



European IPR Helpdesk

Fact Sheet

IP due diligence: assessing value and risks of intangibles

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Introduction

Nowadays, companies are increasingly becoming aware of the importance of intellectual property (IP) assets as a means to expand their business, to raise capital and to provide financial gain. Indeed, many Small and Medium-sized Enterprises (SMEs) are considering IP assets as a part of their balance sheets². Consequently, to understand the full value of their intangibles and make the most of their potential benefits, companies regularly conduct IP audits.

Any entrepreneur should make steps to identify and monitor the IP assets owned and used, to assess risks, to overcome problems and to assess their commercial value. To this end, IP assets should also be included in business plans, with a view to presenting them to potential investors.

These actions are commonly grouped under the name of **IP due diligence**, intended as the exercise to gather as much information as possible on the value and the risks of a company's intangible assets, with a view to **acquiring IP, raising capital** and **seeking financial assistance** (e.g. bank loans). Although IP due diligence is a **precondition for capital investments**, it can be helpful

¹ This fact sheet was initially developed in September 2012 and was updated in November 2015.

² The balance sheet segment on properties gives investors an idea as to what the company owns and owes.

for enforcing IP rights and reducing IP-related costs. In a few words, IP due diligence can be considered as an essential process when developing an IP strategy.

This fact sheet explains the importance of IP due diligence audit for SMEs, public and private research and technology organisations (RTOs) and universities. The following paragraphs outlines when, why and how IP due diligence needs to be undertaken.

1. When conducting IP due diligence

IP due diligence is commonly defined as an exercise intended to value a company's key assets and liabilities. Above all, such an evaluation is fundamental for business transactions³ since it focuses on the management of the IP assets of selling company (also called the "target") involved in trade sale of IP.

More specifically, IP due diligence includes an appraisal of the real and appropriate value of the IP concerned and the IP-related risks that buyers might incur further to a business transaction. Accordingly, *from the buyers' point of view IP due diligence is about risk management.*

Some scenarios where IP due diligence is foreseeable are:

- **A buyer is interested in acquiring a company's IP assets;**
- **A venture capitalist wants to invest in a start-up company with relevant IP;**
- **A potential business partner is interested in licensing-in a company's IP;**
- **A company wants to use its IP assets to obtain financial loans.**

Mainly due to the recent economic disorders, venture capitalists, business angels and banks are more and more cautious about financial information and extremely careful in valuing risks. For this reason, IP due diligence is increasingly assuming a fundamental role in capital investments. Indeed, information provided therein may certainly have an influence on the investors' final decision on whether the proposed transaction is worth that price or whether the deal should be revised or even terminated.

It is worth noting that IP due diligence is very likely to be requested in situations of IP assignment and licence or when companies are seeking financings. This means that IP experts will check the company intangibles: ownership, contracts, (e.g. licences, assignments), IP filings and registrations. The aim of this enquiry

³ To have an overview of the specific issues to be addressed in international business transactions, read the fact sheet on „How to deal with IP-related issues in transnational negotiations“, available online in the European IPR Helpdesk [library](#).

is to discover some gaps or defects in the company IP management that could lead to liabilities and therefore could present a risks for the investors.

Overall the experts' pool will go all out to discover if there are *IP due diligence defects*, and more particularly will ascertain:

- **The ownership of the IP concerned;**
- **User rights to the specific IP⁴;**
- **Whether the IP is protected:**
 - **rights acquired or under examination,**
 - **internal and external safeguards⁵;**
- **Whether the IP rights are still in force;**
- **Whether there are some restrictions affecting the use of the IP concerned ⁶ (so-called *freedom to operate*).**

2. Why performing IP due diligence

2.1. Risks of overlooking it

Ignoring IP due diligence could cause some negative consequences for companies selling their IP assets. In particular, the due diligence could discover some flaws in the seller's IP management and result in a loss of credibility to the entrepreneur's image.

Firstly, *the due diligence defects may result in the value of the deal being reduced*. As an example, the terms of royalty payments that have already been agreed upon during negotiations may be revised to the IP owner's detriment.

As a second point, *due to those defects the deal might be delayed*. That is, if the due diligence discovers that the supposedly owned IP is jointly owned by a third party, the transaction will be stuck until the joint owner's consent has been reached. The main risk here is that investors may lose interest in the overall deal. Moreover, in the second negotiation the seller's financial expectations may fall in price because of a likely diminished value assigned by the joint owner to the intangible.

