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DUE DILIGENCE IN ASIAN IP ACQUISITIONS: HOW MUCH IS ENOUGH?

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Intellectual property (IP) acquisitions are becoming commonplace in Asia with the move to knowledge-based economies. Agricultural and manufacturing economies may not have been prolific creators of IP, but these are often key territories for global or regional deals. In many cases, acquiring companies are Asian, looking to fast-track the design / invention / branding process and acquire IP as going concerns, complete with marketable products.

IP, in legal terms, is the classic intangible asset. IP can create value, including cash, in a number of ways. It can be sold. It can be licensed in or out. It can be contributed as capital into a joint venture. It can be offered to enter into strategic alliances. It can be integrated with a current business or used to create a new business. It can also be used as collateral when it is pledged, mortgaged or charged.

The value of intangible IP assets is a changing paradigm. IP is fast becoming a focus for capital markets and the investment community. It is a "tradable" commodity in its own right and serves as a vital tool for a company's ability to sustain its competitive advantage. IP value has seen a dramatic increase in recognition in recent years. Today IP is less a defensive tool, but more a layer of additional value on products and services, and in some cases a pure asset in its own right. For this reason, Asian companies are now waking to the value of Intellectual Asset Management (IAM), a business process in which IP experts review a company's IP assets and align them to the corporate strategy, realising costs savings and creating new revenue streams, as well as increasing the overall value of the business.

Due Diligence

According to the Chinese, "sharpening the axe before chopping the tree is not a waste of time". In the context of intellectual property, due diligence is critical. This should not only include a review of the status of registered rights, but also an analysis of previous transactions and other relevant agreements which may affect what can be done with the IP.

When acquiring IP (by way of either purchase or licence) or when IP is contributed as part of a joint venture's capital, due diligence on that IP is critical to confirm several things.

First, a buyer wants to identify the property to a degree sufficient to confirm it fits his needs. Do the patents cover what you hope them to achieve? Are the trademarks in the appropriate classes for the goods / services you will use them with? Full searches are ideal, but not always practical in the time available or if costs are limited, in which case prioritisation is crucial.

Second, a buyer wants to confirm that the IP is owned by the seller (and in the context of patents, including whether any government funds were involved in development or whether any inventor may have lingering inventorship rights) so that the seller can legally assign the property to the buyer. This is mainly confirmed by review of all licences, agreements and encumbrances relating to the IP.

Third, a buyer wants confirmation that the IP does not infringe any third party intellectual property rights which, after acquisition, could pose a risk to the new owner. Due diligence must consider all disputes and litigation related to the IP including IP registry actions by trademark, patent, copyright and industrial design offices in each jurisdiction the IP is registered. Contested IP may come at a lower price, but a buyer may be precluded from using that IP or may even be sued for its use of contested IP upon acquisition. This needs to be addressed and settled long before the signing of any acquisition agreement and it is unwise to rely solely on indemnifications.

Additionally, the IP itself may not be completely sufficient on its own to market goods / services in a particular territory. For example, there may be necessary regulatory permits or product certifications or accreditations which should flow with the IP from the seller to the buyer. This is normally true for IP covering food, beverage, pharmaceutical, nutritional and personal care items. There may also be valuable know-how, associated materials or technical knowledge related to the IP for use in manufacturing products or dealing with customers. This needs to be identified, verified and included in the acquisition. If such know-how, etc., is transferred only by way of licence, it is best to understand who else will be allowed to use it, where and under what terms.

Patents will require an assessment of the technology in question by the buyer's patent attorneys and an analysis of the strength of the patents to be acquired. Patent mapping can identify related technologies and current competitors, as well as key inventors in the field (buyers may want to recruit them) and, through forward citation mapping, who will be a future competitor.

The amount of time required to complete the due diligence depends on the amount of disclosure and the depth of investigation the buyer thinks necessary and the seller thinks reasonable. The exercise itself culminates in the production of two very important documents. First is the Due Diligence Report prepared by the buyer's counsel setting out in condensed format a complete picture of all relevant information disclosed by the seller and obtained by the buyer's counsel. The Due Diligence Report will assess legal risks and liabilities so that a decision came be made to proceed or not. Second is the Disclosure Letter which is prepared by the seller's counsel and sets out the IP, the defects in the IP and other risks. The Disclosure Letter often serves to limit the warranties set out in the S&P so that the buyer will be precluded (save for fraudulent misrepresentation) from taking action against the seller after the deal is completed.

The process of acquiring IP in Asia is much the same as anywhere else. However, there are several areas of concern, which, if left unsettled, may cause difficulties in the future. This isn't a job that should be left entirely to your corporate M&A lawyers at head office. IP assets are unlike tangible asset deals. They require a great deal of specialist knowledge both in relation to the assets and the conduct of the necessary due diligence. Indeed, even within IP asset classes, specialist technical knowledge may be needed. Likewise, Asian companies looking to expand abroad are buying up distressed IP assets in the West. Corporate lawyers sometimes overlook this in their push to complete a deal. Calling the IP lawyers at the last minute is often a complaint. However, with the increased sophistication of Asian technologies and established brands, these deals are increasing significantly.

IP Due Diligence Checklist

Trademark. All trademarks should be listed and their status noted, including jurisdiction, precise wording, images and non-alphabetic marks used, renewal dates, the registered proprietor, pending applications, copies of registration certificates, and lapsed or expired marks in the last five years.

Copyright. All copyrighted works should be listed, noting the date and place of creation, identity and contact details of the author(s)/creator(s) and of the current owner, and the mode of copyright acquisition.

Design. All designs should be listed, noting jurisdiction, design and image thereof, Locarno class(es), application and registration numbers, annuity / extension dates, the registered proprietor, and all expired or invalidated designs in the past 10 years.

Patent. All patents and patent applications should be listed, noting jurisdiction, application and registration numbers, status, and the registered proprietor. Any patentability opinions, patent plans, the patent portfolio, descriptions of "design around" efforts, infringement assessments, freedom to operate opinions, clearance opinions, or validity assessments held by the seller should also be included.

Know how, associated materials, technical knowledge, etc.

Other Intellectual Property Rights

- Domain names
- Common law unregistered and unfair competition rights and common law goodwill
- Unregistered trademarks, logos, and/or business names, including those in foreign languages
- Brand descriptors or brand extensions or any other tag lines, sub brands, and slogans

Third Party Rights in the IP should be listed, noting all third parties with any interest in the IP, rights held, the source of those rights, and the relevant jurisdiction.

Litigation and Disputes should be listed, noting parties, the nature of the dispute, jurisdiction, cause(s) of action, status, etc. for any actual, pending, or threatened litigation, administrative action, or settlements.

Regulatory Approvals should be listed for all countries where obtained or applied for, along with a copy of such approval, for food, beverage, pharmaceutical, nutritional, and personal care items.

Other Issues

- *Security interests in intellectual property*
- *Product formulations* for branded products
- *Manufacturing information*, including current and past manufacturers, copies of current manufacturing contracts, and current and past label and packaging printers, print plates, and mould ownership details
- *Customers, shops, outlets or wholesalers* involved with the IP
- *Territory*, if the acquisition is non-global
- *Transitional arrangements* are important in cases where Seller participation is necessary for Buyer's smooth takeover of existing business.

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