Intellectual Property Issues in M&A Transactions
This is a Guide for business professionals and in-house counsel confronting issues related to intellectual property in the context of mergers and acquisitions. The outline includes a discussion of basic forms of intellectual property rights and how those rights are embodied in a variety of forms. Particular focus is placed on providing concrete advice for practitioners through the entire process of an M&A transaction, from the confidentiality agreement to post-closing licensing relationships. This edition reflects developments through the end of February 2021.

The views expressed are the authors’ and do not necessarily represent the views of the partners of Wachtell, Lipton, Rosen & Katz or the firm as a whole.

Trevor S. Norwitz, Ronald C. Chen, Selwyn B. Goldberg, David M. Adlerstein, Nicole D. Sharer and Albertus G. A. Horsting
# Intellectual Property Issues in M&A Transactions

## TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Introduction</td>
<td>1</td>
</tr>
<tr>
<td>A. Who Should Read This?</td>
<td>1</td>
</tr>
<tr>
<td>II. What Is Intellectual Property?</td>
<td>3</td>
</tr>
<tr>
<td>A. Introduction</td>
<td>3</td>
</tr>
<tr>
<td>1. Intellectual Property Rights</td>
<td>4</td>
</tr>
<tr>
<td>2. How Do Intellectual Property Rights Relate to Technology?</td>
<td>7</td>
</tr>
<tr>
<td>3. Assigning versus Licensing Intellectual Property</td>
<td>8</td>
</tr>
<tr>
<td>B. Forms of Intellectual Property Rights</td>
<td>9</td>
</tr>
<tr>
<td>1. Patents</td>
<td>10</td>
</tr>
<tr>
<td>2. Trademarks</td>
<td>13</td>
</tr>
<tr>
<td>3. Copyrights</td>
<td>15</td>
</tr>
<tr>
<td>a. Ownership and Works Made for Hire</td>
<td>17</td>
</tr>
<tr>
<td>b. Moral Rights</td>
<td>18</td>
</tr>
<tr>
<td>4. Trade Secrets</td>
<td>18</td>
</tr>
<tr>
<td>5. Comparison of Forms of Intellectual Property Rights</td>
<td>20</td>
</tr>
<tr>
<td>C. Data and Privacy</td>
<td>20</td>
</tr>
<tr>
<td>1. What Is Data?</td>
<td>20</td>
</tr>
<tr>
<td>2. Does IP Law Protect Ownership Rights in Data?</td>
<td>21</td>
</tr>
<tr>
<td>3. What Other Laws May Protect the Ownership, Use and Disclosure of Data</td>
<td>23</td>
</tr>
<tr>
<td>D. Internet Properties</td>
<td>26</td>
</tr>
</tbody>
</table>
III. Intellectual Property in the M&A Process .................................................29

A. The Relevance of the Transaction Structure to Intellectual Property Issues .................................................29
   a. Public versus Private Deals............................................29
   b. Whole-Company Deals versus Carve-outs .............................................30
   c. Typical Deal Structures.............................................31

B. Preliminary Issues in Drafting the Acquisition Agreement.................................................................................32
   1. Defining the Business .............................................32
   2. Identifying the Registered Intellectual Property Rights to Be Assigned or Licensed ......33
      a. Patents .................................................................33
      b. Trademarks..........................................................35
      c. Registered Copyrights..............................................36
   3. Identifying the Transferred Technology .................36
   4. Identifying Other Intellectual Property Rights .................................................38
      a. Trade Secrets .........................................................39
      b. Copyrights ..........................................................40
   5. Representations and Warranties .................................................40
      a. Identification and Ownership of Business Intellectual Property Rights ......41
      b. Ownership of Intellectual Property and Encumbrances ........................................42
      c. Validity and Enforceability ........................................43
      d. Maintenance of Registrations ........................................44
      e. Maintenance of Trade Secrets ........................................44
      f. No Infringement by Third Parties ........................................45
      g. No Infringement by the Business ........................................46
      h. Material Intellectual Property Agreements ...........................................49
      i. Obligations to License ..........................................................................................50
      j. Employee Intellectual Property Assignments and Confidentiality Agreements ........................................49

-ii-
k. Sufficiency .......................................................... 51
l. Open Source .......................................................... 52
m. Data Security ....................................................... 53

6. Covenants ........................................................................... 55
   a. IP Interim Operating Covenants .................. 55
   b. IP Prosecution Files and Maintenance Deadlines .... 56
   c. Security Interests and Chain of Title ......... 56
   d. Third-Party Consents ............................................... 56
   e. Open Source ............................................................. 57
   f. Wrong Pockets ......................................................... 57
   g. Further Assurances ................................................... 57
   h. Transitional Trademark License ..................... 57
   i. IP License ................................................................. 58

C. Indemnification and Other Forms of Recourse ................. 58
   1. Indemnification for Breaches of IP Representations and Warranties ........................................ 59
   2. Limitations on Indemnification: Survival Periods, Baskets and Caps ........................................... 63
      a. Survival Periods .................................................. 63
      b. The Cap ................................................................... 64
      c. Baskets .................................................................... 65
   3. Holdbacks and Escrows ............................................... 66
      a. Holdbacks ........................................................... 66
      b. Escrows .................................................................. 67
   4. Exclusivity .................................................................. 67
   5. Excluded Forms of Damages ...................................... 67
   6. Equitable Remedies ..................................................... 68
   7. Specific Indemnities ...................................................... 68
   8. Indemnification for Excluded Liabilities .................. 69
   9. Representations and Warranties Insurance ............. 70

D. Closing ................................................................................. 71
   1. IP Assignments and Recording .................................. 71
2. Effectuating the Assignment of Intellectual Property Rights ..................................................... 72
3. The Correction of Patent Schedules ................................................................................. 72

E. Confidentiality Agreements ......................................................................................... 73
1. Definition of Confidential Information ................................................................. 73
2. Residuals Clause ........................................................................................................... 74
3. Treatment of Confidential Information ........................................................................ 74
4. Term and Return or Destruction of Information ......................................................... 75
5. Confidentiality Agreements if the Transaction Proceeds ........................................... 75

IV. Intellectual Property Relationships After Closing: Licensing and Related Issues ...................................................................................76
A. General License Terms and Forms ........................................................................... 76
B. The Need for Licenses in the M&A Context ................................................................ 78
   1. Patent Licenses ......................................................................................................... 79
   2. Other Patent License Terms ..................................................................................... 84
   3. Copyright Licenses ................................................................................................... 85
   4. Trade Secret Licenses ............................................................................................... 87
   5. Other Intellectual Property Rights Licenses and Software Licenses ......................... 89
   6. Trademark Licenses ................................................................................................ 90
   7. Treatment of Licenses in Bankruptcy ...................................................................... 92
      a. Hypothetical Test .................................................................................................. 93
      b. Actual test ............................................................................................................. 93

V. Additional Topics ........................................................................................................ 95
A. Transition Services Agreements .................................................................................. 95
B. Joint Ventures ............................................................................................................. 96
I. Introduction

The importance of intellectual property rights, data, technology, privacy and cybersecurity in M&A continues to grow. For companies in a variety of sectors, such as technology, pharmaceuticals, communications and entertainment, intellectual property rights are core drivers of economic value. Moreover, for companies in nearly every industry intellectual property rights are important, and sometimes critical, to ongoing operations and the ability of such companies to remain competitive and achieve their long-term objectives. It is thus essential in M&A transactions to understand the ways in which a company relies on intellectual property rights to protect its strategic position and to operate in the marketplace. This Guide provides an overview of key issues regarding intellectual property rights and technology in M&A transactions, from the way in which intellectual property rights and technology may be defined and transferred or shared in transactions to the challenges that parties face in navigating often complex commercial relationships beyond the closing of the M&A transaction.

Chapter II of this Guide begins with a discussion of the major forms of intellectual property rights likely to be encountered in the M&A process. Special emphasis is placed on the distinction between legal rights themselves and the embodiment of those rights in forms such as documents, software, know-how, hardware and other types of tangible technology.

Chapter III applies the legal and theoretical framework outlined in the previous chapter to issues that arise in the M&A context. This Chapter provides guidance to practitioners on IP issues arising from the signing of a confidentiality agreement to the drafting of definitive transaction documents and closing.

Chapter IV is dedicated to issues arising in the negotiation of the licenses that may be required in carve-out or other private company transactions.

Finally, Chapter V deals with certain additional topics not addressed elsewhere in this Guide, including issues arising in joint ventures and financing transactions.

A. Who Should Read This?

The intended audiences for this Guide are business professionals involved in corporate development or M&A and their advisors, including in-house corporate lawyers,
and others involved in the M&A process. As IP\(^1\) assets become an ever more critical aspect
of businesses in all industries, M&A practitioners will benefit from becoming better
acquainted with IP law and the key distinctions that animate it. Throughout this Guide,
emphasis has been placed on providing practical instruction to participants in the deal
process so that they can understand what really is at stake and how to structure transaction
documents in order to obtain the results they desire.


The increased salience of IP issues in M&A transactions is explained in part by the
growing importance of technology companies in the broader economy. In addition to the
growing importance of the tech sector in M&A, almost every deal, whether or not it in-
volves companies typically associated with IP-intensive industries, now implicates some
IP-related issues, which may have important value implications and may in some cases be
critical to the viability of a transaction. For example, where:

- the target’s brand (and thus its trademarks) is of significant value to the transaction
  (e.g., consumer products, luxury goods, hospitality, food service);
- the transaction structure divides IP rights and assets between the buyer and the
  seller (e.g., carve-outs, spin-outs, joint ventures);
- the target’s key products or services are protected by patents (e.g., life sciences,
electronics, chemicals, consumer goods);
- the target’s key products or services are protected by copyright (e.g., software, film,
  media, arts, entertainment);
- the target’s business is built upon IP acquired from third parties (e.g., where the
target was the result of a spin-out from another company or where the target part-
ners with third parties for research and development);
- as is almost universally the case, the target relies on IP that is licensed from third
  parties;
- the target’s business is based upon the collection and use of data or proprietary
  methods of processing data (e.g., payment system, e-commerce, social media, most
  companies with an internet presence); or
- the target maintains a competitive advantage from the secrecy of its processes or
  formulations for products (e.g., manufacturing, chemicals, food & beverage).

\(^1\) The term IP is used throughout the document in its colloquial sense and to refer to Intellectual Property rights and
tangible embodiments of those rights, as the context requires. See page 9 for additional information on this distinction.
II.

What Is Intellectual Property?

A. Introduction

Most business professionals and lawyers have a general notion of what they mean when they refer to intellectual property or IP. But what are the boundaries of the meaning of the term, and what are the key distinctions within the category of IP that deal participants should keep in mind? Approaching the question intuitively, most people would include patents, trademarks and copyrights in the category of IP. But what about a specialized instrument or machine? A secret recipe or formula? A method for extracting patterns from data? Files with experimental data or the software a company’s developers have developed? And what about “property” even harder to control or describe with precision, such as employees’ operating know-how? Some of these forms of Intellectual Property Rights are registered (or registrable) with governmental agencies, and some are not. Some exist in tangible form, and some are purely legal grants. Some can be easily replicated, and some are impossible to copy. A single approach to such a heterogeneous collection of rights and things will rarely be satisfactory when parties desire to structure a deal of any complexity.2

It is therefore important that the term IP and related terms be clearly understood and defined when drafting deal documents. Perhaps the most fundamental distinction we will employ is that of abstract rights related to IP versus the embodiment of those rights in a variety of different technological forms. To keep this distinction clear, throughout this Guide we employ three distinct terms: (i) Intellectual Property Rights; (ii) Technology; and (iii) IP, which is an umbrella term covering (i) and (ii).

While the definitions that follow may seem formalistic, they are beneficial in that they precisely define both the IP assets to be transferred and the ongoing commercial and competitive relationship between the parties following the consummation of the transaction. In keeping with a goal of transaction documents to clearly reflect the parties’ intent, in an IP-intensive transaction this means deciding, at the very least, (i) which party gets what IP, and in what form, (ii) after closing, what each party is permitted to do, or not do, with the businesses and assets they have purchased or retained, and (iii) what representations are made with respect to the value of and risks associated with both the acquired IP and third-party IP.

2 From an IP perspective, a public company deal, even a very large one, is a relatively simple transaction, as all of the assets and liabilities of the acquired company will be transferred to or assumed by the acquiring company. Private deals, especially carve-outs where businesses have to be separated, may be far more complex from an IP perspective. See Section III.A.a below.
With the foregoing distinctions in mind, the following are generic definitions of Intellectual Property Rights to which we will refer throughout the Guide.\(^3\)

“Intellectual Property Rights” means any and all common law or statutory rights anywhere in the world arising under or associated with:

(a) patents, patent applications, statutory invention registrations, registered designs, and similar or equivalent rights in inventions and designs, and all rights therein provided by international treaties and conventions (“Patents”);  
(b) trademarks, service marks, trade dress, trade names, logos, and other designations of origin (“Marks”);  
(c) copyrights and any other equivalent rights in works of authorship (including rights in software as a work of authorship) and any other related rights of authors (“Copyrights”);  
(d) trade secrets and industrial secret rights, and rights in know-how, data, and confidential or proprietary business or technical information that derives independent economic value, whether actual or potential, from not being known to other persons (“Trade Secrets”);  
(e) domain names, uniform resource locators, internet protocol addresses, social media handles, and other names, identifiers, and locators associated with Internet addresses, sites, and services (“Internet Properties”); and  
(f) other similar or equivalent intellectual property rights anywhere in the world.

In the Sections that follow, we will consider in further detail the various elements that make up this definition.

1. Intellectual Property Rights

Four Intellectual Property Rights are relevant to most transactions: (a) patents, (b) copyrights, (c) trade secrets and (d) trademarks. The nature and rights associated with each are quite different. The following is an overview of these Intellectual Property Rights, each of which is described in more detail in the corresponding Sections below.\(^4\)

Patents and copyrights are rights granted under federal law (as required by Article I, Section 8 of the U.S. Constitution). These rights are negative and exclusive in nature: each confers on the holder the right to exclude, for a limited period of time, others from

---

\(^3\) These definitions are included for heuristic use and the precise wording is not intended to be prescriptive—many drafting variations can be encountered in transaction documents, and variation may be desirable depending on the facts and circumstances.

\(^4\) This Section discusses only U.S. IP law. However, laws governing IP in most countries are similar to those in the United States, and in many cases the application for and registration of IP has been harmonized through international treaties.
engaging in the conduct protected by the right; they do not grant the holder the positive right to engage in any conduct.  

For example, a utility patent is granted under federal law, after a lengthy examination procedure by the U.S. Patent and Trademark Office (the “USPTO”), to the inventor of a new (novel) and useful invention described by the claims in the issued patent. For the life of the patent (normally 20 years from the date of the patent application), the patent owner has the right to exclude others from making, using, selling or importing the patented invention. The patent does not, however, confer on the owner the right to practice the invention claimed in the patent. In some instances, the patent holder may not practice the patented invention without infringing another patent that it does not own.

A copyright is also the right to exclude. However, in contrast to a patent, the right protects the tangible expression of an idea, but not the idea itself. For example, a copyright holder has the right to prevent the unauthorized duplication of a book describing a novel manufacturing process, but has no right to prevent people from using the process described in the book. The copyright in the tangible expression, or work of authorship, arises the moment the work is “fixed in tangible form,” such as a written document, a sound recording, a photograph, or software code. The copyright holder has the exclusive right to reproduce, distribute, create derivative works of, and publicly perform or display the copyrighted work. Further ownership of the work of authorship (for example, by purchasing a book) is distinct from the ownership of the copyright in the work. Unlike patents, the copyright arises automatically at the moment the work is fixed in tangible form and, though a registration regime is available, registration is not required. The duration of the copyright is approximately 70 years from the date the work is created. While copyright protection arises automatically and no formalities (such as adding the copyright symbol) or registration are required to obtain a copyright, there are substantial advantages to registration. In particular, registration is generally required to enforce the copyright in federal court and is prima facie evidence of the copyright’s validity.

5 A copyright, unlike a patent, does not protect against subsequent independent (without copying) creation of a work by another party. However, it is exceedingly rare that a party is able to prove that it created a work of authorship that is substantially the same as a prior work of authorship without copying (even if the copying was not intentional) the prior work.

6 There are two other types of patents: (i) design patents that protect novel, non-functional designs and (ii) plant patents that protect asexually reproduced plants.

7 In return for this exclusive right, the inventor must disclose the invention in the patent, which is a public document, in sufficient detail to enable others to practice the invention when the patent expires. Accordingly, an invention cannot be both the subject of a patent and a trade secret.

8 17 U.S.C. § 102. This is in distinct contrast to the protection afforded by a patent, which in fact does protect the idea itself from misappropriation.

9 For the classic formulation of the distinction between ideas and their expressions, see Baker v. Selden, 101 U.S. 99 (1879).
Trade secrets consist of information which derives independent economic value from not being publicly known; the formula for Coca-Cola is an archetypal example. Unlike patents, copyrights and trademarks, there is no mechanism for registering a trade secret with a state or federal agency. The state and federal law of trade secrets provides protection against misappropriation. In other words, the legitimate holder of valuable, confidential business or technical information has the right to be protected against a third party obtaining that information by improper means. For information to be protected as a trade secret, reasonable measures under the circumstances must be taken to protect the secrecy of the information. A trade secret right does not protect the holder of the right against third parties independently discovering the same information or learning it by legitimate means (e.g., by reverse engineering a competitor’s product).

The foregoing three rights, while not specific to what is commonly thought of as “tech,” are involved in most transactions involving some form of Technology. Patents are typically an important asset in tech industries ranging from pharmaceuticals to computers, but may also be relevant to non-tech companies. Copyrights are often the most important right protecting software or creative content, and nearly every company relies to some degree on trade secrets to give it an advantage over its competitors.

The fourth category of Intellectual Property Rights, trademark rights, is fundamentally different from the three discussed above in that trademarks do not protect Technology or creative works. Rather, a trademark symbolizes the reputation or goodwill of the trademark owner and identifies a single source origin of a good or service. A trademark can be anything that is perceived by the relevant public as identifying the source or origin of a good or service. Typically, trademarks are words or symbols, but colors, sounds and even fragrances can serve as trademarks if they are distinctive and associated with a particular source of a product.

Trademarks are typically registered with the USPTO. However, trademark rights arise from usage of the trademark in commerce, not from the registration of the trademark. For a trademark to be registered with the USPTO, the registrant generally must certify that the mark is in use in interstate commerce. The owner of a trademark has the exclusive right to use the trademark in association with its goods or services. Trademark infringement occurs when a third party uses the same or a confusingly similar mark on or in connection with similar or related goods or services in a way that could lead to confusion. The trademark right does not exist in the mark itself, but rather in the association the mark

---

10 The Defend Trade Secrets Act of 2016 (the “DTSA”) defines misappropriation as the “acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means” or, under certain circumstances, the “disclosure or use of a trade secret of another without express or implied consent.” 18 U.S.C. § 1839(5).

11 In this Guide, the term mark refers to the word, symbol, logo, color, etc., that is being used as a trademark, regardless of whether it is legally recognized as a trademark.

12 In addition, trademark infringement may also constitute unfair competition under Section 43(a) of the Lanham Act, 15 U.S.C. § 1125(a).
has with the source of a particular good or service. For example, Apple is not just a trademark for a multinational technology company; it is also a trademark for, among other things, an unrelated bank and the Beatles’ record label. No trademark owner can prohibit the use of the term apple to refer to the fruit by that name. The various Apple trademarks coexist because there is no likelihood a purchaser of the product would be confused, for example, into thinking that the computers bearing the trademark Apple are manufactured by the bank by that name or that the bank bearing the trademark Apple is run by the technology company of that name. The strength, and typically the value, of a trademark is a function of the recognition and reputation, referred to as goodwill, associated with the trademark. Under U.S. law, for the purposes of the transfer of ownership, a trademark and the goodwill it symbolizes are inseparable.

While these rights are relevant to the assets or business being acquired, when held by third parties, they are also relevant to the risks, especially of infringement claims, associated with the acquired business or assets. See Section III.B.5 below for a discussion of representations concerning infringement by third parties.

2. How Do Intellectual Property Rights Relate to Technology?

While intuitively understood, it is hard to articulate a single satisfactory definition of the term technology. Colloquially, we use the term to refer to knowledge (often in recorded form) of techniques, processes and the like, together with the things produced with this knowledge (such as machines, drugs, chemicals, etc.). For the purpose of this Guide, we use the term Technology to refer to an embodiment of Intellectual Property Rights, as opposed to the rights themselves. More precisely, we define Technology to be the information or materials, in whatever form (including in intangible form, in the case of knowledge), that instantiate or record a trade secret or, if in tangible form, a work of authorship. Consider the following generic definition:

“Technology” means embodiments of Intellectual Property Rights, including documentation, confidential information, materials, data, databases, software, works of authorship, and know-how or knowledge of employees, relating to, embodying, or describing processes, methods, designs, formulae, recipes, or other technical information.

As the definition provides, Technology includes embodiments of confidential know-how, whether in the form of documents, software, or the proprietary knowledge of employees, as well as software and other works of authorship protected by copyright. Critically, this

---

13 However, as an illustration of the blurred boundaries between fields of use, and disputes that may arise as a result, there was extensive litigation between Apple Inc. and Apple Corps (the record label) regarding matters such as computer recording capabilities and the use of the Apple Inc. logo in the iTunes music store.

14 Standing alone, this model definition of Technology may be too broad. For example, it may cover business records and IT systems. To avoid such overlaps and potential confusion, it is typically necessary to add additional restrictions to the definition of Technology by, for example, excluding business records and personal property.
definition of Technology is distinct from the Intellectual Property Rights embodied in the Technology.

We can further distinguish between Technology that can be easily copied and Technology that cannot be easily copied. Copyable forms of Technology such as documents and software generally do not derive their value from the physical object in which they are recorded, but from the Intellectual Property Rights embodied in the object. For example, a physical CD-ROM containing software may in and of itself cost a few pennies. The license to use the software on the disc is granted for hundreds of dollars, but the Intellectual Property Rights that give the licensor the exclusive rights to the software on the disc may be worth billions of dollars. Other forms of Technology, for example, a machine, cannot easily be reproduced, and the value of the Technology lies both in the thing itself (essentially as personal property) and in the Intellectual Property Rights embodied by, discoverable from, or used in the manufacturing of the machine.

Figure 1 above shows the relationship between IP Rights and the embodiments of those rights in the form of Technology. Copyrights and trade secrets reside at the intersection of the two sets, since they are always associated with some form of Technology. Patents and trademarks, on the other hand, exist independently of any tangible embodiment.

3. Assigning versus Licensing Intellectual Property

The terms governing ownership of IP in a transaction should not be viewed as ends in themselves but rather as instruments to serve the intent of the parties. Frequently, business professionals (and their deal lawyers) are excessively concerned about who owns the IP, rather than concentrating on a functional approach. A more nuanced understanding of the different types of IP involved in a transaction opens up the possibility of fashioning
different mechanisms for identifying, transferring and/or licensing each particular form of IP to achieve the desired goal and for allocating risk appropriately. To employ the popular legal metaphor of property rights as a bundle of sticks, it may be advantageous to apportion those sticks among the parties through license agreements rather than insisting on an all-or-nothing approach of complete ownership.

In many transactions involving the sale and purchase of assets, certain IP is shared between the retained and divested businesses and certain other IP is exclusive to each. This shared IP would typically be either retained by seller or assigned to buyer and licensed by the party owing the IP to the other. For example, frequently the seller will assign certain Intellectual Property Rights to the purchaser and obtain a license back to the shared IP. However, in some cases it may not be possible to clearly to distinguish between shared and exclusive IP. In such cases, the risk of incorrectly classifying shared versus exclusive IP can be mitigated by the owning party granting the other party a broad license which gives the licensed party substantially the same freedom to use such IP as it would have had as an owner. The structure of the grants and licenses will depend on the nature of the Intellectual Property Rights being transferred. See Section B below for further information.

For example, regardless of whether trade secrets and copyrights are assigned or licensed, the transferring document should take into account that the transferee or licensee needs the same access to the Technology in order to exercise the assigned or licensed rights. In most cases, Technology can be copied, so unless the transferor agrees to not retain a copy of the Technology that is transferred—something that may be hard to implement (and even harder to police), both parties may possess a copy of the same or identical Technology. In that case, the scope and exclusivity terms of the copyright and trade secret licenses, and in some cases a non-compete, will determine what each party can or cannot do with its copy of the Technology.

In contrast, the transfer or license of a patent or trademark, while requiring precise identification of the right to be transferred or licensed, does not require the delivery of any Technology and therefore ownership of and licenses to such rights can be crafted independently of what Technology or other assets are transferred or retained.

As discussed in greater detail in Section III.D.1, the assignment of ownership of each type of Intellectual Property Right requires unique assignment terms. A general bill of sale or a general assignment of Intellectual Property Rights is may not always be effective to transfer legal title.

B. Forms of Intellectual Property Rights

The prior Section provided a brief survey of Intellectual Property Rights and their relationship to Technology. In this Section, we discuss in greater depth each of the major forms of Intellectual Property Rights.
1. **Patents**

A patent is a government-granted right that provides an inventor the right to exclude others from (i) making, (ii) using, (iii) offering for sale, (iv) selling or (v) importing any new, useful, and nonobvious invention (as defined by the claims in the issued patent) for a limited time in exchange for the public disclosure of the invention. Generally, the requirements and process for obtaining a patent are established by the laws of the country in which the patent is issued. Nonetheless, the Patent Cooperation Treaty\(^\text{15}\) permits a party to use the application filed in one country as the basis for applications in all member countries. However, the rights associated with the patent, once granted, extend to only the country in which it is issued (e.g., a U.S. patent is enforceable only within the United States).\(^\text{16}\) In the United States, patent law originates under the U.S. Constitution.\(^\text{17}\)

The most common type of patent is a *utility* patent, which covers inventions for a new and useful process, machine, manufacture, or composition of matter or a new and useful improvement thereof and provides the inventor with an exclusive right to the invention for a term that is generally 20 years from the date the application was filed. There are, however, two other types of patents: (i) *design patents*, which cover a new, original, and ornamental design for an article of manufacture for a term that is generally 14 years from the grant of the design patent, and (ii) *plant patents*, which cover asexually produced distinct and new varieties of plants for a term that is generally 20 years from the date of filing. Unless otherwise stated, we will be referring to utility patents in this Guide.

A U.S. patent requires the filing of an application with the USPTO. A patent examiner will then review the application to determine if the invention is worthy of a patent. In this process, the patent claims in the original application may undergo several revisions in response to the examiner’s “rejections” before the patent will be issued. In particular, (i) the invention must be “patent-eligible subject matter,” defined by statute as “any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvements thereof”\(^\text{18}\) and (ii) it must be both novel and non-obvious. As between two independent inventors of the same invention, a patent will be granted to the first inventor to file its patent application. A patent in the United States is issued to and owned by the inventors, not their employers. However, employees are generally under an obligation to

---


\(^{16}\) The European Patent Office provides for a single patent authority to issue patents that are valid in all member states. Convention on the Grant of European Patents art. 64(3), Oct. 5, 1973, 1065 U.N.T.S. 16208.

\(^{17}\) U.S. Const. Art. I, § 8, cl. 8. Title 35 of the U.S. Code sets forth the laws governing patents and answers many of the issues deal practitioners may encounter in a transaction (e.g., what is needed to assign a patent).

assign their patents to their employers and do so for each patent issued to them. Absent such an assignment, the employer will have, at most, limited “shop rights.” 19

In exchange for a government-granted exclusive right, the inventor discloses enough information about the invention so that someone “skilled in the art” could make and use the invention described in the patent application when the patent term expires, as well as the “best mode” known to the inventor for the practice of the invention. 20 Therefore, by filing a patent application, the inventor must make a full and complete public disclosure of the invention. Patent applications are published and become publicly available 18 months after the earliest filing date. Such a disclosure will result in a loss of any trade secret rights held in that invention, even if the patent is not granted. Therefore, the inventor should consider the risk of the patent application being published but later found ineligible for patent protection. Although patents are territorial in scope, a U.S. patent application can generally be used as a basis for an application in foreign jurisdictions.

