# The Intellectual Property Transaction: The Basics About Buying and Selling Intellectual Property Assets

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## I. Introduction

The driving force in many stock and asset transactions today is the seller's intellectual property portfolio, which may consist of patents, trademarks, service marks, copyrights, trade secrets, trade names and domain names. In pursuing such a transaction, a primary goal of the parties' counsel and management is to ascertain what property rights the purchaser desires to acquire and what rights the seller is capable of delivering. The seller's counsel should be prepared to deal with problems that arise or are likely to arise through the purchaser's due diligence check.

The purchaser's due diligence check typically includes, among other things, obtaining a detailed list from the seller describing each intellectual property right within the scope of the transaction, conducting a review of relevant company files of the seller, and running a computerized search of government and other readily available records to confirm the existence of registered rights in intellectual property, the status of such rights and, in some cases, the existence of potentially relevant third-party rights. As more data resources have become available, conducting independent searches now serve as an essential tool in assessing the existence of any gaps or irregularities which may dramatically affect the **nature** and **extent** of the seller's rights in its intellectual property and the **value** of such rights to the purchaser. This article is intended to highlight some of the more common problem areas that arise in intellectual property acquisitions.

## II. Defining the Goals of Due Diligence

Due diligence can often be time consuming and costly. To make sure that such activities are properly focused, counsel for the purchaser should start by defining the assets that the purchaser desires or needs to acquire. This is best accomplished by interviewing the business strategists in charge of the deal to find out what is really important to the purchaser and to define the specific rights that are essential to acquire from the purchaser's point of view, as well as those which are of little or no interest or concern. In every acquisition, the purchaser has decided to purchase the seller or a line of business of the seller, or is evaluating whether to do so, in order to accomplish some desired objective. As examples: The primary objective may be acquisition of a brand or group of brands for which the purchaser already has the means of production. A purchaser may be seeking to enter the market only in the United States or in a limited group of countries and may have no desire to expand into many other countries where the seller owns trademarks. The converse situation may exist where the purchaser has a strong international distribution capacity in markets where the seller has a weaker presence or where its trademarks/service marks may be of dubious enforceability because of nonuse.

A cost-effective due diligence plan will focus principally on those assets that are actually of interest to the purchaser. However, because the objectives of the deal often evolve over time, it is also important to keep rechecking whether the purchaser's priorities have changed. It is not unusual for previously "absolute" requirements to become subject to tradeoffs later as a result of ongoing negotiations between the parties.

Where the seller's intellectual property is the principal focus of the acquisition, the purchaser should identify every intellectual property asset that is necessary or desirable to acquire. A failure to properly identify the rights to be included in the transaction can result in documentation that does not convey all of the property desired by the purchaser.[1] If purchaser's counsel fails to identify important intellectual property to be acquired, adequate due diligence may not be conducted and essential rights may be omitted from the transaction.

## III. Determining the Structure of the Acquisition

The decision as to whether the purchaser will purchase assets or stock normally will be driven by a variety of issues other than intellectual property considerations. These will generally include tax and corporate organizational issues for both the purchaser and seller in virtually every deal, and often include successor liability questions ranging from pension plans and union contracts to environmental cleanups. However, from the purchaser's point of view, due diligence is needed in every case to ensure that the desired rights are acquired.

In a purchase of defined assets, everything the purchaser wants to obtain must be identified and included in the scope of the acquisition documents. The purchaser's counsel may incorporate representations and warranties that the assets are owned by seller and include all of the intellectual property of a particular line of business as a contractual safety net for any omissions from grant clauses and schedules. However, the reasonableness of the purchaser's reliance on such representations and warranties may depend on state law and on the extent to which relevant data was or should have been found by due diligence and known to the purchaser prior to closing.[2]

In a stock deal, the purchaser generally acquires whatever rights the seller may own, which may or not be clearly defined with regard to intellectual property assets. Because stock purchases involve the sale of securities, they are governed by Section 10b of the SEC Act of 1934.[3] The caselaw under Rule 10b-5 imposes an affirmative duty on the seller not to engage in material misrepresentations and on the purchaser to conduct reasonable due diligence. Therefore, the purchaser's failure to exercise due diligence can be asserted as an affirmative defense in subsequent litigation.[4]

## IV. Dealing with Gaps and Discrepancies and Potentially "Killer" Issues

In an intellectual property acquisition transaction, it is important for the purchaser's counsel to identify any rights that must be acquired to make the deal worthwhile, as well as any limitations on the purchaser's freedom to exploit the intellectual property that could destroy or substantially diminish the value of the acquisition to the purchaser. For example, if the purchaser is acquiring a restaurant chain for expansion throughout North America, the value of the acquisition could be greatly diminished if the restaurant's name were owned by another company in Canada or subject to concurrent use rights of a regional restaurant chain on the West Coast. Therefore, due diligence should focus, at any early stage, on making sure that the seller owns all of the rights that are crucial to the purchaser and that those rights are not subject to any burdens or deficiencies that may affect their value to the purchaser.

