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INTELLECTUAL PROPERTY DUE DILIGENCE: PROTECTING INNOVATION IN MERGERS AND ACQUISITIONS

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I. ABSTRACT

The critical importance of intellectual property (IP) due diligence within mergers and acquisitions (M&A) is greatly magnified in business segments that possess high amounts of innovation along with significant intangible assets that drive value. In light of the fact that the amount of value attributed to corporate entities is increasingly comprised of the intangible asset classes of patents, trademarks, copyrights, and trade secrets, a systematic identification, valuation and protection of intangible assets are a prerequisite for successful transactions.⁴ This research paper explores how IP due diligence serves multiple functions over the course of the M&A lifecycle, from the development of an asset inventory, verification of ownership and litigation analysis through to regulatory compliance and integration of the acquired company. This study highlights several high-profile acquisitions such as Google's purchase of Motorola Mobility, Adobe's acquisition of Figma, the acquisition of Alcatel-Lucent by Nokia, and Hewlett-Packard's acquisition of Autonomy and demonstrates how a comprehensive evaluation of IP will identify hidden liabilities, strengthen a negotiating position and enhance overall strategic and financial returns. The paper also offers a collection of best practices and frequent pitfalls, comprising a practical framework that can be employed by legal professionals, corporate counsel and investors involved in transactions with a heavy reliance on innovation.

II. KEYWORDS

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⁴ Russell L. Razgaitis, *Valuation and Pricing of Technology-Based Intellectual Property* (John Wiley & Sons 2009).

Intellectual Property, Mergers and Acquisitions, Due Diligence, IP Valuation, Regulatory Compliance.

III. INTRODUCTION

Since the knowledge economy is so strong today, intangible assets (i.e., intellectual property or IP) have become the most important area of value for corporations, surpassing the importance of physical infrastructure. The value of IP creates the competitive position of many companies in many industries, including technology, biotechnology, pharmaceuticals, media, and consumer goods.⁵ Many companies are pursuing mergers and acquisitions as a way to achieve growth and drive innovation; therefore, the integrity and strategic value of the target company's IP portfolio have become a critical factor in determining the outcome of a deal.

IP due diligence is the process of examining the target company's IP assets prior to concluding the transaction to determine if the target's IP is sound, valid, and valued appropriately.⁶ Unlike the financial and operational due diligence (i.e., balance sheet, revenue, and operational efficiency), which only examines a portion of the corporate wealth that is considered tangible, IP due diligence examines an area of corporate wealth that is intangible, complex from a legal perspective, and often inadequately reported in the standard financial statement. These three factors create unique challenges, such as improperly documented IP assets, joint ownership of IP assets, encumbered IP assets due to restrictive licenses, and IP assets that are subject to unresolved litigation.

When an acquiring company uncovers these issues after the completion of the transaction, the acquiring company may face significant financial consequences as evidenced by Hewlett-Packard's \$8.8 billion write-down of the Autonomy Corporation acquisition in 2011.⁷ (The rise in patent litigation, the rise in complexity associated with open-source

⁵ Baruch Lev, *Intangibles: Management, Measurement, and Reporting* (Brookings Inst. Press 2001).

⁶ RAZGAITIS, *supra* note 1; see also Gordon V. Smith & Russell L. Parr, *Intellectual Property: Valuation, Exploitation and Infringement Damages* (John Wiley & Sons 2005).

⁷ James Hurley, HP Writes Down Autonomy by \$8.8bn, *FIN. TIMES*, Nov. 20, 2012.

software licensing, and the rise in legal developments that apply data privacy legislation like the European Union's General Data Protection Regulation ('GDPR') and India's Digital Personal Data Protection Act 2023 (the ('DPDP Act, 2023')⁸, have made Intellectual Property ('IP') due diligence increasingly important. Cross-border transactions may involve multiple layers of jurisdictional variation, stamp duty obligations, and fulfilment of export compliance obligations. Each of these factors is made even more complicated by transactions involving defence, semiconductor, and non-defence items.

Section II provides an overview of the importance of IP due diligence as it relates to the M&A process. Section III describes the phases of the IP due diligence process. Section IV gives examples and analysis of well-known M&A transactions that were either successful or unsuccessful. Section V offers recommendations for what can be done to manage IP due diligence successfully. Section VI outlines the common mistakes attempted by organisations when managing IP due diligence. Section VII of the paper presents observations regarding future trends and challenges related to IP due diligence. In general, technology-driven M&A activities will continue growing at a rapid pace. This will create both significant challenges and risks for organisations engaged in M&A activities.