Patents can only be enforced in the country of issuance. In the United States, patent infringement cases must be brought in federal district court, and only the patent owner has standing to sue (except in rare circumstances).

After a patent has been issued, anyone (other than the patent owner) who makes, uses, imports, offers for sale or sells the patented invention without a license to do so is an “infringer” of that patent. Patent infringement does not require copying or knowledge of the issued patent. Independent invention is not a defense.

A finding of patent infringement enables the patent owner to obtain injunctive relief and damages. The measure of damages is generally lost profits or no less than a reasonable royalty on up to six years of infringing activity (see also Section III.B.5.g below for further information on infringement). If it is determined that the infringer acted with deliberate purpose to infringe the patent (“willfulness”), then the infringer can be liable for “enhanced damages” of up to three times actual damages and attorneys’ fees.

Often when a patent owner enforces an issued patent against an alleged infringer, the alleged infringer will challenge the validity of the patent (i.e., argue that the USPTO should have never issued the patent). Once issued, a patent is presumed valid and “clear and convincing evidence” is required to overcome this presumption. However, the burden of proving infringement is on the patent holder. The validity of the patent can be challenged in federal district court, either in a declaratory judgment action or in defense to a patent infringement claim or in certain administrative proceedings at the USPTO. 21 It is important

19 An implied license under which the employer may use a patented invention owned by the employee.


21 Since the passage of the Leahy-Smith America Invents Act in 2012, it is possible to challenge the patentability of a previously granted patent in an administrative proceeding known as an inter partes review (“IPR”), conducted before the Patent Trial and Appeal Board (the “PTAB”). 35 U.S.C. §§ 311–19.
to note, especially in the context of representations and warranties, that historically more than half of the patents challenged in such proceedings are ultimately invalidated.\textsuperscript{22}

It is also important to note that a patent provides the patent owner the right to exclude others but does not provide the patent owner an affirmative right to practice the patented invention. There are circumstances where the practice of a patented invention by the owner of the patent would subject it to a claim of infringement of a “dominant patent” owned by a third party. This is illustrated by the following:

A invents and obtains a patent on a lead pencil. B subsequently invents a pencil with an eraser on one end (an actual invention patented in 1858). B cannot, however, make his invention without infringing A’s patent. A can make pencils, but if he makes a pencil with an eraser, he would infringe B’s patent.

Because patent rights are territorial in scope, an inventor must ultimately obtain a patent in each jurisdiction in which the inventor wishes to obtain patent protection. The inventor may do this by filing individual independent applications simultaneously in each desired jurisdiction, a costly and complicated process.

The ratification of certain multinational treaties has eased some of the burdens associated with obtaining patent protection across jurisdictions. Originally adopted in 1883, the Paris Convention for the Protection of Industrial Property provides that a patent application filed in one member state may serve as the basis for filing subsequent applications in other member states.\textsuperscript{23} All such subsequent applications, if filed within 12 months of the initial application, are deemed to have been filed on the same date as the initial application.

A more common alternative is to file a single “international” patent application under the Patent Cooperation Treaty (the “\textit{PCT}”), directly after or within 12 months of a first application.\textsuperscript{24} While the PCT application has the effect of a national patent application (and certain regional patent applications) for all PCT member states, the granting of the patent remains under the control of the national or regional patent offices in what is called the “national phase.” A key benefit of the PCT is that it extends the time available to commence the national patent application process, which can involve considerable cost, until after the end of the PCT procedure (generally, by approximately 30 months).


In certain foreign jurisdictions, there are other types of patent-like, exclusive rights that inventors can obtain to protect their inventions. A utility model\(^{25}\) is a form of protection similar to a U.S. utility patent that is available in a number of countries outside the United States. Utility models vary from country to country but generally protect new technical inventions through a limited right to exclude others from commercially exploiting the protected invention. Utility models are usually thought to protect minor inventions because, as compared to patents, the term of protection is shorter, the requirements for acquiring utility models are less stringent and the process to obtain registration is both faster and cheaper.

In addition to utility patents, U.S. law provides for design patents, which protect "ornamental designs for an article of manufacture."\(^{26}\) While design patents have not traditionally been thought of as valuable, this view has recently been reconsidered, particularly in the wake of recent litigation between Apple and Samsung. In 2018, Apple was awarded $539 million for infringement by Samsung of Apple’s design patent covering the shape of the iPhone.

An industrial design is a form of protection similar to a U.S. design patent that is available in different forms in a number of jurisdictions outside the United States. Industrial designs protect two- and three-dimensional design features. Like U.S. design patents, industrial designs generally provide the owner the exclusive right to the protected design and to prevent third parties from making, selling or importing articles that copy the design for a limited period of time. In general, in order to obtain protection in other countries, a patent for an industrial design must be filed in each country where protection is sought, in accordance with the law of that country. Industrial design rights are territorial and an inventor must seek protection by filing an application in each country. The Hague System for the International Registration of Industrial Designs allows an inventor to file a single international application to seek registration in many jurisdictions.

2. Trademarks

A trademark is any distinctive word, name, color, logo, design, slogan, sound or other symbol used to identify and distinguish goods or services of one source from those of another. Trademarks include many sub-categories of source identifiers, including service marks, trade names and trade dress (source identifying characteristics of a product or its packaging). Trademark protection provides an incentive to produce quality goods and services by enabling customers to identify the source of quality goods and services and distinguish them from others. Distinctiveness is an important quality in a trademark and trademark law will provide greater protection to marks that have a more distinctive character.

\(^{25}\) Utility models are also known in some countries as utility innovations, utility certificates, invention patents, short-term patents or petty patents.

The strength of trademarks is described in a spectrum from (i) generic marks (“Shoe” for shoes), which can never function as a trademark, to (ii) descriptive marks (“Sharp” for Television) or suggestive marks (“Airbus” for airplanes), which have acquired trademark significance through use, to (iii) arbitrary (“Apple” for computers) or fanciful (“Exxon” for an oil company) marks, which are inherently distinctive. The heightened protection given to arbitrary and fanciful names explains in large part the phenomenon of the use of neologisms like Netflix, Exxon and Verizon.

Trademarks are territorial in scope, meaning the owner must register the mark (or otherwise establish trademark rights) in each country in which the owner desires to obtain trademark protection. In the United States, trademarks can be protected by federal and state registration or by common law. Common-law protection can arise when the use of a mark in commerce to identify goods or services over time accumulates to the point that the mark functions as a source identifier. Federal and state registration, though not mandatory, provides significant benefits over common-law protection. In particular, federal registration provides nationwide protection and a presumption of validity.

Trademarks can be registered with the USPTO if the mark is being used in commerce or if there is a bona fide intent to use the mark in commerce. As a general rule, trademark rights are determined based on the first to use a mark on a good or service in a particular geographic market. The United States also allows for “intent-to-use” trademark applications which allow an applicant to file a trademark application before the mark has been used in commerce, thereby preserving its priority.

Trademark protection is accorded to marks to the extent that confusion would occur in the marketplace if two entities used the same or similar trademarks (“likelihood of confusion”). In the United States, trademark infringement requires the trademark owner to prove that there is a likelihood of confusion between the marks at issue. Courts use a number of factors to determine the likelihood of confusion, including the strength of the trademark, the similarity between the marks at issue, the proximity between the products and/or services in the marketplace and proof of actual consumer confusion. In the United States, “famous” marks can also be protected from “dilution,” which occurs when a third party uses the mark in a way that impairs the famous mark’s distinctiveness or harms its reputation (but not necessarily in a way that causes a likelihood of consumer confusion).

---


30 Section 43(c) of the Lanham Act defines a famous mark as one that “is widely recognized by the general consuming public of the United States as designation of source of the goods or services of the mark’s owner.” 15 U.S.C. § 1125(c)(2)(A).
For infringement and dilution actions, the trademark owner may seek injunctive relief, damages (enhanced damages in certain circumstances), lost profits, and attorneys’ fees. The federal Lanham Act provides causes of action for infringement of federally registered marks under Section 32, infringement of unregistered marks under Section 43(a) and dilution of both federally registered and unregistered marks under Section 43(c).

Trademark rights last as long as the trademark serves the function of identifying the origin of the goods in services. In the United States, federal registrations have a 10-year term with unlimited additional 10-year renewal terms with proof that the mark is still being used in commerce on the goods and/or services identified in the registration.

Trademark rights in a mark can be lost through abandonment, nonuse or failure to adequately police the mark. There are a number of circumstance under which a once valid mark can cease to function as and be recognized as a legally protected trademark. The two circumstances of particular relevance in corporate transactions are (i) a transfer of the mark without the associated goodwill and (ii) a “naked license.”

For a transfer of a trademark to be properly effective, the assignment should include a recital that the “goodwill associated with the mark” is transferred together with the mark itself. In addition, the transfer of the mark needs to be accompanied by assets or rights that will result in the continuity of the assignor’s goods or services associated with the mark.

In the case of a trademark license, the goodwill is retained by the licensor. Consequently a trademark licenses provides that the goodwill arising from a licensee’s use of the mark inures to the sole benefit of the trademark owner. Furthermore, to maintain that goodwill and trademark, the licensor will typically have the right to “police” the licensee’s use of the mark. In other words, the licensor will have the right to monitor the quality of the licensee’s goods and services with which the mark is used to ensure that they are of a quality commensurate with the reputation of the mark. In order to prevent loss of the mark and the attendant goodwill, the licensor will exercise this right, by, for example, conducting periodic audits of the quality of the licensee’s products. If the mark is not adequately policed, the licensor may be deemed to have abandoned the mark, and in fact the mark may become associated with the licensee. In an extreme case, it is even possible that a licensed mark becomes associated with a type of product or service rather than a specific brand to the point where it becomes “genericized” and the protection is lost. Words like aspirin, thermos, popsicle, escalator, jeep and velcro were all once registered trademarks.

3. Copyrights

A copyright provides certain exclusive rights to authors of “original works of authorship” once the work is “fixed in a tangible medium of expression.” There are two main requirements for copyright protection: (i) the work must be original (i.e., a minimal degree of creativity is required) and (ii) the work must be fixed or documented in a tangible medium (e.g., a document, video or audio recording).
Computer programs, whether in source code or machine code, are considered “literary works” eligible for copyright protection. A copyright protects against copying the particular expression of the work, but does not protect the ideas or functions embodied in the work. Therefore, copyright law does not protect the functional aspects of a computer program, such as the program’s algorithms, formatting, functions, logic or system design. A copyright provides the author with the exclusive right to reproduce, distribute copies, publicly display and publicly perform the copyrighted work. Copyright protection also extends to compilations or collections of copyrighted works, as well as “derivative works,” in which a preexisting work is recast, transformed or adapted (for example, a movie based on a book). Certain other rights are applicable for specific types of works, such as sound recordings and mask works.

Copyright protection automatically exists when an original work is fixed in a tangible medium, and no formalities are required. There are, however, certain benefits to providing notice (e.g., © 2021 Wachtell, Lipton, Rosen & Katz) and registering a copyright with the U.S. Copyright Office, including the ability to bring an action for infringement in the United States, *prima facie* evidence of validity and the availability of statutory damages and attorneys’ fees.

The duration of copyright protection depends on the year a work was created and the type of work. In general, the term of copyright protection for works by an identifiable author producing the work on his or her own behalf is the author’s life plus 70 years. For anonymous/pseudonymous works or “works made for hire,” the duration is 95 years from date of first publication or 120 years from creation, whichever expires first.

The owner of a copyright can sue for infringement when an unauthorized party reproduces, distributes, publicly performs, publicly displays or creates a derivative work of the copyrighted work. While infringement requires substantial duplication of the copyrighted work, that does not mean that the work must be knowingly copied. Generally, the plaintiff has to prove only access to the infringed work and substantial similarity between the two works. A finding of copyright infringement enables the copyright owner to obtain injunctive relief and damages, including potentially statutory damages, lost profits and attorneys’ fees. As stated earlier, statutory damages are one of the benefits of federal registration. Under the Copyright Act, statutory damages range from a minimum of $750

---

31 See *Apple Computer, Inc. v. Franklin Computer Corp.*, 714 F.2d 1240, 1249 (3d Cir. 1983). *Source code* is the set of statements and instructions (often accompanied by comments) authored using a programming language in plain text, which can be written, read, interpreted and manipulated by a human being. The source code must be translated by a compiler into *machine or object code* so that it can be executed by a computer. Most applications are distributed only in assembled, machine code versions.

32 Mask works are photolithographic templates used in the production of integrated circuits. The U.S. Copyright Office has the authority to regulate mask works under the Semiconductor Chip Protection Act of 1984. Protection for a mask work lasts for 10 years from the earlier of the registration date or the date when the mask work was first commercially exploited. Mask work protection provides the owner with the exclusive right to reproduce the mask work and to import or distribute a semiconductor chip that includes the mask work.

33 17 U.S.C. § 504(c)(1)-(2).
up to $150,000. Statutory damages can be a significant benefit to copyright owners as actual damages may be difficult to prove, and in some cases, nominal.

In an action for copyright infringement, the alleged infringer will often challenge the validity of the copyright and/or assert a defense of “fair use.”

The “fair use” doctrine permits the unlicensed use of copyrighted works in certain circumstances. For example, the fair use doctrine would permit copying some portion of the copyrighted work for purposes of criticism, comment, news reporting, teaching, charity work, scholarship, and research. In determining whether an unlicensed use would be permitted under the fair use doctrine, the Copyright Act lists four non-exclusive factors: (i) the purpose and character of the use; (ii) the nature of the copyrighted work; (iii) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (iv) the effect of the use on the potential market for, or value of, the copyrighted work. Another limitation on the copyright owner’s exclusive rights is the “first sale” doctrine. The first sale doctrine permits further distribution (but not copying) of copyright-protected works once a copyrighted work is sold or otherwise transferred by or with the approval of the copyright owner.

a. Ownership and Works Made for Hire

Ownership of a copyright automatically vests in the author of the copyrighted work at the moment the work is fixed in a tangible medium of expression. Transfer of ownership requires a formal, operative assignment of the work. A general covenant to assign, or a recital that the works will be owned by another party are not sufficient to transfer ownership.

The exception to this rule is a “work made for hire,” where ownership will vest in a third party without a formal assignment. There are two circumstances where a work is considered “a work for hire”: (i) when the work was created by an employee within the scope of employment; or (ii) when the work was specially ordered or commissioned and falls under one of the nine categories enumerated in the statute, and the parties expressly agree in writing that the work will be considered “for hire.”

As a practical matter, the types of works typically encountered in most M&A transactions (for example, software), do not fall into one of the categories defined by the statute and, if produced by a third party, will not be automatically owned by the entity engaging

such third party absent an express assignment. Merely reciting that a work is a work made for hire will not be effective to vest ownership if the foregoing criteria are not met.

As noted above, the term of copyright protection of works for hire is 95 years from date of first publication or 120 years from creation, whichever expires first. However, if the work is not a work made for hire but is nonetheless effectively assigned by the individual author to a third party, subject to certain other requirements, the author (and author’s heirs) retains the right, which cannot be waived, to terminate the transfer of ownership and recapture the copyright, generally within a five-year window beginning 35 years from the date of the original grant of rights.39

b. Moral Rights

Generally, moral rights refer to certain personal and noneconomic rights in a copyrighted work, including the right to claim authorship of the work. In the United States, moral rights of authors are limited to attribution (the author’s right to acknowledgement as the author of a work) and integrity (the author’s right to object to alteration, distortion, or mutilation of the work that is prejudicial to the author’s reputation) of narrowly defined works of visual arts under the Visual Artists Rights Act (“VARA”).40 However, many other countries provide authors with greater protection for moral rights. For example, unlike the United States, many European countries extend moral right protection to all types of copyrighted works (not just works of visual arts). In addition, it is common in the United States to include in legal documents (where relevant) a general waiver in which the author will purport to give up his or her moral rights. However, such a general waiver of moral rights is ineffective in most cases under U.S. law41 and is always ineffective under the law of most European countries.

4. Trade Secrets

While trade secrets are typically considered to be, and treated in most agreements as, Intellectual Property Rights, they differ in important respects from patents and copyrights, especially when it comes to ownership and the transfer of ownership from a seller to a buyer. Trade secrets are defined by federal statute and the large majority of states42 as:

• information of any kind and in any form;

39 17 U.S.C. §§ 203 and 304(c), (d).


41 Moral rights arising under VARA are not transferable. They may, however, be waived if the author expressly agrees to such a waiver in a written instrument signed by the author specifically identifying the work and uses of the work to which the waiver applies. 17 U.S.C. § 106A(e)(1).

42 All states other than New York have adopted a version of the Uniform Trade Secrets Act (the “UTSA”), together with its definition of trade secret. The federal Economic Espionage Act, as amended by the DTSA, 18 U.S.C. § 1839, defines trade secrets, misappropriation and improper means in terms largely consistent with the UTSA.
• that the owner or licensee thereof has taken reasonable measures to keep secret; and
• that derives independent economic value from not being generally known or ascertainable by another person who can obtain economic value for the disclosure or use of such information.

The first two parts of this definition essentially describe confidential information, but the third part is fact-specific and cannot generally be determined *a priori*. Examples of trade secrets include confidential formulas, patterns, compilations, programs, devices, methods, techniques, processes or other business information.

There are several important distinctions between trade secrets and other forms of Intellectual Property Rights, particularly patents and copyrights. These distinctions are important to consider when dealing with trade secrets in the M&A context.

First, unlike patent and copyright statutes, statutory trade secret law does not define the rights that are associated with trade secrets in terms of “exclusive rights.” Rather, the legitimate possessor of a trade secret (which may be the owner or licensee) has a cause of action against a third party that “misappropriates” the trade secret. Misappropriation encompasses a variety of acts, including criminal acts (*e.g.*, theft), unfair competition, breach of contract, and breach of fiduciary duty.

Second, unlike patent rights and copyrights, trade secret rights do not protect against independent discovery or discovery by legitimate means (like reverse engineering). It follows that more than one party can have independent rights to the same trade secret. Further, both the legal owner and a licensee may rightfully possess the trade secret and, therefore, have an equal right to bring an action for misappropriation and obtain monetary damages and injunctive relief against someone who misappropriates that trade secret.

Third, there is no necessary limit to the duration of a trade secret right. Patents and copyrights involve a bargain with the government: the holder receives a limited-duration monopoly in return for dedicating the invention or work to the public when the monopoly ends. Trade secrets, on the other hand, involve no such bargain. So long as it remains secret, the protections afforded to a trade secret can be perpetual. Moreover, a license may require the licensee to pay a royalty for use of a trade secret even if the “trade secret” is no longer secret.43

Fourth, unlike other forms of Intellectual Property Rights, trade secrets are not registered with any central authority. Until recently, trade secrets were only protected under the laws of each individual state. The DTSA provides a federal cause of action for trade secret misappropriation.

---

Finally, unlike patents, and to some degree copyrights, it is not typically possible to precisely identify and define a business’s trade secrets. It is therefore uniquely challenging for parties in a transaction to divide and purport to allocate ownership of trade secrets. See Section III.B for a discussion of how this issue can best be addressed in the transactional context.

5. **Comparison of Forms of Intellectual Property Rights**

The different forms of Intellectual Property Rights and their primary attributes are summarized below.

*Figure 2. Comparison of Forms of Intellectual Property Rights*

<table>
<thead>
<tr>
<th></th>
<th>Patents</th>
<th>Copyright</th>
<th>Trademark</th>
<th>Trade Secret</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Subject Matter</strong></td>
<td>Use useful appara-</td>
<td>Ornamental</td>
<td>Word, symbol,</td>
<td>Information:</td>
</tr>
<tr>
<td></td>
<td>tus, process,</td>
<td>design for</td>
<td>sound, shape to</td>
<td>process, list,</td>
</tr>
<tr>
<td></td>
<td>composition</td>
<td>article of</td>
<td>identify source</td>
<td>formula, etc.</td>
</tr>
<tr>
<td><strong>Must Be</strong></td>
<td>New and nonobvious</td>
<td>Original,</td>
<td>Distinctive</td>
<td>Secret</td>
</tr>
<tr>
<td></td>
<td>New and nonobvious</td>
<td>creative</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Obtaining Rights</strong></td>
<td>Application with</td>
<td>Fix in tangible</td>
<td>Use (registration</td>
<td>Reasonable efforts of secrecy</td>
</tr>
<tr>
<td></td>
<td>U.S. government</td>
<td>medium (notice</td>
<td>optional)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Application with</td>
<td>and registration</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>U.S. government</td>
<td>optional)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Rights Conferred</strong></td>
<td>Prevent others</td>
<td>Reproduce,</td>
<td>Prevent others</td>
<td>Prevent others</td>
</tr>
<tr>
<td></td>
<td>from making (having</td>
<td>disperse,</td>
<td>from using</td>
<td>from misappropriation</td>
</tr>
<tr>
<td></td>
<td>made), using,</td>
<td>prepare</td>
<td>same or confusing-</td>
<td></td>
</tr>
<tr>
<td></td>
<td>selling, offering</td>
<td>derivative</td>
<td>ly similar</td>
<td></td>
</tr>
<tr>
<td></td>
<td>for sale, importing</td>
<td>works, perform,</td>
<td>mark</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>display</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

C. **Data and Privacy**

In addition to the aforementioned Intellectual Property Rights, data and privacy issues may be a key component of a corporate transaction. In this Section, we discuss what the term *data* entails, its relation to Intellectual Property Rights, and its role in M&A transactions.

1. **What Is Data?**

Although knowledge and information are among the great drivers of wealth in our modern economy, the treatment of data in M&A agreements—quantitative or qualitative information which may have value to a business—is frequently less coherent than the treatment of other types of intangible assets. This is perhaps unsurprising insofar as the term
“data” can refer to many different things. For example, is the term data referring to a database as a whole, the individual records, certain data fields, or the structure of the database? Moreover, there are a wide variety of data types that may be encountered in an M&A transaction, including many, such as personally identifiable information, that are subject to complex external contractual and legal constraints. These may include, among others:

- customer details;
- prospect lists;
- information regarding market / industry trends;
- behavioral information and records of interactions;
- inventory tracking;
- risk metrics;
- experimental and product data;
- end-user data;
- personal information;
- medical records;
- sale and pricing data; and
- social media records (e.g., state of residence of followers), etc.

The categories of information listed above are manifestly necessary in order to successfully operate even a simple business, and for many might be a critical aspect of their competitive position. On the other hand, a business may be exposed to liability in connection with its collection and retention of certain classes of information (such as the obligations around safeguarding personally identifiable customer information, health information, etc.). As we discuss in this Section, there is considerable debate regarding what data is and the degree to which it is possible to have a proprietary interest in data. While we acknowledge these complexities, we nevertheless refer to data in this Guide as an asset belonging to a business and as a potential source of liability for a business.

Increasingly, M&A agreements are reckoning with how ownership rights in data are, as applicable, collected, transferred, retained, or shared, as well as with risk allocation around the sensitive area of data protection and cybersecurity.

2. Does IP Law Protect Ownership Rights in Data?

Owing to the amorphous nature of data, ownership rights in data can be very challenging to ascertain. While data undoubtedly is a valuable asset, it does not necessarily squarely fit into the traditional categories of protectable Intellectual Property Rights—categories which predate the modern information economy by hundreds of years. Currently, there is no U.S. legal regime expressly creating a property right in data or for recording title to data. While there is a burgeoning effort in some jurisdictions to establish statutory property rights in certain types of data (notably in the European Union with the promulgation of the GDPR, as discussed below), it is likely that over time a more coherent body of law will develop on this issue.
Practically speaking, data may be instantiated in many different written or electronic forms within a company. However, as is the case with Technology, there is a distinction between ownership of the data record itself (e.g., in the form of an electronic record or a database) and the Intellectual Property Rights in the data. Data is not an invention subject to patent protection, and copyrights rarely apply to data absent the data being an original work of authorship.\(^{44}\)

While possession of data without restriction in its use, distribution or disclosure is functionally tantamount to ownership, that “ownership” is not exclusive. Indeed, it is unlikely that ownership of data is anything more than ownership of a trade secret (assuming the data meets the definition of a trade secret). And if the data is public, then it is unlikely that there is any ownership interest in such data beyond the ownership of the physical copy of the data. Following is a brief overview of how the square pegs of data may fit into the round holes of traditional IP categories.

**Copyright protection.** Copyright law extends protection to original works: an author’s own creation that is capable of expression in a material, concrete form. As discussed in Section II.A.1 above, copyright law protects the tangible expression of an idea, but not the idea itself. In other words, a copyright does not protect facts, ideas, heuristic principles and so on, apart from their physical embodiment in a fixed work. Consequently, a naked list of market statistics would likely not be eligible for copyright protection\(^{45}\) (although a statistical report including substantial original presentation or analysis likely would). However, it is not atypical for M&A agreements to include “rights in data and databases” within the definition of copyrights without specific qualification that an element of creativity is necessary. Notably, the European Union has promulgated a directive to formalize the protection of databases under copyright law where databases “by reason of the selection or arrangement of their contents, constitute the author’s own intellectual creation.” There is, however, no comparable regulation in the United States. The burgeoning business use of machine-generated data and artificial intelligence further challenges the ability to obtain copyright protection for business data, as it is questionable whether work produced by a non-human “author” can be considered original.\(^{46}\)

**Patent protection.** As discussed in Section II.B.1 above, patent protection extends to a new, useful and non-obvious invention of a machine, process, article of manufacture or composition of matter.\(^{47}\) In the classic statement of what cannot be patented, the Supreme Court held that “manifestations of laws of nature, free to all men and reserved

---


\(^{45}\) See, e.g., *ProCD v. Zeidenberg* (7th Cir. 1996) (CD-ROM with information compiled from thousands of phone directories did not merit copyright protection).

\(^{46}\) The U.S. Copyright Office will only register original works of authorship created by a human being. *See COMPENDIUM OF U.S. COPYRIGHT OFFICE PRACTICES § 306* (3d ed. 2017).

\(^{47}\) 35 U.S.C. § 101 et seq.
exclusively to none” are “part of the storehouse of knowledge of all men,” so no person has a “claim to a monopoly . . . which the law recognizes.”48 In general, data in and of itself is not patentable. So while, for example, an artificial intelligence system used to generate data could be protectable under patent law, the data the system generates would not be.

Trade secret protection. As described in Section II.B.4 above, trade secrets are defined by federal statute and a large majority of states to be information that the owner has taken reasonable measures to keep secret and that derives independent economic value from not being generally known or ascertainable by another person. Data may therefore be subject to trade secret protection if these criteria are met. For example, a company that has collected and compiled data from public sources (for example, data with respect to matters such as market pricing) and kept the resulting database secret, would have a trade secret misappropriation claim against a third party that used improper means to access and use that data. However, it would have no claim against a third party that independently collected and compiled the same data.49

3. What Other Laws May Protect the Ownership, Use and Disclosure of Data?

While the forgoing focused on data as corporate asset, depending on the type of data in question, data’s ownership and use may be subject to regulation under an increasingly complex mosaic of federal, state and international law and regulation. In particular, personally identifiable information (such as social security numbers, credit card information or biometric records) and individual medical data are subject to extensive regulation, substantially impacting business practices in fields such as banking, consumer finance and healthcare.50 While a detailed discussion of this topic is beyond the scope of this Guide, extensive cybersecurity requirements, applicable to consumer data, now apply across a range of business practices at the federal and state level. Thus, while in a transaction, as between the parties, one party may be (or may become) the owner of a database, the rights of the owner will be circumscribed by the terms of a privacy policy or other contract under which the data was provided, as well as a web of laws applicable to the collection, use, and transfer to third parties of individual data records comprising the database.

