack of enablement, inequitable conduct, etc.). A validity analysis can provide some assessment of the risk of a patent being found invalid on some particular basis.

As with freedom-to-operate searches, 'prior art' searches can be expensive and require discussion with a patent attorney regarding depth of investigation and budget. The purpose of such searches is to determine whether any prior art exists that might invalidate a key patent. Search results could uncover potentially damaging prior art that could invalidate an issued patent. Alternatively, it could provide an opportunity to amend pending patent claims to distinguish from such located prior art. Patent prosecution files (also referred to as 'file histories' or 'file wrappers') should be reviewed on key patents to ensure that the claims are enforceable, have adequate scope, and are not easily designed around by competitors. It should be noted that not all patent applications will be open and available to the public for review. For example, most patent applications are not open to the public for a period of 18 months from the filing date. As such, some pertinent information may not be available and any conclusions based on a review of a pending application can be compromised. Likewise, PCT (Patent Cooperation Treaty) applications which have not entered the national phase in a particular country may not be found in a search of the records of the patent office for that country. However, a search of the PCT records for applications that have not entered the national phase can be conducted.

For any patents that are critical to the business of the target company, a claims analysis can be conducted. This analysis will provide an indication of the scope of the claims that make up the patent, which affects the value of the patent. If the claims are narrow in scope, then it may be possible for a competitor to design around the patent, making the patent less valuable.

If the target is developing new technology for which it intends to file patent applications, an analysis can be conducted to determine the likelihood that a patent will be granted for this technology and the likely scope of protection that will be granted. This involves reviewing the records at the patent office to determine whether or not a third party has a patent or patent application which covers the invention. Often, inventions may not fully overlap. In that case, the target may still be able to obtain a patent for part of the invention. The foregoing also applies to any applications for patents that the target has already filed.

Once a letter of intent is signed or a purchase/merger is completed, issues uncovered in the patent due diligence are often forgotten. It is encouraged to follow up on any necessary items identified in the course of the due diligence. Such follow up may include reassignment of patents, which typically requires recordation at the patent office in the country where the patent was granted, addendums to licence agreements providing notice of the transfer, making any necessary changes to pending claims, and obtaining formal opinions of noninfringement.

Each business deal is unique and involves particular budgetary considerations. It is hoped that this primer on patent due diligence provides a guide to identify key issues and prioritise tasks in order to maximise the success of the transaction. ■

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