3 IP Questions Every Government Contractor Must Ask Before Entering a Corporate Transaction

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One of the roles of John Cleese in the comic movie “Monty Python and the Holy Grail” was Tim the Enchanter. Tim the Enchanter posed three questions to the Knights of the Round Table to determine if they would be allowed to cross a Bridge of Death to reach the Holy Grail, or would be thrown into a chasm.

This blog entry poses three less dangerous, but nevertheless important, intellectual property questions for government contractors that may participate in some form of a corporate transaction, whether it be a sale of stock, merger, sale of assets, or even a secured investment:

1. Who are you?
2. What do you have, and what do you own?
3. What have you done with it?

Depending on the nature of the transaction, an investor or purchaser may also be asking these questions, and the answer could influence the value of the deal and of your company.

Another way to consider these questions is from the perspective of the due diligence period. This is a time of investigation that typically precedes a corporate transaction, when the parties seek to establish the underlying value of the company, along with potential liabilities. The investor or buyer may be working through a due diligence checklist, and trying to ascertain if the valuation is justified by the assets, or if previously unknown liabilities should decrease the valuation.

Preferably, you will enter the due diligence period with strong answers to these questions that show the value of your company.

Who are you?

This question relates to the identity of your company’s brand in your market. Put another way, if you change the name of your company’s trademark or brand tomorrow, would it matter?

Trademarks vary greatly in value. Some are very descriptive of what businesses do and can be dropped or changed very easily. Others might be fanciful, and represent a lot of goodwill that has been built up based on corporate advertising and successful delivery of goods or services associated with the trademarks over the years.

The frequency and duration of advertising can affect the perceived value of a company. The viability of trademarks can also increase the attractiveness of companies to investors or buyers. For example, a well-advertised, registered trademark that has federal and/or international protection may be more valuable than a simple trade name registered with the state corporation commission. However, if a company's trademark is highly utilitarian, or descriptive of what it does, then it may not be beneficial to pursue a trademark.

One distinction to bear in mind is that a corporation's name is generally referred to as its trade name. A trademark or a service mark relates to the branding of your goods or services. The branding suggests advertising that identifies or associates your company as the source of those goods or services.

To acquire a service or trademark registration, for example, you must submit a specimen to the United States Patent and Trademark Office (USPTO) to show that your company has used the service or trademark in a manner that communicates this association to your customers. A specimen for a trademark might be the packaging of a product, for example. A specimen for a service mark could be a brochure that describes your services.

The underlying advertising and attention to branding can build a marketing presence that enhances the value of a company in a tangible way. An investor or buyer may see value in this.

What do you have, and what do you own?

This question relates both to the type of your intellectual property and the history of its development, something I refer to as its provenance.

You must first conduct a comprehensive inventory of your intellectual property. Sometimes this is called an intellectual property audit. Let us assume that you are a software developer. If you have a portfolio of patents, then you need to identify them. You can also have copyright registrations that might be relevant to the software that could be of value. You may have tightly held trade secrets in the form of source code, or technical documentation of your software.

In many cases, government contractors may not have any patents or registered copyrights. If that describes your company's situation, you will need to explore further to see if there is any intellectual property, such as unregistered copyright interests or trade secrets. The following questions can help guide your analysis:

- How are you performing your services?
- What goods are you delivering to the government?
- What is the nature of your business?
- Are you providing any commercial goods or services?
- What has your company been doing to satisfy the contract(s) you have been serving?

The second part of the question – who owns your intellectual property – can be a bit more challenging.

A good protective rule of thumb is to assume that the first owner of the intellectual property is the individual or person who authored it or invented it. If it is a patentable invention, then the inventor is the first owner. If it is a work of authorship, then the default position is that the author is the first owner. For copyrights, there is a statutory exception that may help – a doctrine called work-for-hire. A company can be the author of the creative works of its employees if those works are produced within the scope of employment. Work-for-hire is different, because it converts the employer into the author. If the author is an independent contractor, then be careful. Calling a contract deliverable a work-for-hire frequently does not have the same effect.

