

Intellectual Property Audits: A More 'Diligent' Approach

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Conducting an intellectual property audit is an important business process.

It can provide information to a potential investor or acquirer or licensee of a company about the company's IP positions and risks. More specifically, it can insure that a company's IP assets are being adequately identified, protected, and enforced. Often an IP audit results in a company adopting or changing an approach toward IP that adds value and reduces risk to the company.

However, at times, IP audits are deficient in a number of areas, leaving potential investors, acquirers, and/or licensees not only without meaningful information on which to base an informed decision, but also greatly exposed.

Although IP audits may differ depending on their purpose and the particulars of the company – its maturity, marketplace, development process – there are some common areas that should be covered in most IP audits.

Past approaches

In most past approaches, an IP audit included a review of all patent applications and issued patents (and perhaps trademarks) for completeness and quality. A report generated from this review often included only a listing of the patents and patent applications, as well as a summary of whether (i) declaration documents were properly executed and filed, (ii) assignment documents were executed and recorded, (iii) priority claims were made properly, (iv) an assessment of the clearness of the claims, and, perhaps, an (v) indication of whether the duty of candor has been, on its face, complied with.

Although this information is critically important, it reveals only a small part of the picture and may mean very little to a potential investor or acquirer or interested licensee.

Suggested approach

A suggested approach on how to appropriately conduct an IP audit on a start-up company, which has a single product in a particular market, for example, follows. This can be expanded to cover how an IP audit should be conducted on a more mature company as well.

Evaluate infringement risk. The first and perhaps most important area is determining the risk the target company's product infringes the IP rights of another. This determination is different from establishing what level of patent protection may be available to the company on its product and includes a separate legal analysis.

To evaluate the infringement risk, IP counsel should identify the product, learn about its relevant technical details, the marketplace for the product, and competitors or potential competitors working in that area.

IP counsel also should conduct an up-to-date patent search to determine whether any patent exists that presents infringement risk to the company and, if so, evaluate the level of risk through a legal infringement analysis.

Perhaps a design-around solution is possible, or a license is available for a reasonable fee, if risk is found to exist. Mitigating business factors also might exist, leading counsel to conclude from a business standpoint that the risk is low that the patent owner would ever pursue an infringement claim.

Determine scope of protection. The second suggested area of an IP audit is determining the scope of patent (or other IP) protection available to the target company on its product and/or innovation, or business approach. To effectively evaluate the scope of protection, IP counsel should learn, at a minimum, details of technical innovation that has occurred, who developed that

innovation, and when it occurred, as well as any release dates of the product or publication dates of the technical subject matter being considered.

Any pertinent employee or third party contracts into which the company has entered, as well as any relevant prior art, also should be reviewed and considered.

A legal patentability analysis should be conducted on each element of innovation that can be potentially protected. In addition, the business value to the company of such protection should be considered.

IP counsel can determine what protection is available to the company, a determination which could greatly affect an investment decision and valuation. The information learned, when considered in view of the business goals of the company, can help with devising an IP strategy for the company.

Handling of IP filings. The third suggested area of an IP audit is determining whether the patent (and/or other IP) filings have been handled well by the company. Such a determination involves not only a review



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of the files, but also should involve probing interviews of company executives, patent counsel and perhaps inventors as well.

Examples of issues that could be discovered include whether: (i) the patent applications were properly filed on a timely basis in accordance with U.S. and foreign patent office rules and laws; (ii) priority was properly claimed; (iii) inventorship was properly determined; and (iv) any duty of candor and other duties were complied with.

Three-step IP audit process

Below is a description of a three-step process for conducting an IP audit that fully addresses the three areas discussed above. The process is efficient, quick and cost-effective. The information learned can help the investor make an informed decision whether, and at what level, to invest, and can help the target company devise an IP strategy that maximizes valuable protection and minimizes risk.

Triage. An interview with potential investors in, or acquirers of, the company identifies where their interest in the company lies, such as technology, the market, an individual or management team, or the brand. This information, in turn, helps focus the next steps of diligence so that valuable information is reported back to the investor or acquirer.

Smoke-out. An interview of company executives reveals the company background, product or service plans and details, release dates, markets, views on IP, whether legal opinions/agreements are in place, any awareness of possible infringements/threats of suit, and so forth. Patent counsel also is interviewed on the specifics of the patent applications and how each is handled. A series of questions is asked to “smoke-out” any areas of risk or weakness in the handling of the IP or in other areas. Areas of strength are identified.

Detailed diligence. This step involves a thorough review of any issues identified during the triage and smoke-out steps, as well as a review of documents, such as patent applications, agreements and opinions.

A final report is generated after all of the information is analyzed, including a determination of infringement risk and level of protection available to the company (as described above), as well as an assessment of how well the IP is being handled. The final report should indicate whether there exists any risk of infringement and what that risk is, as well as what level of patent protection is available to the company. How the filings have been handled also is reported.

Finally, in order to maximize valuable protection and minimize business risk, IP counsel should make recommendations on the future handling of the company’s IP, taking into consideration business goals of the company and any relevant business and market information learned.