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Database-Aided IPR Due Diligence

1 Introduction

In an interesting new book, *Rembrandts in the Attic – Unlocking the hidden value of patent* (McGraw Hill 2001), Kevin Rivette, chairman of Aurigin Systems, and David Kline highlight the need for corporate strategies aimed at identifying, protecting and commercialising intellectual property rights. Basing their analysis on in-depth studies of how major companies such as IBM, Gillette, Microsoft, Xerox and Lucent have succeeded – or failed – partly as a result of their intellectual property identification and protection strategies, Kline and Rivette draw the conclusion that there is an enormous potential for companies in maximising their intellectual property right assets. Kline and Rivette quote IBM, among others, as an example of how an aggressive IP strategy can help in boosting IP-related revenues from \$ 15 billion in 1990 to more than \$ 100 billion in 1998. On the other hand Kline and Rivette tell the story of Kodak, which in 1960 embarked on a long patent litigation journey aimed at disqualifying Polaroid's Instamatic patents, a litigation which cost Kodak more than \$ 40 billion and ended in failure.

Since the US patent system takes a more liberal attitude towards the patentability of business methods and technology, patents form more of a core role in a US IP strategy. In Europe – and Sweden – patents will not serve such a central role, due to the fact that the Swedish legislator and the European Union, and in particular the European Patent Office and the Swedish Patent and Registration Office, do not have as generous an attitude as the US Patent Office when it comes to affording software and methods patent protection. The same considerations as apply for patents do, however, also apply to other intellectual property rights such as copyrights, trademarks and tradenames, design rights and semi-conductor rights, which, if identified and duly protected can serve as a major competitive advantage and be of great commercial value.

In the course of our daily advising of clients, in particular IT, telecommunication and media clients, we have experienced an increase in the importance of intellectual property rights for a successful market penetration and a method of successfully keeping competitors on a distance. In order to be able to give clients qualified advice on the management and strategic handling of intellectual property rights, as practising lawyers we have devoted substantial efforts to developing a method for taking an inventory of intellectual property rights, the specifics being that a so-called

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IPR Due Diligence needs to take all intellectual property aspects into account and that it addresses issues such as multiple and over-lapping protection of intellectual property rights. The result is a computerised database aimed at managing the great amounts of information, which emerge as a result of an IPR Due Diligence. The overall contents of the IPR Due Diligence method will be described in short in this article. The ambition of this article has, however, primarily been to describe the general issues posed in an IPR Due Diligence and to, very briefly, exemplify the legal issues with examples from different intellectual property law areas. Finally, the article aims to provide an example of how legal practice today involves extensive use of Information Technology.

2 Briefly on accounting issues and intellectual property rights

One major reason for the necessity of performing an IPR Due Diligence is that intangible assets in many cases are not visible in a company's balance sheet. Although many voices have been raised, calling for intellectual capital to be made part of the balance sheet, current accounting rules do not provide for intellectual capital and least of all for intellectual property rights to be stated in the balance sheet, apart from exceptional cases. Trademark rights, for example, may not be entered in the balance sheet at all. Consequently, if no IPR Due Diligence has been performed within a company, you will not be able to find any comprehensive documentation listing its intellectual property assets and visualising their strength. Instead the information, if any, about the company's intellectual property rights is normally scattered, and stored in different departments. This being so, an overall review is often necessary in order for intellectual property rights of interest concerning such a company to be identified.

3 The overall purpose of conducting an IPR Due Diligence

Due Diligence procedures are normally carried out when one company is about to acquire another. Such procedures are very often performed within narrow time limits and normally are aimed only at identifying certain documentation, whereof intellectual property rights form a minor part. The purpose and methods of performing an IPR Due Diligence differ in many respects from due diligence procedures performed in connection with a company acquisition, since the primary aim of an IPR Due Diligence is to ascertain which intellectual property assets exist and which are used, and only at the second stage to establish whether there exists any documentation regarding the intellectual property rights. In a word, our primary objective when performing an IPR Due Diligence could be compared to a financial SWOT analysis¹, but this time aiming to:

¹ Strength, Weaknesses, Opportunities, Threats.