A. Research Objectives

This paper seeks to examine the role and significance of intellectual property due diligence in mergers and acquisitions, with a particular focus on its impact on valuation, risk mitigation, and post-acquisition integration. It aims to analyse how effective IP due diligence contributes to identifying hidden liabilities and enhancing transactional outcomes in innovation-driven industries.

B. Research Questions

The study is guided by the following questions:

⁸ Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 (General Data Protection Regulation); Digital Personal Data Protection Act, 2023, No. 22, Acts of Parliament, 2023 (India).

1. What constitutes effective intellectual property due diligence in mergers and acquisitions.
2. How does IP due diligence influence valuation and risk assessment in such transactions.
3. What are the common challenges and pitfalls encountered in conducting IP due diligence across jurisdictions.

C. Research Methodology

This research adopts a doctrinal and comparative legal methodology. It relies on the analysis of primary legal sources, including statutes, regulatory frameworks, and reported case law relevant to intellectual property and mergers and acquisitions. Secondary sources such as academic literature, industry reports, and transaction case studies have also been utilised to provide contextual and analytical depth. The study focuses primarily on jurisdictions such as the United States, the European Union, and India, recognising variations in legal frameworks. The scope of the research is limited to publicly available information and does not incorporate empirical data collection, which may constrain the ability to generalise findings across all sectors.

IV. STRATEGIC IMPORTANCE OF IP DUE DILIGENCE IN M&A

A. Valuation of Intangible Assets

One of the most important aspects of IP diligence is valuing intangible assets. In businesses that rely heavily on knowledge-related assets, IP represents much of the overall market value of the business, thus making it impossible to rely solely on financial statements to determine acquisition price.⁹ There are three primary methodologies for valuing intangible assets: the income approach projecting revenues for future years attributable to IP; the market method comparing the contract to other recent contracts for similar intangibles over time; and the cost method determining how much it would cost to recreate or to replace.

⁹ Baruch Lev & Feng Gu, *The End of Accounting and the Path Forward for Investors and Managers* (John Wiley & Sons 2016).

Determining the most appropriate valuation method is based on the type of intangible concerned, whether or not there are comparable market values available, and/or whether the intended buyer has strategic objectives for the use of the intangible.

Additionally, due diligence can reveal IP that is not present in formal financial statements (e.g. proprietary algorithms, undocumented trade secrets or patents in early stages of development). Such "hidden value" can significantly change the economics of the transaction. An example of this is Google's \$12.5 billion purchase of Motorola Mobility in 2012 based largely upon the estimated value of Motorola's approximately 17,000 issued patents and approximately 6,800 to 7,500 pending patent applications, which Google retained when it sold the hardware portion of the business to Lenovo two years later.

B. Risk Identification and Mitigation

Early identification of possible legal and operational challenges is accomplished through IP Due Diligence; this process serves as an early warning system for any such deficiencies in the target company's business and will usually uncover any operational/mechanisms that may become a problem for an acquirer after their contract has been signed with a target. A thorough review of the target's business will investigate whether the IP being considered for acquisition is encumbered by any type of lien, has any restrictions to operation imposed by its Licences, or has third party rights that would limit the buy-side party's ability to utilise that IP.¹⁰ Also assessed during IP Due Diligence is whether the Products / Technologies of the target company infringe on any rights of Third Parties, as this is a risk that creates the potential for post-acquisition litigation with significant financial costs and risks if left unidentified prior to the close of the acquisition transaction.

OSS Compliance includes an area that requires extra attention. A lot of the new Software products now being developed and sold include some type of COD (OSS, including the GNU General Public Licence (GPL) amongst many others) component that may force the acquirer to disclose or make public all or part of their proprietary source code when built

¹⁰ William Anson, IP Value Drivers (PricewaterhouseCoopers LLP 2005).

and delivered to the customer.¹¹ Failure to identify such requirements during IP Due Diligence could fundamentally degrade the exclusivity and therefore the value of the IP being acquired as a result of the transaction.

There are several examples of transactions where a lack of adequate risk reviews has had a significant impact on the parties to the transaction. For example, the Daiichi Sankyo - Ranbaxy deal resulted in an arbitral award of approximately USD 525 million due to inadequate due diligence related to undisclosed legal and compliance liabilities in the transaction. The principal damages component was approximately USD 385 million, with the total award including interest and costs amounting to approximately USD 525 million, as reflected in Daiichi Sankyo's public disclosures.¹² The message is simply that an appropriate level of due diligence associated with ensuring the accuracy within the identified contracts for the purpose of Commercial Risk Assessment using IP Due Diligence, is a critical element in Financial Risk Management / Mitigation.

