IP Risk Strategy: Insurance for Mergers & Acquisitions

INTELLECTUAL PROPERTY Insurance Services Corporation

Mergers and acquisitions (M&As) continue to be a viable and attractive solution to intellectual property (IP) monetization. Many well-conceived M&As have the potential to create a win-win situation with respect to a small company commercializing its most important innovations. It has long been known that the best way to monetize an innovation is to create a company that produces a product incorporating it. After the company is up and running, the owner-innovator can feel satisfied that all has been done that is required to optimize the return from his innovation. He will have proven the innovation works, that is can be scaled up to commercial production and that it can be sold. This is the quickest route to a maximum return, and has proven to be the best, since the innovator controls all of the critical development steps. This is in contradistinction to licensing, where others must pursue the passion-requiring steps of proving the innovation works, that it can be scaled up to commercial production and that it can be sold. Granted, by forming a company the innovator takes more risk but correspondingly reaps more reward upon an M&A.

Obviously, a big part of any M&A transaction revolves around IP rights. As a legal representative of either the buyer or the seller in an M&A, you have several important issues to address. The first is to determine if the IP-related practices of the target company are sufficient to establish whether there is a likely risk the IP rights of others are being infringed. A corollary to this analysis is a determination as to whether the target company has an ongoing methodology in place to avoid infringement concurrently as innovations are implemented, messages are created, the company's identification is promoted and know-how is developed. Note: Innovations lead to patents, messaging leads to copyrights, identification leads to trademarks and know-how results in trade secrets, all of which are collectively the company's IP rights.

The next step is to verify that the scope of the target's IP is broad enough to cover its operations and protect its market share, goodwill and trade secrets. Of course, it goes without saying that the ownership of these IP rights must be confirmed to be with the target company. If the target company uses open source software, it is important to determine whether that the target company is in compliance with the terms associated with the open source software.

The final issue is terminology of the representations and warranties with respect to both the ownership and scope of the IP rights, as well as the freedom from infringement of others' proprietary rights.

It is at this stage that IP insurance plays a major role in transferring the risk from both the seller and the purchaser to an insurance carrier established to accept such risk. For example, a transferrable IP defense policy would mitigate the purchaser's concern over the target company being sued for infringement after the sale. Similarly, a transferrable IP infringement enforcement policy would preclude the concerns of the purchaser that the target could have its IP rights "ripped off" by a competitor. Either of these IP insurance policies could also deter the need for the seller to escrow a portion of the purchase price to cover the IP infringement risks.

Correspondingly, a multi-peril policy, first-party coverage, could be used to cover business interruption, loss of economic advantage or the cost of redesign, remediation and reparation resulting from the above risks. The multi-peril policy can also be used to cover the loss of IP value if the policy holder's IP rights were ultimately held to be invalid or unenforceable. Lastly, unauthorized disclosure coverage could be brought into play to cover the risk associated with an unauthorized disclosure of a company's trade secrets.

In summary, enlightened M&A advisors will bring IP insurance into play as a useful risk transfer tool in M&A transactions to create a win-win situation for both the buyer and seller of an innovative company.

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