At the U.S. federal level, for example, under the Federal Trade Commission Act, the Federal Trade Commission (the “FTC”) is empowered to bring enforcement actions in


50 Certain states have enacted laws that specifically regulate the collection and use of biometric data. See Illinois Biometric Information Privacy Act of 2008 (740 ILL. COMP. STAT. 14/1 to 14/99); Texas Capture or Use of Biometric Identifier Act (TEX. BUS. & COM. CODE ANN. § 503.001) of 2009; Washington House Bill 1493 regarding biometric identifiers (WASH. REV. CODE §§ 19.375.010 to 19.375.900), which became effective in 2017.
cases of unfair or deceptive practices in the marketplace, which has been construed to include the misuse of personally identifiable information. To date, the FTC has brought hundreds of privacy and data security cases involving violations of privacy statutes such as the Fair Credit Reporting Act. In the domain of healthcare data, the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”) establishes privacy rights in medical records, empowering individuals to determine to whom their information may be disclosed.

Some states have aggressively extended their regulatory reach over personal data. Under the California Consumer Privacy Act (“CCPA”), which became effective on January 1, 2020, consumers are granted rights: to know what personal information companies collect about them; to require that this information be deleted; to opt out of the sale of personal information; and to non-discrimination in terms of price or service when a consumer exercises privacy rights under the CCPA. Businesses are subject to the CCPA if they conduct business in California and meet one of the following thresholds: (i) their annual revenues exceed $25 million; (ii) they buy, receive or sell personal information of 50,000 or more consumers, households or devices; or (iii) they derive 50% or more of annual revenue from selling personal information. Under recently effective cybersecurity regulations in New York, all entities regulated by the New York Department of Financial Services are required (among a host of stringent cybersecurity requirements) to develop and maintain written cybersecurity policies and procedures. In addition, the New York Stop Hacks and Improve Electronic Data Security Act (the “SHIELD Act”) of 2019 requires that biometric information be protected through a formalized data security program, comprised of reasonable administrative, technical and physical safeguards.

Internationally, the European Union has been at the vanguard of establishing consumer property rights in data with the promulgation of its sweeping General Data Protection Regulation ((EU) 2016/679) (the “GDPR”), which became effective in 2018. The GDPR applies to the “processing” (i.e., the collection, recording, storage, or other operation) of “personal data” of individuals located in the European Union, defined to include any information relating to an identifiable person, such as a name, ID number, online identifier or other identifying factor. The regulation applies not only to data “controllers,” in other words, the parties that determine the purposes and means of processing the data, but also to data “processors,” the parties that perform that processing. Importantly, the GDPR is extraterritorial in scope, applicable to companies outside the European Union where the processing relates to the offering of goods or services to European Union individuals or the monitoring of European Union individuals’ behavior. The GDPR’s


52 CAL. CIV. CODE § 1798.100 et seq.

53 23 NYCRR § 500.

54 N.Y. GEN. BUS. LAW § 899-aa(1)(b)(5). The SHIELD Act also broadened New York’s data breach notification law to include biometric information among the forms of private information that may implicate breach notification requirements if the information is compromised.
requirements are extensive, and penalties for noncompliance may be severe. Many U.S.-based multinational corporations have thus been subject to the GDPR (to a greater or lesser degree) since 2018.

As far as private ordering is concerned, contract law and internal company policy are critical frameworks for the maintenance and protection of business data, irrespective of type, providing a basis for companies to enjoin or obtain remedies for breaches. Larger companies are veritable lakes of business data; contract law and company policy are lifeguards determining who can enter the water and how far they can swim. Commonplace protections include the following:

- employees are required to keep business information confidential (by policy if not by formal non-disclosure agreement) and may only access business information on a need-to-know basis;
- employee training;
- vendors and other third parties who may have access to business information are contractually restricted in its use and required to keep the information confidential;
- promulgation of formal written policies for data protection and management; and
- stringent cybersecurity practices (e.g., encrypted systems only accessible with permission, two-factor authentication, etc.).

4. **What Issues Regarding Data Should Be Considered in M&A Transactions?**

The degree of focus on data in a particular M&A transaction will usually correspond to the importance of data for the businesses concerned. For example, treatment of data is more likely to be a point of focus in a deal involving a consumer marketing company than, for example, a timber company. But even a pure brick-and-mortar company will have customer lists, development plans and so on. Accordingly, the following matters are worthy of some consideration in transactions of all profiles.

*Due Diligence.* Given the centrality of data to the success of a business and the risks associated with misuse or breaches of data, in evaluating an M&A transaction, it is valuable to understand (from both a business and legal standpoint):

- what data is collected, how it is stored, how it is used and by whom, and with whom it is shared;
- the quality of the data that the company collects;
- applicable data privacy and cybersecurity protocols;
- applicable insurance protections (for breach, disaster, etc.);
- relevant pending or threatened litigation;
- agreements with third parties (including vendors) relating to handling of data, especially personally identifiable information; and
- relevant company policies.
Scope of Acquired Data. In a whole-company transaction, the acquirer will necessarily acquire all of the target’s data. But in a carve-out transaction involving the sale of a discrete business or assets, it is necessary to determine what data is included as an asset, whether that data is sufficient to operate the acquired business or assets, how any shared data is to be shared between the parties (whether permanently or transitionally), and how to actually convey the data in question. Generally, this would entail identification of particular books and records that are either included or excluded from the assets sold in the transaction—which may be complicated where records are commingled—and/or the negotiation of covenants permitting access to books and records for some period of time after closing. Apart from including books and records as an asset (and a deliverable), as a contractual matter, insofar as “Intellectual Property” is defined to encompass data or rights in confidential information within the sub-definitions of “Copyrights” and/or “Trade Secrets,” rights in particular IP assets may be conveyed via the inclusion of IP as an asset. See Section III.B below concerning how to draft definitions of Intellectual Property and related terms.

Risk Allocation. M&A agreements often include representations and warranties with respect to data integrity, i.e., the target company’s systems for maintaining and protecting data, the absence of breaches and similar representations. As discussed in Section III.B.5 below, these representations have a closing condition function and, in a private transaction, may also have an indemnification function or be subject to coverage under representations and warranties insurance. Coverage will commonly include some or all of the following:

- maintenance of books, records and data under the target’s exclusive ownership and control;
- compliance with laws regarding data protection;
- soundness of privacy policies;
- cybersecurity practices and absence of data breaches;
- disaster recovery protocols; and
- occasionally, data quality, such as the accuracy and utility of the information the target collects (particularly if the target monetizes data as a core business or provides data processing services).

D. Internet Properties

Like data rights, Internet Properties are intangible assets generally included within the definition of Intellectual Property Rights more as a matter of convenience and convention than because they are, strictly speaking, Intellectual Property Rights. The term Internet Properties is generally used to refer to domain names (the top-level, registered identifier of an internet protocol address that identifies it as belonging to a particular domain, such as wlrk.com), uniform resource locators or URLs (particular pages within a domain, such as www.wlrk.com/guides), and various other addresses used on the internet, such as social media accounts used to identify a particular entity or destination. For the most part, these Internet Properties represent unique addresses or destinations on the internet and are issued
by various private and quasi-private organizations. As such, they are more analogous to street addresses and telephone numbers than the Intellectual Property Rights with which they are grouped. However, as modern business is increasingly conducted through online channels, these digital addresses can be counted among a company’s most valuable assets. It is therefore important to understand how these assets can be defined and transferred in M&A transactions.

As noted, Internet Properties are generally reserved for the exclusive use of a party through some type of registration mechanism. For example, a party acquires ownership of a domain name (e.g., wlrk.com) by being the first person to register that particular domain with an accredited registrar who interfaces with the Internet Corporation for Assigned Names and Numbers (“ICANN”), the nonprofit organization responsible for coordinating the protocols of the internet and top-level domains such as “.com”. The domain name is associated with a unique IP (internet protocol) address of a host server on the internet.\(^\text{55}\) Registration vests the registrant with the exclusive right to use the domain name and enables the domain holder to establish an unlimited number of associated URLs.

In many cases, a domain name may also be a trademark (e.g., www.apple.com). Furthermore, a generic term such as Booking.com may function as and be protected as a trademark if the domain name acquires secondary meaning.\(^\text{56}\)

Accordingly, even if a person (a so-called “cyber-squatter”) is the first to register a domain name based upon the trademark of another, the trademark holder should be able to force the original registration to be revoked in favor of a new registration in the name of the trademark holder. Moreover, it would have a cause of action for trademark infringement and unfair competition against the cyber-squatter that first registered the trademark as a domain name.

The transfer of a domain name is typically accomplished by an agreement whereby the current registrant of the domain agrees to instruct the domain name registrar to transfer the registration of the domain into the name and account of the new registrant. Similarly, social media “handles” (names) and the like are generally transferred by changing the entity to which they are registered.

In an asset sale, the domain names to be transferred would generally be enumerated on a schedule to the sale agreement. Parties are increasingly electing to also provide for domain name assignments in an ancillary “assignment” agreement. However, while styled as an assignment, such an agreement does not in and of itself assign ownership of the domain names. Rather, it is an agreement by the seller to take the steps necessary to transfer the registration of the domain names to the buyer, including instructing the existing domain

\(^{55}\) For example, the domain name wlrk.com corresponds to the IP address 50.57.240.162.

name registrar to transfer the registration, providing a confirmation of the transfer in accordance with the registrar’s protocols and, if applicable, making provisions with a new registrar. The transfer protocol will vary, including based on whether the buyer intends to use the same registrar as the seller, but typically entails, among other things, that the seller obtain and use a special authorization code. This process is usually completed within a few weeks following the closing and should be addressed as part of transition planning.

Of course, domain names and associated URLs are mere addresses where users can locate internet content. Under intellectual property law, the content of a website (which, for purposes of copyright law, is a tangible medium of expression) is inherently copyrighted insofar as it constitutes original work. Although not obligatory, a website or website content can be registered with the U.S. Copyright Office. Notably, the Digital Millennium Copyright Act of 1998 (the “DMCA”) serves to clarify copyright law applicable to digital media. While a detailed summary of the DMCA is beyond the scope of this Guide, the DMCA criminalizes production and dissemination of technology, devices or services that evade measures that control access to copyrighted works. Among other things, the DMCA also provides that internet service providers will not be liable for copyright infringement that occurs through the use of their services, provided they abide by prescribed guidelines (including blocking access to or remove infringing material when they receive notice of an infringement claim from a copyright owner).

---

III.

Intellectual Property in the M&A Process

This Chapter of the Guide follows the path of a typical acquisition of a business from the execution of a confidentiality agreement, through the process of drafting acquisition agreements, up to the consummation of the transaction, and recommends approaches for handling commonly encountered issues. While the approaches described here are generally appropriate to most situations, dealmaking is not a cookie-cutter process, and divergent approaches to particular issues may be appropriate depending on the facts and circumstances.

Section A describes the basic transaction structures that will impact parties’ approaches to the treatment of IP. Section B describes approaches for addressing IP issues in acquisition agreements and describes some of the pitfalls deal practitioners need to be careful to avoid. Section C is dedicated to the various mechanisms parties can use to obtain recourse for breaches of the acquisition agreement. Section D deals with the mechanics of consummating the transaction. The process for effectuating and recording the conveyance of registered IP are discussed, as well as potential approaches to updating IP-related disclosures based on new information arising after signing and prior to the closing. Finally, Section E discusses how concerns around IP can emerge when parties enter into confidentiality agreements and begin to exchange sensitive, proprietary information with each other.

A. The Relevance of the Transaction Structure to Intellectual Property Issues

The scope and complexity of IP issues raised in an M&A transaction depends not only on the nature of the business but also on the structure of the transaction. In this Section, we consider how different transaction mechanisms and deal parameters influence issues related to, and the treatment of, IP in a transaction.

a. Public versus Private Deals

At the outset, it is important to distinguish between public and private M&A deals. This distinction is not defined by the nature of the parties to the transaction (i.e., a public company could participate in a private deal, such as when it divests a line of business). Rather, a private deal is one in which there is one or a manageable number of identifiable sellers, who receive the consideration in the transaction and so can be pursued after the closing for recourse in the event of a breach.

In a public transaction, the buyer pays the consideration a diffuse group of shareholders, and there is no way to reclaim it after closing to compensate the buyer for a breach that is subsequently discovered or proven. For this reason, and setting aside insurance, the only protection a buyer can have in a public company transaction is to find out about a problem before closing, and to terminate the agreement if the problem is sufficiently large to allow the buyer to do so. Of course, because of the detrimental implications of a broken
deal for a public company, the standard for permitting a party to walk away is usually very high, requiring not just a material breach of a simple representation but a material adverse effect on the entire organization. (Several important judicial opinions have expounded on what exactly that means, but suffice it to say for purpose of this Guide that it is a high standard, making it extremely difficult for a buyer to walk away from an announced public company deal.)

The most important protection a buyer can have when entering into a public transaction is to engage in intensive due diligence to understand the risk profile of the target company as much as possible. Fortunately, public companies are required to make public filings with the SEC which are generally very reliable sources of information. These public filings do not, however, include all the granular information that a buyer would want to know, and so due diligence remains very important. Consequently, it is important in a public company deal to have representations and warranties that are sufficiently broad in scope so as to enable the buyer to reconsider or renegotiate the transaction in the event a major problem (whether or not related to IP) manifests before closing.

In a private transaction, there is greater room for a buyer to seek recourse after the transaction because the consideration is paid to a seller (or to a relatively small number of sellers) who is identified and with whom the buyer can more readily deal after the closing. Increasingly (or as an alternative), there may be recourse to private representations and warranties insurance. If certain representations and warranties are breached, then the buyer can claim money back from the seller (or insurer), effectively leading to a purchase price reduction to take account of the breach. The indemnification provisions in M&A agreements, which are discussed in Section III.C below, specify limitations on the buyer’s right to recovery, including time limits, baskets and caps.

The key point is that, practically, indemnification is only available in a private transaction. We will return to this distinction throughout this Guide, but it is critically important to understand at the outset this important difference between a public and a private M&A transaction.

b. Whole-Company Deals versus Carve-outs

We can conceive of deal complexity on a spectrum: at one end would be a merger of two public companies; at the opposite end would be the separation and disposition of a business line from a larger entity that will continue to exist after the deal. In the first situation, there are no real concerns about critical IP assets being “left out.” Since the entirety of two companies will be merged, there are no issues around ongoing IP relationships between disparate companies after closing. As a result, IP issues are likely to be limited to concerns about potential liability to third parties and the consequence of the transaction on existing contractual relationships. Such issues can be discovered through targeted due diligence and addressed by limited representations and warranties that may not require an in-depth understanding of the nature of the business or the IP involved in it.
By contrast, successfully carrying out the second type of transaction frequently raises difficult questions not only about the nature of the business and assets being transferred, but also about the businesses not being transferred and the relationship between the transferred and retained businesses following the closing. The colloquial name given to such transactions, carve-outs, obscures the often painstaking, surgical process of separating one product line, one group of employees, one IT system and one set of contractual relationships from another. The name also obscures how frequently it is impractical or impossible to make a clean division between the transferred and the retained businesses. Often, the parties in such transactions need to make plans for temporary or ongoing contractual relationships that will endure after the conclusion of the purchase and sale. For a discussion of transition services agreements, see Section V.A below.

The complexity will be heightened if the assets and liabilities that constitute the business being separated are not already located within one or more separate subsidiaries that can be transferred but are scattered through the business and commingled with assets and liabilities that are not being transferred. Because transactions of that type lie on the maximal end of the complexity spectrum with respect to IP, they are the best place to see the full range of tools available to deal professionals when confronting IP issues connected with M&A. We will therefore emphasize them in the discussion that follows.

c. Typical Deal Structures

While the course of merger deals varies, in most cases negotiated deals follow a similar pattern and have the following components roughly in the same order: a confidentiality agreement, sometimes a term sheet, due diligence, a negotiated acquisition agreement and a closing (and sometimes ongoing relationships are governed by either a transition services agreement or a longer-term commercial arrangement between the parties).

Term sheets are less common in public company deals, which tend to follow a more established format with more limited areas of negotiability, in large part because public company transaction documents are filed with the SEC, leading to more standardized expectations by market participants and investors. In private company transactions, a term sheet can be a very helpful step to ensure that the parties are aligned on key deal principles before the parties invest substantial resources to pursue a transaction. In the event a term sheet is utilized in negotiations and to the extent IP issues are addressed, it will be important to keep in mind some of the key issues raised in this Guide. In particular, it will be critical to ensure that any definitions limiting the IP in the transaction are properly considered, as well as general statements regarding the licenses to be granted, together with any limitations on those licenses.

As mentioned above, asset carve-out transactions, in which the buyer acquires a bundle of assets and associated liabilities but not an entire business or entity, typically are the most complex transactions from an IP perspective. Therefore, the following Sections explore these transactions and the associated deal components in the most detail. Furthermore, while the transaction document is not the first step in the process, it is the end towards
which the ancillary documents are oriented. Accordingly, the discussion that follows deviates from the typical sequence of a transaction. We will begin with the main acquisition agreement and then return to issues related to confidentiality agreements.

B. Preliminary Issues in Drafting the Acquisition Agreement

The transaction document will dictate (i) which party gets what IP and in what form; (ii) what each party is permitted to do, or not do, with the businesses and assets it has purchased or retained; and (iii) which party bears the risk if the representations turn out not to be accurate. Achieving these goals requires a systematic and sequential approach. The parties will need to:

- develop a working definition of the business to be divested (the “Business”) if the object of the sale is to be characterized as a business as opposed to a collection of assets and attendant liabilities;
- identify the registered Intellectual Property Rights (i.e., patent, trademarks and registered copyrights) to be assigned or licensed to the buyer (“Assigned Registered Intellectual Property Rights” and the “Licensed Registered Intellectual Property Rights,” respectively);
- identify copyable and non-copyable Technology which the seller will deliver to the buyer (“Transferred Technology”);
- identify other Intellectual Property Rights (i.e., trade secrets and unregistered copyrights), which will be transferred to the buyer (“Transferred Other Intellectual Property Rights”) and licensed back to Seller, or retained by the seller (“Retained Intellectual Property Rights”) and licensed to the buyer; and
- identify third-party IP necessary to the operation of the Business and determine how to ensure continued access to it.

1. Defining the Business

The process typically starts off with a working definition of the Business on which the other definitions will be based. There are many ways to define the Business, and it is not unusual for the parties to refine and elaborate on the definition in the course of due diligence and negotiations. A definition of the Business can be based upon a wide variety of factors, including the location of operations, products, people, financial statements, revenue sources and other factors. Often, the most convenient definition is based on the products or services provided by the Business, as these can generally be clearly distinguished and listed.58

Sometimes one or both parties may have reasons for preferring to characterize an acquisition as either the purchase of a bundle of assets and liabilities or the purchase of a “business” as a going concern. While this is partly a semantic distinction, there can be

---

58 To give one example: “The Business means the business and operations of the seller related to designing, making (or having made), distributing, selling and supporting the Products listed on Schedule [●], in the countries listed on Schedule [●].”
advantages and disadvantages to both characterizations. Characterizing an acquisition as merely a purchase of assets and liabilities may allow the buyer to “cherry-pick” the assets it wants and leave behind the parts of the business it deems to be extraneous to its goals and, importantly, the liabilities it does not wish to inherit.

On the other hand, if the buyer takes the position that it is just buying assets and not a business, the seller may be in a better position to resist giving a “sufficiency” representation (that the buyer will receive everything it needs to run the acquired business). The seller may also argue that it should not have to agree to a non-compete covenant (that it will not compete for some period with the business it is selling) if what it is selling is not characterized as a business. A buyer may be in a better position to argue for a strong sufficiency representation and a rigorous non-competition covenant if it considers itself to be buying an operating business. But it may then be vulnerable to the seller’s arguments that it should then assume all of the legacy liabilities of that business together with its assets. Ultimately, however, these are all negotiable points and the parties’ relative bargaining power will often have a greater effect on the outcome than the semantic characterization of the object of the sale.

Once there is a working definition of the Business, the next task is to deal with the Technology and Intellectual Property Rights.

2. Identifying the Registered Intellectual Property Rights to Be Assigned or Licensed

a. Patents

In a carve-out transaction involving patents, regardless of whether the transaction is structured as an asset sale or the sale of the equity of an entity, a determination will need to be made as to which patents will be transferred to the buyer (or remain in the divested entity) and which patents will be retained by the seller (or transferred out of the divested entity). Most buyers believe it is in their interest to acquire as many patents as possible. Generally, the seller has the opposite perspective, especially if it does not feel that the purchase price reflects the value of the patents. Furthermore, the buyer’s general goal of assuring that it gets everything that it “needs” to run the acquired Business will extend to patents. While in many carve-out transactions patents are assigned to the buyer based on general rules applicable to all classes of assets, such as “all patents primarily used in” or “necessary to” the divested business, these rules are, for the following reasons, often imperfectly suited to patents:

- As a technical matter, patents are arguably not used in or necessary for the continued operation of a business (although where agreements reflect that phraseology, as is not uncommon, the meaning can be understood). As we have noted above, a patent is purely a negative right: it is the right to prevent others from carrying out the activities covered by the patent. Patents therefore confer no positive right on the patent owner to practice the patented invention. For example, patents that are infringed by a competitor from whom royalties can be obtained, or patents that can
be used defensively in a lawsuit brought against the patent owner may be far more valuable than patents that cover inventions related to the patent owner’s business.

- Ownership of patent is not necessarily “needed” in the traditional sense to enable the buyer to run the Business; a license to patents retained by the seller may be functionally equivalent and sufficient.
- Patents may have dramatically different value in the hands of different parties. For example, a patent portfolio that is material to a private equity buyer may be immaterial to a large strategic buyer that already owns many patents in the same field. The valuation of patents is a complex process, and the incremental value to a buyer or seller of owning a particular patent may be different and depend on multiple factors.
- The sum of the value of the parts of a patent portfolio to each of the buyer and seller, respectively, may be greater than the value of the whole portfolio being owned by only one party.
- Ownership of patents involves considerable maintenance costs. A party simply wishing to avoid the risk of infringement may be in a better economic position by negotiating for a license rather than retaining or acquiring ownership.

For these reasons, especially where the seller holds a significant patent portfolio, it is generally prudent to address the identification and transfer (or licensing) of patents in a manner that reflects both the unique characteristics of the patents as well as their potential value in the transaction. Moreover, regardless of the rules used to define the Assigned Patents, an assignment must identify the specific patents (usually on a schedule), and the assignment for each patent must be recorded. The preparation of the schedule will ultimately be determined by negotiation rather than the mechanical application of a decision rule, but different principles may be applied in the creation of a patent schedule, such as: (i) all patents invented by transferred employees; (ii) all patents the cost of which is attributed to the Business; (iii) all patents that have been identified and listed as covering the products of the Business, or in some cases (iv) an ad hoc, patent-by-patent determination based upon multiple factors.

In addition, even when the parties agree on the relevant patent portfolio, there are a number of ways in which the patents can be treated, depending on the particular business and circumstances:

- the seller can separately price the transaction with and without the assignment of the patents;
- once the relevant patents have been identified, all can be assigned, all can be licensed or only some may be assigned and the remainder licensed;
- the patents can be sold to a third party that licenses them to both the seller and the buyer (this introduces complexity, but is appropriate in certain circumstances); or
- the buyer might acquire all the patents and then resell some or all of them (and retain a license to what it has sold).
In a typical carve-out transaction, in addition to the assignment of certain patents, there will be a cross license pursuant to which the seller will grant the buyer a license to retained patents and the buyer will grant the seller a license to the assigned patents. A license to the retained patents serves to assure the buyer that the seller cannot sue for patent infringement when the buyer operates the acquired Business after closing. Stated another way, the sum of the assigned patents and the Licensed Patents should include all patents of the seller that are practiced by the Business as of the closing.59 These will be identified by means of a disclosure schedule. See Section III.B.5.a below. As was the case with determining the schedule of assigned patents, there are a number of ways to define the Licensed Patents. In addition, the determination of the Licensed Patents will depend on the nature of the license, about which see Section IV.B below. For example, the Licensed Patents could be defined as:

- all retained patents but with the field of the license limited to the field of the divested Business; or
- listed patents but with broad or unlimited field of use (on the assumption that the listed patents cover the field of the Business).

Where the Licensed Patents are limited to scheduled patents, there will typically be a mechanism to correct the list if a patent is inadvertently omitted. For example, a “wrong pockets” covenant provides that if it is determined within a certain amount of time after the closing that the seller owned a patent at closing that was neither assigned nor listed as a licensed patent, and such patent was practiced as of the closing, then that patent will be deemed a Licensed Patent. See Section III.D.3 below. This mechanism is generally self-enforcing, as the seller cannot assert a patent against the buyer if that patent should have been licensed. In addition, unlike a license to the seller’s entire portfolio, this mechanism provides the seller with certainty as to which of its patents are licensed.

b. Trademarks

Like patents, the allocation of owned versus licensed trademarks should be unambiguous. This is something that frequently cannot be accomplished with a primarily-used-in or related-to standard. Moreover, while the parties to a transaction may be able to correct errors in the allocation of ownership of patents and copyrights, this may be more difficult to accomplish with regard to trademarks. Only one party can own a trademark and accumulate the goodwill associated with the use of the trademark.60 Any usage of a trademark by the other party has to be subject to a license from the owner, which gives the owner the right to police how the mark is used. Without this, the trademark rights may be lost. In most cases, however, the most significant trademarks of a business are registered and can

59 The concept of “practiced” is equivalent to the statement that “such patent would, absent a license thereto, have been infringed by the operation of the business as of the closing.”

60 Joint ownership of trademarks is possible in theory but is generally not advisable.
be scheduled, rendering the risks of misidentification of common law trademarks less crit-
ical.

c. Registered Copyrights

In most transactions, the relevant copyrights are not registered and will be treated as “Other IP,” as discussed below. Like patents, registered copyrights that will be transferred to the buyer will need to be scheduled and the assignment recorded in the Copyright Office.

3. Identifying the Transferred Technology

The next step in the process is to identify “Transferred Technology.” For the purposes of this analysis, Transferred Technology is treated as a tangible asset.

In a disposition of a business by means of an asset sale, the seller generally transfers to the buyer ownership of at least a copy of all of the seller-owned Technology (such as software, documents and information) used in, or necessary for (or some similar formulation), the conduct of the divested business. This is the transfer of ownership of a tangible asset (the Technology) and is independent of whether the rights in that Technology (for example, trade secret rights) are to be assigned or merely licensed. For example, a covenant to deliver a hard drive containing software would be the same regardless of whether the rights in the software are being assigned or licensed to the recipient of the drive. Thus, where copies of the same Technology are used or needed in both the divested Business and the retained business, both parties may own the tangible copy of the same Technology, however, their rights to the Intellectual Property Rights in that Technology may be different.

In Section II.A.2 above, we considered a model definition of Technology, which for convenience we duplicate below. Building on that definition, we also propose a model definition of Transferred Technology:

“Technology” means embodiments of Intellectual Property Rights, including documentation, confidential information, materials, data, databases, software, hardware, works of authorship, and know-how or knowledge of employees, relating to, embodying, or describing processes, methods, designs, formulae, recipes and technical information.