1. identify the value of intangible assets not accounted for in the balance sheet;
2. identify the intellectual property rights forming the company's core values;
3. identify intellectual property shortages;
4. ascertain the possibility of otherwise of registering or otherwise protecting the intangible assets;
5. establish future routines for the identification of intellectual properties;
6. establish a future IPR strategy to be adopted by the board;
7. identify the measures are necessary to compensate intellectual property shortcomings.

Furthermore, an IPR Due Diligence differs from a traditional M & A due diligence insofar as the IPR Due Diligence will often be helpful in other situations than an M & A situation.² For example, a company may gain advantages by performing an IPR Due Diligence before the launch of a new product. By identifying the intellectual properties connected with the product in question, the company will be able to achieve more comprehensive protection of the product and thus a market advantage, since it will then be able to keep its competitors at a comfortable distance. Other situations where a company could gain advantages from having identified and listed its intellectual property assets are for example:

1. when procuring insurance coverage;
2. when signing licence agreements which are of core importance to the company;
3. when procuring capital, for example by a new issue of shares;
4. when acquiring a product.

If a company has performed an IPR Due Diligence before entering into the aforementioned transactions, its possibilities of negotiating better commercial conditions and achieving greater legal certainty will be correspondingly increased.

4 How to identify the rights concerned and the protection afforded

As mentioned above, the purpose of an IPR Due Diligence is firstly to ascertain which intellectual property rights exist and are used within a company. Hence, in the initial phase of an IPR Due Diligence procedure, the primary objective is to identify, for example, the material and symbols and words used by the company in its market activities, but also to identify the software products, databases and other technology products the company depends on. Once such critical elements are identified, the next stage of the due diligence procedure is to ascertain whether:

1. the elements are protected by intellectual property rights;

² Merger & Acquisition.

2. if so, the scope of such protection;
3. the elements are used within the scope of such protection;
4. the elements infringe third-party rights.

In order to ascertain whether an element is protected by intellectual property rights, we have to ask a wide range of questions, ranging from practical issues such as whether the company provides for restricted computer access to documents stored in computer networks (the answer to that question is necessary, for example, in order to establish whether information is protected as trade secrets) and whether the company has stored marketing materials (necessary, among other things, in order to establish whether a trademark is protected by means of acquired distinctiveness on the market or whether the trademark has been used in the past five years and consequently is not in danger of de-registration).

In addition to the aforementioned identification of material and information supporting the existence of intellectual property rights, a range of searches of publicly available patent, design, trademark and tradename registers is necessary in order to establish whether an element has obtained protection by means of registration, and in that case, the scope of the protection. Such searches will not only extend to searches of national registers: a search will also have to be made of international registers such as the trademark register of the Office for the Harmonisation of the Internal Market (OHIM). Such searches must not be limited to the registration certificate as such, but must also be more detailed and for example analyse whether a trademark registration is dependent on third party consents submitted to the Patent and Registration Office or OHIM.

5 Has the company duly acquired the rights?

Having established which elements are of interest in the due diligence procedure, it is of the utmost importance to analyse whether the rights have been duly acquired from third parties and if the elements are surrounded by restrictions as to their use. As regards copyright, for example, the general principle under Swedish copyright law is that the copyright stays with the originator unless otherwise agreed. Works developed as part of an assignment are to some extent licenced to the assignee, but if the parties have not agreed on a full transfer of copyrights, the assignee is only granted a limited licence to use the works. Similarly, since the Anglo-Saxon copyright “*work for hire* principle” does not apply under Swedish copyright law, copyright (with the exception of computer programmes and supporting material) instead remains with the employee. This means that employment agreements and consultant agreements have to be analysed in order to establish to what extent the employer has acquired the copyright in works created by the employee. Since the use of employees hired from manpower rental firms has become quite common, arrangements of this kind will also give rise to complicated copyright assignment issues.

Similar principles also apply under patent law where the employee, depending on the kind of invention and whether it has been developed in the employee’s spare time or not, is entitled to remuneration for patentable inventions.

Summing up, in the course of a due diligence procedure, it will be necessary firstly to ascertain where the intellectual property right has originated and if and how it has been acquired by the company. In many cases, employment and assignment agreements can be used as the basis of such an analysis. It is, however, very important not to simply identify the written existent agreements and to base an analysis on such facts, but also to go beyond the written documentation and to identify verbal agreements and other factors which indicate the intellectual property rights have been acquired in a certain manner.

