Special Due Diligence Concerns When Buying Unmanned Aircraft Systems

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BY: ROBERT E. KORROCH, THOMAS B. MCVEY AND JOSHUA B. BRADY

The regulatory lid is about to come off domestic commercial use of Unmanned Aircraft Systems ("UASs")[1]. When that happens, like a vacuum, the U. S. commercial market will seek to deploy every viable system. In the rush to acquire systems that will open the door to market access, acquirers should be wary to assess the pedigree of the intellectual property ("IP") associated with a UAS and the UAS's history in foreign markets. Similarly, astute developers are safeguarding their IP and are complying with the U.S. export control regulatory regime as they groom UASs for commercialization.

In the 2012 Federal Aviation Administration ("FAA") Reauthorization Act, Congress directed the FAA to implement regulations to integrate certain UASs into the National Air Space by 2015. The FAA is diligently moving toward that goal, having established a UAS Integration Office, and in December 2013 designating six UAS research and test site operators across the country.

The rush into the UAS market has already generated significant congestion in associated IP markets. For instance, over 150 patents issued in 2013 that include the term "unmanned" in the claims. A system's value and likelihood of market success depend materially on the system's IP pedigree. In many instances, the associated IP will determine the strength and longevity of a system's only competitive advantages. It is therefore critical for participants in the UAS market to identify the IP that corresponds to current – and forecasted – products and services, with a special emphasis on the core aspects and critical technologies that comprise the backbone of existing and future products and services.

Once the corresponding IP has been identified, participants in the UAS market should consider the scope, chain of title, and enforceability of the IP, and determine whether any core aspects or critical technologies are exposed and unprotected. Likewise, participants should assess what systematic processes exist to capture and protect new IP generated during research and development, and whether adequate procedures are in place to monitor IP space for intrusion by competitors. Failing to timely protect IP can result in a loss of rights, just as failing to enforce IP rights may have dire consequences.

It is equally critical to assess the scope of competing IP. Participants in the UAS market must remain vigilant and ensure that products and services – and particularly those that are business-critical – avoid third party IP. Early clearance searches and "freedom to operate" reviews are therefore important, if not critical, to a system's market viability. In the highly competitive and increasingly congested UAS market, failure to seek early clearance may lead to catastrophic results.

In the UAS market, lingering government IP rights are an often overlooked component of IP due diligence. UAS systems are frequently developed under federal contracts or using another form of government support. Depending on the type of funding or support, the federal government may have nonexclusive rights to any IP developed under government support – rights that can be passed on to competitors, or form part of a participant's offering to the federal government. On the other hand, there may be procedures available for a contractor to protect both pre-existing IP and new IP generated during the development. It is therefore imperative that counsel for companies considering the government market have a combination of IP and government contracting experience and knowledge to not only advise on IP issues in government contracting, but also identify potential government IP rights and evaluate the impact those rights may have on strategic use of IP.

The UAS's history of compliance with U.S. export control regulations is another important aspect of UAS due diligence. U.S. law prohibits the export of defense articles or defense services that are regulated under ITAR without an export license or Technical Assistance Agreement approved by the State Department. An export can occur by transferring physical articles overseas, or by providing a foreign national access to ITAR-controlled technical data or software in the U.S. Risk of violations arises in at least two contexts: (1) because foreign markets have been friendlier to the use of UASs, U.S.-developed systems are being sold overseas; and, (2) foreign nationals may be participating on development teams in the U.S. Since many UAS products and technologies are listed on the US Munitions List (and regulated under ITAR) or on the Commerce Control List (and regulated under the Export Administration Regulations) industry executives should use care to avoid export control violations. The stakes can be high – violations can result in criminal penalties of up to 20 years' imprisonment for the company and its employees.

U.S. companies should take a number of steps when acquiring UAS assets or systems to protect themselves from export control liability. First they should conduct a careful due diligence review of export control issues in the target company to assess whether the target company has export control problems. If the target company has prior export control problems, the acquirer could be stepping into the shoes of the target company and taking on its liability. Issues that the acquiring company should look at in its due diligence review include: (i) are the target company's products listed on the US Munitions List or the Commerce Control List? (ii) has the target company obtained all export licenses and other authorizations that it was required to obtain under ITAR and EAR? (iii) has the target company disclosed export-controlled technical data or software to foreign parties (either in the US or abroad) without obtaining the requisite license authorizations? (iv) has the target company registered with the State Department under ITAR pursuant to 22 CFR Part 122? (v) has the target company complied with the ITAR recordkeeping, reporting, broker and other requirements? (vi) does the target company have an ITAR Compliance Program and has it

conducted annual compliance audits as required under the program? Second, the acquiring party should comply with the provisions of 22 CFR Section 122.4 and 15 CFR Section 750.10 in executing acquisition transactions.

These are exciting times. The possibilities for commercial deployment of Unmanned Vehicle Systems appear to be limitless. But, in the race to acquire systems to introduce to the marketplace, buyer beware.

[1]Unmanned Aircraft Systems, or “UASs,” are a subset of the universe of Unmanned Vehicle Systems, which includes unmanned systems that operate on land, in the water, and in the air. Recent news items have been focused on UASs, which frequently are described, but often in a pejorative manner, as “drones.”

Related People

- Anthony H. Anikeeff – 703.760.5206 – aanikeeff@williamsmullen.com
- Patrick A. Cushing – 804.420.6541 – pcushing@williamsmullen.com
- Robert E. Korroch – 757.629.0624 – rkorroch@williamsmullen.com
- Thomas B. McVey – 202.293.8118 – tmcvey@williamsmullen.com
- John M. Paris, Jr. – 757.473.5308 – jparis@williamsmullen.com
- Robert Van Arnam – 919.981.4055 – rvanarnam@williamsmullen.com
- Richard A. "Rick" Zechini – 919.981.4074 – rzechini@williamsmullen.com

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