“Transferred Technology” means all Technology with respect to which the Intellectual Property Rights embodied therein are owned by Seller, that (i) if capable of being copied, are used in or necessary to the operation of the Business, and (ii) if not capable of being copied are [●] or are identified

---

61 In some transactions it may be possible to define some rule for determining what non-copyable forms of Technology will be transferred, such as all Technology located at a particular facility or all Technology used in the manufacturing of a particular product.
on a schedule; provided that Transferred Technology does not include books and records, equipment, personal property or information technology Assets. 62

As evident from these definitions, the term Technology covers a broad range of assets that take two forms: (i) non-copyable technology, and (ii) copyable technology. As such, this model definition of Technology may overlap with other asset categories. Accordingly, it is often more convenient from a drafting point of view to exclude these overlapping asset categories from the definition of Transferred Technology. For example, non-copyable technology may include a broad range of things as such as equipment, prototypes, mask works and chemicals, some of which also fall within the definition of personal property. Similarly, some forms of copyable Technology, such as documents and records, may also fall within the definition of books and records and are better treated as such.

A second important limitation is that for the purposes of defining Transferred Technology, the definition applies to only Technology in which the underlying Intellectual Property Rights are also owned by the seller. For example, the Business may own the copyright in software developed by its employees, but it may also use software and other forms of technology licensed to it by a third party. Both types of software fall within our definition of Technology and are capable of being physically delivered to the buyer. However, only in the case of the internally developed software can the seller freely assign or license its rights embodied in the software. In the case of the software licensed from a third party, at most, the seller can transfer the license under which it received the limited right to use the software. Thus, while the internally developed and owned software should be treated as an asset under the full control of the seller, the software licensed from a third party should be treated as a retained or transferred contract.

As already noted, it is fairly common in an asset transaction to determine who gets what on the basis of the degree to which an asset or class of assets is related to the Business. For example, the buyer may agree to acquire the assets related, primarily related or exclusively related to the Business. However, when dealing with technology that can readily be duplicated, use of a relatedness standard can be overly constraining. Moreover, it is often difficult to apply a relatedness standard in practice. Therefore, parties may agree to transfer to the buyer a copy of all Technology to the extent used in and necessary to the operation of the Business without qualification, and permit the seller to retain a copy of the same Technology to the extent used in the retained business. 63 Moreover, even if Transferred Technology cannot be precisely defined in a transaction document, it is a tangible asset that

---

62 As a practical matter, in most instances the carveouts to the second part of the definition of Transferred Technology reduce the definition of Transferred Technology to copyable materials.

63 There may be exceptions for certain categories of Technology, including, for example, Technology retained by the seller to provide services to the buyer.
in practice will be transferred. Furthermore, even if Technology is transferred to the buyer, the seller may retain a copy of the same Technology. Nonetheless in certain situations it may be desirable, where practicable, for the Seller to not retain copies of technology used exclusively in the divested business.

4. Identifying Other Intellectual Property Rights

In most transactions involving a sale of a business or assets, there will be Technology that is needed by both the retained business and the divested business. Dealing with Transferred Technology involves two distinct but related exercises: (i) identifying and effectuating the conveyance of the Technology itself and (ii) assigning or licensing the rights embodied in the Technology. In other words, the buyer should ensure that in addition to obtaining the “goods” themselves (e.g., digital copies of a program, a specially designed machine or apparatus, a written copy of the “secret recipe”), the buyer should also ensure that its ongoing use and possession of those goods will not violate the seller’s Intellectual Property Rights.

Because Technology is the embodiment of copyrights (as a work of authorship) and trade secrets (as confidential information), defining Transferred Technology and Retained Technology forms the basis for identifying the unregistered Intellectual Property Rights embodied in that Technology (which we refer to as “Other Intellectual Property Rights”). Thus, once the parameters of Transferred Technology have been fixed, the parties should then determine which of the Other Intellectual Property Rights embodied in the Transferred Technology should be assigned to the buyer and which should be retained by the seller and licensed to the buyer. This can be thought of as a simple equation:

\[(x) \text{ the assigned Other Intellectual Property Rights} \quad plus \quad (y) \text{ the licensed Other Intellectual Property Rights} \quad equals \quad (z) \text{ all of the Other Intellectual Property Rights embodied in the Transferred Technology.}\]

Solving for \(x\) and \(y\) requires separating Transferred Technology and the Other Intellectual Property Rights associated with that Technology into distinct licensed and assigned components. This is often a difficult exercise and may prove to be impracticable in some situations. The discussion below proposes certain ways to address this problem.

While the following treats trade secrets and unregistered copyrights separately, many of the same principles apply to their treatment in a transaction. It is therefore common to have the same provisions apply to both. The parties can also choose to separate for special treatment particular items of Technology, such as the copyrights in certain discrete software programs or proprietary Technology.

---

64 Confirmation that all Transferred Technology necessary to a business is in the possession of the business is typically the subject of a sufficiency representation. See Section III.B.5.k below.
a. Trade Secrets

There is an important distinction between the rights arising from the ownership of registered Intellectual Property Rights and the rights associated with trade secrets. As we note above, patents and copyrights provide the owner with certain exclusive rights delineated by federal statute. Therefore, a license is essentially an agreement by the licensor not to enforce these clearly defined rights under certain conditions. In contrast, the parties to a trade secret license or assignment have nearly total freedom to specify the contractual relationship between the licensor and licensee, or assignor and assignee, of the trade secret. Furthermore, while the scope of a patent or copyright is clearly delineated, it can often prove difficult to describe with specificity what constitutes a trade secret.

If the rights of a licensee are sufficiently broad, there may be no practical difference between an owned and a licensed trade secret. Some general formulation, such as some variation of a primarily-related-to standard, may be adequate, and whether a trade secret is categorized as owned or broadly licensed is often more a matter of emotion or principle than one of substance. If, however, there are restrictions on the licensee that do not apply to the owner of the trade secret, the distinction between owner and licensee may have a profound effect on a party’s future freedom of conduct. In such a scenario, the distinction between an owned versus a licensed trade secret could be critical.

From the point of view of drafting the terms of the license, it is important to first seek to determine what each party can and cannot do with the Technology in its possession after closing. In other words, what conduct (e.g., field of businesses, territory, products, etc.) will be within the scope of the license? This determination requires balancing each party’s need to operate the retained or divested business freely against the desire for exclusivity (i.e., the desire to limit the other party’s freedom to operate).65 Once the parties are in agreement as to this balance, the scope of the licenses and the definitions can be formulated on a principled basis.

Where a party’s freedom to operate is paramount, the trade secret license grant should be functionally equivalent to a form of nonexclusive ownership, such that there is little or no practical difference between being the legal owner and the licensee of a trade secret.66 In that case, the difficulties involved in precisely defining who owns which trade secrets should become far less salient to the parties.

On the other hand, where a party places a premium on holding exclusive rights—which is often the starting point for a buyer that does not want the seller to have the ability

---

65 For example, there may be an information imbalance between buyer and seller (that is, the seller typically knows more than the buyer about how trade secrets relate to the divested and retained parts of their business) and because the buyer will want to be sure that the seller is not retaining copies of the purchased assets that will enable it to compete with the buyer (or perhaps even to sell the same assets to someone else).

66 Both the trade secret owner and licensee would have a claim against a third party that misappropriates the trade secret.
to compete with the divested business—the license to the other party may impose significant restrictions (for example, by imposing field-of-use or geographical restrictions, or by restricting sub-licensing or transfers). This will of course entail more risk for the licensee party going forward and require more intense negotiation. Furthermore, unless the licensed trade secrets can be distinguished from the owned trade secrets, there is the risk that the license limitations may apply to both owned and licensed trade secrets equally and may even cause the receiving party’s broader business to be “infected by” the license limitations. This could lead to significant future liability in connection with claims for breach of contract and trade secret misappropriation.

In some cases it will not be possible to agree on definitions and license terms that clearly define the scope of each party’s permitted conduct. The parties may then need to consider implementing some other mechanism to obtain analogous protection, most commonly in the form of a time-limited non-competition provision or a field-of-use restriction. These mechanisms are often necessary to give one or both parties sufficient assurance that, at least in the near term, an overly broad transfer and license of trade secrets will not enable the other party to compete outside the scope of the acquired business or retained business, even when the license grants are unlimited.

b. Copyrights

While the rights associated with copyrights are quite different from trade secret rights, copyrights can in many cases present the same issue of identification, especially when dealing with software and unregistered copyrights. For example, an acquired software product may be comprised of hundreds of subprograms and code libraries, some of which are shared between the seller’s retained products and the products acquired by the buyer. Furthermore, the products being acquired by the buyer may be derived from and closely related to products retained by the seller.

Thus, as is the case with trade secrets, it can be difficult in a deal of any complexity to distinguish with perfect clarity between those unregistered copyrights to be assigned versus those to be licensed. Rather, it is often better to take the same functional approach as applied to trade secrets: determine who can do what with what software or other copyrighted work, and then allocate ownership and license rights to support the desired outcome.

Once again, if there are specific copyrighted works of greater importance, most often distinct software products, it may be desirable to exclude these for the general terms applicable to Other Intellectual Property Rights and address them in a separately negotiated software license.

5. Representations and Warranties

Like all of the representations and warranties made by parties to an M&A transaction, the IP representations made by a seller to a buyer can play an important role in any acquisition agreement. The IP representations will play an important diligence function in
helping to paint a picture of the company or business being acquired; they will impact the buyer’s obligation to close the transaction; and, depending on the structure of the transaction, they will have implications for the buyer’s ability to recover damages in the event the representations turn out not to be accurate.

There are certain peculiarities connected to the nature of IP assets and licensing contracts that require attention in the negotiation of IP representations, which fall into the following broad categories: (i) IP asset identification and ownership; (ii) IP “quality” and “value drivers”; and (iii) IP risks, including infringement risk.

In this Section, we highlight the key issues underlying IP representations and discuss certain approaches to drafting representations dealing with IP. It is important to recognize that in a complex transaction, IP is only one of many considerations. As with tax, employment issues, real estate or other specialized areas of the law, the treatment of IP in an agreement will often need to be adjusted in light of the larger transactional framework into which it must fit.

a. Identification and Ownership of Business Intellectual Property Rights

The first representation relating to IP in most transactions is one requiring the seller to list in a disclosure schedule all of the Intellectual Property Rights of the Business. This seemingly simple representation appears in many forms. Rather than discuss all the variations this representation takes in practice, the following simplified form of the representation serves as the basis for the discussion that follows:

Schedule [●] is a complete and accurate list of all Business Intellectual Property Rights that are Registered Intellectual Property Rights.

In the case of a merger or other transaction in which a legal entity is acquired, the Business Intellectual Property Rights can be defined as “all Intellectual Property Rights owned or purported to be owned by the Business.” Registered Intellectual Property Rights refer to patents, registered copyrights, trademarks and other Intellectual Property Rights that are subject to registration, application or filing. As such, in a typical merger or stock sale it should be relatively easy to construct this schedule from the Business’s records. However, in a carve-out transaction, Business Intellectual Property Rights are usually defined for the purposes of the asset transfer (see Section III.B above), and therefore the schedule to this

---

67 For the purpose of this discussion, the entities or assets being acquired is referred to as the “Business.”

68 This representation will often include details as to how and in what detail the Intellectual Property Rights are listed.

69 The representation should be limited to Intellectual Property Rights and not include Technology.
representation will be the same as the schedule used in the definition of Business Intellectual Property Rights. Accordingly, while common, this representation as such conveys little new information.

It is common practice for this representation to require the listing only of Registered Intellectual Property Rights. Nonetheless, in some transactions a buyer will also require the seller to list unregistered Intellectual Property Rights (typically trade secrets and unregistered copyrights). However, listing unregistered Intellectual Property Rights may be neither practical nor desirable. For example, a requirement to list all unregistered copyrights would technically require the listing of nearly every document, note and email ever written by anyone at the company. Similarly, not only might it be impractical to list and identify trade secrets, the disclosure of the listing could itself imperil the listed trade secret.

Moreover, in a transaction to acquire the entire business of a seller (for example, in a public merger), it is unclear what the buyer gains from requiring the scheduling of unregistered Intellectual Property Rights; the buyer will receive ownership of all Business Intellectual Property Rights regardless of what is scheduled or whether it is material. Even in a transaction in which the seller provides the buyer an indemnity, the buyer would not have recourse if the seller omits to schedule a “material” unregistered IP asset if no indemnifiable loss would result from the omission.

Further, even limiting the listing to only material unregistered Intellectual Property Rights provides little benefit to the buyer, and both parties may be exposed to certain unnecessary risks, including characterizing (by omission) an Intellectual Property Right as not material in a manner that may be detrimental to the future enforcement of that right.

b. Ownership of Intellectual Property and Encumbrances

The foregoing scheduling representation is often followed by an ownership representation, for example:

(i) Seller owns exclusively and has good and exclusive title to each item of Business Intellectual Property Rights free and clear of all liens and encumbrances [other than Permitted Liens]; and (ii) Seller is the exclusive owner of all trademarks and trade names used in connection with the operation or conduct of the Business, including the sale of any products or the provision of any services by the Business.

The first part of this representation is often circular, since Business Intellectual Property Rights are defined as the Intellectual Property Rights owned (and in some cases “purported to be owned”) by the Business. However, the specification that the seller owns Business Intellectual Property Rights free and clear is important, since encumbrances either have to be released or may impact the value of the Business Intellectual Property Rights. The parties will negotiate the scope of encumbrances covered by the representation with the goal of excluding encumbrances that do not materially impair the Business’s ownership or use of the Business Intellectual Property Rights. For example, non-exclusive licenses
would not generally be considered encumbrances (or will be “Permitted Liens”). Depending on the nature of the Business, the scope of this representation may require the listing of Business Intellectual Property Rights that are subject to a security interest, Business Intellectual Property Rights that are jointly owned and Business Intellectual Property Rights that have been exclusively licensed to a third party. This representation may also include that the Business Intellectual Property Rights are not impaired or limited by any outstanding consent, settlement, decree, order, injunction, judgment or ruling.

c. Validity and Enforceability

There are often a number of representations that address the quality or value of the Business’s Intellectual Property Rights. Intellectual Property Rights are valuable only if they are valid and can be enforced against third parties that infringe or misappropriate those rights. A typical representation concerning IP validity and enforceability would state:

All of the Business Registered Intellectual Property Rights are subsisting, and [to Seller’s knowledge] are not invalid or unenforceable.70

While this representation is important when valuable Intellectual Property Rights are acquired, neither party can know with absolute certainty that the acquired Intellectual Property Rights are valid and enforceable. An issued patent, trademark registration or copyright registration generally provides the registered owner with only a presumption of validity. Registration is not a guarantee that the validity or enforceability of a patent, trademark or copyright will be upheld if challenged in a court or other relevant forum.

Particularly with respect to patents, it is not unusual for a significant percentage of patents to be held invalid when challenged. For this reason, many companies will build a portfolio comprised of a number of patents covering similar topics, since they expect that some of their patents will not survive a challenge. Moreover, the validity of an acquired patent is unlikely to be challenged unless the buyer seeks to enforce the patent against a third party after closing. For these reasons, a seller will often seek to include a knowledge qualifier and phrase the representation in the negative:

To the knowledge of Seller, no item of Business Registered Intellectual Property Rights is invalid or unenforceable.

As is true with many of the typical IP representations, prior to insisting on its inclusion, the buyer should get an understanding of the disclosure the seller may make in response to this representation. The buyer should balance the value of including this representation against the adverse admissions that may be disclosed because of the seller’s desire to limit its liability by broad disclosure against this representation. If there are significant potential issues around the validity or enforceability of the registered Intellectual Property Rights,

70 The representation may also include a representation that there are no claims regarding the validity or enforceability of the Business Intellectual Property Rights.
the issues may be addressed by limiting the effect of the seller’s disclosure (e.g., for purposes of avoiding fraud only). Alternatively, the foregoing representation may be replaced by one that does not elicit a subjective disclosure of facts:

None of the Business Registered Intellectual Property Rights has been held invalid or unenforceable and there are no pending proceedings or threatened claims challenging the validity or enforceability of the Business Registered Intellectual Property Rights.

This representation may also include a representation that the target’s registered Intellectual Property Rights are *subsisting*—in other words, that the issued patents, trademarks or copyrights are “alive” (but not necessarily valid or enforceable). The purpose is to ensure that the target has adequately maintained its patent, trademark or copyright registrations by, for example, timely filing required documents and paying fees. Whether a registration has been abandoned or is alive is generally ascertainable though a search of public databases. Thus, this issue can alternatively be dealt with as a diligence matter.

In negotiating this validity or enforceability representation in a transaction with an indemnity, careful consideration should be given as to how indemnifiable losses would be calculated in the event of a breach. See Section III.C.1 below.

d. **Maintenance of Registrations**

If legal due diligence has identified concerns about whether the seller has taken necessary steps to maintain its registered Intellectual Property Rights, then the addition of a representation concerning the proper protection and maintenance of such Intellectual Property Rights can be a useful addition to the “subsisting” representation discussed above. This may include a representation that all registration, maintenance, and renewal fees due have been paid and that all documents, recordations, and certificates required to be filed have been filed with the relevant authorities for the purposes of prosecuting, maintaining, and perfecting Intellectual Property Rights and recording the ownership interests:

Except where Seller has made a reasonable business decision not to maintain an item of Business Registered Intellectual Property, all applications, renewals and other applicable fees and steps required for the maintenance, protection and enforcement (as applicable) of the Business Registered Intellectual Property have been duly paid or taken on time. Schedule [●] lists all actions (including the payment of any fees) that are required to be made within 120 days of the date hereof to maintain or continue to prosecute all Business Registered Intellectual Property.

e. **Maintenance of Trade Secrets**

As discussed in Section II.B.4 above, information must remain confidential for trade secret status to be maintained. Accordingly, the equivalent of the validity and maintenance representation for patents and copyrights is a representation that the seller has used
reasonable efforts to maintain the confidentiality of its trade secrets and that there has been no misappropriation or unauthorized disclosure of any trade secret.

In addition, the parties may include additional representations regarding the seller’s efforts to maintain trade secrets, including, for example, that the seller has required all employees and contractors to execute confidentiality agreements (see Section III.B.5.j below), and that seller has not disclosed source code, or agreed to disclose, to any escrow agent or other person.

Seller has taken commercially reasonable steps to protect and maintain any material Trade Secrets (including any material confidential Business Data or other material confidential information) included in the Business Intellectual Property and, to the knowledge of Seller, there have been no material unauthorized uses or disclosures of any such Trade Secrets. Without limiting the foregoing, each current and former employee of the Business who developed, invented or contributed to any Intellectual Property or Technology while an employee of the Business, and each contractor or third party engaged by the Business to develop any Intellectual Property or Technology for the Business, has assigned to the Business its rights in and to any such Intellectual Property and Technology either (i) by operation of law or (ii) as a result of such employee or contractor entering into a Contract under which they have assigned all such rights, except as may be limited by applicable Law.

f. No Infringement by Third Parties

The value of the Business Intellectual Property Rights can be diminished by third parties infringing those rights, and it is not uncommon to negotiate for the inclusion of a representation to address this situation:

No third party is infringing the Business Intellectual Property Rights.

Depending on the nature of the business, it is possible that the seller is aware of many instances where third parties may be violating Business Intellectual Property Rights but has made a business decision not to take enforcement action against such infringers. For example, the seller may be aware that third parties and customers are using or displaying marks in a way that would technically be a violation of the seller’s trademarks, but such infringement may not be viewed by the seller as significant enough to warrant enforcement action. Therefore, a buyer should carefully weigh the advantages and disadvantages of this representation, including:

- If the seller makes disclosures relating to the representation, will the knowledge of such infringement adversely affect the buyer’s ability to sue for infringement at a later date?
- Could the buyer show any damages if the representation is breached?
- Is the issue better addressed as a diligence matter?
An alternative to the foregoing representation would be one that requires the disclosure of only specific attempts of the seller to enforce its Intellectual Property, and does not require the seller’s subjective judgment as to what should be disclosed:

In the past [●] years there have been no proceedings, and Seller has not brought or threatened any claim, regarding the infringement of the Business Intellectual Property Rights.

g. No Infringement by the Business

Often, the most contentious IP representation in a transaction is the one concerning non-infringement. It is generally perceived that the greatest risk to a buyer is that the buyer or the acquired Business may be sued by a third party for IP infringement, which may have the potential to disrupt the closing or cause significant post-closing liability. While parties tend to view this risk as a pure deal issue of who should bear this risk, there are a number of deal-dependent subtleties that need to be considered in crafting and negotiating this representation.

For the purposes of this discussion, consider the following simplified form of the representation:

[To the knowledge of Seller] the operation of the Business does not[, has not] [and will not] infringe, dilute, misappropriate or otherwise violate the Intellectual Property Rights of third parties [in a manner that could reasonably be expect to be materially adverse to the Business].

[There have been no threatened, asserted or pending claims [in the past [●] years] alleging that the operation of the Business infringes, dilutes, misappropriates or otherwise violates the Intellectual Property Rights of third parties.]71

In assessing this representation and its variations, several questions should be considered:

- What constitutes infringement?
- How likely is it that there is infringement or that there would be a claim of infringement, and is the risk for the seller greater than the norm for the industry?
- Is the representation only a closing condition or is there an indemnity?

---

71 On occasion, one will encounter versions of this representation stating that “the Intellectual Property Rights of Seller do not infringe the Intellectual Property Rights of any third party.” As a technical drafting matter, there are potential issues with this formulation. Only conduct, such as some past or present product or operation of the target’s business, can infringe third-party IP. Intellectual Property Rights by themselves cannot infringe other Intellectual Property Rights. To be accurate, the seller should represent either that the use of the IP of the Business or the operation of the Business does not infringe any third-party IP.
• What is the potential magnitude of a loss resulting from a breach of this representation?

_What constitutes infringement?_ Infringing conduct is a function of the type of Intellectual Property Right being violated (see Section II.B above). Patent infringement can occur unknowingly and without intent, but copyright infringement, trademark infringement and trade secret misappropriation are generally based on some knowing, and in some cases, intentional conduct. It is also important to bear in mind that a typical patent non-infringement representation covers not only the products made by the Business but also any third party’s products or services used or sold by the Business.

_What is the likelihood that a third party will make an infringement claim?_ The likelihood that a third party may make a claim of infringement depends on a number of factors, including the relevant industry, markets, the competitive landscape, the length of time a product or service has been in the market, the diversity of the products, product revenue, the origin of the products and employee profile, and even the profile of the buyer. In some cases, the likelihood of an infringement is minimal; in others, the transaction or the identity of the buyer is likely to attract attention and almost certainly result in a claim. This is a complex analysis and it is important to understand the risk of a claim before negotiating the representation.

_What is the likely consequence of a breach of the representation?_ Typically, a successful claim of patent or copyright infringement results in the recovery of monetary damages. Although less common, a court may also enjoin future infringing conduct. In the case of patent infringement, the liability is typically a percentage of the sales revenue (a “reasonable royalty,” which varies with industry) for the infringing product for up to six years of prior infringement and a royalty-bearing license for future conduct. As trade secret liability generally arises from improper conduct such as theft, an injunction and significant damages are possible.\(^72\) It is usually possible to get a rough idea of potential liability in the diligence process that will inform the negotiation of the representation.

_What effect would an infringement claim have on the transaction?_ In a typical public company merger transaction where the accuracy of the representations are a closing condition, it is unlikely that a claim of IP infringement will rise to a level of materiality that would give a party the right not to close. In a transaction in which there is a post-closing indemnity (or representations and warranties insurance), the terms of the representation are far more significant. Particularly in asset transactions, the terms of the representation need to be considered in light of how the indemnity is drafted and the allocation of pre- and post-closing liability. See Section III.C below for additional information.

Is the infringement representation knowledge qualified? The issue most likely in contention in the infringement representation is whether it should be knowledge qualified, particularly with respect to patent infringement. There are a number of arguments that can be made on either side of the argument and often the outcome is determined by the party with the most leverage.

The question of whether to include a knowledge qualifier is particularly relevant to the patent infringement representation. Infringement of copyrights or misappropriation of trade secrets generally requires intentional conduct that the seller is more likely to know about than the buyer. In light of this information imbalance, it is less common to add a knowledge qualification to representations regarding infringement of copyrights and misappropriation of trade secrets. However, patent infringement does not require intentional conduct, and it is often not possible or desirable to diligence the issue. In many cases, neither the seller nor the buyer is in a better position to assess the risk.

Especially in the case of a knowledge-qualified patent non-infringement representation, which is unlikely to be breached absent fraud, a seller may seek to limit its exposure by disclosing instances where it believes the Business is infringing. In addition to limiting the effectiveness of the representation, there is the risk that by giving the buyer notice of potential infringement, the buyer would be exposed to greater damages post-closing as a willful infringer.

If the patent non-infringement representation is knowledge qualified, it may be advisable to mitigate the risk of the seller’s disclosure by instead limiting the representation to one that states that the seller has not received any notice of any alleged infringement, nor has the seller sought or obtained a legal opinion regarding infringement.

When a knowledge qualifier is used and the definition of Knowledge includes an obligation of reasonable inquiry or investigation, the parties should consider including an exclusion so that “reasonable inquiry or investigation” does not require individuals to conduct IP searches or analyses (including clearance or prior art searches) or obtain legal opinions (including freedom-to-operate opinions).\(^73\)

It is also common and potentially beneficial to include some materiality qualifiers in the representation so that the seller is not forced to disclose every instance of potential infringement. Without such qualifiers, the scope of disclosures in the disclosure schedule may be undesirable from the buyer’s perspective. Look-back periods are also used to limit the burden of disclosure. Often, look-back periods extend to infringement in the past. In considering whether to limit the look-back period, the relevant statute of limitations should be considered (three years for copyright infringement and trade secret misappropriation and six years for patent infringement). In addition, this representation may also include a

\(^{73}\) Nonetheless, it may be advisable to conduct diligence and obtain a representation that the seller has not conducted any infringement investigations or obtained any legal opinions on the subject. A patent freedom-to-operate opinion can take several weeks to prepare and may be expensive.
statement that there have been no threatened, asserted or pending claims alleging that the

h. Material Intellectual Property Agreements

The agreements under which a company licenses Intellectual Property Rights to
third parties—outbound licenses—and those under which it licenses Intellectual Property
Rights from third parties—inbound licenses—often form an important part of the contra-
tual matrix in which a company operates. These IP licenses may be covered either under a
generic representation concerning material contracts, in the IP representations or in some
combination of the two. Typically, although this is more a matter of style than substance,
the IP licenses would be defined in the IP representations (often along with representations
that are specific to IP (for example, exclusivity or transferability)). In this approach, the
contracts representation would then include IP agreements in the definition of material
contracts so that the general material contract representations would apply as well.

Generally, the seller is required to list a Business’s “material” IP agreements. The
definition of materiality varies with the Business. For example, materiality can be based
on various criteria such as the monetary value of expected expenditures or whether the IP
at issue relates to a particular product. Alternatively, the requirement to list material IP
agreements can be defined by exclusion. For example, material IP agreements can be de-
defined as:

All IP agreements other than (i) in-bound IP Agreements for generally avail-
able licenses for commercial off-the-shelf, “shrink-wrap” or “click-wrap”
computer software; (ii) agreements granting nonexclusive licenses to IP en-
tered into in the ordinary course; and (iii) outbound agreements pursuant to
which the total consideration paid or payable is less than $[●].

In addition to the standard representation concerning material contracts, the IP agreements
representation may include the following representations, which may apply to all IP agree-
ments, and not just the material IP agreements that are scheduled:

All IP Agreements are [fully transferable] [and/or will survive the transac-
tion].

Upon the consummation of, or as a result of, the transaction (i) no material
terms of the IP Agreements (e.g., term or royalty rate) will change; (ii) none

74 The location of the representation may be significant, since in some cases the survival period for IP representations
may be longer than for other representations.

75 Thus, for example, representations regarding an agreement being valid and binding, in full force and effect, and the
absence of a breach or violation, which are applicable to material contracts, would apply equally to the IP agreements
covered in the contracts representation.