In a perfect world, due diligence information gathered and exchanged by the seller and purchaser in a transaction will result in a comprehensive and accurate information exchange. However, rarely is the world perfect, particularly in the case of complex business transactions which may raise a multitude of gaps and/or discrepancies. How these gaps and discrepancies are dealt with is often the subject of vigorous negotiations.

### A. Assessment of Risks

Once a gap or discrepancy is identified, the first priority of the parties is to assess its materiality to the transaction. Further investigation of materiality may result in a finding that the gap or discrepancy is immaterial, in which case it may be ignored. On the other hand, the risk may be sufficiently material and serious that the transaction does not go forward.

### B. Representations and Warranties

Many transactions include representations and warranties relating to the intellectual property being transferred, which encompass a multitude of issues including ownership, registration, knowledge of infringement, and so forth. Representations and warranties may, particularly for the seller, present significant ongoing obligations and

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[1] *See, e.g.*, *H.S.W. Enters., Inc. v. Woo Lae Oak, Inc.*, No. 00 Civ. 5582 (HB), 2001 WL 379224 (S.D.N.Y. Apr. 13, 2001) (addressing claims of trademark infringement arising out of sale of interest in high end Korean restaurants); *Middleby Corp. v. Hussmann Corp.*, Nos. 90 C 2744, 91 C 3188, 1992 WL 368023 (N.D. Ill. Dec. 1, 1992) (finding a breach of warranty claim where asset purchase failed to result in transfer of three patents).

[2] *Compare CBS, Inc. v. Ziff-Davis Publ'g Co.,* 553 N.E.2d 997 (N.Y. 1990) (purchaser prevailed on breach of warranty claim in spite of underlying facts discovered through due diligence prior to closing), *with Hendricks v. Callahan*, 972 F.2d 190 (8th Cir. 1992) (purchaser's reliance on warranty barred by knowledge of defects prior to closing).

[3] 15 U.S.C. §78j(b).

[4] *See, e.g.*, *Straub v. Vaisman & Co.*, 540 F.2d 591 (3d Cir. 1976) (denying due diligence defense under the circumstances of that case).

possible liability. Negotiations on this subject are key for both sides and require complete communication between the business people and attorneys for each of the purchaser and seller so that any risks in agreeing to or not agreeing to a particular representation and warranty can be fully appreciated.

### C. Allocation of Risks

It is not unusual for attorneys representing the purchaser and seller to disagree on the risk presented by a particular gap or discrepancy relating to an intellectual property asset. Impasses on such issues can sometimes be resolved by the parties reaching agreement on a formula for allocation the risk, indemnity, or adjustment of the purchase price.

## V. Trademarks/Service Marks

When seeking to acquire trademark or service mark rights from another, there are a number of important issues that one must investigate.

### A. Ownership

One should confirm that the seller owns the trademark and/or service mark rights that the seller purports to convey in the transaction. Licenses, assignments, security interests or other burdens on the seller's absolute rights (such as "field of use" or settlement agreements) must thus be identified. One should also review alleged dates of adoption of trademarks and facts supporting the allegations, since in some cases the stated date of "first use" could be a non-trademark or "token" use that may not support a claim of priority of rights.[5]

### B. Registration

One should ascertain whether the marks in question have been registered federally and/or in one or more states. If so, one should investigate whether the registrations have been properly maintained (*e.g.*, the filing of appropriate Sections 8 and 15 affidavits) or renewed, based on statutory requirements. The issue of federal registration may be a particularly crucial one, as it conveys certain legal rights and benefits; in particular,

(1) on the Principal Register constitutes *prima facie* evidence of the validity of the registered mark, of the registrant's ownership of the mark, and of the registrant's exclusive right to use the registered mark; and

(2) a Principal Register registration is constructive notice of a claim of ownership so as to eliminate any defense of good faith adoption and use made after the date of registration.

One should also inspect federal registrations and pending applications for irregularities (*e.g.*, improper owner named, incorrect description of goods or services, changes in the word or design form of a mark) as they have dire consequences in future disputes regarding priority of rights.[6] A potentially valuable source of information about a particular federal trademark or service mark registration or pending application may be the "file history" maintained by the Patent and Trademark Office. The file history contains a history of communications between the applicant's attorney and the Patent and Trademark Office and may provide enlightening information on a mark's "strength," the scope of registered rights, or likelihood of confusion with other marks. Where a seller's portfolio includes one or more marks for which foreign registrations have been obtained or applications are pending, conducting searches in the relevant countries to confirm their existence and status may also be desirable and can be performed with the assistance of foreign trademark counsel.