To conclude with the worst scenario, *the defects discovered could cause the investors to give up on the overall deal*.

⁴ It specifically refers to licence rights and the related right to sub-license the asset at stake.

⁵ This is the case of non-disclosure clauses within employment contracts and confidentiality agreements with employees and business partners.

⁶ Rights affecting the free use of the IP could be for instance the rights of the co-owners, subcontractors or in some cases the employees.

2.2. Advantages of carrying it out

Generally speaking, *IP due diligence helps an entrepreneur reorganise its business with the aim of enhancing the marketability of its company and better exploit its products or services*. In this sense, IP due diligence is a part of a broader **IP audit** process. The latter in fact is normally conducted to identify a company's IP assets and to develop an efficient IP management.

An IP audit may assist IP managers to:

- **Set the IP development and commercialisation strategy;**
- **Detect risks connected to the company's IP assets;**
- **Take appropriate actions regarding IP protection and enforcement;**
- **Avoid a waste of financial resources in the acquisition or development of IP⁷;**
- **Reduce the risk of third parties' rights infringement.**

Thanks to this exercise it will be also possible to draw an **IP map** to present to investors at the time of negotiations. The IP map has the purpose of facilitating the due diligence carried out by the investor so as to accelerate the course of the negotiations. Briefly, an IP map serves to identify the intangibles and to retrace the relationship with co-owners, employers and business partners supported by appropriate documents (such as joint ownership agreements, licence agreements, employment contracts, distribution agreements, joint ventures and the like). The aim of this document is essentially to:

- > **Identify each IP asset and its inventor;**
- > **Ascertain its ownership and the rights to use it⁸.**

More specifically, IP due diligence is deemed to be fundamental when small businesses wish to sell their IP assets, raise capitals and seek financial assistance. To this end, as the IP owner **it is very important to undertake IP due diligence upon** itself since:

⁷ Thanks to the IP audit it is possible in fact to avoid acquiring or developing a duplication of an already owned IP asset, and to get rid of the obsolete technology. In so doing, IP costs may also be reduced.

⁸ More precisely, the existence of any third party's rights.

- ✓ **It can help reveal defects that may be discovered by the investors;**
- ✓ **The gaps revealed can be filled first, before the business transaction;**
- ✓ **The risks of having the deal devalued or even abandoned because of those flaws may be reduced or eliminated altogether.**

At the end of this process you will need to prepare a final *IP due diligence report*. Such a document needs to identify all the relevant issues mentioned above, to present the possible associated risks and to provide relative solutions. The report should also point out the areas where more examination is needed.

Bear in mind that the investor will double check your IP due diligence exercise so that presenting a consistent and comprehensive report will make you look like a serious and reliable business partner in the counterpart's eyes. Moreover, sellers doing IP due diligence and drawing an IP map on their own before the deal are likely to have the agreement reached in a more timely fashion. This is why conducting IP due diligence as a seller is strongly advised.

3. HOW to conduct IP due diligence

The exercise of conducting IP due diligence is a technical one and it certainly requires professional skills. It is therefore recommended that the assistance of an IP professional be sought to carry it out. Nevertheless, to give you a grasp of what that would entail, below you can find a breakdown of the main steps necessary in this process, noting that the scope and costs of this exercise will depend on the nature of the transaction⁹.

⁹ Meaning that the more complex is the transaction (e.g., terms of the contract and its economic value), the more extensive IP due diligence can be.

I. Identify IP assets

The initial goal of any IP due diligence is to identify a company's IP assets – patents or patentable assets, trade marks, designs, confidential business information¹⁰, copyright, domain names and so forth. This will show the IP that is or is not used and the opportunity of changing the use for different business purposes. It will also demonstrate the relevance of the asset concerned to the core business of the company (e.g., whether it is a principal or a supplementary asset).

II. Verify ownership and existence of IP

An assessment of the intangible is made based on whether it is owned by the company (e.g., sole or joint ownership, exclusive or non-exclusive licence, etc.). This not being the case, it will be evaluated to find out if proper steps were taken to obtain adequate rights and if not, whether their acquisition is necessary. This will serve to see if there are some ownership problems, why they exist and what should be done to avoid or fix them. It will also reveal if there is an appropriate system to protect intangible assets with employees and business partners¹¹.