76 The appropriate language will depend on the transaction structure.
of Buyer’s existing IP operations or assets will be subject to, or adversely
effected by the terms of any IP Agreement;\(^\text{77}\) and (iii) neither the Business
is or will be, nor will the business or operations of Buyer be or become,
subject to any non-competes, exclusivity, or other limitations.

i. Obligations to License

In certain situations, a Business may be contractually obligated to license its IP to
a third party on unfavorable terms. Particularly in the electronics industry, if an entity
actively participates in a standards setting organization (for example, the Institute of Elec-
trical and Electronics Engineers), it may be obligated to license any of its patents that are
essential to the standard on reasonable and non-discriminatory ("\textit{RAND}\") terms to anyone
that wants to manufacture products in conformity to the standard. Similarly, government-
 funded development agreements typically grant the government rights to any Intellectual
Property Rights that arise from the development efforts conducted pursuant to the agree-
ment. If there is a concern about this possibility, the buyer may insist on a representation
that the Business is not a member of any standards setting organization and has not received
government or other public funding for the development of its Technology.

j. Employee Intellectual Property Assignments and Confidential-
ity Agreements

This is a representation intended to confirm that the Business owns all material IP
developed by its employees and independent contractors and has protected the confidenti-
ality of its trade secrets. Generally, the representation takes the following form:

All employees and third-party contractors engaged in the development of
any material IP for the Business have entered into the Business’s standard
form “[Employee/Contractor] Confidentiality and Invention Assignment
Agreement,” and all rights to such IP are owned exclusively by the Busi-
ness.

While it is recommended that the employee invention assignment and confidentiality
agreements (“IA&C”) be reviewed in due diligence, the adverse impact of an employee not
having executed such an agreement may be limited in practice.\(^\text{78}\) See Section II.B.3.a
above for further information on ownership of copyrights and works made for hire.

\(^\text{77}\) This can be a significant issue for buyers that own material IP that could be covered by an outbound license of the
Business.

\(^\text{78}\) Even absent a written agreement: (i) copyrights authored by an employee automatically are owned by the employer as
works for hire; (ii) employees are typically bound by company policy and practice to maintain the Business’s confidential
information and trade secrets and (iii) while a patentable invention initially belongs to the employee/inventor of the pa-
tent, an employee will typically assign the invention to the employer upon filling the patent application.
k. Sufficiency

A sufficiency representation is typically a separate stand-alone representation to the effect that the assets (including the Intellectual Property Rights) of the Business, along with the services to be provided under the transition services agreement (if there is one), are sufficient to conduct the Business post-closing in substantially the same manner as it was conducted pre-closing. While some form of this representation is frequently sought, it is often resisted by sellers (particularly where discrete assets may constitute less than a “business”), and where agreed to, it is common to carve out non-infringement from the general sufficiency representation. Without this carve-out, the sufficiency representation would also function as a non-infringement representation: if the Business is operating without all of the necessary Intellectual Property Rights by ownership or license, it is infringing a third party’s rights.

It is also not uncommon for parties to provide for a separate sufficiency representation for IP alone. For example:

The Business owns or has a valid and enforceable license to all Intellectual Property Rights necessary to operate the Business following the Closing in the same manner it was conducted prior to the Closing.

Like the general sufficiency representation, this representation may also be equivalent to a non-infringement representation, and it therefore may be preferable to address concerns about infringement in a precisely worded non-infringement representation (about which see Section III.B.5.g above). If, however, the buyer is concerned that as between it and the seller, it is getting all the seller’s IP required for the Business either though the transfer of IP ownership or through a license from the seller, the following is appropriate and avoids creating a potentially unintended non-infringement representation:

The Business Intellectual Property Rights and the Intellectual Property Rights licensed from Seller to the Business are all the Intellectual Property Rights of Seller used in or necessary to operate the Business following the closing in the same manner it was conducted prior to the closing.80

---

79 For example, “the foregoing is not intended to be and shall not be construed as a representation as to the non-infringe-
ment of any third party’s Intellectual Property Rights. Section [●] sets forth the sole and exclusive representation with
respect to non-infringement of any third party’s Intellectual Property Rights.”

80 In addition, the covenants will often provide the buyer assurance that after the closing the seller will transfer or license
to the buyer any of the seller’s Intellectual Property Rights necessary for the operation of the business that were not
included as of the closing. See Section III.B.6.f.
1. Open Source

At a very general level, open source software is software licensed under an open source license.\(^81\) There are many forms of open source licenses, ranging from merely requiring the licensee to include a notice in its software that such software includes licensed open source, to “viral” licenses like the GNU General Public License (the “GPL”), which requires a licensee that distributes\(^82\) software including or based upon the GPL open source to also make available its source code under the same provisions as the GPL.\(^83\) It is this sort of viral license that is of most concern to buyers. In the worst case, the seller may have compromised or lost its right to control or monetize its software, and the buyer faces the same risk if it combines the acquired software with its own proprietary software. This risk needs to be balanced by the fact that nearly every business now uses open source to some extent.

The risks associated with open source are highly dependent on the nature of the Business. Open source issues should be addressed early on the diligence process, and the form of the representation should reflect the particular situation. It may not be possible for a Business to list all open source software it uses. However, in the absence of more information to craft an open source representation tailored to a particular Business, it may be advisable at least to confirm that the business is not subjecting its proprietary software to the terms of an open source license. For example:

The Business has not used Open Source in a manner that would require the Business to make available or license the source code for its proprietary software under the terms of an open source license.

Alternatively, if open source is an issue, it may be advisable for the seller to preemptively conduct and make available to the buyer an open source scan (e.g., a “Black Duck” audit) of the software products it distributes. Where an open source scan is available, it may be possible to rely on the following form of representation:

Seller has provided to [Black Duck] for the purpose of doing an open source scan (the “Scan”) a copy of the source code for all the software seller distributes, a complete and accurate copy of the Scan has been made available

---

\(^81\) See What is Open Source?, OPENSOURCE.COM, https://opensource.com/resources/what-open-source. Open source licenses are generally form agreements that have been drafted by the open source community over time. They are often poorly drafted and open to a range of interpretations. As such, experience is needed to assess open source issues, which in many cases depend on the prevailing views of a decentralized open source “community.”

\(^82\) Under most, but not all, open source licenses, if the open source is used to create code that is used only internally and not distributed or to provide a service, there is no obligation to license proprietary source code under the open source terms.

\(^83\) In most cases, companies that license software products license their software in object code (machine-readable) form only, and maintain the source code that generates the object code as a closely guarded and valuable secret.
m. Data Security

Data collection has become more prominent in many businesses today. As such, data security representations are increasingly important to buyers because of the increased regulatory focus on data collection and privacy, together with the potential risk associated with data breaches. This is particularly the case where a business collects personally identifiable or sensitive information, such as social security numbers, health records, etc.

It is generally a best practice for businesses today to have an internal policy with respect to the collection and use of company data and an external, customer-facing privacy notice if the business has a practice of collecting customer data. Depending on the nature of the business and the jurisdiction in which the business operates, there may be laws requiring such policies. For example, under the CCPA (discussed in Section II.C.3 above), companies must make their website privacy policy accessible to the public, and must provide consumers with the ability to cause the company to delete their private information. Often, transaction documents will include a representation regarding the existence of and compliance with privacy policies and external company statements.

Such a representation may also include references to an information security policy, which is an internal policy that outlines best practices for administrative, technical, and physical safeguards for handling the business’s sensitive data. Depending on the business, this representation may include specific references to a written information security program (a “WISP”) incorporating specific requirements under the Gramm-Leach-Bliley Act and the Massachusetts Data Security Regulation. For example:

The Business has implemented written policies relating to the collection, storage, use, access, disclosure, processing, security, and transfer of personal data, including, without limitation, a publicly posted privacy policy and a comprehensive information security program that includes appropriate written information security policies (“Privacy and Data Security Policies”). At all times, the Business has been and is in compliance with all such Privacy and Data Security Policies, has at all times made all disclosures to users or customers required by applicable laws, and none of such disclosures made or contained in any such Privacy and Data Security Policies has been inaccurate, misleading or deceptive or in violation of any applicable laws. The Business has provided all necessary notifications to, and has obtained all appropriate consent from, persons regarding its collection, storage, use, access, disclosure, processing, security, and transfer of personal data.

Privacy and data security can be an area with risks of significant liability. However, it is generally difficult for a buyer to ascertain through due diligence whether the seller is operating the business in compliance with privacy and data security laws and regulations. As
such, it is increasingly common to see transaction documents include a specific representation that the seller has complied with all applicable laws and regulations concerning privacy and data security (although these matters may also be covered through a more general representation concerning compliance with law). Depending on the nature or industry of the business, the representation may also identify compliance with specific laws or regulations (e.g., PCI-DSS, HIPPA); however, the buyer should be aware of the disclosure obligation this may place on the seller. For example:

The Business has at all times complied in all material respects with all applicable information privacy and security Laws, all of the Business’s privacy policies and all their contractual obligations to any Person regarding privacy and data security, or the processing of personal data. The Business has not received notice from any applicable governmental entity alleging a violation of any information privacy and security Laws by the Business, nor has the Business been threatened to be charged with any such violation by any governmental entity.

The Business contractually requires all third parties, including vendors, affiliates, and other persons providing services to the Business that have access to or receive personal data from or on behalf of the Business to comply with all applicable privacy Laws, and ensure that all Business personal data in such third parties’ possession or control is protected against damage, loss, and against unauthorized access, acquisition, use, modification, disclosure or other misuse.

Similarly, unless the seller has made a public disclosure or provided documentation, it is difficult for a buyer to discover whether the seller has had past data privacy or other security breaches or instances of security-related claims or investigations. Transaction documents often include a representation that the seller has not had any material data breaches or security incidents and that there are no pending or threatened claims, complaints, investigations, or enforcement actions against the seller relating to its privacy and data security practices. This representation may be subject to a look-back period of a specified number of years. For example:

Since [●] the Business has [taken commercially reasonable steps (including, without limitation], implementing, maintaining, and monitoring compliance with government-issued or industry standard measures with respect to administrative, technical and physical security) to ensure that all personal data in its possession or control is protected against damage, loss, and against unauthorized access, acquisition, use, modification, disclosure or other misuse.

There has been no unauthorized access, use, or disclosure of personal data in the possession or control of the Business [or, to the Knowledge of the Business, any of its contractors with regard to any personal data obtained
from or on behalf of the Business, nor has there been any unauthorized intrusions or breaches of security into any Information Systems].

There is no pending, nor has there since [●] been any, complaint, audit, proceeding, investigation, or claim against the Business initiated by any person, entity or government alleging that any collection, storage, use, access, disclosure, processing, security, and transfer of personal data of the Business: (i) is in violation of any applicable privacy laws; (ii) is in violation of any applicable Contracts; or (iii) is in violation of any Privacy and Data Security Policies.

The Business has implemented and maintained, consistent with its contractual and other obligations to other Persons, commercially reasonable security and other measures necessary to protect all computers, networks, software and systems owned or controlled by the Business and used in connection with the operation of the Business (the “Information Systems”) from viruses and unauthorized access, use, modification, disclosure or other misuse. Since [●] there have been no unauthorized intrusions or breaches of the security of the Business’s Information Systems.

6. Covenants

Regardless of whether the transaction is an asset sale or a public-public merger, or anything in between, except in simultaneous sign-and-close transactions (e.g., where no pre-closing regulatory approvals are required), there is a period between signing and closing during which each party is required to fulfill certain covenants. In the case of IP matters, these covenants are typically directed to preserving the value of the target’s IP, maintaining the status quo with respect to the target’s IP-related activities and ensuring a smooth handover of the business. When representing the seller, it is particularly important to confirm that the seller is able to comply with the covenants in the agreements and that the obligations imposed are consistent with the seller’s existing business operations, systems and controls.84

a. IP Interim Operating Covenants

The covenants are intended to strike a balance between, on the one hand, assuring that the seller takes (or refrains from taking) actions necessary to preserve its IP assets, and, on the other hand, not disrupting the operation of the target business prior to closing. Further, the covenants should reflect the complexities of the relevant IP and the role that business judgement may play in a business’s management of its IP.85 However, it is often

84 For example, when the Seller is a multinational entity, the Seller may be confident that it can comply with the covenants in the United States but may lack the processes and controls to assure compliance outside the United States.

85 For example, a Business may reasonably determine that it is not in its interest to continue to incur the expense of maintaining a patent, or that it would be counterproductive and risky to attempt to enforce its IP against an infringer.
difficult when negotiating the interim covenants to anticipate all of the conduct that may affect the target business IP. Thus, covenants are usually subject to an “in the ordinary course and in accordance with past practice” qualification. In many cases the seller can seek the buyer’s consent if it is unclear whether an particular action is permitted or required. In addition to the practical limitations on the seller’s ability to comply with overly prescriptive interim covenants, the scope of the covenants may be constrained by antitrust “gun-jumping” rules.

Covenants intended to preserve a business’s IP will often (i) prohibit the seller from abandoning, disposing of, granting licenses, assigning, or otherwise encumbering or taking other adverse actions with respect to the IP assets and (ii) require the seller to make necessary actions to maintain and enforce its Intellectual Property Rights, including making the necessary filings and payments to maintain its registered Intellectual Property Rights and to timely file applications for registered Intellectual Property Rights.

b. **IP Prosecution Files and Maintenance Deadlines**

Depending on the nature of the business and the relative value of the registered Intellectual Property Rights, the buyer may also want to include a covenant that requires the seller to deliver the files necessary for the continued prosecution and maintenance of the registered Intellectual Property Rights. Such a covenant may also include an obligation to provide lists of maintenance or renewal fees and filings that are due in the months immediately following the closing so that the buyer can ensure that no deadlines are missed when it assumes responsibility for maintaining the registered Intellectual Property Rights after the closing.

c. **Security Interests and Chain of Title**

If the parties identified any unreleased security interest or chain-of-title issues and such issues were not corrected before signing, the buyer may seek a covenant requiring the seller to release the security interests and make necessary filings to correct the chain-of-title issues prior to closing. If there are specific IP assignments from former and current employees or contractors that were not obtained or were insufficient, the buyer could also seek a covenant for the seller to obtain such assignments.

d. **Third-Party Consents**

Depending on the transaction structure, some of the seller’s material contracts may need to be individually assigned to the buyer, or the seller may need to obtain the consent of a contractual counterparty in order to assign the contract due to change-of-control provisions triggered by the transaction. In this case, the buyer will often seek to require the seller to agree to a pre-closing covenant (and/or, in a private company transaction, a closing condition) requiring the seller to obtain some or all consents required to assign such contracts. IP license agreements are considered personal and not transferable in the ordinary course, and even absent language to the contrary will not be considered transferable without the consent of the licensor. Care should therefore be taken to determine which critical
IP agreements should be included in the general covenant to obtain such third-party consents.

e. Open Source

If the due diligence process identified issues with open source software, the buyer may seek a covenant requiring the seller to complete certain source code remediation and other related activities (for example, updating or replacing software to ensure compliance with open source licenses and to eliminate potential inadvertent grants of open source licenses to third parties).

f. Wrong Pockets

Transaction agreements may include a general “wrong pockets” clause that provides that assets that had been retained by the seller for the retained business and are later identified as belonging to the target business will be transferred to the buyer (or vice versa). For example, in an asset purchase, the registered Intellectual Property Rights that transfer to the buyer are typically identified on a schedule (see Section III.B.2 above). If a patent, trademark, copyright or domain name is accidentally omitted from the schedule, then such asset may not be transferred or licensed to the buyer in connection with the asset purchase. The wrong pockets covenant is often used to mitigate this risk. For IP assets, a covenant can be included that amends and updates the schedule of transferred or licensed Intellectual Property Rights to include any retained Intellectual Property Rights that meet the relevant criteria for transfer or license as of the closing.

g. Further Assurances

After closing, there may be actions required of the seller in order to transfer the IP assets to the buyer. For example, short-form assignment agreements are typically executed and filed with the relevant government authority to effectuate the transfer of patents, registered trademarks and registered copyrights. In the case of Internet domain names, short-form assignment agreements are also helpful, but the seller may need to take other actions with an Internet domain name registrar to process the transfer of ownership, such as requesting authorization codes from the Internet domain name registrar. Depending on the foreign jurisdictions in which the target business has registered Intellectual Property Rights, there may be other specific actions that need to be taken after closing. To address this concern (also as to non-IP matters), most transaction agreements include a general further assurances provision that would require the seller to take all reasonable actions to transfer fully the target business to the buyer after the closing. In some cases, the buyer may seek to include an additional provision that requires the seller to timely execute all documents or instruments, and take all other actions reasonably requested by the buyer, to transfer the IP assets.

h. Transitional Trademark License

In certain transactions, the parties may need a license to continue using certain trademarks for a limited period after closing while such party transitions away from using
the trademark. For example, the seller may be retaining the house brand or other trademarks that had been used in the target business. Once the target business is in the buyer’s control, the buyer may need a license for the target business to continue using trademarks associated with the seller for a period while the target business transitions away from using such trademarks, for example, in its stationary, signage and websites or to sell off remaining product. Similarly, when the target business is purchased by the buyer, the seller may need to continue using certain trademarks that were sold along with the target business. If applicable, such a provision may also include an obligation for the target business to change its name to one that does not include any of the seller’s retained trademarks or vice versa. It may also be necessary for the parties to allow for transitional domain name and email use, such as redirecting webpages and forwarding email accounts. In many transactions, a transitional trademark license can be addressed as a provision in the transaction agreement. However, if the transitional trademark license requires additional complexity or an extended duration, the parties may choose to enter into a separate trademark license agreement.

i. IP License

As discussed in Section III.A.b above, in a carve-out transaction, there may be IP that is shared between the target business and the retained business. In such a case, the buyer will need a license from the seller to use the IP that is used in the target business but retained by the seller. The complexity of the license to shared IP may determine whether the IP license is best addressed as a provision in the transaction agreement or as a separate IP license agreement. See Section IV below for additional information on drafting IP licenses.

C. Indemnification and Other Forms of Recourse

Anyone engaged in M&A is familiar with the concept of indemnification, which is one of the primary mechanisms for obtaining recourse for a breach, or for shifting risk or loss, in a transaction.86

Derived from the Latin roots in- and damnum, meaning to be unhurt or secure from injury, indemnification generally refers to the contractual obligation of one party to hold another harmless. Indemnities typically also include the separate but related obligation of the indemnifying party (or indemnitor) to defend the indemnified party (or indemnitee) against claims made by third parties. Indemnification can be a remedy for breaches of representations and warranties, or other contractual provisions, or can be a freestanding allocation of loss or risk.

The common law of contract does of course provide default consequences for breach; a party to a contract that has suffered a breach by a counterparty can (unless the

86 In recent years, representations and warranties insurance has become more common in private M&A transactions as a means of protecting a buyer in respect of seller breaches. Many of the principles articulated here with respect to indemnification will be relevant in considering the coverage of such insurance, where applicable. See Section III.C.9 below.
contract provides otherwise) sue for breach of contract and if successful receive contract damages. There are a number of ways in which contract damages are calculated, but the general principle is to award the non-breaching party monetary damages equal to the loss it suffered as a result of the breach, so as to put it in the position it would have been had the breach not occurred. However, the breaching party is generally not required to compensate the non-breaching party for consequential damages or damages that were not reasonably foreseeable. Moreover, contracts will often expressly exclude liability for punitive damages, lost profits, diminution of value, special or incidental damages, and other forms of consequential damages.

In many cases, the parties to an agreement may consider the default common law recovery to be inadequate: compensation for direct damages may be insufficient to make the non-breaching party whole or adequately allocate risk between the parties. An indemnification clause, especially in the M&A context, can be extremely helpful in addressing this limitation by, among other things, providing for the recovery of damages that may not otherwise be considered recoverable as direct contract damages. In addition, a typical indemnification provision will further allocate risk by specifying upper and lower limits to the indemnification obligation, by providing for specific types of damages to be included or excluded and by specifying procedures and time limitations for indemnification. The specificity that can be provided in an indemnification clause can achieve the parties’ goals much more precisely than simply relying on a breach of contract claim and greatly enhances both certainty of outcome and efficiency of enforcement.

As we discussed in Section III.A, indemnification is only a feature of private transactions and not public company deals. In a public company deal, once the transaction closes and the consideration has been distributed to thousands of shareholders, there is no way to recover that consideration to pursue an indemnification claim. The only protection available in a public company deal is to find out about a problem in advance and, if it is large enough, to walk away from the deal.

All of the above is as true for contractual provisions in general as it is for IP. There are, however, specific considerations relating to indemnification when it comes to IP assets and liabilities, which we will consider in this Section. As a preliminary matter, it is important to remember that IP is only one of several classes of assets and liabilities dealt with in a typical M&A transaction. Unless it is clear that the transaction in question is fundamentally an IP deal, the broad transaction and indemnification parameters—survival, baskets, caps and so on—will likely be established for the business as a whole, and the IP lawyers often have to simply “fit in” with what has been agreed for the overall transaction. That said, it is important to understand what might justify distinct treatment for IP and when that treatment might be appropriate.

1. Indemnification for Breaches of IP Representations and Warranties

As described in Section III.B.5 above, representations and warranties regarding IP fall into several categories. Two important general categories are (i) those representations
addressing whether the seller (or target company) is infringing, or has infringed, the Intellectual Property Rights of a third party (often referred to as the “non-infringement representations”) and (ii) those addressing the “quality” of the acquired Intellectual Property Rights, including unencumbered ownership, validity and enforceability and infringement by third parties.

While indemnification will generally apply to a breach of any of the seller’s representations and warranties, a breach of the non-infringement representations is the type most likely to result in payment of material damages to a third party that may not be considered direct damages. Moreover, in the case of patent infringement in particular, in many cases, neither the seller nor the buyer is in a clearly better position to estimate the likelihood that this representation has been or will be breached. Consequently, this representation raises concerns that are not present in breaches of other types of representations and may therefore be more difficult to address with standard indemnification provisions.

A successful infringement claim made by a third party will likely result in monetary damages. Moreover, in some cases, the third party may obtain preliminary and permanent injunctive relief that could potentially shut some or all of the acquired business down or result in it being unable to sell its products. Monetary damages can be recovered for up to six years of past infringement. While a patent holder is entitled to recover actual damages for infringement, in the majority of cases patent damages are calculated on the basis of a reasonable royalty applied to infringing sales. Typically, the non-infringement representation will apply to both infringement that occurred prior to closing and continues after closing, or only arises after closing. Consider the situation where some amount of breaching activity may have preceded the transaction (and thus have occurred “on the seller’s watch”), but the buyer has continued breaching after the closing (that is, “on the buyer’s watch”). How should the indemnity allocate the resulting liability?

The wording of the indemnity is significant in determining if the indemnitee can recover for a breach of the non-infringement representation. As shown below, a typical M&A indemnity will not clearly address many of the situations that arise from a breach of intellectual property representations. Accordingly, if a claim is a significant possibility, it

---

87 See William C. Rooklidge et al., COMPENSATORY DAMAGES ISSUES IN PATENT INFRINGEMENT 12 (Federal Judicial Center, 2d ed. 2017) (“In most patent cases, the patent owner seeks reasonable royalty damages…”).

88 For example, patent infringement that did not exist before closing can arise after closing for a number of reasons, including infringement of a patent issued to a third party after the closing, the loss of an inbound patent license as a result of the transaction, or a change in the conduct of the business after the closing.

89 Whether in the first instance the buyer would even be liable for this liability depends on the nature of the transaction. In an asset sale, absent agreement to the contrary, the buyer would generally not be considered a successor and so would have no liability for pre-closing infringement. Typically, such liability would be considered an excluded liability for which the seller would fully indemnify the buyer. However, if, as is the case in some asset acquisitions, the buyer agrees to assume this pre-closing liability, the buyer would need to indemnify the seller because regardless of how the buyer and seller allocate this liability between them, the seller may be sued for infringement.
is important to consider the following questions and whether IP representations require differential treatment.

First, does the indemnity apply to breaches of the representations only or also to claims which if true would constitute a breach? If it is the former, the indemnitee faces the dilemma that if it is successful in defending the claim of infringement it will not be able to recover its defense costs which can be considerable. If, however, it is not successful, it could be exposed to damages well in excess of the indemnity. If the indemnity includes the obligation to defend against a claim, the indemnitee needs to consider the risk of not fully controlling the litigation.\footnote{It is unlikely that the indemmitor will agree to indemnify for defense costs without at least having the option to control the litigation.}

Second, to state the obvious, an indemnification claim for a breach of the non-infringement representation is unlikely to be made unless there is a third-party claim. It is very unlikely that it would be in the buyer’s interests to admit infringement in order to seek indemnification absent such a claim. However, consider the scenario where the buyer approaches a third party for a license, based on its belief that the license is necessary to avoid, or in anticipation of being sued for, infringement, but does not admit being an infringer or there ever having been a finding that it is an infringer. Unless the indemnity expressly address this scenario, an indemnitee will have to balance the benefit of proactively avoiding a claim and foregoing indemnification against the risk of a claim which could result in damages in excess of the indemnity.

Third, what losses are covered by the indemnity? For example, losses may be broadly defined as “any and all losses, costs, obligations, liabilities, settlement, payments, awards, judgments, fines, penalties, damages, diminutions in value, deficiencies, or other charges.” Some of these losses would be considered direct contract damages, while others (\textit{e.g.}, “diminutions in value”) would generally be considered consequential damages that are not ordinarily recoverable in claim for breach of contract. Nonetheless, one function of the indemnity should be to allow a party to recover for all of these losses regardless of whether they would be recoverable in a breach of contract claim.

Typically, and especially in the case of patent infringement, a successful claim results in the defendant paying both damages for past infringement and prepaid royalties or ongoing royalties for a future license. The allocation of these damages and future royalty payments can be significant, since the future royalty payment may exceed the damages for past infringement.\footnote{A patent holder can recover up to six years of past damages, although patents generally have a 20-year term.} In addition, since damages will be based on the basis of the revenue derived from the infringing product, the losses for which the indemmitor is responsible increases with increasing sales (and therefore presumably the greater success) of the
business. Further, once the indemnitee has received notice of a credible claim of infringement, under certain circumstances the prudent thing may be to limit the infringing activity. Indeed, if the indemnitee continues the allegedly infringing conduct without a sound basis to believe it is not infringing or the patent is invalid, it may be exposed to punitive damages (which are unlikely to be covered by most indemnities) as a willful infringer. However, if it stops selling the infringing product or acquires alternative non-infringing technology either to avoid incurring further liability or in response to an injunction, or if the litigation results in damages but the indemnitee is not granted a license, it may incur significant costs in redesigning the infringing product; will those costs be considered indemnified “losses?”

The above discussion primarily addresses issues related to infringement of a third party’s patents, as this is the most common situation. However, infringement of a third party’s copyrights or trademarks or misappropriation of trade secrets present similar issues with the addition that, unlike patent infringement, such infringement or misappropriation generally arises from willful or at least knowing conduct (or conduct that the seller could reasonably be expected to know is infringing another’s rights). Thus, while there is often considerable debate as to how the risks for unknowing patent infringement should be allocated, for these other forms of Intellectual Property Rights it is more likely that the risks will be allocated to the seller.

While the foregoing deals primarily with the issues that arise from a breach of the non-infringement representation, the other IP representations, primarily those relating to the “quality” of the acquired IP assets, present a different set of issues with respect to indemnification. In particular, the relationship between a breach of these representations and quantifiable losses is more attenuated, particularly since for the most part Intellectual Property Rights are only exclusive rights. For example, how would the loss associated with a patent or trademark being held invalid or unenforceable be determined? Moreover, most businesses will acquire several patents and trademarks in anticipation that some of them will be held invalid or unenforceable, and thus it may not be reasonable to penalize a seller for owning more rather than fewer Intellectual Property Rights. In addition, the validity or enforceability of the acquired Intellectual Property Rights is unlikely to be challenged unless the buyer seeks to enforce those rights.