### C. Use

The fact that an active federal registration for a particular trademark or service mark exists does not necessarily translate into protectable rights in and to a mark if that mark is not and has not been used for a substantial period of time in connection with the goods and/or services covered by the registration. One should investigate the entire list of trademarks and service marks being sold and verify that all of those marks are still in use and that each is being used in a proper trademark sense. Non-use for a certain period of time might constitute "abandonment," and consequently the loss of trademark or service mark rights. Indeed, the Lanham Trademark Act provides that non-use of a mark for three consecutive years is prima facie evidence of abandonment. In such cases, an

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[5] *Compare Marvel Comics Ltd. v. Defiant*, 837 F. Supp. 546 (S.D.N.Y. 1993), *with Brookfield Commc'ns, Inc. v. W. Coast Entm't Corp.*, 174 F.3d 1036 (9th Cir. 1999).

[6] *See, e.g., Data Concepts, Inc. v. Digital Consulting, Inc.*, 150 F.3d 620 (6th Cir. 1998); *Van Dyne-Crotty, Inc. v. Wear-Guard Corp.*, 926 F.2d 1156 (Fed. Cir. 1991).

unsuspecting purchaser may purchase one or more marks for substantial consideration which are of little or no value. Improper use of a trademark may result in its being subsequently found to be generic or unprotectable otherwise.[7]

### D. Licenses and Assignments

One should carefully evaluate all licenses of trademark and service mark rights, as such licenses may significantly restrict or otherwise affect the nature, scope and duration of the purchaser's activities under a particular mark. Licenses should also be scrutinized to determine whether the seller has engaged in uncontrolled or "naked" licensing, which could result in a loss of trademark rights.[8] Similarly, where marks have been acquired by assignment, a court, in future litigation, may inquire into whether the assignee's product or service was similar in type and quality to the products or services of the previous mark owner as a prerequisite to allowing the assignee to rely on the predecessor's priority of rights.[9] Trademarks and service marks are not property rights that may be sold apart from the goodwill with which they have been developed and associated. Trademarks that are sold, licensed, or assigned without the accompanying goodwill may be deemed abandoned and available for use by others without risk of infringement.[10] This is because assignments-in-gross or naked licenses generally constitute use of a trademark or a service mark in connection with a business other than the one symbolized by the mark, and thus fraud on the public. The ultimate inquiry is whether any prior licensees or assignees have produced a product or performed a service of substantially similar kind and quality to that of the licensor or assignor so that consumer would not have been deceived or harmed by the license or assignment of a mark they have come to rely on as an indication of quality. A motivating factor behind some transactions is the purchaser's desire to achieve priority in a dispute with a third party. While this at first blush may seem to be "underhanded," courts have routinely held that a purchaser's motivation for acquiring a trademark or a service mark is irrelevant to the validity of the transfer.[11]

### E. Conveyance

As a procedural matter, the purchaser will need an assignment form for each trademark or service mark being conveyed. A seller cannot assign trademarks merely with a general conveyance in the closing documents. Also, some international jurisdictions require that a consideration amount be stated in each assignment.

### F. Court and Patent and Trademark Office Litigation

Previous cease and desist letters sent or received by the seller as well as prior litigation concerning the marks, either in courts or the Patent and Trademark Office, may significantly impact the scope of the rights acquired. Additionally, trademark rights may be affected by positions which were taken by the seller or its predecessors in earlier litigation. The seller's rights also may be restricted by administrative or judicial decisions regarding the mark or by prior undertakings and settlement agreements which may limit future use of the mark in new geographical or product markets. A review of the seller's files with regard to any suits and controversies can be supplemented by on-line searches including the U.S.P.Q. and Lexis or Westlaw legal databases.

### G. Review of Packaging, Advertising and Products

A review of actual examples of current packaging, advertising and promotional materials used by the seller is useful in evaluating proper trademark use, compliance with applicable regulations, and identification of unregistered marks, slogans, configurations and trade dress rights which may be appropriate for specific inclusion in schedules of rights to be transferred. Advertising materials and packaging also may disclose misuse of marks which may raise genericness issues as well as potential claims of false advertising or infringement of third party marks.

### H. Who Files? Who Pays?

An agreement should be reached by the parties as to which party will be responsible for preparation and recordal of appropriate assignment documents. The fees required to record assignments and transfers of trademark rights

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[7] *See BellSouth Corp. v. DataNational Corp.*, 60 F.3d 1565 (Fed. Cir. 1995).

