

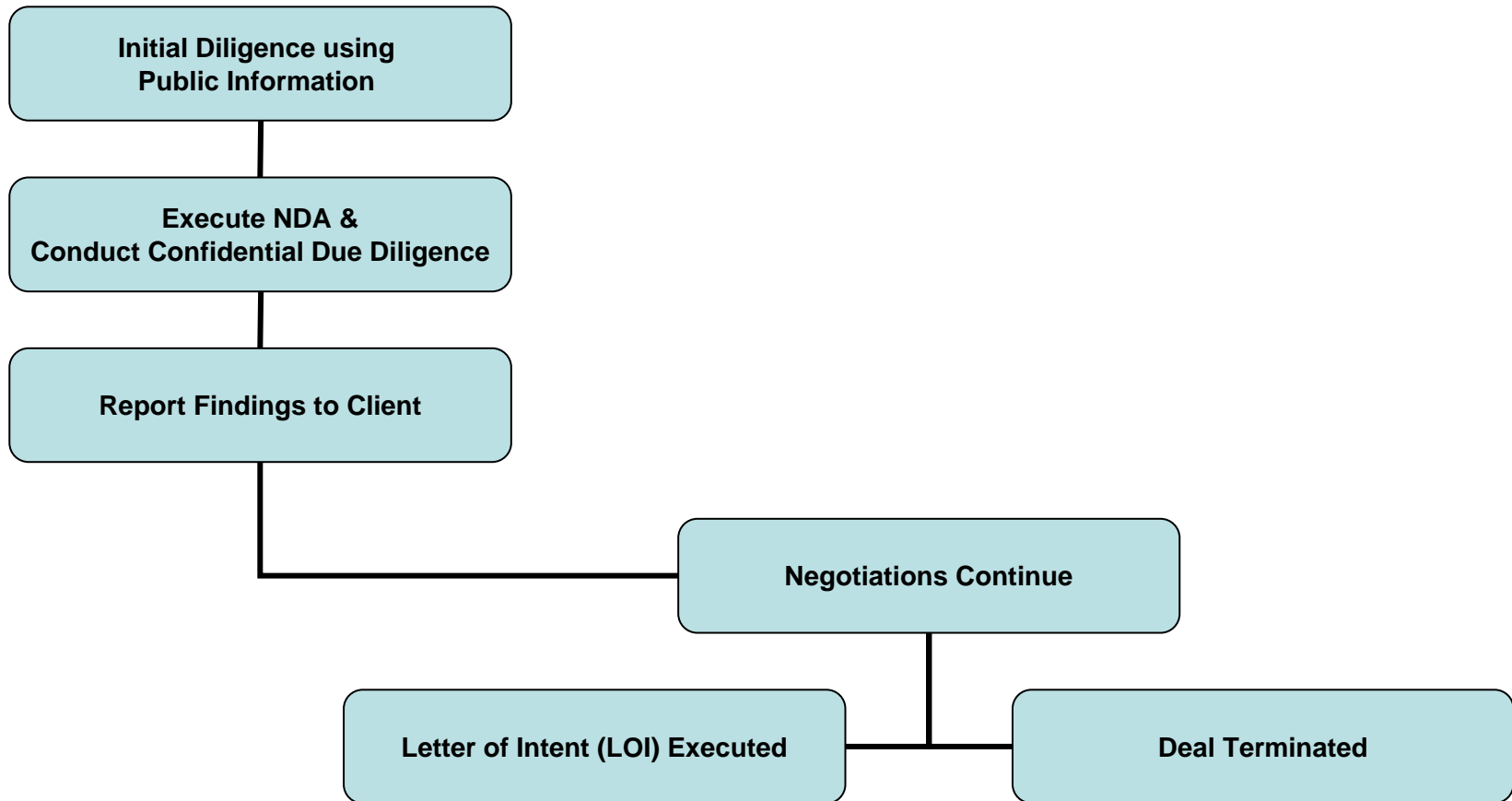


Dance Fever - Living (La Vida Loca) Under Your NDA: Strategies for Ethical M&A Diligence

