§ 3:10 Intellectual Property Matters

§ 3:10.1 Generally

Nearly every IPO company has intellectual property assets. For companies in technology or life sciences fields, intellectual property is often their lifeblood—central to their business models, competitive positions, and valuations. Other companies may not think of themselves as IP-reliant, but they almost certainly rely on trade secrets, trademarks, copyrights, domain names, and other intellectual property in their businesses. Every company going public should pay attention to its intellectual property assets. An excellent means for a company to take stock of its intellectual property assets is a so-called intellectual property audit, and an opportune time to conduct one is during corporate housekeeping in connection with an IPO.

§ 3:10.2 Intellectual Property Audit

An intellectual property audit is a systematic review of all significant intellectual property used by the company, whether owned or licensed. It is conducted by management with the company's incumbent intellectual property counsel or, if the company wants a fresh perspective—particularly on patent matters—by different intellectual property counsel.

[A] Components of an IP Audit

Inventory: The company should start by creating an inventory of all of its significant domestic and foreign intellectual property assets. These include issued patents, pending patent applications, and unfiled invention disclosures; registered and unregistered trademarks and service marks; distinctive trade dress; registered copyrights and significant unregistered copyrights; domain names; and a summary of important trade secrets and other know-how. The inventory should also encompass intellectual property rights under licensing, joint development, collaboration, technology transfer, OEM, distribution, and other contractual arrangements.

Rights: Next, counsel should probe whether the company owns the rights it believes it owns, by asking questions such as the following:

- Have all employees engaged in research and development signed agreements assigning developments to the company?
- Do all of the company's consulting and outsourcing agreements provide that the intellectual property rights in all materials arising out of such agreements are assigned to the company?

- Have all patent applications and patents been assigned from all of the inventors to the company and have the assignments been recorded with the PTO?
- Were all acquired patent applications and patents properly re-recorded in the company's name?
- Has the company registered the trademarks it uses?
- Does the company have evidence of independent creation of copyrightable works, including software?
- Is the company using open source code and, if so, does it maintain an inventory listing the applicable license for each open source software package?
- Has the company taken reasonable precautions to maintain the confidentiality of its trade secrets? Has source code been kept confidential?
- Are all significant in-license agreements in full force?
- Do exclusivity or field-of-use provisions in any intellectual property agreements impede expansion of the company's business?
- Has the company paid all royalties owed to third parties?
- Do existing joint development and similar agreements allocate intellectual property ownership in the intended manner?
- Was any development activity funded in whole or in part by the federal government?
- Is the company in compliance with federal laws regarding the exploitation of government-funded inventions?
- Did research occur in a university setting and, if so, have the university's policies on invention ownership been considered?
- Has the company granted any security interests in its intellectual property to lenders?

While not providing certainty, the answers to these and follow-up questions should help unearth any ownership gaps.

Sufficiency: The company next should consider whether its ownership and license rights in its inventoried intellectual property meet the company's present and foreseeable needs. If not, the company may need to register intellectual property rights in additional jurisdictions, in-license selected intellectual property, make outright intellectual property acquisitions, or devote internal resources to developing the necessary rights. By ascribing estimates of future values and costs to its intellectual property assets, the company can also prioritize among them and decide which ones to maintain, which ones to pursue vigorously and, perhaps, which ones to sell or abandon.

Weaknesses: Counsel should advise the company concerning its potential intellectual property liability. Allegations of infringement must be investigated, and—even in the absence of pending or threatened claims—the company should consider the need for a freedom-to-operate analysis to identify third-party patents that potentially may block aspects of the company's business. Infringement is never a pleasant discussion, but early knowledge will give the company more time to weigh its options, such as litigation, cross-licenses, settlement, or design-around. Another potential vulnerability is open source software, which can expose the company to the risks inherent in the use of undocumented code, limit the ability of the company to commercialize programs based on it, or force the company to disclose confidential code. Management should confirm that the company is not in breach of any in-license agreements, which could put critical rights in jeopardy. Intellectual property counsel should evaluate the company's potential exposure under infringement indemnities contained in agreements between the company and its customers, distributors, and suppliers. Counsel should also review the company's compliance with technology export controls.

Creation and Protection: With intellectual property counsel's assistance, the company should assess the adequacy of its practices and policies for creating and protecting intellectual property. All employees, consultants, business partners, and other third parties who have access to the company's proprietary information should sign non-disclosure agreements, and those engaged in development activities on behalf of the company should assign the developments and intellectual property rights to the company. A trade secret control program should be in place. The company should have policies requiring employees to keep laboratory notebooks or other contemporaneous records of their inventions and discoveries, and educate employees about the importance of intellectual property rights. The company should also monitor compliance by third parties to which it has licensed intellectual property rights, while being alert to potential infringements by others. Intellectual property "watchdog" services can help.

Opportunities: Intellectual property rights can be underutilized assets. An assessment of the company's intellectual property portfolio may lead to opportunities to extend existing rights to new product lines, license rights to third parties, sell surplus intellectual property, or commence litigation against infringers.

[B] Benefits of an IP Audit

An intellectual property audit offers both short-term and long-term benefits. The process will provide a solid basis for the IP-related

disclosures in the prospectus, including potential infringement risks that could lead to liability if not disclosed. Longer term, the exercise should help company management devise informed intellectual property strategies to maintain and improve the company's market position.

§ 3:11 Human Resources Matters

There is a variety of employment-related matters that typically should be addressed during corporate housekeeping.

§ 3:11.1 Staffing

Pre-IPO companies generally operate with lean staffing, reflecting economic constraints and an entrepreneurial culture. Public company needs usually force the company to hire new employees as the IPO approaches—such as additional finance and accounting staff, investor relations personnel, and a general counsel—and may cause the company to reevaluate present employees.[10]

§ 3:11.2 Management Arrangements

In private companies, management arrangements tend to be informal. If an IPO company has any unusual executive compensation arrangements, it may wish to modify or eliminate them voluntarily—before potential unseemly prospectus disclosure or concerned managing underwriters necessitate changes. As part of its IPO preparations, the company should develop the executive compensation programs that will be appropriate and necessary following its IPO. Many companies engage compensation consultants for assistance. The company should consider the need for new, or modified, employment, severance, and change-in-control agreements with its senior executives. Unless already done, the company also should enter into indemnification agreements with each director and officer, rather than rely on the indemnification provisions contained in the corporate charter or bylaws.[11]

§ 3:11.3 Employee Agreements

The company should verify that all employees have signed non-disclosure, invention assignment, and non-competition agreements, to the extent appropriate in light of the nature of the company's business.[12] Any omissions should be rectified.

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10. Personnel needs resulting from the IPO are discussed in more detail in chapter 9. *See* section 9:2.
11. Indemnification arrangements are discussed in chapter 12. *See* section 12:7.3.
12. These topics are discussed in chapter 2. *See* Table 2-1.