[8] *See Stanfield v. Osborne Indus., Inc.*, 52 F.3d 867 (10th Cir. 1995); *Woodstock's Enters., Inc. v. Woodstock's Enters., Inc.*, 43 U.S.P.Q.2d (BNA) 1440 (T.T.A.B. 1997), *aff'd*, 152 F.3d 942 (Fed. Cir. 1998).

[9] *Pepsico, Inc. v. Grapette Co.*, 416 F.2d 285 (8th Cir. 1969).

[10] *See Haymaker Sports, Inc. v. Turian*, 581 F.2d 257 (C.C.P.A. 1978).

[11] *See, e.g., Lone Star Steakhouse & Saloon v. Alpha of Va.*, 43 F.3d 922 (4th Cir. 1995); *Dial-A-Mattress Operating Corp. v. Mattress Madness*, 841 F. Supp. 1339 (E.D.N.Y. 1994).

can be substantial, particularly when there are many marks and/or many foreign registrations. It is thus important that the agreement be clear as to who is required to pay for recording the transfers involved in the transaction.

### I. Domain Names

Domain names, when used in their traditional sense (*e.g.*, as an electronic "address" for where a web site can be located on the Internet), are not, without more, protectable as a trademark or a service mark.[12] A domain name may be registerable as a service mark where it is used in an appropriate and sufficiently distinctive manner (in a fashion that will be recognized as identifying and distinguishing applicant's services).[13] The passage of Anticybersquatting Protection Act makes conducting proper due diligence in acquisition of domain names critical.[14]

### J. Some Special Considerations

As indicated above, a good starting point in performing due diligence (on trademark/service mark assets) is conducting a search to ascertain the existence of possible third party conflicts.[15] While as described above, trademarks and service marks are generally conveyed by simple assignment, some caution must be exercised when the mark at issue is subject to an intent-to-use registration application. Such applications may be transferred prior to the filing of a Statement of Use only to a successor of the applicant's business or portion of the business to which the mark subject of the application pertains, if that business is ongoing and existing.[16] Finally, it is not uncommon to uncover during a due diligence review a trademark that has an incomplete chain of title from the original registrant to the seller who purports to be its current owner. This can pose a particular problem at the renewal stage when certain owners in the chain no longer exist or cannot be found. In such cases, the Patent and Trademark Office may accept, in lieu of an assignment, an affidavit containing sufficient facts to support the transfer of title.[17]

## VI. Patents

Representations and warranties can provide comfort that acquired technology is the subject of appropriate commercial exclusivity, and that the technology does not infringe third party rights. Patent issues deserve great attention in this respect because of the broad scope of protection they afford and because of the formidable array of sanctions that are available when infringement occurs. Representations and warranties are, however, no substitute for the information that competent due diligence reveals about the value, scope, and strength of the patent rights being acquired. The following issues, in particular, deserve close scrutiny.

### A. Ownership

One must ascertain that the seller actually owns all rights in the patent it is purporting to transfer. The failure to secure a proper assignment may have disastrous consequences in litigation involving the patents which were the subject of the purported acquisition.[18] One should further identify in which countries the patent rights exist, whether all required fees have been paid to maintain the rights, and whether the period for patent protection has expired.[19] The search for encumbrances on patent rights should include state UCC filings in addition to Patent and Trademark Office Records.[20]

### B. Applications Pending

The due diligence should include a determination about whether any patent applications are currently pending before the Patent Office, as well as the status of any such applications. This would include review of any pending Office Actions.

### C. Validity/Enforceability

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[12] *Panavision Int'l, L.P. v. Toeppen*, 141 F.3d 1316 (9th Cir. 1998). *See also Brookfield Commc'ns, Inc. v. W. Coast Entm't, Corp.*, 174 F.3d 1036, 1052 (9th Cir. 1999) ("mere registration of a domain name was not sufficient to constitute commercial use for purposes of the Lanham Act"); *In re Eilberg*, 49 U.S.P.Q.2d (BNA) 1955 (T.T.A.B. 1998).
[13] *Id.*
[14] *Compare World Wrestling Federation Entm't, Inc. v. Bosman*, Case No. D99-0001 (WIPO Jan. 14, 2000) *with Cello Holdings LLC v. Lawrence-Dahl Co.*, No. 97 CIV 7677 (DC), 2000 WL 335737 (S.D.N.Y. Mar. 6, 2000).
[15] *See Zazu Designs v. L'Oreal S.A.*, 979 F.2d 499 (7th Cir. 1992).
[16] *See* 15 U.S.C.A. §1060 (West 2000); *see also Clorox Co. v. Chem. Bank*, 40 U.S.P.Q. 2d (BNA) 1098 (T.T.A.B. 1996).
[17] *See* TMEP, §1603.05(a).
[18] *See, e.g., Gaia Techs., Inc. v. Reconversion Techs., Inc.*, 93 F.3d 774 (Fed. Cir. 1996); *Arachnid, Inc. v. Merit Indus., Inc.*, 939 F.2d 1574 (Fed. Cir. 1991).
[19] For an interesting recent case on the effect of failure to pay maintenance fees *see Utecht v. Olson*, 84 F. Supp. 2d 1039 (D. Minn. 2000).
[20] *See Moldo v. Matsco Inc. (In re Cybernetic Servs., Inc.)*, 239 B.R. 917 (B.A.P. 9th Cir. 1999).

