IP Due Diligence Readiness

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Intellectual Property owners submit their intellectual property ("IP") to due diligence for a number of reasons. Amongst them are:

1. a prospective licensee is interested in a license
2. a venture capitalist is interested in investing into a start up company into which IP may be assigned or licensed
3. a buyer is interested in a trade sale of IP
4. preparation for an initial public offerring and listing on a stock exchange.

In the case of an initial public offering the IP owner does a due diligence upon itself. It:

1. reviews the ownership and license rights of its IP
2. discovers any due diligence gaps, wrinkles or defects, and
3. fixes or repairs any due diligence gaps, wrinkles or defects it may discover.

In the case of an IPO it needs to do this. The prospectus or information memorandum needs to make positive statements about the ownership and license rights of the IP. Important criminal and civil consequences follow from any inaccuracy in the prospectus or information memorandum. To ensure that there are no inadvertent misleading or deceptive statements, and no risk of criminal or civil penalties, the IP owner undertakes a robust due diligence, identifies any problems, and fixes them.

The same robust approach is not customarily taken in the remaining three situations: a license, a start up, or a trade sale.

If an IP owner does not undertake a due diligence itself, upon its own IP, and submits to a due diligence by a prospective licensee, venture capitalist, or IP buyer, then it submits to the consequences of any due diligence gaps, wrinkles or defects that may emerge from the due diligence.

The due diligence may discover that some critical part of the IP believed to be owned and unencumbered, in fact is not owned, or not unencumbered.

That can create risks.

The first risk is that the value of the deal may reduce. Financial terms may already have been agreed. For example, a royalty may have been agreed. The percentage ownership of shares in the start up company in return for the IP may have been agreed. Or, the trade sale price may have been agreed. A due diligence defect may result in these agreed financial terms being sought to be renegotiated, in a downwards direction, to the IP owner's disadvantage.

The second risk is that the transaction may be delayed while due diligence defects are fixed. It may be necessary, for example:

1. to seek the consent of a joint owner of IP

2. to license in IP that was believed to be owned, but is found to be jointly owned
3. to seek an assignment of IP that was believed to be owned, but is discovered to in fact be owned by someone else, such as a collaborator, student, or a contractor to whom some part of the work creating the IP may have been outsourced.

A delay in the transaction may be short, but it could be many months, or even a year. The risk with such a delay is that the licensee, venture capitalist or IP buyer may in that time become disinterested, or enthused by other opportunities, and as a result the deal being investigated in the due diligence may be lost.

The third risk is that if such a license or assignment is necessary, it may result in having a second negotiation with the joint owner that is licensing in, or the student or contractor from whom an assignment may be necessary. In such a second negotiation it is possible that the party whose assistance is necessary to fix the due diligence defect may have an inflated assessment of the IP it has created, and an inflated expectation of its share of the financial return. It having as a result a bargaining position to assert its expectations, this may result in the IP owner having to compromise more generously than it otherwise would have.

The fourth risk is that the due diligence discovers defects that result in the deal being abandoned altogether.

None of these scenarios are good from an IP owner's point of view.

Just as an IP owner undertakes a robust due diligence upon itself if it is considering an initial public offerring, so also an IP owner should consider a due diligence upon itself in each other situation of: licensing, formation of a start up company with a venture capitalist, or trade sale.

The advantage of undertaking a due diligence upon oneself is that due diligence defects that the licensee, venture capitalist or IP buyer would have discovered, are instead discovered by the IP owner.

This gives the IP owner the opportunity to identify them, and to fix them, before the deal with the licensee, venture capitalist, or IP buyer.

In this way, the defects being identified and fixed first, there is a reduced possibility that the licensee's, venture capitalist's or IP buyer's due diligence may result in the deal being devalued, the deal being delayed, a weak bargaining position with a joint owner, or the deal having to be abandoned. These risks may not just be reduced, they may also be eliminated.

The other advantage is the opportunity for the IP owner to prepare an IP map, and to present it to the licensee, venture capitalist, or IP buyer.

An **IP map** is a document that:

1. identifies each component of the IP
2. identifies the inventor or creator of each component
3. identifies the current owner or licensee
4. identifies each link in the chain from inventor to owner or licensee, and
5. cross references each supporting document that validates each link in the chain from inventor to owner or licensee, such as an employment contract, collaboration

agreement, joint venture agreement, assignment from a student, assignment from a contractor, consultancy agreement, license, material transfer agreement, consent from a joint owner, etc.

The preparation of an IP map achieves two things.

First, it facilitates an IP owner undertaking a due diligence upon itself, helping to identify any gaps, wrinkles or defects, and facilitates those gaps, wrinkles or defects being fixed.

Second, it is a document that can be presented to the licensee, venture capitalist or IP buyer that will do its own due diligence. The IP map facilitates that due diligence, shortens its length, ensures that no defects are discovered, and speeds up the time that it takes to do the deal.

There is hardly a transaction that does not have a due diligence gap, wrinkle, or defect of some sort.

Amongst the most common due diligence defects are:

A part of the IP may be jointly owned by collaborators, and there is, or worse, isn't, a collaboration agreement.

What may be necessary is a license from the joint owner, or an assignment from the joint owner, or a consent to a license from the joint owner.

A part of the IP may be jointly owned by a student.

An assignment of the IP from the student will be needed, and it will need to be upon terms that are equitable, and it will need to be procured in circumstances that do not raise the possibility that the student's assignment is involuntary or made under duress, or in circumstances that may be described as unconscionable, having the risk in each case that the assignment may be void.

Or, there may be an assignment from a student, but the terms of the document, or the circumstances in which it was procured give rise to the possibility that the student's assignment is involuntary or made under duress, or circumstances that may be described as unconscionable, again, having the risk in each case that the assignment may be void.

A part of the IP may be owned by a contractor to which some of the research and development work may have been outsourced.

An assignment of the IP may be necessary.

Whether the correct inventors are named in a patent application.

The omission of an inventor, or adding a person as an inventor who is not an inventor, may be grounds for challenging a patent.

A due diligence can be a time consuming exercise. Not all projects deserve or justify an IP owner undertaking a due diligence upon itself. Those projects that concern IP that is sought to

be commercialised do justify the time and resources to undertake that due diligence, and to prepare an IP map.

Organisations that do a due diligence upon themselves, and prepare an IP map, before the deal, do deals much quicker, with less likelihood of the deal being delayed, abandoned or renegotiated.

Organisations that do not do a due diligence upon themselves run the risks of deals taking longer, with an increased likelihood of the deal being delayed, abandoned, or renegotiated.

Undertaking a due diligence upon oneself is therefore much recommended.

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