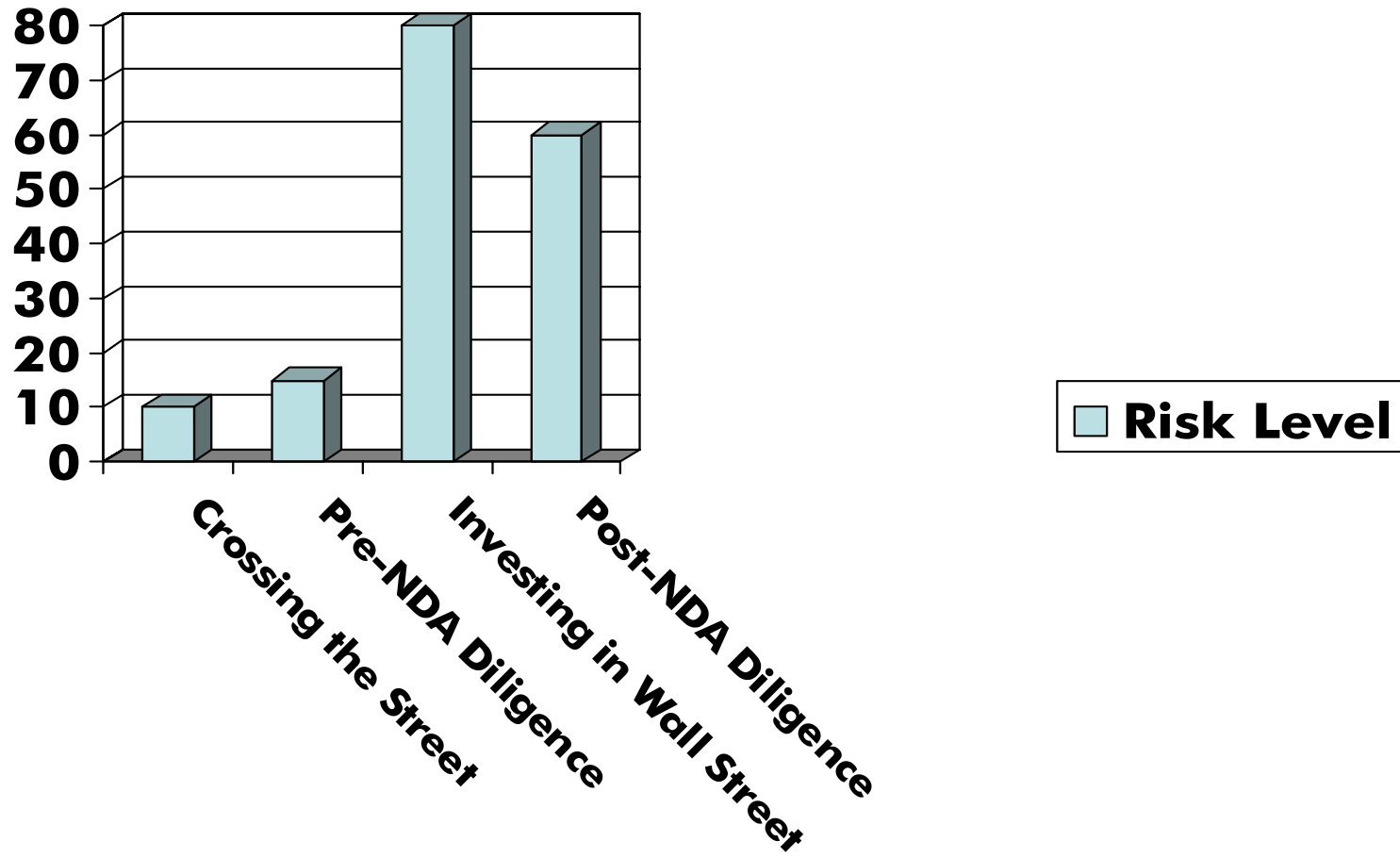
July 1, 2009

Jeffrey A. Wolfson

Pre-Letter of Intent Overview



Risks Before & After NDA



Intro: IP Due Diligence Roles

- Buyer's counsel's inquiry:
 - Any unacceptable risks/deal breakers?
 - Any risks/problems that would drive the price down?
- Target's counsel's objectives:
 - Help Target explain IP Rights & disclose material risks
 - Demonstrate minimal infringement risks to Buyer
 - Establish high value of IP to maximize deal value
- Both: Avoid creating later-arising problems

Key Questions in Due Diligence

- What IP exists in Target & relevant market?
 - Define the type of rights
- Does the IP have commercial value?
 - Any impairments to value?
 - Do IP Rights exclude others?
- Does the Target have rights to use the IP?
 - Third party IP may dominate Target IP

Ethics – A Common Concern

POLLING QUESTION

- When is counsel likely to encounter ethical/privilege concerns in conducting diligence?
 - 1) Confidential due diligence review
 - 2) Reporting to the client
 - 3) Deal completion
 - 4) Deal termination
 - 5) All of the above

Ethics - Confidential Due Diligence

- Subject to NDA terms
- Target's counsel may limit materials disclosed to Buyer's counsel/consultants
- Likely to see areas of concern in Target's documents and personnel interviews
- Buyer should limit number and type of recipients of materials under NDA

Ethics - Confidential Due Diligence

- Target's Counsel - Tailored Disclosures
 - Preserve attorney/client privilege
 - Limit access to freedom-to-operate opinions
 - Avoid Buyer's relying on Target's opinions
 - Limit access to on-going litigation materials
 - Comply with confidentiality agreements with third parties, including opposing litigants

Ethics - Confidential Due Diligence

- Target's Counsel - Tailored Disclosures (cont.)
 - Consider representations and warranties
 - Is disclosure necessary for due diligence?
 - Must not conceal material information
 - Track materials to guard against misuse:
 - what is actually disclosed to Buyer; and
 - who is receiving the materials