Similarly, while the cost of removing a lien on the acquired Intellectual Property Rights would likely result in a quantifiable loss, a failure of the seller to own an Intellectual Property Rights and

92 For patent infringement, a very rough estimate of potential exposure can be determined by calculating the product of the revenue for up to six years of sales (the statute of limitations) and a likely royalty (generally 2-6% for a consumer product).

93 For example, if the threat comes from a patent “troll” the matter may more likely than not be resolved by payment of a settlement amount. However, a threat from a competitor may present a greater risk of damages and an injunction.

94 For example, seller owns the assigned Intellectual Property Rights free and clear (see Section III.B.5.b); the assigned Intellectual Property Rights are valid and subsisting (see Section III.B.5.c); no third party is infringing the assigned Intellectual Property Rights (see Section III.B.5.f).
Property Right is unlikely to result in an indemnifiable loss unless a third party owns that right and bring an infringement action. As another example, how would the losses be determined if a third party is infringing the acquired Intellectual Property Rights—a successful assertion of those rights would result in the infringing third party paying damages to the business and would not constitute a loss to the buyer; an unsuccessful assertion against a third party may mean that the representation was not breached. The foregoing is not meant to lead to the conclusion that indemnification is not appropriate with respect to these “quality” representations, but rather that where the IP is particularly important, it may be prudent to define with particularity how the losses will be determined for breach of these representations rather than rely on the general definition of losses.95

2. Limitations on Indemnification: Survival Periods, Baskets and Caps

One of the principal benefits of including an indemnification provision rather than simply relying on common law breach of contract is that the remedy can be very finely crafted to satisfy the parties’ intentions. If there is a non-fraudulent breach (because fraud is usually carved out of the indemnification limitations and exceptions by contract, if not by law) there is a wide range of possibilities for how those risks and losses are to be allocated between the parties.

M&A practitioners are well aware of the various devices used to achieve the desired allocation, including survival periods, caps, baskets, and *de minimis* provisions. A detailed treatment of these topics falls outside the scope of this Guide. For our purposes, it is sufficient to note that these devices apply to breaches of IP representations as they would to breaches of any other representation, although there may in some cases be reasons for treating IP differently.

a. Survival Periods

The so-called “survival period” is the contractually determined period of time after closing during which a party has the right to seek indemnification for a breach of a representation. As already explained, in a public company deal there is no survival period. It is not possible for representations to survive at all, as there is no identifiable seller left holding the proceeds from whom to claim money back. In private company deals, general survival periods can range from as short as six months to as long as five years. Certain types of representations often survive even longer, including those relating to subject areas that have long-tail liabilities, such as those relating to environmental regulations (which often survive as long as the statute of limitations to which they relate) or that are so fundamental that it may be considered inequitable to have them lapse (such as, in many cases, the representation that the seller actually owns the shares being sold). Tax representations are often considered to meet both of these standards, because tax audits can take many years

95 For example, the exclusivity of a drug, and hence most of the value of a business based on that drug, may depend on the validity of very few patents. In contrast, an electronic device may be covered by tens or hundreds of patents, and the invalidity of a few of those patents is unlikely to be material.
to resolve, and because it is considered particularly irksome for one person to have to pay another’s taxes.

In general, survival periods have been shrinking in recent years. According to a recent study,96 of those deals that permit survival, the median general survival period is between 12 and 18 months, and only approximately 11% of such deals have a general survival period longer than 18 months. This movement towards a more seller-favorable deal structure—which is reflected in the shorter survival periods for representations and warranties and in lower caps—is largely due to the growing incidence of private equity repeat players on the sell-side as well as on the buy-side. When they act as sellers, private equity funds argue that they need to have a “clean sale” so that they can distribute proceeds to their investors.

Typically, a claim that is asserted before the survival period ends is not extinguished by the mere passage of time but remains until finally resolved. This is why both buyers and sellers keep a close eye on the calendar after the closing of a private deal and why so many claims are brought shortly before the survival period expires. Indemnified parties (typically buyers) often wait until close to the end of the survival period to assert their claims so as to have the best available information and sometimes to allow time for attempts to resolve claims amicably. It is, however, often advisable not to wait until the last minute, but to provide time for the provision of further information if requested by the indemnifying party (typically the seller). Indemnifying parties may accuse indemnified parties (sometimes fairly) of making a panoply of possible claims they might want to bring just before the end of the survival period without actually having a valid basis for their claims, simply to hold open the possibility of establishing a valid claim in the future and thereby doing an end-run around the survival limitation.

More often than not, IP representations are classed with the general representations and warranties about the business being sold, and the survival period is dictated at a business level. There may be reasons in particular situations for IP to be treated differently, if, for example, IP assets are especially fundamental to the value of the business being sold or if there is reason to believe that IP liabilities may arise a long time in the future. In making these determinations it is important to understand the IP risk environment in which the business operates. While, in most cases, it is impossible to fully assess the likelihood of a claim of infringement being made during the indemnity period, it is nonetheless possible to get a general understanding of the risk and to negotiate the terms of the representations and indemnities accordingly.

b. The Cap

An indemnification “cap” limits the aggregate amount of indemnification recovery available to the buyer for breaches. The cap is the largest divergence from the common law remedy of putting the buyer in the position it would have been in had there been no

---

96 American Bar Association, PRIVATE TARGET MERGERS & ACQUISITIONS DEAL POINTS STUDY 81 (2019).
breach, because it ensures that the seller is able to retain a portion of the purchase price whatever damages the buyer may suffer. While it was common many years ago for damages to be capped at a very high percentage of the purchase price, caps have come down dramatically in recent years (although cap sizes as a percentage of deal value will vary, and tend to be larger in smaller transactions). As noted above, this shift towards a more seller-favorable recovery structure is at least in part due to private equity repeat players in their capacity as sellers needing the certainty of a “clean sale.” Sellers will sometimes agree to allow the buyer to hold back a portion of the purchase price or put it in escrow with a third party for some period of time after closing in order to satisfy the seller’s indemnification obligations. Such a holdback or escrow gives the buyer some comfort that, up to the amount of the holdback or escrow, funds will be readily available if it can sustain a claim for breach, while also giving the seller the certainty that it will retain—and so can spend or distribute—a portion of the proceeds from the sale.

It is possible that there may be cases where a buyer may insist that the cap for selected IP representations should be higher than for regular representations because of a specific known risk, but in most cases the cap will be determined as part of the negotiated risk allocation between the parties’ business representatives. It is worth noting that in some (generally smaller) cases, the cost of defending a claim can be close to or even higher than the actual amount in dispute, and so it may be important to be explicit as to whether the indemnification obligation, and the cap, include defense costs or not.

c. Baskets

A “basket” is a risk allocation mechanism or formula that can be structured to meet the parties’ objectives with respect to sharing the risk of breaches, aligning their incentives, and avoiding nuisance claims.

The two basic formulations of the basket provision are the “true deductible” and the “tipping basket.” A true deductible basket operates like a deductible in an insurance policy to provide that the indemnified party (typically the buyer) will absorb a specified amount of losses before it is able to recover anything from the seller as a result of a breach. A “tipping basket” is one that must be filled up before it “tips over” but once it does tip, the full amount of loss may be recovered. A true deductible is effectively another form of materiality threshold and indeed in many cases (where the parties view the deductible as high enough to constitute the appropriate risk allocation), references to “materiality” in the individual representations and warranties are “stripped out” when determining the amount of damages that can be recovered. A tipping basket is more appropriately aimed at minimizing the nuisance of disputes over small claims. Essentially, it amounts to the buyer saying to the seller: “we won’t bother with nickels and dimes but when they add up to a dollar, we should get back the whole dollar.”

Another variant of risk allocation mechanism is the de minimis threshold (sometimes called the “mini-basket”), which essentially specifies a dollar level below which claims are considered so insignificant that they are to be ignored, counting neither towards filling the basket, nor in the amount of damages that can be recovered.
Because baskets are simply risk- and cost-allocation mechanisms, the “business deal” negotiated as an overall matter will more often than not apply to the IP representations as well. There may, however, be situations where a normal basket structure does not fully protect a buyer where there have been breaches of the IP representations. If, for example, the company being acquired is found to be in breach of the Intellectual Property Rights of a third party, and the buyer is not able to assert a claim until a certain level of damages is suffered, the buyer may be at risk that the owner of the Intellectual Property Rights could enjoin future violations, thereby inflicting much more substantial damage on the buyer’s business, potentially even shutting down the acquired business, before the basket is filled. In transactions where such a breach could be a real possibility, alternative means of protecting the buyer need to be considered.

3. Holdbacks and Escrows

We have all heard the old aphorism “possession is nine-tenths of the law.” It is, in short, usually better to have possession of funds that someone else is trying to claim than to be forced to claim funds in someone else’s possession.

One reason is simply the creditworthiness or reliability of the party holding the funds. In the case of an M&A deal, where the seller receives all of the consideration but is on the hook for future indemnification obligations, the buyer might be concerned that the seller could distribute the proceeds of the sale, or just spend or waste them, and not be able to fulfill its indemnification obligations when the time comes for it to do so. Aside from credit concerns, possession tends to give the possessor obvious negotiating leverage: it is, quite simply, harder to take something away from someone than to hold onto it. In a dispute, the party with the stronger claim should ultimately prevail, credit concerns aside, but the perception that it is advantageous to have possession is undeniable and has its own weight.

For both of these reasons, indemnified parties (principally buyers) have always preferred to hold back a portion of the purchase price they are paying in case of potential breaches. This gives them a substantial tactical advantage if they need to assert a breach. Sellers similarly fear that if buyers hold back a portion of the purchase price, they will never see it.

The two mechanisms that have evolved to address these conflicting considerations are holdbacks and escrows.

a. Holdbacks

A holdback is exactly what it sounds like: the buyer holds back a portion of the purchase price until the end of the survival period. At that point, to the extent the buyer has indemnification claims, it continues to retain the amounts subject to those claims until final disposition and returns any amount that is not subject to the claims. Sellers dislike holdbacks for the reasons described above, but can sometimes be convinced to accept a holdback if the amount is small enough and especially if the holdback is also the limit of
their indemnification obligations (that is, if the holdback is equal to the cap). Private equity sellers often favor this sort of arrangement because it gives them certainty as to their ability to distribute to their investors funds received from the sale of a portfolio company, with the possibility of a further distribution at the end of the survival period.

b. Escrows

In an escrow, the parties agree to place a specified amount of funds (in this case, the buyer would place a portion of the purchase price) with a third party, the escrow agent. The escrow agreement provides that the escrow agent would have no discretion with respect to these funds, would be obligated to invest them very conservatively (at a very low return, of course) and would be compensated, typically on a fixed-fee basis, for its services. Often, the escrow arrangement can only be “broken” and the funds paid out upon agreement of the parties or some specified level of judicial determination. The principal benefit of an escrow arrangement is to solve the credit problem, by eliminating the risk that the seller may abscond with or dissipate the proceeds of the sale before the indemnification claim becomes payable.

4. Exclusivity

An important protection often associated with indemnification provisions is the exclusivity clause. Where the parties have negotiated specific indemnification parameters for financial recourse, it is normally not appropriate to both allow those to play out and to also allow the parties to make parallel claims for recourse under common law or some statutory regime. While this parallel path may sometimes be appropriate if both parties agree (environmental liability is one area where statutory and contractual indemnification obligations may coexist), it is more often the case where there is a well-developed indemnification provision that this provision is intended by the parties to be the exclusive path to financial recourse for the parties. Fraud is of course a frequent exception to the exclusivity provision (as it is to other contractual limitations on recovery).

5. Excluded Forms of Damages

M&A agreements often limit recovery for breaches to damages directly attributable to the breach. The indemnification provisions will often provide that the seller will indemnify the buyer for breaches of its representations and warranties (subject to the caps, baskets and other negotiated limitations) but that the damages payable will not include punitive damages or other indirect, special or consequential damages, other than those that are specifically included in the indemnity such as defense costs. An exception usually applies when punitive damages have to be actually paid out by an indemnified party because such damages are then damages directly incurred by that indemnified party. These limitations are often considered part of the contractual “boilerplate” and not intensely negotiated, the usual rationale being that the contract should not provide recourse for speculative damages but only consequences that are reasonably foreseeable. Sometimes, those words (which generally reflect the common law standard for contractual damages) are actually used, but more often exclusions of indirect and consequential damages are used to get to the same
place. Like other limitations on recovery, they will often be agreed to as a “business matter” and not separately negotiated among the IP lawyers.

While IP representations for the most part are not different from other business representations, they do pose a greater risk of indirect or consequential damages. For example, if a company being acquired has been breaching a third party’s Intellectual Property Rights, the damages for historical breaches can be ascertained in dollar terms, but it is also possible that the Intellectual Property Rights owner could obtain an injunction which could cause significant consequential damage to the acquired business (and possibly even to the buyer’s broader business) going forward. IP is also an area where punitive damages are not just a hypothetical possibility but could be awarded, especially if a breach is found to be deliberate. In these situations, IP lawyers need to be alert to the possibility that the customary exclusions may have serious impact and may need to think creatively about other ways to protect their clients’ interests.

6. Equitable Remedies

Financial recourse is not the only enforcement mechanism offered by the law of contract. The equitable remedies of specific performance, and injunction, can be extremely important in the IP world and in general.

Specific performance refers to the ability to have a court compel actual affirmative performance by a party to a contract of the obligations it has undertaken. Injunction is the negative version, referring to the ability of a court to enjoin, or stop, a party from breaching a contract or continuing to do so. These can be extremely powerful remedies, especially in the IP context. If a court finds that a person is violating another person’s patent and enjoins ongoing violations, such an injunction could put the violating party out of business, or compel them to enter into a license, which could be extremely costly under those circumstances. In the context of an M&A transaction, it is important to understand the full implications of any potential breach of the acquisition agreement, or, as a due diligence matter, possible breaches by the company being acquired.

7. Specific Indemnities

Indemnification is not only available as a remedy for breaches of representations and warranties or violations of covenants. It can also operate as a mechanism for expressly shifting risk in a transaction and for crafting specifically agreed parameters for that risk-allocation. If, for example, the parties to a transaction are aware that the company being acquired has been (or might have been) operating in violation of a third party’s patent, the agreement could expressly provide that the seller will indemnify the buyer with respect to any violation of that patent. To align the parties’ incentives, the indemnification section might provide that the parties will share the liability equally up to a certain threshold and, above that threshold, the seller will indemnify the buyer up to a specified cap. In this way, the indemnification provisions can allow the buyer to “size” a potential problem and factor it into its business decision. The parties will of course want to be sensitive to not creating
a record of an acknowledged violation or potential violation and so will craft those provisions with care. They may prefer to include such a provision in a schedule to the agreement or a side-letter rather than in the agreement itself, especially if the agreement will be publicly filed (subject to SEC disclosure rules if the information in the schedule is material).

8. Indemnification for Excluded Liabilities

One very important distinction in the world of M&A is between stock transactions and asset transactions. As discussed in Section III.A.b above, in a stock deal (which would include a public company merger), the buyer acquires the actual corporate entity. One could say that the buyer acquires the “box” and everything in that box, including all assets and all liabilities it contains. Of course, the parties will negotiate representations and warranties describing what the box contains and defining their expectations (and, in a private deal, indemnification provisions may provide recourse if those expectations are not met).

In an asset deal, the subject matter of the transaction is not only the stock of a corporation (although it may include stock of one or more subsidiaries engaged in the business being acquired), but includes assets and liabilities that exist outside of any corporations being acquired.

Buyers sometimes prefer an asset deal so that they can “cherry-pick” among the seller’s assets and liabilities, but sometimes an asset acquisition is the only way a transaction can be effected because the assets and liabilities constituting the business to be sold are not already neatly sitting within one or a group of subsidiaries.

One of the critical distinctions between an asset deal and a stock deal is of course that, when negotiating an asset deal, the parties have to specifically identify the assets and liabilities to be transferred. Several mechanisms are used to do this, including listing specific assets and liabilities on disclosure schedules, tying them back to the balance sheet for the business being transferred, and describing the assets and liabilities to be transferred formulaically (for example, the agreement might specify “all assets primarily related to the acquired business”).

The asset purchase agreement will typically identify not only the assets and liabilities that are included but also those which are expressly excluded. Whether a liability is included or excluded can be a critical distinction when it comes to determining the parties’ financial responsibility for those liabilities. Assets that are defined as “excluded” are not acquired by the buyer, and liabilities defined as “excluded” are not assumed by the buyer. This means that any third party having the right to assert such an “excluded” liability will have less ability to effectively assert a claim against the buyer (although it is possible the third party might be able to assert a claim against the buyer as a successor to the acquired business or if proper corporate formalities were not adhered to). In an asset purchase agreement the seller often indemnifies the buyer with respect to excluded liabilities without limiting that indemnification by reference to baskets and caps, because the idea is that those liabilities never left the seller and never went to the buyer at all and so any risk should be completely retained by the seller. A similar result could be achieved in a stock deal if the
parties included a specific indemnity for a known liability or represented that such a liability did not exist and then indemnified for a breach of that representation, but that indemnification would often be affected by the limitations described in this section.

9. **Representations and Warranties Insurance**

In recent years, there has been a significant increase in the acceptance and prevalence of representations and warranties insurance ("RWI") as a means of providing a buyer recourse for breaches in lieu of seller indemnification. RWI is exactly what it sounds like: an insurance company compensates the buyer for breaches of representations and warranties in exchange for a premium paid up front, instead of the seller. According to a recent study, approximately 52% percent of private M&A transactions referenced some form of RWI. Most typically when it is used, RWI is the exclusive remedy for breaches, but it can also be used to supplement a seller indemnity. RWI is a very flexible tool that can provide broad protection for breaches and can be paid for by the buyer, the seller or both (although it currently is more typical for the buyer to pay the premium).

The benefit to the seller is obvious: if RWI replaces (or significantly reduces) a seller indemnity, the sellers get to receive and retain the entire purchase price (or a larger portion of it than they would have otherwise). RWI offers benefits for buyers as well. Assuming that the buyer has performed adequate diligence, RWI can provide more robust and more reliable protection than a seller indemnity with respect to unknown risks. RWI insurers are generally sophisticated parties and have demonstrated that they are capable of understanding and evaluating deal terms and deal structures and accommodating the parties with respect to deal timelines. In addition, RWI policy terms have become somewhat standardized and typically offer coverage that is more favorable than one could easily negotiate with a seller, such as longer survival periods and a higher caps. In addition, RWI policies typically include a “double materiality-strip,” that is, reading out materiality qualifiers both for purposes of determining whether the representation was breached and for determining the magnitude of loss suffered. For a buyer who wants to clinch a deal but needs to be able to say (to the market or, with respect to the responsible individuals, to their superiors or even to the board of directors) that they secured reasonable and customary protections, RWI can provide an elegant solution.

Private equity firms, in particular, when selling portfolio companies, greatly prefer that buyers use RWI and not hold back or have a claim over any portion of the purchase price. This allows them to exit an investment cleanly and distribute the proceeds to their investors. The growing importance of private equity companies as repeat players on both the seller and the buyer sides has contributed to the increasing acceptance of RWI.

There are certain issues that buyers should be aware of with respect to RWI. *First,* RWI generally will not cover known breaches or risks (including those listed on disclosure

---

97 According to the 2019 **PRIVATE TARGET M&A DEAL POINTS STUDY**, 52% of 2018-19 private target deals referenced RWI, compared to 29% in 2016-17.
schedules or that the buyer learns through the diligence process). While it may be possible to secure insurance for a known risk, RWI is intended to apply to unknown risks. Known risks will generally need to be addressed by a specific indemnity or a separate insurance policy. Second, RWI insurers perform their own diligence with respect to the scope of the representations to confirm that the buyer’s due diligence of the representations made by the seller is adequate; if the RWI insurer is not satisfied with the level of diligence performed by the buyer, that may lead to additional exclusions from the RWI policy. Third, RWI policies typically include a sizeable deductible (retention) before paying out under the policy: that deductible is usually around 0.75% of the enterprise value of the transaction. Each of these issues is manageable, and as noted, none of these issues has proven to reduce the attractiveness (and ubiquity) of RWI policies.

With respect to IP representations in particular, as is the case with other features of the indemnification arrangements, the choice of whether or not to rely on RWI is often determined at an overall business level. Where the parties have determined to use RWI and not have any seller indemnification, buyers should understand the limits of the protection available to it. In some cases, it is possible that risks posed by IP breaches may not be adequately protected by an insurance payment, for example where an injunction obtained by a third party could shut down the acquired business. In such a case, it may be appropriate to have a specifically negotiated indemnity operating independently of the RWI for general breaches of representations not involving IP. Alternatively, in some cases a seller may be able to covenant to ensure that the buyer will have all the IP rights necessary to operate the acquired business.

D. Closing

1. IP Assignments and Recording

   Patents are transferred pursuant to a patent assignment executed by the assignee. The assignment lists (by patent number, or application number, and other relevant information) the patents and patent applications to be assigned. The assignment document, or a short form version of it, is then recorded with the USPTO with reference to each assigned patent. The recording of the assignment is necessary to cut off the rights of a subsequent bona fide purchaser.

   Similarly, an assignment of registered trademarks would be executed by the assignee and recorded in the USPTO against the registered trademark or application.

   Copyrights are assigned pursuant to a general copyright assignment which describes the work of authorship in which the copyright exists, regardless of whether the copyright has been registered. If the assigned copyright is registered, the assignment would be filed in the Copyright Office with respect to each registered copyright. However, if the copyrights are not registered the assignee may subsequently file a copyright registration as “owner by assignment.”
Trade secret assignments present unique issues. It is common for purchase and sale agreement to include language purporting to transfer ownership of trade secret from one party to the other. However, unlike the other forms of Intellectual Property Rights discussed above, a purported assignment generally presents two difficult to resolve issues: (i) how to define the trade secret, and (ii) what is the effect of the transfer (i.e., what conduct is permitted or proscribed following the purported assignment). Merely reciting that a party owns a trade secret is rarely sufficient to resolve these issues. As discussed above, a trade secret right is the legal right to seek monetary damages and injunctive relief against a third party that obtains the trade secret by improper means. Both the purported owner and a licensee of a trade secret have this right. Moreover, the terms under which a trade secret owner or trade secret licensee may use or disclose a trade secret can be arbitrarily set by contract. Unlike patents and copyrights, the relevant law defines when information will be considered a trade secret, not the rights associated with the trade secret.

What this means in practice is that even if the agreement purports to transfer ownership of a trade secret, it is necessary to specify in detail what the owner and the licensee of the trade secret are permitted to do (for example, how they may use the trade secret information and to whom they may they disclose it). Moreover, whereas patents, trademarks and to a large extent copyrights can be clearly defined in schedules, it can be difficult or impossible to list or even describe the trade secrets to be assigned or retained in a transaction and therefore drawing a distinction between owned and licensed trade secrets may not be possible.

2. **Effectuating the Assignment of Intellectual Property Rights**

The effective assignment of registered Intellectual Property Rights (typically, patents, registered trademarks, registered copyrights, and applications for each) requires that the assignment for each item be recorded. Typically, the seller will deliver and execute assignment agreements for each category of registered IP at closing, together with executed (and in most cases notarized) recordable “deeds of assignments” for each category of IP and for each jurisdiction. After the closing, it will be the buyer’s responsibility to record these assignments. However, in transactions involving extensive IP portfolios in multiple jurisdictions, it may take an extended period after closing to complete the execution and recordation of the specific assignments in each jurisdiction.

3. **The Correction of Patent Schedules**

As noted, the determination of which of the seller’s patents will be assigned versus licensed to the buyer depends on many factors. These factors often determine the list of assigned patents, which is deemed to be final and not subject to adjustment after signing. However, in the most protective cases the buyer will want a license to any patents retained by the seller so as be assured that the seller will not sue the acquired business for patent

---

98 While the assignment is sufficient as between seller and buyer to transfer title to the relevant Intellectual Property Right, unless the assignment is recorded it will be void as against any subsequent purchaser or mortgagee for a valuable consideration. 35 U.S.C. § 261.
infringement. A license to all of the seller’s retained patents would satisfy this condition. However, especially where the seller has a large patent portfolio, it may not wish to encumber potentially all of its patents with a license. An alternative is to license only those patents on a schedule. In such a case, the buyer will require assurance that the schedule is complete. This can be achieved by means of a covenant, akin to a wrong pockets covenant, that states that if it is determined within a defined period of time after closing that the Business was practicing a retained patent as of closing, and such patent was not on the list of licensed patents, then it will be added effective as of the closing date. See Section III.B.6.f above for further information.

E. Confidentiality Agreements

In almost all M&A transactions, the seller will need to share confidential information with the potential buyer. This information may range from business information such as sales data to highly proprietary technical information regarding the seller’s technology. Consequently, in many cases the first legally binding undertaking in an M&A negotiation is the execution of a confidentiality agreement, also referred to as a non-disclosure agreement or an NDA. The NDA will, among other things, set forth terms under which the disclosing party, in most case the seller, will disclose “Confidential Information” to the recipient, and the permitted uses of that information by the recipient. From an IP perspective, the NDA is essentially a trade secret license of very limited scope.

1. Definition of Confidential Information

Since there is no statutory or other fixed definition of “Confidential Information,” precisely defining the term is essential. The disclosing party will want a broad non-specific definition of Confidential Information, since this will provide the greatest degree of protection for the information it discloses. By contrast, the recipient will want a narrow, precise definition of Confidential Information (by limiting Confidential Information to only those material marked as such) so that it limits its risk of inadvertently breaching the NDA. In addition, the recipient may want to limit the information it receives so as not to become “tainted” and risk a claim that it has misused the Confidential Information. Furthermore, not all information is equally “confidential” and merits equal treatment. Thus there are a broad range of possible definitions of “Confidential Information” in M&A-related confidentiality agreements. Practitioners should carefully consider what is appropriate in the particular circumstances. Additional terms or a new NDA may be needed to address particular categories of information in the diligence process. For example, it is unlikely that the typical NDA will be adequate to address the disclosure of source code.


100 For example, Confidential Information could be defined to include all information disclosed, or derived from such information, unless the recipient can demonstrate that such information was obtained from another independent source.
2. **Residuals Clause**

While it is possible to return or destroy tangible embodiments of Confidential Information (e.g., documents), some information is of a nature that once it is known to an individual it is impossible to, as it were, “unknow” it. If this so-called “residual” information, retained in the unaided memory of a recipient’s employee or representative, is considered Confidential Information, there is a significant risk that such a person may use that information in breach of an NDA. In such circumstances, it will often be necessary to prohibit such employees or representatives from engaging in any activity where they could inadvertently use that information.\(^{101}\) Consequently, a recipient of Confidential Information may want to exclude such residual Confidential Information from the restrictions otherwise applicable to Confidential Information. For example:

> Notwithstanding anything to the contrary contained in this Agreement, Residuals shall not be subject to the restrictions set forth in Section [●] with respect to Confidential Information of the Disclosing Party. The term “Residuals” means information of a general nature which may be retained, [without conscious attempt to memorize], in the unaided memories of persons who have had access to the Disclosing Party’s Confidential Information.

Residuals clauses are not uncommon in smaller, private company acquisitions. Particularly in technology acquisitions where the potential buyer has operations or products in the same technical field as the seller or where the parties are potential competitors, the buyer may want to limit the risk that it is accused of misusing Confidential Information if it does not proceed with the transaction. Sellers generally attempt to resist residuals clauses. Therefore, whether or not an NDA contains a residuals clause is most likely determined by the relative negotiating leverage of the parties. In the absence of such a clause, the recipient of Confidential Information should be particularly careful to limit who will have access to the Confidential Information it shares with potential buyers.

3. **Treatment of Confidential Information**

Just as important as the definition of Confidential Information are the terms governing the recipient’s treatment of Confidential Information: Who can access the information? For what purpose may it be used by the recipient? To whom may the recipient disclose the information? Regardless of what the agreement may permit the recipient to do with the Confidential Information, it is prudent for the recipient to keep careful track of what it receives and to whom it gives access.

