Don't Buy Someone Else's IP Problem

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Acquiring a company can be one of the most significant investments a business ever makes. The strategic rationale may be compelling: new markets, new customers, a talented team, or a complementary product line. But in many deals, the most valuable asset being acquired is not the employees or equipment or even the revenue. It is the intellectual property (IP). That makes IP due diligence not just a legal formality, but a core business imperative. And yet, deal after deal, IP review is treated as an afterthought — a box to check near the close of a transaction rather than a lens that should be shaping valuation and deal terms from the very beginning. The consequences of that mistake can be severe.

When a target company's competitive advantage rests on a patent portfolio, a body of trade secrets, or brand equity built on its trademarks, those IP assets are central to the deal. Everything else may be replicable or replaceable. If the IP turns out to be weaker, narrower, or less secure than it appeared, the strategic and financial rationale for the acquisition can unravel.

Consider a few scenarios that play out more often than acquirers expect. A software company is acquired for its proprietary technology, but it turns out key developers never signed invention assignment agreements. That means the code they wrote may belong to them, not the company. Another example: A pharmaceutical company acquires a start-up based on a promising patent portfolio, only to discover that the patents, while granted, face serious validity challenges that were never disclosed. Or, imagine that a consumer brand is purchased at a premium, only for the acquirer to learn that the trademark was never properly registered in key international markets. In each case, the buyer paid for something that wasn't really there.

The most basic mistake is stopping diligence once the IP assets are confirmed to exist. Confirming existence is a necessary first step but nowhere near sufficient. The next two questions should be whether the IP covers the competition and whether it is enforceable. For example, a target's patent may cover its own products but may not be broad enough to exclude the competition. Before placing value on a portfolio, counsel needs to map the claims to the competition, not just confirm that patents exist in a general field. Even if the claims cover the current competition, ask whether there are viable ways to design around the claims. If a competitor only needs to make a small change to avoid infringement, then the patent is of little value. Next, even if the patent covers the competition, it may be later invalidated over prior art. For example, the target company may have made sales of the claimed invention more than one year prior to filing the patent application, which could render the patent invalid when discovered in litigation.

Ask whether the ownership is clearly documented. Founders who worked at prior employers may have assigned their inventions, inadvertently or otherwise, before they ever started the target company. Contractors who built core technology may have retained rights under agreements that never addressed IP. Co-inventors who left the company years ago may hold ownership interests that were never resolved. A patent can be filed in the company's name and still belong, in whole or in part, to someone else.

Determine whether the IP has been properly maintained. Trade secrets, in particular, require active steps to maintain protection. If a company has been sloppy about confidentiality agreements, security practices, or access controls, the trade secret protection it claims may not exist as a legal matter. For patents, maintenance fees must be paid and deadlines observed. A portfolio that has been allowed to lapse in key markets, or where important continuation applications were never filed, may offer far narrower coverage than it appears.

These questions should be addressed early on when considering an acquisition, not as a rushed step during the final stages of a deal. By that point, valuations have been agreed to, management has been wooed, and momentum has built toward closing. The practical and psychological pressure to overlook problems, or to accept representations and warranties as adequate protection, becomes enormous. IP diligence should begin early, ideally during preliminary discussions, and should be integrated with the financial and commercial analysis that drives valuation. If the deal depends on a particular patent position, that position needs to be verified before the price is set, not after the fact. Representations and warranties in a purchase agreement can provide some recourse after the fact, but they are a poor substitute for knowing what you are actually buying. Litigation to enforce a warranty claim is expensive, slow, and uncertain. Prevention is far better.

IP due diligence is ultimately a risk-calibration exercise. It is not about killing deals, because many IP issues can be corrected if the issue is discovered early enough. What it cannot do is correct an unfixable problem that is discovered after the wire has transferred. Intellectual property is often the most valuable thing in a deal. It deserves to be treated that way. CEP

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