The lawyer should determine whether any actions have been filed on behalf of or against the seller for patent infringement with regards to the patents and/or patented products or processes involved in the transaction. Inheriting a lawsuit is generally an undesirable proposition. With technology covered by patents or pending patents which is particularly key, it may be desirable to conduct an independent validity search.

### D. Patent Scope/Marketing

A key issue in evaluating the value of patents that are subject to an acquisition is ascertaining their scope. With respect to issued patents, the "file history" maintained by the Patent and Trademark Office should be obtained and reviewed. Moreover, an assessment should be made to determine whether the patents adequately cover any products or processes that are subject to the transaction. In the event they do, further investigation should be conducted to ensure that the seller has complied with the marking requirements of 35 U.S.C. § 287.[21]

### E. Licenses and Assignments

It is important that any licenses or assignments of patent rights be identified, so that the purchaser does not pay for exclusive rights when, in fact, others have rights to, or interests in, the patent(s) being transferred. Particular attention should be paid to the grant clauses of any such licenses and the presence of any field of use or geographic restrictions.

### F. Secrecy Agreements

Purchasers need to review all active secrecy agreements to determine whether they also contain provisions that prohibit the assignment of rights and obligations thereunder to assigns and the like. Most secrecy agreements restrict assignment unless written permission is first obtained; therefore, the purchaser must request that the seller obtain written waivers prior to transferring confidential information to the purchaser.

### G. Who Pays?

One should check the asset sale agreement to see if it specifies whose responsibility it is to record the patent assignments at the Patent and Trademark Office and/or internationally. As is true with trademarks, the fees involved in recording transfers of rights can be significant, and it is thus important to specify who will bear this burden in the agreement.

## VII. Copyrights

### A. Ownership

Any works containing copyrightable subject matter must be examined to determine who owns the respective rights in the copyright bundle, as specified by § 106 of the Copyright Act, and whether appropriate steps have been taken to preserve those rights. The exclusive rights enumerated in § 106 are:

(1) the right of reproduction;

(2) the right to prepare derivative works;

(3) the right of distribution;

(4) the right of public performance; and

(5) the right of public display.

One should begin by determining who is the author of the original version of the work in question. This involves a careful examination of all outside sources that contributed to the creation of the work, such as third parties, customers, employees, etc. The due diligence should include an investigation as to whether the material contributed is public domain or proprietary.[22] If proprietary, the terms pursuant to which such contributions were made must be determined so as to identify any parties who may have rights to the work or portions thereof.

If more than one person or entity made a significant contribution to the creation of the work, the work may be considered a "joint work," resulting in a jointly owned copyright.[23] If the creator of the work incorporated protected material from other pre-existing works, then the work may be a "derivative work" based upon such earlier works rather than an original work.

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[21] *See Am. Med. Sys. v. Med. Eng'g Corp.*, 6 F.3d 1523 (Fed. Cir. 1993).
[22] *See, e.g., Bridgeman Art Library, Ltd. v. Corel Corp.*, 36 F. Supp. 2d 191 (S.D.N.Y. 1999).
[23] *See Seshadri v. Kasraian*, 130 F.3d 798 (7th Cir. 1997).

Additionally, one must consider the work-for-hire doctrine.[24] If the work is deemed a "work made for hire," then any copyrights in a work created by an employee or independent contractor belong to the company. Otherwise, the rights may reside with the individual employee or contractor, such that the company has no ownership rights whatsoever. With respect to registered copyrights, it is now possible to conduct a computer search of the underlying works by title or author. The search for encumbrances on copyright rights should include state UCC filings in addition to the Copyright Office.[25]

### B. Compliance with Statutory Formalities

Although the Berne Convention Implementation Act, which went into effect on March 1, 1989, significantly reduced the significance of copyright formalities, one must consider several specific factors:

(1) Pre-Berne copyrights being acquired are still subject to the more stringent formality requirements under the 1976 Copyright Act.[26] These include the affixation of proper notice (the letter "c" in a circle, or the word "copyright"; the year of first publication of the work; the name of the copyright owner), deposit and registration, and the recordation of transfers of copyright ownership with the Copyright Office. If proper formalities have not been observed, consideration should be given to whether, for example, the failure to affix proper notice may still be cured by taking remedial action. If no cure is possible, it should be determined precisely what material has fallen into the public domain.

