

PRACTICAL PROCEDURES TO IMPROVE INTERNAL CONTROL AND REDUCE LITIGATION RISK RELATED TO INTELLECTUAL PROPERTY

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INTRODUCTION

Professional valuation analysts (“analysts”) are often asked to provide expert testimony and other litigation support services with regard to intellectual property (IP) controversies. Before such controversies arise, analysts can help their clients to develop and implement procedures that protect the client’s intellectual property. Such procedures can also be used to (1) reduce the client’s exposure to IP litigation risk and (2) increase the probability of a successful outcome if IP litigation does occur.

Analysts who have been involved in IP litigation are uniquely qualified to provide these consulting services to IP owners. First, analysts are trusted advisors to the senior management of IP owner companies. Second, as a result of their varied valuation, corporate finance, and capital markets experience, analysts should have a general awareness of the types and functions of typical client IP. Third, analysts are experienced in procedures related to the inventory, documentation, and valuation of client company assets. The same procedures that analysts perform related to tangible and intangible property can be adopted for application to client IP. Fourth, analysts are experienced at (1) identifying internal control weaknesses related to property management and (2) recommending corrections to those weaknesses. The procedures presented in this discussion relate specifically to the client’s internal control related to IP. Fifth, analysts are familiar with risk assessment procedures. These procedures can be adapted to (1) identify and (2) reduce the risks related to client IP.

The term *intellectual property* includes four specific intangible assets: (1) copyrights, (2) trademarks, (3) patents, and (4) trade secrets. For purposes of this discussion, the term IP will also encompass intangible assets directly related to IP, such as patent applications, trade dress, engineering drawings and technical documentation, computer software, and all of the contractual rights related to IP exploitation. And, for purposes of this discussion, the term “IP owner” includes owners, developers, inventors, licensors, joint venturers, and others with a direct or indirect IP ownership interest.

This discussion describes practical procedures intended to protect client IP. Analysts should tailor these procedures to fit individual client needs. In addition to recommending IP control procedures, analysts should assist clients with the documentation and implementation of these procedures.

IP owners often become involved in controversies that may escalate into litigation, such as infringement matters, contract disputes, license disputes, breach of noncompete/confidentiality agreements, taxation claims, eminent domain/ expropriation issues, bankruptcy matters, and others. The following procedures are intended to (1) decrease the probability that IP

controversies will result in litigation and (2) increase the probability of IP owner success if litigation cannot be avoided.

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PRACTICAL PROCEDURES TO PROTECT INTELLECTUAL PROPERTY

Procedure Number One. The IP owner should document the existence of all of the organization’s intellectual property. The first step is to inventory all owned IP. This procedure should include (1) the listing of all IP, (2) a description of each IP on the listing, and (3) the recording of all IP registration information. This registration information should include: country/agency of registration, registration number, and original/renewal/expiration registration date. And, this listing should include both domestic and international IP registrations.

The second step in this inventory procedure is to document the historical development process for each IP. To the extent that the data are available, this documentation should include: (1) dates of initial development phase, (2) individuals/departments responsible for development, and (3) information regarding development expenditures (both internal and external).

The inventory procedure should document both (1) developed IP and (2) IP currently under development. This procedure should document all owned IP and, to the extent possible, all licensed (both inbound and outbound licensed) IP.

Procedure Number Two. The IP owner should centralize both (1) the inventory and (2) the ownership of all IP. The first step in this procedure is to centralize all IP documents (i.e., registration applications, registration certificates, licenses, important correspondence, etc.) in one location. This centralized location could be the corporate accounting department or corporate legal department. This centralized location could also be a plant engineering department or the field marketing department. The issue is that all important IP documentation should be centralized in one place which can be any convenient location within the IP owner organization.

The second step is to centralize all IP ownership in one country (or, at least, in a very few countries). Also, the ownership of all domestic IP should be centralized in one state. The IP owner should investigate forming a single (typically corporate) entity to hold all of the domestic IP. Many IP owners form a wholly owned holding company to own and control all of its current and future IP. This structure typically requires the creation of license agreements between (1) the holding company and (2) the operating companies for the use of the subject IP. While the drafting of these intercompany licenses involves some effort, this procedure actually helps to document (1) the existence of and (2) the economic validity of the IP.

Procedure Number Three. The IP owner should make one person in the organization ultimately responsible for all IP. This person could be a senior engineer, the corporate counsel, the company controller, or a marketing executive, for example. Obviously, other employees may perform the IP development, registration, commercialization, and licensing work. And, the responsible person does not need to be located in the same location as the above-described IP inventory.

However, this employee should be organizationally responsible for (1) omniscience about all IP and (2) protection of all IP. And, all individuals involved with IP activities within the organization should know exactly who this responsible person is.

Procedure Number Four. The IP owner should identify the person who is directly responsible for the development/maintenance of each individual IP. For each individual IP, the organization should identify one person who is directly responsible for technical development, physical safekeeping (of documentation, etc.), and commercial exploitation. There may be many individuals who are involved with the development/commercialization of each IP. Of these individuals, however, the IP

owner should select one person to be the ultimately responsible party for each IP. And, in a large IP-intensive organization, there may be dozens (or even hundreds) of employees designated as the “responsible person” for an IP.