---

\(^{101}\) This is particularly true where the Confidential Information is “negative” information, such as the knowledge that a competitor spent a large sum of money on researching a potential technology, only to determine that the technology was not suitable for use.
4. Term and Return or Destruction of Information

A key concern of parties to an NDA is what the appropriate term of the agreement should be if discussions are terminated or an agreed upon transaction fails to close. This is complicated by the fact that it may not be possible to predict when Confidential Information will no longer be of value. A buyer may ask for a relatively short term and will argue that it needs a termination provision to eliminate the continuing burden of complying with and monitoring the confidentiality agreement long after most or all of the Confidential Information has lost its sensitivity. In contrast, a seller may object to the notion of any termination date on the theory that disclosed confidential materials may be commercially sensitive for an indefinite period of time.

A compromise between these two positions is to tie the termination date to the end of a finite period after the recipient returns or destroys the Confidential Information in its possession, and not the effective date of the NDA or the date of disclosure. This approach, which relies on the near universal requirement in an NDA that the recipient return or destroy Confidential Information on demand or if negotiations cease, essentially permits the recipient to use residual information, in the unlikely event that it can remember such information months or years after it no longer has access to the underlying material containing the Confidential Information.

Even when there is an obligation to return or destroy Confidential Information, the parties may negotiate certain exceptions to this obligation to permit the recipient to, for example, retain backup copies and derivative materials. Nonetheless, a recipient needs to carefully balance the benefit of these exceptions against being bound indefinitely by an NDA.

5. Confidentiality Agreements if the Transaction Proceeds

If the transaction proceeds, consideration should be given as to whether the original NDA should be superseded by the terms of the definitive transaction agreement, or at least that the terms are consistent between the two. This is particularly important in a carve-out transaction where confidentiality terms will survive the closing (and in some case the recipient will become the “disclosing party”) and may be closely related to the terms of any trade secret license between the parties.
Drafting intellectual property licenses can be a complex task. Outlined below are the basic principles needed to draft and negotiate IP licenses in an M&A transaction and to review IP licenses as part of the due diligence process.

As was the case with the transfer of Intellectual Property Rights, the terms of an IP license are a function of the Intellectual Property Right being licensed. For example, a patent license can be thought of as a licensor’s covenant not to sue a licensee that engages in one or more of the exclusive patent rights: to make, use, sell and import the patented invention as described and claimed in the patent. In contrast, a copyright license grants rights under one or more of the copyrights: to copy, distribute, create derivative works, etc., of the copyrighted work of authorship. And a trade secret license can be thought of as a set of covenants specifying what each party can do with respect to the use, disclosure and protection of confidential information.

A. General License Terms and Forms

Before discussing license terms applicable to each type of Intellectual Property Right, let us examine the following general form of license:

Effective as of the closing, subject to Licensee’s continued satisfaction of its obligations hereunder, Licensor hereby grants, and agrees to grant, to Licensee, for the Term, an [exclusive (including as to licensor)], [sole], [non-exclusive], [perpetual], [non-terminable], [irrevocable], [non-sub licensable (except as provided in Section [●])], [non-transferable (except as provided in Section [●])] license under the Licensed Intellectual Property Rights to [make, use, sell and import], [copy, distribute, create derivative work of, publicly perform and display, use and disclose] the Transferred Technology Licensed Products solely in the Licensed Field.

a. “Licensee . . . Licensor”: Careful consideration needs to be given to the parties to the license grant. For example, is the license granted by a named party only, or by the party to the agreement and its current and/or future affiliates? A grant by the named party and its current or future affiliates may adversely affect the ability to carry out a future acquisition of the licensor.
b. “subject to . . . continued satisfaction of its obligations hereunder”: By conditioning the license on the licensee’s compliance with certain agreement terms, the licensor has the basis to claim that the license ceases to be in effect if the licensee does not satisfy a condition without the licensor having to terminate the agreement. Thus, upon the licensee’s breach or failure to satisfy a condition, the licensor has a basis to claim that the licensee is in fact an unlicensed infringer, as well as being in breach of the agreement.

c. “and agrees to grant”: The future grant language is desirable for a license if the license will include future Intellectual Property Rights of the licensor, to counter an argument that the licensor could not have granted a present right to Intellectual Property Rights that was not in existence at the time of the grant.

d. “for the Term”: The parties have wide latitude to set the term of the license, provided that the term of a copyright or patent license cannot extend beyond the term of the right being licensed.103

e. “an [exclusive (including as to licensor)], [sole], [non-exclusive]”: An exclusive license grant places a limitation on the licensor, and, under certain circumstances, is equivalent to a transfer of ownership.104 In a sole license, the licensor retains its rights to the licensed Intellectual Property Rights but agrees to not grant any further licenses. A non-exclusive license is essentially a covenant by the licensor to not enforce the Intellectual Property Rights against the licensee, but it does not limit the licensor’s rights to the licensed Intellectual Property Rights, including the right to grant future licenses.

f. “[non-terminable], [irrevocable]”: Especially in situations where a licensee’s business is dependent on the license, the right to terminate a license may give the licensor disproportionate leverage in a dispute. In such situations, the licensee may consider terms that limit the licensor’s right to declare a breach and terminate the license such as, for example, requiring a final court adjudication of breach before the licensor can terminate the license. Licensees should also consider whether it is to their advantage to reserve the right to terminate the license, especially if the license is royalty bearing or is not assignable in a change of control.105

g. “[non-sublicensable (except as provided in Section [●])]”: Sublicensing permits the licensee, as a sublicensor, to extend some or all of its licensed rights to a third party

---

103 This limitation may not apply to trade secret rights. That is, a licensee that agrees to a license term may have to continue to pay royalties and observe the license terms even if the licensed trade secret has been publicly disclosed. See, e.g., Warner-Lambert, supra note 43, at 666 (holding that, even after the secret formula for Listerine had become publicly known, Warner-Lambert was obligated to continue making the royalty payments for as long as it continued to make a product based on the original Listerine formula).

104 For example, in an exclusive patent license, the right to prohibit practice of the patented invention transfers from the licensor to the licensee; the licensee can sue the licensor if the licensor practices the patented invention.

105 Generally, a patent license would no longer be enforceable if the licensed patents are no longer valid and enforceable. However, a trade secret license may be enforceable, and, for example, may require the continued payment of royalties, even after the licensed trade secrets become public.
(the sublicensee). A licensee’s right to sublicense may significantly affect the licensor’s right to protect and exploit the licensed Intellectual Property Rights, especially in the case of a patent license.

h. “[non-transferable (except as provided in Section [●])]: IP licenses are typically considered personal and are not transferable or assignable by the licensee absent language to the contrary. Whether a stock sale, reverse triangular merger or other deal structure constitutes a transfer of a license is determined by state contract law, which is not uniform on the issue. It is therefore important to expressly address in an agreement whether, and under what circumstances, a license may be transferred to, or assumed by, a third party, including in connection with a change-of-control transaction. In contrast, absent language to the contrary, the licensor is generally free to assign the license or the licensed Intellectual Property Rights; however, such an assignment will not affect the licensee’s rights. 106

i. “license under Licensed Intellectual Property Rights”: An essential component of the license grant is to define what rights are being licensed. It is not sufficient to say that the licensee is licensed to do something without describing what rights of the licensor are being licensed. The definition of Licensed Intellectual Property Rights may often include only some of the licensor’s Intellectual Property Rights. For example, only rights on a schedule, or only rights in existence prior to a particular date.

j. “[copy, distribute, create derivative work of, publicly perform and display, use and disclose]”: The conduct being licensed is a function of the Intellectual Property Rights being licensed and is key to defining the scope of the license, especially when the license does not extend to the full scope of the rights associated with the licensor’s Intellectual Property Rights.

k. “Licensed Products solely in the Licensed Field”: Licensed conduct is typically defined by the terms “Licensed Product” and/or “Licensed Field.” Consider, as an example, a license to make a particular version of a component for use in only cars but not trucks under a patent that covers multiple versions of a component for use in both cars and trucks.

B. The Need for Licenses in the M&A Context

As discussed in Section II.A above, in a transaction in which a business is divested, there are typically Intellectual Property Rights that will be “shared” by the buyer and seller. Some of these shared rights may be retained by the seller and licensed to the buyer, and others may be assigned to the buyer and licensed back to the seller. While the scope of these licenses varies, in most transactions the need for these licenses is recognized by both parties: neither the seller nor the buyer wishes to be sued by the other for operating the retained or divested business, as the case may be. In a typical asset divestiture, there may

---

106 While this is true for a license, it may not be true where the rights are granted pursuant to a covenant not to sue. This difference in outcome may be particularly important in determining whether a covenant not to sue is an appropriate alternative to a license.
be three licenses (assuming all types of Intellectual Property Rights are implicated in the transaction): (i) a patent cross-license; (ii) a cross-license covering “Other Intellectual Property Rights;” and (iii) a trademark license. In addition, other licenses may be required to cover specific Technology or Intellectual Property Rights. For example, the seller may need to license a retained software product to the buyer under the seller’s standard commercial terms.

1. Patent Licenses

In a carve-out transaction, the patent license will usually license to the buyer certain of the seller’s retained patents and license back to the seller certain of the patents transferred to the buyer. Although it is often easier to draft the grant of rights from the seller to the buyer and from the buyer to the seller as two separate licenses, for the purposes of illustration consider the following license where the licensor and licensee could be either the buyer or seller:

Effective as of the closing, Licensor\(^a\) hereby grants, and agrees to grant, to Licensee\(^a\), for the Term\(^b\), a non-terminable, irrevocable,\(^c\) non-exclusive,\(^d\) non-sublicensable (except as provided in Section \([\bullet]\)),\(^e\) non-transferable (except as provided in Section \([\bullet]\))\(^f\) license under the Licensed Patents,\(^g\) to make, have made, use, sell and import the Licensed Products, solely in the Licensed Field and solely in the Territory.\(^h\)

Patent licenses are often quite complex and require an understanding not only of the substantive law but also of the patents being licensed and the business relationships. Thus, while a patent license follows the general form described above, as the following discussion illustrates the structure and certain terms will be particular to patent licenses.

a. “Licensor . . . Licensee”: In the cross-license form, Licensor and Licensee will refer to both the buyer and the seller, together with certain related parties. However, as noted below, the related parties included in the definition may not be the same for the seller and the buyer. For example, as discussed below, the seller as Licensor may include the seller’s affiliates, whereas the buyer as Licensor may include only the buyer’s subsidiaries.

If the seller holds the licensed patents in one or more separate corporate entities, Licensor may need to be defined to include the seller and its affiliates or subsidiaries.\(^107\) If the licensor’s affiliates are included without additional clarification, there is the possibility that the license grant could be construed as extending to the patents of an entity that later acquires the licensor, unless the definition is limited to current affiliates.

Similarly, the definition of Licensee can be either the party to the agreement or the party and its affiliates or subsidiaries. If the licensee includes both the contracting party

---

\(^{107}\) An alternative wording is for the party to the agreement to grant the license “itself and on behalf of its affiliates.”
and its affiliates (or subsidiaries), then no further action is needed for the affiliates (or subsidiaries) to enjoy the benefits of the license. Alternatively, the definition of Licensee can be limited to the named party with the right to grant sublicenses to affiliates or subsidiaries. It is also typical to have the license to an affiliate or subsidiary expressly terminate when such entity ceases to be an affiliate or subsidiary. However, there is often an exception to this rule in the case of a spin-off. It should be noted that for purposes of IP licenses, the definition of affiliate or subsidiary may not follow the definition under the securities laws, and may be limited to a greater than 50% ownership interest or in some cases a higher threshold.

b. “for the Term”: The term of a patent license generally ends upon the last expiration date of the licensed patents. Especially where a license imposes an obligation on the licensee, such as the obligation to pay royalties, it is not permissible for the license to extend beyond the patent term.

c. “a non-terminable, irrevocable”: When a patent license is terminated or revoked, the licensor regains the right to sue the licensee for patent infringement. If successful, the licensor will be entitled to monetary damages and may be granted an injunction prohibiting the licensee from engaging in the conduct that had been licensed prior to termination. It is important to note, however, that if the licensee engages in conduct outside the scope of the license, the license would often not limit the licensor’s ability to sue the licensee for patent infringement independent of the license. Particularly, in the M&A context, where the license grant is necessary for a party to continue a transferred or retained business, an injunction could be highly disruptive and undermine the value of the relevant business. In addition, the mere threat of an injunction gives the licensor leverage in any dispute. Accordingly, whether the license is terminable or revocable is often the subject of intense negotiation. One compromise is to provide that no termination is effective unless there is a final determination by a court that there is a breach permitting termination by the licensor.

In relatively rare cases in the M&A context, a patent license may be royalty bearing or impose other continuing obligations on the licensee. If this is the case, the licensee may want to reserve the option to terminate or give up the license.

d. “non-exclusive”: A fully exclusive patent grant is likely to be considered the equivalent of an assignment of ownership. Accordingly, in the M&A context, patents that are not transferred to the buyer are typically licensed on a non-exclusive basis. However, in some cases, the grant from the seller to the buyer may be exclusive for a limited period of time, generally co-extensive with the term of a covenant not to compete, and for a limited field.

108 See, e.g., Speedplay, Inc. v. Bepop, Inc., 211 F.3d 1245, 1250 (Fed. Cir. 2000) (“[A] party that has been granted all substantial rights under the patent is considered the owner regardless of how the parties characterize the transaction that conveyed those rights”). Relatedly, the uncertainty as to who owns the patent will complicate enforcement of the patent against third parties.
In contrast to a true exclusive license, a “sole” license allows the licensor to continue to practice the licensed patents. If it is intended that the license be fully exclusive, and not be interpreted as a sole license, parties may choose to include the following: “exclusive (including as to Licensor).” In addition, the grant of an exclusive patent license typically requires additional terms, such as those regarding enforcement of the patents against third parties.

e. “non-sublicensable (except as provided in Section [●]):” Even in the commercial context, patent licenses frequently prohibit the licensee from granting a sublicense. A licensee’s right to sublicense the licensed patents could significantly impair the value of the licensed patents. For example, the licensee could offer a third party a “better” deal than the licensor is offering, or prevent the licensor from enforcing the patents. Further, there is rarely a need for the licensee to sublicense patents. Generally, a patent license includes both the right to make the licensed product and to have it made.

f. “non-transferable (except as provided in Section [●]):” Patent licenses are typically, by their terms, not assignable, except in connection with a change of control of the licensee. As is the case with sublicensing, a transfer of a patent license to a third party could have significant negative consequences for the licensor. However, this risk to the licensor has to be balanced against negatively affecting the value of the licensed business in a future change-of-control transaction if the license may not be assigned. A typical assignment provision would state:

The patent license may not be transferred or assigned directly or indirectly to, by operation of law or otherwise, or assumed by, a third party, and such license shall immediately terminate upon any purported assignment or assumption, including in connection with a change of control of Licensee; except the Licensee may assign the license [but not this section [●]], and the license shall be assumable, as the case may be, in the event of a change of control of Licensee or the sale of substantially all of the assets [to which this Agreement relates] of Licensee to a third party, provided that prior to such event Licensee notifies Licensor and provides Licensor with an acknowledgement by the assignee or successor to Licensee that it agrees to be bound by the terms of the license.

In addition, the assignment provision may include additional restrictions driven by the particular circumstance of the transaction. For example, a restrictive license may provide that upon an assignment or assumption, the license will extend to only the products of the licensee in existence on the date the acquisition document is executed or, alternatively, when the transaction closes. A less restrictive alternative would be to say that upon a change of control, the license extends to only the products that originate from the licensee and not to the acquiror’s existing product lines. In addition, the license may limit assignment to competitors of the licensor.

There may, however, be circumstances in which the licensor will not want the patent license to be transferable under any circumstances. Merely stating that the license is
not transferable may not suffice to foreclose all of the possible ways a third party or successor entity could obtain the benefit of the license, and therefore the drafting should carefully consider and address all possible scenarios.

g. “license under the Licensed Patents”: A patent license can be thought of as having two “gates.” The first gate determines what patents “get through” and are licensed. The second gate determines the scope of the license granted under the patents that pass the first gate. These gates are typically related. For example, a license under all, or a broad set of, seller’s patents and a narrow license field may be equivalent in many respects to a broad license to a narrow set of patents. Accordingly, the considerations set forth below for defining the licensed patents should be considered in the context of the scope of the license and vice versa.

There are generally significant differences between the definition of patents to be licensed by the seller to the buyer (the “Seller Licensed Patents”) and the definition of the patents to be licensed back by the buyer to the seller (the “Buyer Licensed Patents”). The Buyer Licensed Patents are typically the patents transferred to the buyer and may include any patents that issue from the transferred patents and applications following closing. If the transferred Intellectual Property Rights include inventions (e.g., invention disclosures) for which patent applications have not yet been filed, the definition may also include any patents filed within a period of time after the closing.

On the other hand, determining what needs to be included among the Seller Licensed Patents is more complex. As we have noted, a patent is a right to exclude third parties from doing certain things: it is not the affirmative right to do anything. Accordingly, a business does not need to own patents following closing in order to operate; a non-exclusive license that forecloses the opportunity of the seller to sue the buyer for patent infringement may be sufficient. Nonetheless, in most deals the buyer will want to acquire at least some of the patents practiced by the business. The division between patents assigned to the buyer versus patents retained by the seller and licensed to the buyer is generally determined by negotiation. The optimal allocation between these two approaches is seldom black and white. However, in most cases, the parties should agree that the sum of (1) the patents that are assigned and (2) the patents that are licensed should at least equal all patents that are practiced by the business. Accordingly, once the assigned patents are agreed upon, the licensed patents will need to be determined to satisfy the foregoing. This can be achieved in a number of ways.

The simplest structure would be for the seller to grant the buyer a license under all of the seller’s patents, but for a limited field of use. In other words, a license with a wide first gate but a narrow second gate. While this structure technically licenses all of the seller’s patents, as a practical matter those patents that do not relate to the licensed field are not within the scope of the license. However, for a seller that owns a broad patent

---

109 The scope of the patent is set forth in a series of claims each covering a variation of the basic invention. It is possible, although not typical in the M&A context, to license only some of the claims of a patent.
portfolio, potentially licensing all of its patents and not having certainty as to which patents are licensed, if even for a limited field, may encumber the entire patent portfolio and is therefore generally undesirable. One alternative for addressing this is to define the Seller Licensed Patents as all patents that are “practiced by the Business as of closing.” This definition satisfies the requirement that the seller cannot sue the buyer for patent infringement post-closing (assuming the Business operates within the field of the license). However, even under this alternative, the seller may be not be able to determine with any degree of certainty which of its patents are licensed.

These issues can be addressed by limiting the Seller Licensed Patents to those on a schedule and providing for a mechanism to correct the schedule post-closing. First, the seller can make a representation that the list of licensed patents includes all patents of the seller that are practiced by the Business as of the closing. However, the remedies for a breach of such a representation are generally of limited duration, and it may be hard to determine the measure of the loss associated with the breach. Alternatively, the seller can covenant that, for a specified period of time, if it is determined that a patent that should have been on the list was omitted (for example, a patent needed to make a representation true), then such a patent will be deemed added to the schedule as of the closing date.

The list of licensed patents plus the covenant or representation provides a high degree of certainty for the seller (up to the expiration of the representation and/or covenant) as to which of its patents are subject to the license, and for the buyer that it has received a license to all “necessary” patents. Moreover, as a practical matter, a claim either regarding the inaccuracy of the representation or breach of the covenant may be unlikely, because the seller is unlikely to bring a claim of infringement against the buyer if there is any possibility that the buyer will be able to claim that the seller has made an inaccurate representation or breached its covenant by failing to include a particular patent on the relevant schedule.

h. “to make, have made, use, sell and import the Licensed Products, solely in the Licensed Field and solely in the Territory”: Regardless of how the licensed patents are defined, the patent license typically includes a second “gate” in the form of a Field and/or Licensed Product definition. This second gate circumscribes the scope of the licensee’s permitted conduct. Because a patent license may be viewed as equivalent to a “covenant not to sue,” this second gate also defines a safe harbor in which the licensee may operate without fear of being sued by the licensor. The interaction between these two license gates should be carefully considered. For example, limiting the patents that are licensed may obviate the need for a narrow field-of-use definition if the licensed patents cover only a narrow field. Nonetheless, careful attention ought to be paid to these terms, since they may serve to restrict the licensee’s operations. In particular, the parties will often determine whether the Field will cover only what the licensed business is doing as of the closing or will extend to include likely expansions of the field and of the type of licensed products.

In addition to complementing a field definition, the licensed product definition may be used to limit who benefits from the license and to prevent circumvention of the no-
sublicensing restriction. Similarly, an overly narrow definition of Licensed Products could limit the licensee’s right to assign the license in a change-of-control transaction. 

Finally, since patents provide exclusive rights only in the country in which they are issued, regardless of the definition of “territory,” the restrictions in a patent license will not apply in any country in which there are no patents in effect.

2. Other Patent License Terms

Spin-Offs. While patent licenses are generally not sublicensable, there is often an exception for a subsequent spin-off or sale of a subsidiary by the licensee. Without express language, an entity that was a subsidiary of the licensee (and therefore covered by the license) and that subsequently ceases to be a subsidiary would no longer be licensed (however, any patents owned by that entity would continue to be licensed to the counterparty). Moreover, even if the license were transferable, the licensee would not want to transfer the license to its former subsidiary, as it would thereby lose the benefit of the license. This outcome can be avoided by the licensee granting a sublicense to its former subsidiary. The licensor will often want to limit this sublicense to apply to the subsidiary only (and not an acquiror of the subsidiary) and to be limited to the business, products or field of the business at the point the subsidiary ceases to be a subsidiary. Consideration should be given to whether the license to the subsidiary should be further sublicensable or transferable.

Enforcement. While enforcement of a patent against infringers is rarely an issue in non-exclusive licenses, in an exclusive license, the licensor’s failure to enforce the licensed patents is tantamount to the granting of another license in breach of the exclusivity. While in some cases a broad exclusive license may be viewed as equivalent to a transfer of ownership, thereby giving the licensee standing, a licensee may not wish to rely on such an argument to protect its rights. Accordingly, if both the licensor and the exclusive licensee want the right to enforce the licensed patents, it is important to expressly address enforcement rights in the agreement, including the right of either party to bring the other party into the litigation as a named plaintiff in order to maintain standing. Typically, the enforcement provision would cover a number of items, including who may initiate the suit, the obligation of the non-initiating party to name the other as a plaintiff if necessary to maintain standing, the right to settle, and the allocation of costs and damage awards.

No Challenge Clauses. It is a well-established principle that a patent licensee reserves the right, which cannot be waived by contract, to challenge the validity of the

---

110 For example, if the Licensed Products are not limited to the licensee’s branded products, the “make” right could be used to make a third party’s products that would be covered by the license.

111 For example, if the Licensed Products are limited to a particular brand of product or only ones in existence at the closing, the license may be of limited value to a subsequent acquiror.
licensed patents. If successful, the licensee would no longer require a license to the invalidated patents. Particularly where the license is royalty-bearing, the licensee has a strong incentive to challenge the licensed patents, because if the patents are invalid, it will no longer be required to pay royalties, and if the challenge is unsuccessful, the licensee will continue to have the benefit of the license as before. However, while the license cannot be terminated, a licensor may include terms, such as increasing or accelerating royalties, to discourage the licensee from seeking to invalidate the licensed patents.

*Patent Maintenance.* Especially in an exclusive license, it is not in the licensee’s interest to allow a licensed patent to lapse or become abandoned. Accordingly, an exclusive license may give the licensee the right to acquire the patent if the licensor is going to abandon the patent.

### 3. Copyright Licenses

A copyright license follows a similar form to that of a patent license, except (i) the rights being licensed differ and (ii) the scope of the right being licensed is determined by the “licensed work,” which necessarily is delivered to the licensee. The discussion that follows is based upon the following example, but only the terms that distinguish a copyright license are discussed:

> Effective as of the closing, Licensor hereby grants, and agrees to grant, to Licensee, for the Term, a non-exclusive, non-sublicensable (except as provided in Section [●]), non-transferable (except as provided in Section [●]) license under Licensee’s Copyrights embodied in the Licensed Work, to copy, distribute, publically display and perform and create derivative works of, the Licensed Work and Licensee’s derivative works thereof, in the form of Licensed Products, solely in the Licensed Field, and solely in the Territory; provided that Licensee may not distribute or otherwise make available to any third party the Licensed Work or any derivative works thereof in the form of a Restricted Work.

a. “Licensed Work”: As noted in Section II.B.3, a copyright is inseparable from the work of authorship in which it is embodied. In many cases in the M&A context, the copyrights to be licensed or transferred are not registered, and may therefore not be specifically identified or scheduled. Accordingly, they are defined by reference to the definition of *Licensed Work*; the copyable Technology is typically delivered to the buyer (or retained

---

112 The public policy is to encourage patent challenges to weed out invalid patents.

113 The Supreme Court ruled in *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118 (2007), that a licensee has standing to challenge a licensed patent even while continuing to pay royalties and otherwise be in compliance with the license. As such, the licensee has little to lose from challenging a licensed patent.

114 In a patent license, the scope of the right is defined by the claims, and there is no need to the licensor to deliver the licensed invention to the licensee.
by the seller). For example, the Licensed Work is typically defined as all works of authorship included in the Transferred Technology or Retained Technology, as the case may be, and in which the Licensor owns the copyright.\footnote{The identification of the Licensed Work may be even further obscured by combining both the copyrights and the trade secret in the delivered Technology into a single defined term, “Other Intellectual Property Rights.” See Section III.B.4 above.} In many cases, however, particularly in transactions involving software, it is possible to clearly identify at least a subset of the Licensed Works. Where such identification is possible, the specifically identified work can be excluded from the general license and subject to a separate narrow license.\footnote{In addition, consideration should be given as to whether the copyright in a particular work should be registered either by the seller prior to closing or the buyer after closing.}

b. “To copy, distribute, publically display and perform and create derivative works”: The Copyright Statute defines six exclusive rights of the Copyright holder.\footnote{The owner of a copyright “has the exclusive rights to do and to authorize any of the following: (1) to reproduce the copyrighted work in copies or phonorecords; (2) to prepare derivative works based upon the copyrighted work; (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending; (4) in the case of literary, musical, dramatic, and choreographic works, pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly; and (6) in the case of sound recordings, to perform the copyrighted work publicly by means of a digital audio transmission.” 17 U.S.C. § 106.} However, for most Technology-related licenses, the foregoing rights are most relevant. A typical license grant may include all, or only some, of these rights. For example, a license that limits the use of the licensed software to internal use only would not include the distribution right, or a license to object code only may not include the right to make derivative works.

The meaning of these rights is fairly intuitive. However, the terms distribution and derivative work merit further discussion.

Except as may be specified in a license, a rightful owner of a copyrighted work is free to resell that work. However, the term distribution refers to distribution (by sale or otherwise) of copies of the copyrighted work.\footnote{There are nonetheless specific terms in the Copyright statute dealing with specific instances, such as lending libraries, re-broadcasting and the like.} Further, distribution is distinct from sublicensing. A licensee that has a license to distribute the licensed works, for example software, may sell copies of the software to third parties. The purchaser may use that purchased copy for its intended purpose as if owner of the copy; this does not require the grant of a sublicense.\footnote{In practice, the software may be distributed along with a license that is subsequently agreed to between the purchaser of the distributed copy and the original licensor (for example, by clicking on an “Accept” button when the software is first used).} Thus, it is important to consider whether the granting of the distribution right in a license is sufficient, or whether either the licensee should be granted sublicensing
rights, or the licensor should enter into a separate agreement with the end-user of the software.