6 Are there any limits to the intellectual property rights as such?

Once having identified which elements are of interest to protect and whether the rights to such elements have been duly acquired, the next stage will be to ascertain whether the rights are limited as such. The possible limitation of an intellectual property right can be instanced with a trademark registered in connection with a disclaimer excluding part of the trademark from protection. Another example is trademarks of a descriptive or possibly generic character, which gives them low distinctiveness, thus limiting the scope of protection to more or less identical symbols or words. Similarly, patents need to be analysed in relation to the product which it is intended to protect, in order to establish whether the patent claims mirror the actual product or whether there are any limitations in the patent protection as such.

Once any limitations of the intellectual property rights have been identified, the findings can be used as the basis of a strategy to strengthen the protection of intellectual property rights which are limited in scope. The findings will also strengthen the awareness of possible infringing consequences of the company's use of intellectual property rights, which is limited as such.

7 Present or future threats towards the existence of the intellectual property right

Apart from the fact that an intellectual property right may be limited in its scope due to disclaimers or other such limitations, it is also highly interesting to analyse the relative strength of an intellectual property right in order to establish whether it is able to resist attacks from competitors or, possibly, infringers as a defensive measure in infringement proceedings.

Industrial property rights in particular face the risk of de-registration or invalidation, due to their having been registered despite the existence of impeding rights or other absolute grounds for registration refusal. A trademark could be de-registered, for example, on the grounds of degeneration, partial or full non-use during the last five years or the fact of its having been registered despite the existence of a confusingly similar

trademark. These risks of de-registration also apply to patents, where, especially in patent proceedings, there is an imminent risk of an alleged infringer claiming that the patent is invalid due to formal shortcomings preceding the registration. One very common counterclaim in such proceedings is that the patented invention was not new, due to the existence of other similar inventions or due to the inventor having made it available to the public before submitting the patent application, when it was patented. The same principles apply to registered designs. Hence, in the course of the IPR Due Diligence it is important to identify any such potential threats against registered industrial property rights and, if any formal shortcomings existed before the date of registration, to take steps to offset them.

8 Maintenance of an intellectual property right

Where industrial property rights are concerned, it is particularly important to monitor actual and potential competitors' applications for patents, designs or trademarks falling within the protective scope of the company's industrial rights. Hence, it is often important that a company has established routines and structures enabling it to react to possibly infringing applications for the registration of new industrial rights. Such routines are of increasing importance, since the public scrutiny of industrial property applications has decreased and will decrease further (cf. the proposed new Swedish Trademark Act, under which the registered trademark proprietor is solely responsible for monitoring applications submitted to the Patent and Registration Office and for opposing such applications within a certain length of time period). Consequently, the scope of an IPR Due Diligence would also need to include the identification of routines for the monitoring of intellectual property rights.

Intellectual property maintenance routines could also take the form of trademark use instructions where the users of the company trademark are instructed to use the trademark in capital letters and in connection with the TM-symbol or the registered trademark symbol ® so as to avoid degeneration of the trademark and to establish bad faith on the part of trademark infringers.

9 Intellectual property infringements

An intellectual property right is of little or no use if it cannot be enforced in relation to third parties. Thus, an IPR Due Diligence should aim at identifying whether the company concerned is, or has been, subject to intellectual property rights infringements and how it has responded to them. In this regard it could be of interest to analyse the company's standard procedures, if it has any, for attacking infringements. In Swedish case law, there are examples of rightholders who have tried to enforce rights in a dubious way and where, as a result of infringement warning letters, the alleged infringer has counter-sued and successfully claimed that the sending of warning-letters amounted to unfair marketing.

On the other hand, an active counter-infringement policy is important since the legal consequences of not instigating procedures

towards an infringer could be the right-holder losing its right to request interim measures, or, at worst, the parallel use of an infringing trademark being recognised in court.

10 Limitations as to the use, assignment or modification of intellectual property right protected elements

Finally, since intellectual property rights could in many respects be subject to limitations as to their use, assignment or modification, an IPR Due Diligence report needs to take into account whether such use, assignment or modification is subject to limitation. One obvious limitation to the use of intellectual property rights could be stipulated in licensing agreements for the intellectual property right in question. Common examples of such restrictions are the format in which the intellectual property right may be used (such restrictions are often, implicitly or explicitly, stated in copyright and trademark licences), whether the licence may be assigned or sub-licensed and whether the works subject to the licence may be modified by the licensee, such modification being subject, among other things, to mandatory copyright rules on modification and moral rights.