Ethics - Confidential Due Diligence

- Target's Counsel – Balancing the Restrictions
 - Approach the third party Discloser to seek consent to share with Buyer or Buyer's counsel
 - Create extract / summary to share with Buyer or Buyer's counsel
 - Consider exactly how 3rd party NDA defines “Confidential Information” and obligations
 - Proceed to share in confidence and bear the risks

Ethics - Confidential Due Diligence

- Buyer & Target - Common Cause
 - Target disclosing 3rd party confidential information could give 3rd party grounds to sue Buyer and its counsel
 - Initially consider sharing opinion list or opinion abstracts, with full opinion possibly shared later
 - Ethics TIP: Consider a Joint Privilege Agreement between the Buyer and Target to help ensure no waiver of privilege when sharing opinions

Conflicting Ethical Duties

- The NDA usually prohibits disclosure of confidential information for any purpose.
- Under 37 C.F.R. § 1.56, patent counsel and others associated with patent application prosecution have a duty to disclose material information to the U.S. Patent Office.

Ethics - Confidential Due Diligence

Example 1:

During the confidential review, the Buyer's patent counsel becomes aware of material information from the Target company indicating that one of the Buyer's patent applications is not novel.

Ethics - Confidential Due Diligence

Question:

Under 37 C.F.R. § 1.56, must Buyer's patent counsel disclose the information to the Patent Office? T/F

Ethics - Confidential Due Diligence

POLLING QUESTION

Question: Does Buyer's patent counsel violate the NDA by disclosing the material information to the Patent Office?

- 1) Yes
- 2) It depends on the type of information
- 3) Probably not, because an NDA is a private contract and Rule 56 is a federal regulation
- 4) No, it's required by Rule 56

Ethics - Confidential Due Diligence

Example 2:

During the confidential review, the Buyer's patent counsel uncovers material information from the Target company indicating that one of the Target's patent applications is not novel.

Ethics - Confidential Due Diligence

Question:

Under 37 C.F.R. § 1.56, must Buyer's patent counsel disclose the material information to the Patent Office? T/F

Ethics - Confidential Due Diligence

Question:

What should Buyer's patent counsel do with the material information?

- 1) Inform Target of it?
- 2) Submit it to the PTO?
- 3) Use it only for the diligence?
- 4) Hang onto it for later use?

Ethics - Confidential Due Diligence

- NDA restrictions may limit zealous advocacy and new innovations
 - Diligence counsel involved in patent prosecution may have difficulty segmenting information
 - Buyer's diligence personnel conducting R&D may be accused of violating NDA even if new technology independently developed

Ethics - Confidential Due Diligence

- TIP: Use Buyer's patent counsel familiar with the technology, but not actively involved in the prosecution
- TIP: Use Buyer's technical experts that are not developing IP for the company
- In both cases:
 - No duty of candor to the U.S. Patent Office
 - Potential conflicts with NDA less likely

Ethically Report to Client

- Buyer's counsel report to management
 - Written v. Oral
 - Negotiation positions on impact of third party IP Rights, validity of Target patents, potential problems that may limit future actions
 - Unless clearly retained, report to only a single client; other investors need separate counsel
 - Reserve/designate issues for deep review post-Closing

Ethically Report to Client

- Buyer's counsel report (cont.)
 - Identify problems and continuing violations
 - Consider preparation of financial impact documents relying on advice of counsel:
 - Are assumptions made that Target's IP covers Buyer's products?
 - Are certain valuations made assuming opinions rendered by counsel?
 - Maintain the attorney/client privilege

Actions If Deal Completed

- Rectify problems identified in due diligence
 - Make any required disclosures to U.S. Patent Office
 - Complete any side agreements/licenses necessary for continued operation of Target business
 - Obtain freedom-to-operate opinions for newly acquired product lines, if needed
- Correct title and record deficiencies

Risks When Deal Terminates

- Either side may initiate IP litigation against the other – minimize risk for when Target sues Buyer
- Direct competitors v. Venture Cap Fund/Indirect
- Buyer may assert Target waived privilege based on due diligence review
- Target may assert violation of NDA if Buyer extends IP into Target's business
- Financial projections supporting deal and negotiation positions may be discoverable

Buyer's Side – Tips to Ethical Diligence

- Retain (a) counsel, and (b) technical personnel, to conduct diligence without triggering disclosure obligations and/or violations of NDA in patenting later tech.
- Careful preparation of financial projections based on advice of counsel to maintain attorney/client privilege

Target's Side – Tips to Ethical Diligence

- Develop draft Reps/Warranties; test accuracy before Buyer due diligence
 - Make necessary disclosures early
- Before diligence determine what, if any, privilege waiver the client will agree to
- Request due diligence inquiries, and track disclosures, in writing

Thanks for your Diligence. Questions?

Jeffrey A. Wolfson
Haynes and Boone, LLP

jeff.wolfson@haynesboone.com

(202) 654-4565