The term *derivative work*\(^\text{120}\) is defined in the Copyright Statute as “a work based upon one or more preexisting works . . . in which a work may be recast, transformed, or adapted.”\(^\text{121}\) A derivative work is itself a separate work of authorship. Absent an agreement to the contrary, a licensor/owner of the copyrighted work does not acquire ownership of the derivative work authored by the licensee. Absent an express license of the derivative work to the licensor, the licensor would have no rights to the derivative work.\(^\text{122}\) However, a licensee’s rights to the derivative work remain subject to the license under which it was granted the right to make derivative works.

4. **Trade Secret Licenses**

Whereas patent and copyright licenses grant rights with respect to an exclusive right, a trade secret license is simply a series of covenants governing the licensee’s use and disclosure of information. As such, a trade secret license can take many forms, and there are few constraints on what can be agreed to. The discussion that follows is based upon the following:

**License.** Effective as of the closing, Licensor hereby grants, and agrees to grant, to Licensee, for the Term, a non-exclusive license to use, in accordance with Section [●] the Licensed Trade Secrets solely for the purposes of operating the Business following the Closing in substantially the same manner as it was conducted prior to the closing and only in the field and in the Territory.

**Section [●]. Terms of use.**

(i) Licensee shall maintain all embodiments of the Licensed Trade Secrets, on a single server that can be accessed by Authorized Users and shall maintain a log of all access;

(ii) Licensee may not disclose the Licensed Trade Secrets to any person other than employees or officers of the Company who have executed confidentiality agreements satisfactory to Licensor; and

(iii) . . .

\(^{120}\) The term *improvement* is commonly used in IP licenses, although it has no clearly defined meaning and should be used with caution.


\(^{122}\) In a commercial license, a grant back of a license to derivative works or “improvements” is uncommon given the practicalities of defining what is a derivative work or improvement and then requiring the licensee to provide copies back to the licensor.
The foregoing is intended to illustrate the *sui generis* nature of trade secret licenses. Hence, rather than discuss the license grant itself, we will highlight the key issues to consider.

Defining *Licensed Trade Secrets* is often a difficult task. There is usually little dispute around the description of the materials embodying the trade secret that will be disclosed to the licensee, and the record will be fairly clear as to what was in fact disclosed. However, defining the boundaries of which elements of the disclosed information are Licensed Trade Secrets is considerably more complex, particularly if the license imposes significant restrictions on the use of the trade secrets and material derived by the licensee from the original trade secrets. Thus, it will be in the licensor’s interest to define the “Licensed Trade Secrets,” while the licensee will want the opposite.

In the M&A context, this complexity can generally be avoided by defining Licensed Trade Secrets as all trade secrets embodied in the transferred Technology or retained Technology, as the case may be. However, whereas a licensee can generally know whether its conduct is covered by a patent license or a copyright in a discrete work (such as a software program), the same is not true for a license to broadly defined trade secrets. Consequently, a licensee is at risk if it engages in an activity that is not within the scope of the trade secret license and if the licensee is required to show that none of the Licensed Trade Secrets were used and its conduct did not breach any of the covenants regarding the use of the Licensed Trade Secrets. If the licensee uses the Licensed Trade Secret in its broader business, even if the license permits such use, the licensee is at risk that its broader business will be “tainted” and subject to the restrictive terms of the license. On the other hand, the licensor may have a legitimate interest in wanting to limit the dissemination of its trade secrets. When negotiating a trade secret license, it is important to keep these competing interests in mind. In addition, while in the M&A context there is typically only one trade secret license, some of the foregoing difficulties can be addressed by having more than one license, each adapted to a particular subset of the trade secrets.

**License Term.** Whereas the terms of a patent license cannot extend beyond the life of the patent, and any obligations of the licensee end when the patent expires or is held invalid, a trade secret license can be perpetual. If not provided for by the terms of the license, any obligations of, or restrictions on, the licensee may continue even after the trade secret information becomes public knowledge. On the other hand, if the term of the license ends while the trade secrets are still in existence, the licensee is at risk if it cannot

---

123 A licensee will want to limit the materials to tangible items that can be documented and not information that is conveyed orally. Moreover, the licensee may want to limit the materials it receives.

124 See, e.g., Warner-Lambert, *supra* note 43, at 666 (“One who acquires a trade secret or secret formula takes it subject to the risk that there be a disclosure.... The terms upon which [the parties] contract with reference to this subject matter are purely up to them and are governed by what the contract they enter into provides. If they desire the payments or royalties should continue only until the secret is disclosed to the public it is easy enough for them to say so. But there is no justification for implying such a provision if the parties do not include it in their contract, particularly where the language which they use by fair intendment provides otherwise.”).
Sublicensing. Permitting the trade secret licensee the right to disclose the Licensed Trade Secret to third parties is essentially the same as a sublicense or a transfer of the license. Hence, rather than rely on generic terms, such as “sublicensable” or transferable, it is preferable to expressly specify: (i) to whom and under what conditions the licensee may disclose the trade secrets, and (ii) what the third party to whom the trade secrets are disclosed is permitted to do with them.

Enforcement. An entity that is in rightful possession of a trade secret would have a cause of action against a third party that misappropriates the trade secret. Ownership is not necessary to be able to maintain the cause of action. Particularly in the M&A context where there is a purported transfer of trade secrets (or confidential information) from one party to the other, it is important to clarify whether both the transferor and the transferee maintain the right to bring an action against a third party that misappropriates the trade secret.

5. Other Intellectual Property Rights Licenses and Software Licenses

Other Intellectual Property Rights. As should be evident from the foregoing, trade secret and copyright licenses share several things in common, including: (i) trade secrets and copyrights are both rights embodied in a “tangible” deliverable, (ii) it is often not possible to define with any precision the licensed trade secrets or unregistered copyrights or to distinguish between owned and licensed rights, and (iii) it is often not practical for the licensee to treat owned trade secrets and copyrights differently from licensed trade secrets and copyrights. Thus, in many cases, trade secrets and unregistered copyrights can be combined into a single definition, “Other Intellectual Property Rights,” and licensed under a single, relatively broad, non-exclusive license that specifies how the Technology that embodies the Other Intellectual Property Rights can be used and disclosed by the licensee. This license may, however, carve out certain Technology or works of authorship, in particular identified software or registered copyrights that are separately licensed. In addition, as in the case of stand-alone trade secret and copyright licenses, there may need to be additional terms addressed to specific issues raised by each IP right.

Software. In many cases, computer software can be treated as “Transferred Technology” and included in the license to Other IP embodied in the Transferred Technology. However, where the software can be clearly identified or is a discrete product, it would typically be licensed under a separate software license. There are essentially two parts to a software license: (i) a copyright license to the software as the licensed work, and (ii) if the licensed software includes source code, a trade secret license to the source code. Even if the software is patented, there would not generally be a license to practice the patent independently of the licensed use of the software. For further information on the distinction

---

125 For example, the license can be perpetual, but the obligations of, or restrictions on, the licensee end after a fixed period of time. Alternatively, the license term ends when the trade secrets become public.
between source code and machine code, see Section II.B.3 above. The following is a general form of software license grant:

Subject to, and conditioned upon, Licensee’s performance of its obligations and duties hereunder, Licensor hereby grants and agrees to grant to Licensee and its subsidiaries a limited, non-exclusive, non-transferable, non-sublicensable, non-assignable, royalty-free, worldwide license under the Licensed Intellectual Property Rights:

(i) to internally copy, use and create derivative works of the Licensed Software in object code and source code form [for the sole purpose of developing Licensed Products and integrating the Licensed Software therein]; and

(ii) to copy and distribute (including pursuant to a sublicense on industry-standard terms and conditions) the Licensed Software (and derivative works created in accordance with clause (i)), in object code form only, to end users within the Territory.

6. Trademark Licenses

As previously discussed, trademark signifies a single source of origin of the products (goods or services) to which it is applied. The value of the trademark lies in the reputation or “goodwill” of the trademark holder symbolized by the trademark. The purpose of a trademark license is to allow a licensee to use the licensor’s trademark on the licensee’s products, thereby representing to purchasers of the products that the licensor is the source of the quality and reputation of the licensee’s products. A trademark license is needed only if the licensee is selling its goods or services under the licensor’s trademark. No license is needed to merely resell or distribute the trademark holder’s products or if the trademark is used to refer to the trademark holder or its products. Thus, for example, a buyer of a business would not need a trademark license to sell finished goods in inventory or to refer to the transaction. However, if following the closing the buyer will continue to manufacture and sell the products of the acquired Business under a trademark retained by the seller, then a license is needed.

Key requirements for a trademark license, particularly relevant in the M&A context, are: (i) the licensor must have the contractual right to “police” or control the quality of the licensee’s products and must in fact exercise this right, (ii) the licensor must have the ability to terminate the license if the licensee’s conduct is harming the goodwill associated with the mark (for example by selling inferior goods), and (iii) the goodwill (and therefore the value) that arises from the licensee’s use of the mark (for example through the licensee’s marketing efforts) inures solely to the licensor’s benefit. For these reasons, it seldom makes business sense for a party to build a long-term business on the basis of a licensed trademark. This is particularly true in the M&A context, and, consequently, in most cases a trademark license is granted for a limited transition period to enable the licensee to transition to a new trademark which it owns. The following is a simplified form of a transition trademark license:
Effective as of the closing, Licensor hereby grants to Licensee, a royalty free, non-exclusive, non-transferable, non-sublicensable, terminable (as provided below) license, for the [Transition Term] under the Licensed Trademarks to use such Licensed Trademarks in the Territory in connection with Licensee’s marketing, support, offering, sale and promotion of the Licensed Products. Licensee shall:

(i) maintain the quality of the Licensed Products at least the same level of quality maintained by Licensor with respect to such products prior to the closing;
(ii) use the Licensed Trademarks only in the form and manner specified by Licensor from time to time; and
(iii) provide Licensor with samples of, or access to, the Licensed Products to enable Licensor to verify the quality of the Licensed Product and that Licensee is using the Licensed Trademarks only as permitted.

Licensor may terminate the foregoing license without liability if Licensee breaches the foregoing or takes any action, or fails to take any action, that harms the value of the Licensed Trademark. All goodwill associated with the use of such Licensed Trademarks by Licensee shall inure to the exclusive benefit of Licensor.

Licensee shall indemnify Licensor against any claims, losses or damages Licensor may suffer or incur arising from Licensee’s use of the Licensed Trademarks (other than for claims that the Licensed Trademarks infringe a third party’s Trademarks).

While the form of a trademark license follows the general form of other IP licenses, there are certain key terms:

**License Grant.** The grant is a license to *use* the Licensed Marks in connection with the sale and marketing of the products—the interactions with third parties that will rely on the licensor’s reputation in deciding whether to purchase the licensee’s product. No trademark license is needed to manufacture the Licensed Products or to resell products provided by the licensor.

**Policing Terms.** In the M&A context, the terms governing the licensor’s control over the quality of the Licensed Products are generally limited, as in most cases the Licensed Products are the same products that were being sold by the licensor prior to the closing. However, if the Licensed Products will include new products developed by the licensee, there will typically be detailed provisions permitting the licensor to inspect and approve both the Licensed Products and the manner in which the Licensed Marks are used.

**Licensee Indemnity.** Unlike other IP licenses, in a trademark license it is not uncommon to have the *licensee* indemnify the licensor in the event that the licensee’s product...
is defective or causes harm and the licensor is sued based on an assumption that the product is the licensor’s.

7. Treatment of Licenses in Bankruptcy

The treatment of IP licenses in bankruptcy differs depending on whether the debtor is the licensor or the licensee. Historically, there was significant controversy over the treatment of IP licenses in a licensor’s bankruptcy. After a lower court decision in 1985 suggested that a debtor-licensor had the power to terminate its licenses, Congress amended the Bankruptcy Code in 1988 to provide licensees with the express ability to retain their rights in a bankruptcy. However, the amendment did not include trademarks within the coverage of the provision, and thus considerable uncertainty remained as to the rights of trademark licensees in a licensor’s bankruptcy.

In 2019, a Supreme Court decision resolved the controversy, holding that the 1985 lower court decision had been incorrect, and that the Bankruptcy Code does not provide a debtor-licensor with the ability to terminate its trademark licensees’ rights. As a result, licensees of all types of intellectual property now have the option to retain their rights in their licensor’s bankruptcy, although minor differences remain between trademarks and other types of intellectual property.

The treatment of IP licenses when the debtor is the licensee is more complex. Normally, the Bankruptcy Code grants the debtor the ability to “assume” or to “assume and assign” its valuable pre-bankruptcy contracts, meaning that it can either retain or monetize its contractual rights. (The debtor can also “reject” a contract, which terminates its rights.) The Bankruptcy Code overrides many types of anti-assignment clauses, in order to help maximize the value of the bankruptcy estate and provide additional recovery to creditors.

IP licenses are a special case, however, because intellectual property law often treats these licenses as a form of “personal” contract, and thus not capable of being assigned

---


127 As amended, Section 365(n) provides that if a debtor-licensor of “intellectual property” rejects the license, the licensee may nonetheless “retain its rights (including a right to enforce any exclusivity provision of such contract…”.” See 11 U.S.C. § 365(n).

128 The definition of “intellectual property” in Section 365(n) does not include trademarks. See 11 U.S.C. § 101(35A).


131 See Mission Prod. Holdings, 139 S. Ct. at 1662.

without the consent of the licensor. For example, nonexclusive trademark licenses are generally considered to fall into this category, because a trademark licensor takes into account the personal attributes of its licensee in determining whether the licensee would be a good candidate to represent its brand. Section 365(c) of the Bankruptcy Code respects this limitation by providing that a contract cannot be “assume[d] or assign[ed] . . . if [] applicable law excuses a party . . . to such contract . . . from accepting performance from or rendering performance to an entity other than the debtor” without the consent of the counterparty.  

Unfortunately, section 365(c) has generated a split its interpretation, meaning the venue of the bankruptcy proceeding can greatly alter the relative rights of the licensor and licensee. The two main approaches are outlined below:

a. Hypothetical Test

The literal text of section 365(c) suggests that if the license is a “personal” one, it cannot be assumed or assigned – even if the licensee would prefer to keep the license and has no intention of actually assigning the license to a third party. Under this interpretation, the licensee is therefore required to reject the license, and loses its rights. Four major appellate courts, including the Third Circuit (which includes the Bankruptcy Court for the District of Delaware), support this view.  

b. Actual test

Other courts apply the “actual test,” which only applies section 365(c) if the licensee actually intends to assign the license to a third party, rather than the “hypothetical test” approach described above, which turns on whether the licensee could assign the license to a third party. Thus, licensees of “personal” licenses that intend to keep the license post-bankruptcy may do so (but cannot assign it to a third party).  

Many IP licenses attempt to contract around the somewhat harsh and often inconsistent results that can arise under section 365(c). One common practice has been for a license to include the following type of provision:

All rights and licenses granted to a party as Licensee hereunder, are, for purposes of Section 365(n) of the United States Bankruptcy Code (the “Bankruptcy Code”), licenses of intellectual property within the scope of Section 101 of the Bankruptcy Code. The Licensors acknowledge that the Licensees, as licensees of such Intellectual Property Rights and licenses hereunder, will retain and may fully exercise all of their rights and elections

---


134 See In re West Electronics Inc., 852 F.2d 79 (3d Cir. 1988).

135 The Bankruptcy Court for the Southern District of New York applies a third approach, known as the Footstar test (after the case in which it was developed), which is the same as actual test, unless an independent trustee is appointed to take over the bankruptcy case, in which case the hypothetical test is used.
under the Bankruptcy Code. Each party irrevocably waives all arguments and defenses arising under 11 U.S.C. § 365(c)(1) or successor provisions to the effect that applicable law excuses such party from accepting performance from or rendering performance to an entity other than the debtor or debtor-in-possession as a basis for opposing assumption of this Agreement in a case under Chapter 11 of the Bankruptcy Code to the extent that such consent is required under 11 U.S.C. § 365(c)(1) or any successor provisions.

Parties to IP licenses should carefully consider addressing the implications of Section 365(c) in their agreements.
V.

Additional Topics

A. Transition Services Agreements

Although it is often left until late in the process to negotiate, one of the most important transaction documents in a private deal, especially a carve-out in which a business is being separated from a larger organization, is the transition services agreement (“TSA”).

A TSA is typically not a feature in public company deals, where the entire company is being acquired and absorbed into the buyer. In a whole-company deal, all of the functions and services necessary to sustain the acquired business as an independent entity are included in the sale (and indeed in many cases there will be duplication of many services, the elimination of which are important synergies of the transaction). In a carve-out transaction, however, an operating business that has been running as part of a broader organization is being transferred to a new entity. See Section III.A above for further information on transaction structures. Some of the people and systems providing services to the transferred business (such as legal, environmental, and payroll and other employee services) will remain with the seller. The TSA is a vital piece of the deal to ensure that the business can continue to operate without interruption while the new owner replaces the services that will no longer be provided by the seller.

In some cases (for example, when the buyer is a private equity firm), the buyer will not be able to easily replace those services by itself, and a new way of providing those services will have to be found to allow the transferred business to “stand up on its own.” In those cases the TSA may last much longer than cases where the buyer is a large public company with all the comparable back office services it can itself provide over time. Sometimes it may be necessary for the transferred business to provide transitional services back to the seller as well. For example, the seller may require certain key transferred personnel with valuable institutional knowledge to continue to provide services to the seller for some period of time.

Sometimes services may be provided on a long-term basis and not just to aid a transition, in which case a long-term commercial services agreement will need to be negotiated. Long-term commercial arrangements of that type are beyond the scope of this Guide, but some of the provisions relating to TSAs may apply to them as well.

The TSA is typically structured to include a form of master agreement, which governs general terms like the quality of services to be provided, indemnification and limits on the provider’s liability, together with a number of schedules describing the specific services to be provided. The details regarding the services to be provided, such as the nature of each service, length of service and payment terms, are included in these TSA schedules. It is not unusual for outside counsel to negotiate the general form of the TSA but to largely
defer to in-house counsel and business personnel to negotiate the specific terms of the individual schedules. While this may be generally efficient, it is often important for IP counsel to be involved in the process.

While the TSA will cover a range of services that are not IP sensitive, such as employee-related services, legal functions and real estate matters, very often some of the most significant items covered by the TSA relate to IT that both the buyer and the seller will need to use on a going-forward basis (at least in the case of the buyer for an interim period). It is important that IP counsel be able to view the purchase agreement and the TSA holistically, because often the provisions relating to ownership and licensing of technology and IP rights can appear in either or both documents.

As discussed in other parts of this Guide (see especially Section II.A.3 above), there are a variety of ways of ensuring that the acquiror receive the technology and IP it needs to operate the business it is buying, including by transfer of ownership or licensing and cross-licensing arrangements. The TSA typically covers ancillary functions that are not a central part of the business being acquired, but are still necessary for its uninterrupted operation. Sometimes acquirors may have a good reason for wanting ownership rights in the IP associated with the provision of these services, but more often ownership is not critical, and it is simply a matter of ensuring that the services are provided adequately. This is certainly the case with respect to standard back-office services like general accounting, personnel and administrative services, and even normal IT services, where it is unlikely any significant new proprietary technology will be created in connection with the performance of these services. Any specific needs with respect to customizing the services in question for the recipient can be addressed in the statement of work relating to those specific services. In the case of these types of standard services, there is usually no need for ownership in any IP to transfer, and to the extent the recipient of the services needs a license from the provider to enjoy the benefit of the services or any deliverables provided under the TSA during or after the term, that license can be granted in the TSA or a separate document.

B. Joint Ventures

A joint venture ("JV") is an arrangement between two or more parties for the purpose of pursuing a new business enterprise or opportunity. The term "joint venture" is broad, covering arrangements from a simple contract to the formation of a new entity in which the JV parties invest. Each JV party usually brings something of value to the JV, whether it be in the form of cash, hard assets, expertise, or, most important to this Guide, technology and IP. Non-monetary contributions like IP are inherently difficult to value, as it is often unclear if the venture will successfully be able to exploit those resources. Because equity interests and governance rights are often tied to the capital contributions made by the JV parties, it is important that valuation issues and logistics of contributions be negotiated upfront. By employing a JV model, as opposed to engaging in M&A, the JV parties are able to retain their corporate identities and flexibility as independent businesses, while taking advantage of the synergies that derive from complimentary resources and expertise and the reduction of risk tied to using pooled resources. As such, JVs can be
especially useful as a means for a company to get a foot in the door in a new geographic region or break into a risky field of business.

JV parties will often put IP to use and develop new technology and know-how throughout the life of the venture. This cooperation between entities that may have competing interests outside the JV raises complex business and legal questions, including regarding their formation and structure, governance and deadlock mechanisms, termination rights, and antitrust concerns, many of which are beyond the scope of this Guide. Regarding IP specifically, the greatest challenges of JVs often relate to the valuation and contribution of IP developed prior to or outside of the scope of the JV (referred to as “Background IP”), the use and ownership of IP created within the JV during the course of its existence (“Foreground IP”), and the treatment of IP upon termination of the JV.

Depending on the importance of IP to the JV’s overall mission and prospects, the decisions the parties make in regard to the above issues are sometimes memorialized in the overall JV formation documents, and sometimes in separate agreements. While there are obvious benefits to having these issues encapsulated in specific agreements, including the speed and efficiency gained by having the subject matter experts focus on them separately, care should be taken to ensure that they dovetail with the overall transaction documents.

One particular type of JV with IP at its core is a research collaboration to, for example, engineer a new drug or create cutting-edge sustainable technology. These arrangements are often expressed in an agreement called a Joint Development Agreement (“JDA”). In providing Background IP to a JV, the contributing JV party may assign ownership of the necessary IP, but more typically will license such IP to the JV. Background IP is often licensed to a JV entity through a sole (non-exclusive) licensing agreement, allowing the contributing party to continue to use the licensed IP, and to tailor the JV’s permitted use of the IP to a limited field of use or geographical region.

Additionally, if IP is licensed to a JV, the JV parties should take care to consider who will be responsible for the enforcement of the licensed IP. If the JV is the product of contractual arrangement, and thus there is no independent entity, the JV parties may cross license the background IP that is needed for each party to perform its contractual obligations within the JV. See Section IV.B for further information on licensing agreements.

Often the JV will lead to the development of new Foreground IP. This raises issues regarding both how to develop and protect the Foreground IP and also how to allocate the rights to it. Issues around confidentiality are of paramount importance, as the parties are

136 For example, in April 2020 Volvo and the truck division of Daimler agreed to set up a joint venture to develop and produce hydrogen fuel cell systems for heavy vehicles. Volvo, Daimler to Found Truck Fuel Cell Joint Venture, ASSOCIATED PRESS, April 21, 2020, https://apnews.com/b13cc8d640582cf6ef1abe0e60ff1f3fc.
likely to exchange sensitive information, the release of which could affect the value of Intellectual Property Rights.\textsuperscript{137}

Allocation of Foreground IP raises its own distinct issues, especially since parties will enter into JV agreements without knowing what IP will ultimately be created. In the case of an entity-based JV, Foreground IP will often vest in the entity, and the arrangements will have to establish the parties rights with respect to the IP when the JV terminates (a similar discussion to allocation of rights in a pure contractual JV). One option is joint ownership of the IP. Under U.S. law, the legal default is that a patentable invention created by multiple inventors results in joint ownership of the resulting patent, giving each party an undivided interest in the entire patent. In this arrangement each party is vulnerable to the actions of the other, as each party can freely license the patent to a third party absent additional consent requirements, lacks a duty to share royalties with other joint owners, and must be a party to any enforcement litigation. Consequently, parties may contract to provide sole ownership of Foreground IP, dividing ownership of subsequent IP based on item such as its subject matter or who played a larger role in its creation. However, no matter how artfully these provisions are drafted, disputes may still arise as to who the true author of a work is or what subject matter an invention “primarily relates” to. Alternatively, parties, especially in cases of unequal bargaining power, may also adopt a “structural approach” in which all Foreground IP is allocated to one party, which can then license that IP to the counterparty. In such a negotiation, the eventual owner of IP would likely want to frame the arrangement as one party essentially hiring the other as a developer, rather than them operating as true collaborators.

The principles referenced in connection with joint ownership of patents generally apply to copyright as well, with certain distinctions: joint ownership similarly arises \textit{ab initio} from joint authorship of a work, though, unlike with patents, the default rule is that authors must share royalties and can sue for infringement without consent or joinder from other owners.

For trademarks, because they would usually be actively policed and are meant to signify a single origin of a product, it is recommended that parties who would seek to create a joint trademark, instead designate one party the owner of the trademark and then license it to another, or that a holding company (that each party has an interest in) be created as the sole holder. Finally, no legal default rules exist for joint ownership of trade secrets, as they are not created from a statutory grant of rights but rather a contractual arrangement.

At the outset of the JV, the parties should also be thinking about their eventual business plan. If the parties orient the JV towards an exit by merger or acquisition (including potentially by one of the parties), it is important to effectively draft the JV’s inbound and outbound IP licenses with an eye towards an eventual change in control. In addition

\textsuperscript{137} For example, recall that trade secrets are only protected from misappropriation, not from a party using leaked or published information. In connection with patents arising out of the JV, the parties should take care to utilize the provisions of 35 U.S.C. § 102(c), which insulates the parties from a prior art or “obviousness” challenge to the patent based on the sharing of confidential information under a joint research agreement.
to the possibilities of dividing the IP, joint ownership (with all its attendant complications), or a structural approach in which one party owns the IP and licenses it to the other, there could be other creative alternatives, such as ending the JV’s function as a business entity, but keeping it as an IP holding company that will then grant licenses to the newly independent JV parties. Parties engaging in JV activity may try to anticipate as many contingences as possible, but reality often has a way of evolving in unexpected directions: JV arrangements are paradigmatic examples of “incomplete contracting” which provide the decision-making framework to address those unanticipated future contingencies. This is good for creative lawyers, but also a reason why companies often prefer simply to buy critical technology rather than enter into a JV for it.

C. Security Interests in Intellectual Property and Finance Transactions

Like other tangible and intangible assets, IP assets can be pledged as collateral to secure a debt obligation. The lender to whom the IP assets are pledged can then perfect a security interest in the assets so as to have priority over other creditors with respect to the pledged collateral. Perfection of a lender’s security interest is generally determined by Article 9 of the Uniform Commercial Code (“U.C.C.”), as adopted by the relevant state. Under the U.C.C., a lender perfects its security interest by filing a UCC-1 financing statement with the secretary of state in the jurisdiction in which the borrower is located. However, this U.C.C. procedure does not apply where there is a specific statute governing the filing of a security interest.

Neither the federal Patent Act governing patents nor the Lanham Act governing trademarks expressly address the perfection of a security interest. It is therefore likely that a UCC-1 financing statement recording the security interest in “general intangibles” is sufficient to perfect a security interest in patents and trademarks. However, there is some uncertainty on this issue, so it is near universal practice to record the security interest by filing both a UCC-1 financing statement and a short form security agreement in the USPTO against the relevant patents and trademarks.138 These filings in the USPTO should be made within 90 days of the granting of the security interest.

By contrast, the perfection of a security interest in a registered copyright is governed by the Copyright Act, not the U.C.C.139 Accordingly, a short-form security agreement with respect to each registered copyright must be filed within one month (or two for agreements executed outside the United States) with the Copyright Office in order to perfect the security interest. It is likely, however, that a UCC-1 financing statement covering general intangibles is sufficient to perfect a security interest in unregistered copyrights. Nonetheless, the best practice is to register material copyrights subject to the security interest.


While it is beyond the scope of this Guide to discuss the drafting of a financing statement, when representing the debtor it is important to review the restrictions (for example, on licensing, abandonment, transferees and so forth) placed on the IP collateral and whether the restrictions are consistent with the continued operation of the borrower’s business.