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FEATURES

**In-Venue Streaming and Broadcasting
of Live Sports Events—Key Legal
Issues for U.S. Clubs and Leagues 1**

Airina Lynn Rodrigues and David Pahl

**Blockchain Games and Collectibles—
Patents and Other Legal Issues 6**

James G. Gatto

Do Not Give NDAs the Short Shrift 11

*Rebecca Edelson, Seong Kim,
and Youngbin Son*

COLUMNS

***Licensing Markets* 15**

Copyright Licensing
Entertainment Licensing
Technology Licensing
International Licensing

***Praxis* 22**

Valuation
Contract Corner

Praxis



Valuation

Chris Cauble

The Private Equity Investor's Guide to Intellectual Property

As 2019 brings the start of new deals and closes old ones, intellectual property assets (broadly known as IP) should be at the forefront of the private equity investor's mind.

IP can secure debt leverage, be sold after purchase, provide new revenue streams, and can increase the company's valuation at sale. Keep these thoughts about IP in mind as you plan and execute your investment strategy this year.

IP Is More Than Just Patents

IP can be divided into four broad categories: patents, trademarks, copyrights, and trade secrets. A patent is likely the most well-known form of intellectual property. As property rights, patents grant an exclusive right to make, use, or sell an invention (or sell the right to all of the above) in the United States, and patents bar others from importing the invention into the United States. Because patents are intended to protect a tangible good that can be sold, or at least the process related to making that good, patents are the primary means for

companies to protect their core products and processes from competitors. In the United States, a patent can be used to stop a competitor after it has been granted by the United States Patent and Trademark Office (USPTO).

A trademark or service mark is a word, name, symbol, or device associated with products to indicate the source of those products and help a consumer distinguish between different products. Trademarks and service marks protect the goodwill a company has developed for itself, its products, and/or its services. Trademarks can be officially recognized by the federal government or state government, and in some cases, trademark rights can be developed without registration with a government entity. Although registration in the United States provides many benefits, it is not necessary to register the mark to act to stop a competitor.

Copyrights protect works of authorship, such as books, music, photographs, and movies, and can represent a source of assets for a company. Companies whose primary function is to produce Web site content, or to produce the software driving new apps, for example, may have copyrights that can provide private equity value. Copyright protection arises at the moment a work is created, but, in the United States, copyrights must be registered with the United States Copyright Office

before a suit can be brought on an infringement claim.

Trade secrets are the fourth category of intellectual property. Trade secrets protect the knowledge or know-how developed by a company that gives the company a strategic advantage by keeping that knowledge secret from competitors. A common example of a trade secret is a customer list or a secret recipe for a beverage. Trade secret rights traditionally were protected under state law, but in 2016, the Defend Trade Secrets Act added a federal right of action for the misappropriation of trade secrets.

When evaluating a private equity transaction, make sure to identify all the potential intellectual property assets in the transaction. Take time to review what the company does, the intellectual property assets the company has explicitly identified, and where the company may have overlooked value in intellectual property.

IP Due Diligence Is Complex but Necessary

Patents, trademarks, copyrights, and trade secrets are not publicly traded. Consequently, a determination of the value of a company's IP can be difficult.

Beginning with the company's patents, review the formal validity of each patent in the company's portfolio and ensure that the maintenance fees for any issued patent has been paid. Next, make sure that all of the patents and patent applications in the portfolio have all the formal documents properly filed with the patent office. Formal documents can include declarations, assignments, and powers of attorney.

Identify how far each patent is into its lifespan, also known as a patent term.

A good evaluation of a patent requires more than a determination of the patent's formal validity—it should include a thorough review of what the patent claims; the relationship between the claims and the company's core business; the history of the examination of the patent; and, if possible, a search of published materials related to the subject matter of the patent.

A formal validity review for trademarks should include a review of renewal fees, the appropriate declarations, and any assignments that have been, or should have been, filed. A more thorough review will determine whether the trademark was unintentionally abandoned and whether the trademark is being appropriately used.

Formal validity of copyrights will include a review of the status of the copyright, and a determination that all of the appropriate samples have been submitted to the copyright office. A thorough evaluation will also investigate the authorship of the copyrights.

Last, trade secrets can be harder to value. Time is well spent to evaluate the company's confidentiality programs, confidentiality agreements, and other policies that are used to identify and maintain the secrecy of their know-how.

A Thorough Evaluation of IP Is Worth the Time and Money

A thorough evaluation of IP can take significant time and money

to complete, especially if IP protection has also been granted in foreign jurisdictions.

A thorough evaluation should never be neglected, however, as it will often reveal new revenue streams, untapped assets that can be developed to boost value at the time of the target's future sale or IPO, and new assets for debt leverage.

Speaking of which, IP can be a source of collateral for a leveraged acquisition. Individual IP assets have monetary value, and a thorough evaluation can increase the total assets to be leveraged against. In particular, patents are a good asset to leverage against as they are easily identifiable and can be more readily evaluated for the value they bring to the company's business.

If you are engaging in a leveraged acquisition, include the patents, trademarks, copyrights, and trade secrets of your target in your list of potential assets against which to borrow. Thorough due diligence will help identify those assets.

Strategic Due Diligence Includes an IP Component

IP plays a strategic role in any solid private equity portfolio. It can be beneficial to consider the following questions:

- Is the company spending any research and development dollars on areas that are not directly related to their current core business?
- Does that research and development complement any other company that is already in the private equity portfolio?

- Has the target company invested in obtaining the appropriate intellectual property assets to protect those research and development dollars? If so, are those assets ready to be sold, licensed, or spun off into another entity?
- If the company is being considered as a platform acquisition, does it have intellectual property assets that could be attractive for later purchases?
- If the company is being considered as a bolt-on acquisition, does it have intellectual property assets that protect any of the platform businesses to which the acquisition will be bolted?

By answering these questions and running your target company's IP through a strategic analysis, you will be better able to determine which companies are worth the investment and which are the overhyped duds.

Although intellectual property law may be complex, and while it may take considerable time and resources to uncover all of the hidden gems or risks in a company's IP portfolio, making an informed decision can be the difference between gambling and investing.

As a principal at Harness Dickey's metro Dallas office, Chris Cauble primarily focuses his practice on preparing and prosecuting patents, but he also has experience with trademarks, copyrights, and inter partes review proceedings. His clients include companies in the medical device industry as well as in energy production.