(2) Registration is still required to institute an infringement action and timely registration, as provided by Section 412 of the Copyright Act, is a prerequisite to recovery of statutory damages and attorney fees. Additionally, registration constitutes prima facie evidence of ownership and validity of the underlying copyrights.

### C. Licenses and Assignments

A key issue in investigating ownership issues in an asset transfer involving copyrighted works is an examination of any prior transfer history to ensure that any earlier transfer has been properly documented. A transfer of copyright ownership (*e.g.*, an assignment or an exclusive license) must be in writing. An oral transfer that is confirmed later in writing can effect a transfer of copyright as of the earlier oral transfer date.[27] The transfer document itself must evidence a mutual interest to transfer copyright rights.[28] Another important issue in copyright licensing that repeatedly arises is the form of media to which the granted rights apply. The licensed rights are often limited to specific uses and specific mediums. Use of the copyrighted work beyond the scope of the license may result in a claim of infringement by the copyright owner.

### D. Modification History

Once the original owner of the work is determined, due diligence should include obtaining a complete modification history of the work with a listing of all publicly released versions, including dates of creation and first publication for each version. To the extent that any new version contains new protectable material added to the pre-existing material of earlier versions, it will constitute a derivative work based upon such versions. For each derivative work, any parties who arguably obtained interests in the work through contributions of new material should be identified. Additionally, written transfers of the copyright, or of exclusive or nonexclusive rights in the original version or any of its derivative versions should be uncovered.

### E. Infringement Claims

One should compare the information provided by the seller with independent search results regarding pending or past infringement claims challenging validity and/or ownership of any copyrights being transferred.

### F. Copyright Registrations and the Need for Independent Corroboration

Unlike the registration of trademarks and patents, the registration of a copyright does not indicate that the Copyright Office has carefully scrutinized the work to ensure that it meets the requisite level of originality to be

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[24] *See Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989); *Schiller & Schmidt, Inc. v. Nordisco Corp.*, 969 F.2d 410 (7th Cir. 1992).
[25] *See Aerocon Eng'g, Inc. v. Silicon Valley Bank (In re World Auxiliary Power Co.)*, 244 B.R. 149 (Bankr. N.D. Cal. 1999), *aff'd*, 303 F.3d 1120 (9th Cir. 2002).
[26] *See Hardwick Airmasters, Inc. v. Lennox Indus., Inc.*, 78 F.3d 1332 (8th Cir. 1996).
[27] *See Magnuson v. Video Yesteryear*, 85 F.3d 1424 (9th Cir. 1996).
[28] *Compare Shugrue v. Cont'l Airlines*, 977 F. Supp. 280 (S.D.N.Y. 1997) *with AMC, Inc. v. Saban Entm't, Inc.*, 45 Cal. App. 4th 579 (Ct. App. 1996). For an interesting case regarding the implications of the copyright owner's utilization of a "selective" licensing program, *see Warner/Chappel Music, Inc. v. Pilz Compact Disc, Inc.*, 52 U.S.P.Q. 2d (BNA) 1942 (E.D. Pa. 1999); *see also CSU, L.L.C. v. Xerox Corp. (In re Indep. Serv. Orgs. Antitrust Litig.)*, 203 F.3d 1322 (Fed. Cir. 2000).

copyrighted. This places a burden on one conducting due diligence to evaluate the validity and/or strength of the copyright independently. In particular, registrants often fail to include, in "Box 6" of their applications, references to all works from which the work being registered was derived.[29]

### G. Some Special Considerations

In some cases, it may not be possible for the purchaser to acquire full title to certain copyright assets that are to be transferred because portions of such assets are owned by third parties (who may have licensed the use of such portions to the seller or a predecessor). Such is often the case with photographs or illustrations that are included in written works. In such cases, the seller should confirm with the purchaser that its proposed use of such works will not exceed the scope of any such license.[30] Finally, the seller should take the time to review carefully form agreements such as assignments as they may occasionally contain unconventional provisions that may be disadvantageous to a purchaser (*e.g.*, termination of the assignment under certain conditions).

## VIII. Open Source

### A. Open Source Software Risks

Open source software ("OSS") presents unique, and often overlooked, risks for companies that distribute software or products containing software. While OSS is generally open and accessible to all, its use, distribution and modification are controlled or conditioned through license agreements. Failing to track OSS usage and ensure compliance with applicable licensing terms and, in a worst case scenario, could unintentionally subject a company's proprietary software to source code publication requirements. Therefore, the need to manage OSS risk in corporate transactions should not be underestimated.