The method for establishing the limits of the permitted use, licence and assignment is firstly to analyse licensing agreements entered into by the company. Secondly, such rights could be evident from the licensor's and licensee's historical behaviour, which may indicate that the licensor has consented to certain forms of use or certain possibilities of modifying the licence object – such information to be gathered through interviews with employees of the company familiar with the historical licence situation.

11 Use of databases to structure IPR Due Diligence information

The IPR Due Diligence database developed in our IPR team is aimed at making the IPR procedures more efficient and able to cross-reference the findings of an IPR Due Diligence in a more sophisticated manner than would be possible if the material had only been categorised in manual files. There are a number of advantages in using database structures when gathering and analysing the vast number of documents and other information emerging in the course of an IPR Due Diligence procedure. Firstly, the material may be cross-referenced so as, for example, to generate a report on which intellectual property rights are connected to a certain product. Secondly, if a flexible database structure is used, it is possible to generate a number of reports which are useful in the future strategic management of a company's intellectual property rights, such as reports indicating which intellectual property rights are about to expire, which products that have not been protected in the best possible way available and which agreements relate to the licensing or sale of a certain intellectual property rights. The use of a database structure also simplifies matters in the event of a separate product or department of a company being sold to a third

party, since the intellectual property rights and agreements affected by such a sale can then be identified immediately.

Furthermore, if a database is used as the information-gathering instrument in the course of an IPR Due Diligence procedure, the risk of personal aberrations if the analysis is performed by several different persons is less than if the procedures were to be performed manually, since that would allow the individuals more scope for using their own methods for analysing the material. If a database is used, the technology can be used to streamline the way the information is analysed, and the provision of support functions such as explanatory texts will make the analysis far easier.

In the rapidly developing technology environment, it could also be observed that the technology could be used for developing database supportive functions like that described above. Voice recognition and optical character-reading mechanisms are good examples of technologies which could be used to enhance the information content of a database. Extended search engine and hyper-linking possibilities could also be used to enhance the possibility of quickly cross-referencing, say, trademark registrations with licensing agreements for the trademark at issue. Databases of the said kind can also be connected to scanning facilities, so that information today stored in a manual format will be readily available within the framework of the database, which in turn will make the management and administration of intellectual property rights far easier. With the extended possibilities of making databases and information available via web interfaces and intranets, the information contained in an IPR database could also be distributed within an organisation in a manner which is quite different from the use of paper-based documentation systems.

12 Concluding remarks

Summing up, the corporate importance of intellectual properties seems to be growing as companies head into more service-intensive areas of business where intangible assets are of crucial value to them. At the same time, with the intellectual property law field growing more and more complex, it is often difficult for a company to obtain an overview of intellectual property rights issues which really matter. Many companies are therefore faced with a situation where it is necessary to adopt a new attitude towards intellectual property rights and to adopt procedures and strategies ensuring that the elements eligible for intellectual property right protection are identified and are registered and upheld to the best extent possible. This also means to say that intellectual property issues will become more of a focal consideration in a company's daily board work and possibly also at meetings of shareholders, since the existence of a certain right could be crucial to the whole existence of a company.

The main objectives of an IPR Due Diligence procedure are to establish:

1. which elements are of interest for the review;
2. whether those elements are afforded intellectual property right protection and – in that case – which protection and to what extent;
3. whether the company has duly acquired the rights;

4. whether there are any restrictions on the intellectual property right at issue;
5. whether there exist any present or future threats to the intellectual property rights identified;
6. whether there are any restrictions on the use, modification or assignment of the intellectual property right at issue.

Once these facts are established, the company which is subject to the IPR Due Diligence procedure will have an overview of the intellectual property rights which are crucial to its operations and of its intellectual property weaknesses and strengths. Further, the company will be able to identify the measures necessary in order to uphold and strengthen the intellectual property rights in question.

If a database instrument is used in the performance of an IPR Due Diligence, major advantages are achieved by comparison with manual filing systems, since a database enables the user to generate reports containing the summarised specific information on certain objects of interest to the user. The use of databases will also simplify the dissemination of information, thereby making the management of intellectual property rights more efficient in the long term.

