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Emerging Life Sciences Companies

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Chapter 32

Acquiring Intellectual Property: Potential Pitfalls

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ACQUIRING INTELLECTUAL PROPERTY: POTENTIAL PITFALLS

When negotiating a life sciences merger or acquisition agreement, the acquiring company must fully understand the chain of title and scope of the IP to be merged or acquired, and the degree of freedom it will have to use the products and services of the merged or acquired company. How thoroughly IP due diligence is conducted can mean the difference between landing in and safely negotiating around possible pitfalls when entering into such transactions. This is particularly important in the life sciences context. This chapter identifies and discusses common pitfalls associated with certain provisions of merger and acquisition agreements. In particular, it focuses on certain definitions and on representations and warranties. These provisions are typically highly negotiated, and in some instances cause the parties to terminate negotiations prior to signing, or form the basis of disputes after closing. This analysis is not intended to be exhaustive; rather, it is meant to identify and facilitate discussion of certain pitfalls.

Definitions

The definitions section in a merger or acquisition agreement is critical to the remainder of the agreement, and sets the scope of the assets of the merged or acquired entity. Among the terms whose definitions usually require the most thought and negotiation are "products" and "intellectual property." From the acquiror's perspective, the definition of "products" should include all those products it believes are owned by the company to be merged or acquired. The more thorough the due-diligence efforts have been, the more detailed this list will be. From the seller's perspective, the definition should be restricted to only those products it does not wish to retain. The degree of specificity in the definition is especially important where the company to be merged or acquired is a subsidiary of a corporation that will carry on similar lines of business as the merged or acquired company postsale, and when the next best product may not fall within the definition. The definition of "intellectual property" should include a list of specific patents, patent applications, registered and unregistered trademarks, trade secrets, confidential information, and copyrights owned by the merged or acquired company, and relevant regulatory clearances or approvals. The definition at a minimum should include all IP necessary to operate the merged or acquired company's business. From the acquiror's perspective, the definition should also include all IP that may be useful to operate the merged or acquired company's business, while from the seller's perspective, it should include the smallest set of the seller's IP necessary to operate the newly merged or acquired business. Again, the due-diligence process is essential to ensuring that the definition is both accurate and complete.

Representations and Warranties

The representations and warranties should be informed by and reflect all that was learned from IP due diligence. Of the time involved in merger and acquisition transactions, IP attorneys typically devote the most to drafting and negotiating the representations and warranties. The most important representations and warranties related to IP typically include:

- Identification of IP
- Ownership of IP
- All patents are valid and enforceable to the merged or acquired entity's knowledge
- Reasonable measures have been taken by the merged or acquired entity to protect and document trade secrets and confidential information
- No infringement or misappropriation of third-party IP
- No infringement or misappropriation by a third party of the merged or acquired entity's IP

Common pitfalls related to representations and warranties include:

- The merged or acquired entity's insistence on including a "materiality" qualifier without defining "materiality"
- The merged or acquired entity's refusal or inability to represent and warrant that it owns the merged or acquired IP without a knowledge qualifier
- The merged or acquired entity's refusal or inability to represent and warrant that the patents are valid and enforceable
- The merged or acquired entity's refusal or inability to represent and warrant that it has taken reasonable steps to protect and document trade secrets and confidential information
- The merged or acquired entity's limiting a knowledge qualifier to the knowledge of a handful of individuals who may not have any knowledge of ownership, validity, enforceability, or infringement of IP rights or products

Conclusion

Mergers and acquisitions offer many potential rewards for the parties involved. However, if the parties fall into any of the many traps that await the unwary, the value of such transactions can be significantly diminished. In many instances, IP due diligence is the key to safely negotiating around possible pitfalls in life sciences merger and acquisition agreements.