III. Detect restrictions on IP asset use

To check if the value of the asset would not be diminished by any previous transfer of IP rights, an analysis of transactions such as licences, collaboration agreements, joint ventures and the like is needed to make sure that there are no other restrictions on the use of the intangible concerned; namely, that the IP concerned can be commercialised with limited risk of liability for infringement - what is referred to as **freedom to operate**.

IV. Ascertain the validity and strength of IP rights

An assessment of the validity of the IP rights in force will be made, as well as an estimation of the legal duration and exploitation lifespan of the asset. As for the latter, this would aim at predicting the time during which

¹⁰ For a better understanding of what confidential business information is, have a look at the fact sheet on "How to manage confidential business information", available in the European IPR Helpdesk online [library](#).

¹¹ See above, note 4.

the IP asset that is the object of the transaction is expected to maintain its market value.

V. Evaluate potential IP infringements

This would be the case when either a third party is infringing a company's IP right or it is the company that might infringe a third party's right. In both cases a dispute is likely to arise with the consequence of disrupting the business operations.

Summing up, the table below sets out a practical overview on the basic elements investigated when performing an IP due diligence.

ISSUES	INVESTIGATION
IP IDENTIFICATION	<ul style="list-style-type: none"> - Workbooks (e.g. laboratory books or log books) - Invention Disclosure Forms¹² - IP map
IP OWNERSHIP	<ul style="list-style-type: none"> - Assignment agreements (e.g. assignment from an independent researcher or assignment from a third party contractor) - Employment agreements - Non-compete agreements - Non-disclosure agreements - Joint venture agreements - Collaborative research agreements
IP VALIDITY	<ul style="list-style-type: none"> - Filing receipts from national and international IP offices - Fee payment receipts - Recording of non-registrable IP - Freedom-to-operate report - Any claim and dispute affecting the grant or validity of the IP (e.g. opposition and revocation proceedings)
OTHER ENCUMBRANCES AND/OR OBLIGATIONS	<ul style="list-style-type: none"> - Pledge guarantees - Court actions - Private and public funding agreements - Distribution agreements - Bank loans

¹² An Invention Disclosure Form is a document to be completed by the creators of a particular IP, setting out the details of its development, as well as details on how it is distinguished from the state of the art.

Useful Resources

For further information also see:

- Fact sheet on “How to manage confidential business information”:
<http://www.iprhelphdesk.eu/Fact-Sheet-How-to-Manage-Confidential-Business-Information>
- Fact sheet on “How to deal with IP-related issues in transnational negotiations”:
<http://www.iprhelphdesk.eu/Fact-Sheet-How-to-Deal-with-IP-Issues-in-Transnational-Negotiations>
- E. A. Meilman AND J. W. Brady, JR. “Due Diligence in Business Transactions Involving Intellectual Property Assets, INTELLECTUAL PROPERTY TODAY, 2003, available at
http://www.dicksteinshapiro.com/files/upload/Due_Diligence_Final.pdf

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ABOUT THE EUROPEAN IPR HELPDESK

The European IPR Helpdesk aims at raising awareness of Intellectual Property (IP) and Intellectual Property Rights (IPR) by providing information, direct advice and training on IP and IPR matters to current and potential participants of EU funded projects. In addition, the European IPR Helpdesk provides IP support to EU SMEs negotiating or concluding transnational partnership agreements, especially through the Enterprise Europe Network. All services provided are free of charge.

Helpline: The Helpline service answers your IP queries within three working days. Please contact us via registration on our website – www.iprhelphdesk.eu – phone or fax.

Website: On our website you can find extensive information and helpful documents on different aspects of IPR and IP management, especially with regard to specific IP questions in the context of EU funded programmes.

Newsletter and Bulletin: Keep track of the latest news on IP and read expert articles and case studies by subscribing to our email newsletter and Bulletin.

Training: We have designed a training catalogue consisting of nine different modules. If you are interested in planning a session with us, simply send us an email at training@iprhelphdesk.eu.

DISCLAIMER

This Fact Sheet has been initially developed under a previous edition of the European IPR Helpdesk (2011-2014). At that time the European IPR Helpdesk operated under a service contract with the European Commission.

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