In the second step of this procedure, the IP owner should create and widely distribute the list of the responsible persons. And, the list should be primarily organized by IP (not by the name/department of responsible persons). Based on this list, the person with ultimate responsibility for all IP will know who the “go to” employee is for each IP. And, more importantly, every person within the organization will know who the “go to” employee is for questions/problems/opportunities related to each IP.

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Procedure Number Five. The IP owner should promote the importance of the organization’s IP in its relevant marketplace. This procedure is as important for not-for-profit organizations as for for-profit organizations. This procedure is equally important for manufacturing companies, for service firms, and for organizations operating in virtually any industry. And, this procedure is

relevant (albeit in different ways) for publicly traded companies and for closely held companies.

To implement this procedure, the organization’s CEO (or corresponding executive position) should “talk up” the subject IP at shareholder meetings, security analyst meetings, press meetings, and at any other public forum. All managers/executives should “talk up” the IP at industry conferences, trade association meetings, employee meetings, and other public forums. And, company marketing managers/sales persons should “talk up” the IP at sales presentations, client/customer meetings, and the like. The purpose of this procedure is to demonstrate that the IP owner believes that the subject IP is so valuable as to be worthy of discussion/promotion in the relevant marketplace.

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Procedure Number Six. The IP owner should promote the importance of the organization’s IP in any written/other mass communications. This procedure encompasses both internal and external mass communications. To implement this procedure, the IP owner should mention the IP in letters/newsletters to employees. The IP owner should mention the IP in external communications with investors/regulators/others in stockholder letters, annual reports, and documents filed with the SEC and other regulatory agencies. The IP owner should also mention (1) the existence of and (2) the importance of IP in print/radio/television advertisements, other promotional media, product/marketing brochures, and the like.

The purpose of this procedure is for the IP owner to publicly recognize the prominence and eminence of the subject IP. It may be difficult to force others (competitors, infringers, etc.) to recognize the importance of the subject IP if the owner does not have a demonstrated history of recognizing the subject IP.

Procedure Number Seven. The IP owner should register its IP in all relevant jurisdictions. This may be a time-consuming and expensive procedure—if the IP is used in various countries and other jurisdictions. However, with consideration of the constraints of time and money, the IP owner should register the subject IP in all commercially reasonable countries/jurisdictions.

The second step in this procedure is for the IP owner to renew all international registrations as they expire. And, the IP owner should document both (1) the registration and (2) the use of the subject IP in all relevant countries/jurisdictions.

Procedure Number Eight. The IP owner should conduct periodic appraisals of all IP. Again, this could be a time-consuming and expensive procedure. Based on cost and staff availability considerations, the IP owner can use internal analysts or independent experts to conduct the appraisals. The purposes of the appraisals are severalfold: (1) to document the IP existence, (2) to document the IP value, (3) to document the IP remaining useful life, and (4) to document a reasonable royalty rate/transfer price for the IP.

First, these periodic appraisals should be extremely useful for management information purposes. They can help establish transfer prices for the intercompany transfer or use of IP. And, they can help establish intangible asset values (1) to assess insurance requirements, (2) to analyze property tax assessments or exemptions, and (3) to estimate an overall organization value.

Second, the periodic appraisals are extremely useful to prove and defend economic damages claims or royalty/license claims in IP controversy matters.

Procedure Number Nine. The IP owner should respond immediately to each and every possible threat to the subject IP. The IP owner should immediately respond—in writing—to any possible infringement, unauthorized use, contract/license dispute, and so forth. This correspondence should explain the importance of the IP to the subject organization. This correspondence should explain that the IP will be rigorously protected. And, this correspondence should explain that violators of the IP owner's rights will be prosecuted without exception. The correspondence should also demand some action—for example, a written response, the immediate cessation of the problematic action, or a payment of economic damages.

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Regarding any possible threat to the organization's IP, the IP owner should begin a thorough investigation immediately. And, the IP owner should make known its intention to defend even the most minor threats to its IP. Obviously, the objective of this procedure is to strongly discourage any current and future threats to the subject IP.

Procedure Number Ten. The IP owner should not hesitate to involve experienced legal counsel at the earliest reasonable time. At that point, the IP owner's legal counsel may communicate with the wrongful party. This communication will typically state counsel's demands and begin the process of negotiation of an equitable settlement. If a settlement is not forthcoming, legal counsel may decide to pursue alternative dispute resolution (ADR) procedures.

If the dispute is not resolved, the IP owner should be prepared to pursue the protection of its IP through litigation, if necessary. If the above-listed IP protection procedures have been implemented, the IP owner will be in a favorable position to realize a successful (and cost effective) conclusion to the litigation.

SUMMARY AND CONCLUSION

IP owners face periodic threats and challenges to their IP. Accordingly, IP owners should document, control, and protect their IP—just as they would any other valuable asset of the organization. IP owners should implement practical procedures to protect their IP. And, analysts are in a trusted position to help IP owners develop and implement cost effective IP internal control procedures.

As with any organizational procedures, the IP owner should analyze the relevant cost/benefit considerations with regard to any IP protection procedures. Not all of the procedures described above can be effectively/efficiently implemented in every IP organization. Nonetheless, the IP owner should recognize that these procedures do not just protect the organization's IP. These procedures also help support economic damages and other claims when the subject IP is threatened. And, these procedures can help achieve the most favorable possible outcome if IP litigation cannot be avoided.

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