Some open source license agreements impose minimal obligations on the licensee, such as obligations to maintain attribution and legal notices and/or to make the licensed source code available to downstream users. Some open source licenses impose obligations on the licensee not only with respect to the licensed open source software but also with respect to any works derived from it. These obligations, often referred to as "copyleft" obligations, typically require publication of the derivative work source code, which could include the proprietary source code. Some open source licenses conflict with one another; the licensee cannot comply with the terms of one agreement without violating the terms of another. Unfortunately, many companies do not have an established OSS policy and are unlikely to know exactly what OSS components are used within the organization or how they are used, let alone whether the company is in compliance with all applicable OSS license agreements.

### B. OSS Usage and Remediation

The first step in an OSS due diligence study is typically to request from the other party a complete list of OSS used in its business, including OSS used internal to the company, OSS used in the development of other software and/or products and OSS included in or used in connection with the company's products and/or services. In cases where the company is not able to produce a complete list of its OSS, the due diligence exercise may become burdensome and possibly expensive for both sides. In the absence of a formal OSS policy and historical OSS tracking practices, the only true way identify all OSS used by the company and to address all known instances of noncompliance is to conduct a full audit of the company's entire code base.

Whether a full audit of the company's code base is appropriate in the context of a particular corporate transaction will naturally depend on the size and nature of the transaction. On the one hand, a corporate acquisition with a price tag of several hundred million dollars will mandate a significant and thorough due diligence effort by the purchaser and will likely involving a complete OSS audit. On the other hand, a deal valued at few hundred thousand dollars may require a less intensive and more focused due diligence investigation. For example, a more focused investigation may include an OSS audit on only the company's most important or highest value software products.

OSS audits are typically initiated using automated code scanning and auditing tools. These tools may perform a variety of functions such as identifying OSS and the applicable OSS licenses, identifying license conflicts and flagging possible copyright issues. Code scanning and auditing tools generate reports that must be analyzed to

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[29] *See Qad, Inc. v. ALN Assocs., Inc.*, 770 F. Supp. 1261 (N.D. Ill. 1991), *aff'd*, 974 F.2d 834 (7th Cir. 1992). For a recent draconian example of how mistakes in a copyright registration application may affect the validity of the registration, *see Raquel v. Educ. Mgmt. Corp.*, 196 F.3d 171 (3d Cir. 1999).

[30] For an interesting demonstration case on the importance of determining the scope of a license in the context of photographs, *see Mendler v. Winterland Prods., Ltd.*, 54 U.S.P.Q.2d (BNA) 1070 (9th Cir. 2000).

filter out false-positives and detect true issues of noncompliance. Thereafter, an analysis must be undertake to determine what, if any, steps can or should be taken to remediate any issues of noncompliance.

In some cases, required remediation efforts may be relatively minimal, for example involving adding attribution notices to a discrete number of software files or making open source code available through an "FTP site," etc. In other cases, remediation efforts may require removal and replacement of open source code components from the company's code base, which can be an extremely time consuming, labor intensive and expensive undertaking. Even where it is not overly burdensome to remediate issues of noncompliance going-forward, addressing past issues of noncompliance may be impractical or even impossible. Another possible option may be to seek a waiver or a commercial license from the author or licensor of the applicable OSS code. The materiality of the noncompliance issues and the expected cost and efficacy of remediation efforts must therefore be carefully weighed as part of any good OSS due diligence investigation.

## IX. Applicability of the Common Interest Doctrine to Disclosures Made During Due Diligence

As previously stated, a proper intellectual property due diligence investigation is designed to reveal defects or risks that may affect the value and/or structure of the proposed transaction. Such defects or risks can include, for example, encumbrances on the ownership of or right to use intellectual property assets, weaknesses or gaps in the protection afforded by intellectual property assets, actual or potential infringement by competitors, and exposure to third-party infringement claims. A company can undertake an intellectual property due diligence investigation, in large part, by using publicly available information and non-privileged confidential information. In some cases, however, the investigator may request access to previously prepared legal opinions and other information that is subject to the attorney-client privilege.

The ability to review attorney-client privileged information during a due diligence investigation can save the investigator significant time and money by reducing the need to conduct legal analyses that have already been done. In addition, access to privileged information can help the investigator understand and assess the nuances of a particular issue to a degree that might not otherwise be possible. As a general rule, however, disclosure of privileged information to a third-party will result in a waiver of the attorney-client privilege. Thus, disclosure of privileged information during a due diligence investigation may involve risks for both parties because it can result in a waiver of the attorney-client privilege regardless of whether the transaction is consummated.

An exception to the general rule that the attorney-client privilege is waived upon disclosure of privileged information to a third party is known as the "common interest doctrine." Broadly stated, the doctrine holds that disclosure of privileged information to a third party will not result in a waiver if the third party has sufficient community of legal interest with the disclosing party. The common interest doctrine is most often recognized in cases involving joint clients (represented by the same attorney) or joint litigants (represented by the same attorney or different attorneys). However, some courts have also recognized the common interest doctrine in other contexts.

