Shallow waters or deep dive – Avoiding costly IP missteps in transactions

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As companies are seeking to scale or pivot into new areas or monetize their intellectual property (IP) portfolios, we are seeing increased partnership, joint venture (JV), product licensing and acquisition activity on the Canadian and international landscape. IP can either be the driving force of the deal or a significant area of risk requiring special consideration, from due diligence to the drafting of substantive provisions of a transaction agreement. The outcomes of IP due diligence and how that information is leveraged, will help converge business and IP goals and bring knowledge to inform decision-making and risk-taking in the transaction.

When conducting pre-deal legal due diligence, the depth and nature of the IP review will have to come early in the transaction process, will be iterative and should always be tailored to particular circumstances of the transaction. The IP considerations in relation to JVs can vary considerably in complexity, depending on the nature of the JV. Similarly, collaboration arrangements are among the most complex relationships a business can establish. Ownership of patents, trademarks and know-how that a partner brings to the table or that are developed jointly can become hotly contested. For companies in pre-IPO or IPO stages, licensing opportunities will be of interest, so enhanced searches will help evaluate investment potential. If you are deep into R&D and looking to combine licensed technologies into product development, your focus will deepen. For an increasing number of organizations, deciding between buy or build acquisitions, collaborations or JVs with high-tech targets has become an instrument of choice to boost innovation, streamline operations and processes, and personalize client offerings.

How far and wide you will cast your IP due diligence net will depend on:

- The type of transaction, the structure and the identity of the parties;
- The industry, geographic scope of operation and density of IP in the field;
- The materiality of IP to the target's business. Is the IP core to the target’s business and at the heart of the transaction or is it just an added benefit that could be capitalized on?;
- Process and timeline considerations;
- Budget limitations – resources are not unlimited for any company, small or large.

Identifying the IP assets and their ownership in each country of operation will help identify geographic or product gaps in the IP portfolio. In the event joint-ownership of IP is uncovered or contemplated post-closing, a word of caution: the default rights of the parties in joint IP ownership arrangements can be different in various jurisdictions and can differ depending on the type of IP rights (e.g., patents, copyrights, etc.). Consequently, there can be many potential pitfalls particularly when the IP rights are commercialized in a number of different markets. Materiality of the IP to the transaction will drive the analysis of those assets and will inform the negotiations and agreements.

As data has become a larger component of transactions and business, it is important to get a sense of who owns the data (and derivative data), who has rights to access or use the data, and who might retain access or use of the data post-transaction. In the case of AI-generated data, ownership and use can be particularly complex and expert advice may be required.

If there are any particular assets in the IP portfolio that are an important consideration for the transaction, a more substantive review can be conducted including an analysis of the strength and scope of the rights, validity of rights, freedom to operate and potential third party risk. In the case of a JV for example, will the JV need to use any IP or confidential information of any of the shareholders in order to carry on with the agreed business plan? Joint development agreements involve the sharing of a company's most valuable information and while iron-clad nondisclosure and confidentiality agreements before disclosing sensitive data in the due diligence process is necessary, so is prior vetting of potential partners and its personnel to gauge trustworthiness, how well they protected their IP and potential for overlap with third party IP rights.

An investor, partner or acquirer will want to confirm that the value it places on the target company is supported by the degree to which the company owns (or has the right to use) all of the IP that is critical to its current and anticipated business. From electric vehicles and supply chain management technology to the metaverse, the surge in M&A activity for the technology sector will require a sharp focus on IP as business-critical.

We have seen transactions fail post-closing because the IP driving the deal was later discovered not to be valid, not to be owned by the purchased company or to be subject to an agreement that restricted the use of the IP. A deep dive review in IP due diligence will unveil red flags of significance to deal value, risk management, structuring and negotiating the transaction and successful post-closing implementation.

For more information of this insight, reach out to Panagiota Dafniotis or any member of Dentons Canada's Intellectual Property and Technology group.

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