What if you are not sure whether your company or a specific employee owns your intellectual property? Sometimes, we will recommend that companies execute a *nunc pro tunc* assignment with an employee, which translates to “now for then.” Here’s how it works: if you have a five-year employee who never transferred his or her title to work product to your company, you can still execute a *nunc pro tunc* agreement today that is retroactive for the entire period of his or her employment.

Nunc pro tunc agreements are an essential part of a paper trail that is often required by buyers and investors who want to ensure that companies actually have good title to the intellectual property that they are using in their businesses. Investors and buyers often do not want to rely just on statutory doctrine, like work for hire; they want to ensure that there is documentation showing that employees transferred their rights to the company. They want assurances that they are getting what they are paying for. Buyers want to operate a business after the transaction in the same manner that it was operated before. In fact, good title is a common representation made in the agreements used in corporate transactions.

Ownership is related to potential liability for infringement. For example, in the world of software coding, the use of third-party code of unknown source suggests that the end-product may infringe the copyright of that third party. If you are dealing with open source code, an investor or buyer will want to know what open source license governs what part of a software product. The investor or buyer will be very interested in knowing if the use of open source code requires the open source distribution and licensing of the company’s software products, which can prevent proprietary licensing.

What have you done with it?

What have you done with intellectual property rights? I refer to this as the question of what are the “goes ins” and “goes outs.” What are the intellectual property rights licensed-in by the company, and what are the intellectual property rights licensed-out?

The “goes outs” of government contractors could be license rights to computer software or technical data as defined in the Federal Acquisition Regulations (FAR). In one scenario, a government contractor might hold title to the intellectual property in its software, but the Federal government, as its sole customer, might have unlimited rights to it. In another scenario, a company might have retained rights greater than a delivery of unlimited rights to the government, such as a delivery with restricted or government purpose rights, based on mixed or exclusively private funding of development, respectively. In each case, the company holds title and may still license out to private licensees.

There are also business or collaboration licenses where, in something like a joint venture, the venturers have taken a license to a company’s patent portfolio for a particular purpose. Investors and buyers need to know about all of the above, because it will affect what can be done with the intellectual property in the future.

You also need to know what third-party intellectual property you are using and communicate that information to the investor or buyer. This is the question of what has been licensed-in from others. A simple example of a “goes in” of intellectual property rights is a license from a subcontractor of its background or pre-existing intellectual property. In some scenarios, you are looking at potential licenses that govern how you are operating as a company; a patent license from an affiliate corporation may be friendly, but a patent license as part of a settlement with a competitor may be very restrictive.

Frequently, we will get involved in software that has been licensed into a company. When we face a corporate transaction, sometimes we can carve out commercial, off-the-shelf software licenses, such as desktop productivity applications that are easily and cheaply replaced. However, many software license agreements may be non-assignable and may not be an asset that can be transferred to a buyer. In due diligence, we will review those agreements and determine if they are going to transfer with the other purchased assets to the purchaser. If the corporate transaction is a stock purchase or an investment, we might not have to worry about that, because the agreements may stay in place. But if it is an asset sale, the buyer may want those licenses to transfer with the other purchased assets. So, we need to be comfortable about that before we start due diligence.

Final Thoughts

To increase the value of your company, ask the three questions early. There is much that can be done to establish business practices that will improve the outcome of due diligence. The use of a simple intellectual property assignment form with employees can avoid many problems. Think about the steps you take to protect confidential information, both yours and your partners’. Can you present your goods and services to the market in a consistent, attractive way that adds value and makes your company recognizable? Review an intellectual property audit questionnaire, or intellectual property due diligence checklist, and implement changes that increase value to your company.

When you are approached by another company about an attractive merger, or if you are discussing the sale of your business, you do not want intellectual property due diligence to look like a “Bridge of Death.”

To learn more about how you can potentially improve the outcome of due diligence before a transaction, please contact Bruce Harper, a partner in the Intellectual Property Section at Williams Mullen, at (757) 473-5357 or bharper@williamsmullen.com.

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