In considering whether the common interest doctrine applies in the context of a due diligence investigation, a central issue for the court to resolve is whether the asserted interest is legal and not solely commercial.[31] The answer to this inquiry is highly dependent upon the facts and circumstances of the case at hand and the prevailing jurisprudence within the relevant jurisdiction.[32] Some courts have held that parties engaged in certain corporate transactions can share a common legal interest and should thus be allowed to exchange privileged information without effecting a waiver.[33] Other courts have declined to extend the common interest doctrine to disclosures made during due diligence investigations, based on the notion that the parties to the underlying transactions are necessarily adversaries engaged in commercial negotiations.[34]

Accordingly, the question of whether a target company should produce privileged information in furtherance of an intellectual property due diligence investigation is one that should be carefully considered by both parties to the transaction. Conservatively, until the case law is more settled, the target company should produce privileged information only in those cases where the risk of a privilege waiver is clearly outweighed by the need for access,

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[31] *See, e.g., Duplan Corp. v. Deering Milliken, Inc.*, 397 F. Supp. 1146 (D.S.C. 1974).
[32] *See, e.g., GNU General Public Licenses*, the *Mozilla Public License, Version 2.0*, the *Common Development and Distribution License, Version 1.0* and the *Eclipse Public License, Version 1.0*. Copies are available at http://opensource.org/licenses/category.
[33] *See, e.g., Hewlett-Packard Co. v. Bausch & Lomb, Inc.*, 115 F.R.D. 308, 309 (N.D. Cal. 1987); *Tenneco Packaging Specialty & Consumer Prods., Inc. v. S.C. Johnson & Son, Inc.*, No. 98 C 2679, 1999 WL 754748, at *2-3 (N.D. Ill. Sept. 14, 1999).
[34] *See, e.g., Corning Inc. v. SRU Biosystems, LLC*, 223 F.R.D. 189 (D. Del 2004); *Cheeves v S. Clays, Inc.*, 128 F.R.D. 128 (M.D. Ga. 1989).

cost-savings, and/or efficiency. However, one can discern guiding principles for increasing the likelihood that a court will apply the common interest doctrine in the due diligence context from some of the more commonly cited decisions directly addressing the issue.

- As a starting point, it is prudent to assume that disclosure of privileged information to a third party will result in a privilege waiver. Clients, and perhaps even the third parties with whom they are dealing, should be advised of the waiver risk and should be encouraged to share privileged information only when absolutely necessary. This guiding principle is particularly true in the context of any arms-length negotiation. Whenever possible, as an alternative to disclosure of privileged information, the parties should provide the due diligence investigator with sufficient non-privileged information to allow the investigator to conduct his/her own legal analysis of a particular issue.
- If a disclosure of privileged information is ultimately deemed necessary, the company should delay disclosure until it concludes substantive deal negotiations, or as near as possible. Delaying may help to minimize a natural assumption that the parties' interests are adverse when a corporate transaction is being negotiated.
- Similarly, although rarely a practical concern in the context of a due diligence investigation, privileged information should not be exchanged unless both parties are represented by counsel.
- Any exchange of privileged information should be performed by and among lawyers, preferably intellectual property lawyers when the privileged information relates to matters of intellectual property law. Involving the lawyers in this fashion, and removing corporate executives from the exchange of privileged information, can help to lay a solid foundation for an argument that the exchange was made in view of a common legal interest rather than a purely economic interest.
- Lastly, when privileged information is disclosed in a due diligence context, the parties should strongly consider executing a common interest agreement and/or a confidentiality agreement to demonstrate their mutual commitment to preserving the confidentiality and privileged status of the disclosed information and to memorialize any shared legal interests. To adequately protect the privilege, such an agreement should protect the confidentiality in perpetuity and forbid disclosure to unauthorized parties even if required by law. The agreement should also limit and/or specifically identify the people who are permitted to have access to the privileged information. Along the same lines, the agreement should restrict the number of copies that can be created and should affirmatively require the return to the disclosing party or destruction of all originals and copies. Whenever possible, the parties should elect to have their common interest agreement and/or confidentiality agreement governed by a jurisdiction with more favorable legal precedent regarding the applicability of the common interest doctrine, such as those jurisdictions most closely following the reasoning, if not precedent, of *Hewlett-Packard Co. v. Bausch & Lomb, Inc.* (Northern District of California).

## X. Conclusion

As illustrated above, there exist important issues in each of the major areas of intellectual property – trademark, patent, and copyright – on which one must focus in evaluating any discrepancies between the information provided by or obtained from the seller and that obtained through the purchaser's independent search.