A Foley Best Practice

KEY QUESTIONS INVESTORS SHOULD ASK (YET OFTEN DO NOT) BEFORE THE DEAL IS CLOSED

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Intellectual property assets are often referred to as the "crown jewels" of a company which need to be protected at all costs. However for many companies, whether acquiring a company with IP assets, or managing your own IP portfolio, this approach can result in the "tail wagging the dog" and could be a material distraction to the growth of a company. In order to understand the most effective and efficient strategy for an intellectual property portfolio, companies should consider the following key questions:

1. How critical is technology to the success of the company? And what are the key technology assets? Make sure the deal team and the technologists are in sync and negotiation is targeted and efficient.
2. Consider alternative structures to the same result - licensing technology with "hair" rather than acquiring the asset.
3. What is the interplay between representations and warranties and the indemnity cap? Typical cap on general indemnity claims is 10-14% of deal size, with average indemnity duration of 18 months.* Consider a special indemnity basket for the "key" IP Asset, and show movement on the non-core assets.
   *Source: *Private Equity Analyst 2007 Survey*
4. What impact will publicity have on this technology? And who should bear the burden of that risk? Consider impact on "MAE" walk away rights.
   - In a recent deal, the Buyer acquired a robust software program that had extreme similarities to a widely used program of another company. The asset was not in line with the Selling company's core business model, and was never marketed. Selling company represented as to ownership, but not as to "non-infringement." Purchase price was dropped considerably because of Selling company's refusal to stand behind the technology. Following the closing and publicity of the deal by Buyer, the competing company sued the Buyer for infringement. Buyer had no recourse against Selling company.

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5. Has freedom to operate search been conducted? Make a condition to closing?
6. Is the genealogy from the inventor to the company clean and defendable? Should you address any breaks in the chain now? Or accept it as a business risk and address it through valuation?
7. Who else has an interest in the technology? Are there burdensome contractual restrictions, such as territorial limitations, non-compete provisions or preferred licensing arrangements?
8. Consider imputed obligation to the Buyer from target company contracts.
    - In a recent deal, Buyer (a large multi-national public company) acquired a small regional competitor. The target's license agreements for key customers (who are also customers of Buyer) provided a broad most favored nation clause on pricing, which by its terms extended to target (and "any parent or subsidiary of target"). As a result of the acquisition, Buyer would have had to offer MFN to these overlapping customers which would have resulted in a multi-million dollar hit to Buyer's P&L. Buyer required amendments to these MFN provisions as a closing condition to the acquisition of target.
9. Consider reassessing your patent strategy; what does it really get you? Is "first to market" more important (in countries like China), or perhaps the only game in town? Consider accepting "infringement" as a business reality and maximizing your potential.
10. Do I have new exposure in the Web 2.0 world? Am I responsible for copyright violators that post information on my web site? Is my compliance with the DMCA (takedown notices) sufficient?