C. Strategic Decision-Making and Integration Planning

In addition to identifying potential risks, intellectual property (IP) due diligence provides all the necessary information needed to form the whole structure of a transaction (including how the deal will be structured, priced, and integrated after acquisition). A comprehensive, well-organized and legally appropriate collection of IP provides the seller with a stronger bargaining position; on the flip side, any weak points an acquirer identifies during due diligence will give that acquirer leverage in negotiating price changes, warranty agreements or indemnity provisions with the seller.¹³

The analysis of an acquirer's "freedom to operate", i.e., whether or not a newly acquired piece of IP has any existing third-party rights in order to infringe upon (and therefore would prevent) the acquirer from using it is the critical factor of conducting IP due diligence. This

¹¹ Lawrence Rosen, *Open-Source Licensing: Software Freedom and Intellectual Property Law* (Prentice Hall 2004).

¹² Anirudh Pradhan, *Daiichi Sankyo v. Ranbaxy: The Arbitration Award and Its Implications*, J. INTELL. PROP. L. & PRAC., 2014.

¹³ Robert F. Bruner, *Applied Mergers and Acquisitions* (John Wiley & Sons 2004).

analysis of an acquirer's ability to use IP without infringing on any existing rights is most critical in the semiconductor, pharmaceutical and telecommunications industries, where there exists IP consisting of a large number of patent (or "standard essential") rights and licenses organized through highly complex licensing agreements.¹⁴ Additionally, determining the current status of target companies' R&D pipelines and any applications that have been submitted (and maybe still pending) would give an acquirer that additional opportunity to determine the target company's expected growth rates and potentially align the acquisition with the acquirer's long-term technology roadmap to sustain future innovation.

Take, for example, Facebook's acquisition of Instagram in 2012. In addition to acquiring a significant customer base, Facebook acquired Instagram's trademarks, patents related to user interface designs, and software that together will allow Facebook to continue providing customers with a recognizable product experience and also allow Facebook to incorporate Instagram into the Facebook ecosystem.¹⁵ Identifying and protecting these IP assets through its due diligence was an important part of facilitating a successful integration of Instagram into the Facebook family of companies.

D. Regulatory Compliance

The fourth component of strategic due diligence is guaranteeing that all of the necessary legal or other requirements are satisfied for all of your Intellectual Property assets. This includes reviewing the formal registration of any Patents, Trademarks or Copyrights; whether they are current; if they are enforceable (i.e., there is nothing that bars your right to enforce it) in all of the jurisdictions you are interested in, and verifying there has been no lapse in registration (e.g., you did not miss a deadline for paying your maintenance fees or you did not renew your trademark filings).

¹⁴ Carl Shapiro, *Navigating the Patent Thicket*, in *Innovation Policy and the Economy* Vol. 1 (Adam Jaffe, Josh Lerner & Scott Stern eds., MIT Press 2001).

¹⁵ Catherine Shu, *Facebook Closes Instagram Acquisition*, TECHCRUNCH (Sept. 6, 2012), <https://techcrunch.com>.

When the transaction occurs, and it is a cross-border transaction, there are additional requirements to comply with for both the United States (like the International Traffic in Arms Regulations (ITAR)) and the Export Administration Regulations (EAR)) when the transaction involves the procurement of dual-use technologies and/or defense-related technologies. Likewise, an acquisition based solely on data will also need to comply with any applicable privacy laws (i.e., the GDPR in Europe and the Data Protection and Privacy Bill (DPDP) in India) related to how personal data may be collected, stored and processed in the software platforms or databases acquired, which have an impact on how the data can be used after the transaction closes.

In India, for example, there is an obligation to pay stamp duty on any assignment of intellectual property rights, and failing to do so will make the transfer deed unenforceable at law. The statutory framework governing such rights includes the Patents Act, 1970 (as amended), the Trademarks Act, 1999, the Copyright Act, 1957, and the Designs Act, 2000, each of which prescribes specific requirements for the registration, assignment, and enforcement of intellectual property. In particular, assignments and transmissions must be duly recorded with the Office of the Controller General of Patents, Designs and Trademarks to ensure enforceability against third parties. Failure to detect these statutory and procedural deficiencies during the due diligence process may jeopardise the acquirer's ability to enforce or exploit intellectual property rights in India after the closing of the transaction.

V. THE IP DUE DILIGENCE PROCESS

The IP due diligence process is typically a six-stage, interconnected procedure, with each successive phase drawing upon and expanding upon the knowledge and understanding developed in the previous phase or stages of IP due diligence. Although this framework is informed by general practice and is necessarily adapted to suit the type of deal and sector in which it is applied, it is based on standard practice in complex M&A transactions.

A. Comprehensive Asset Inventory

The IP due diligence process begins with the creation of a comprehensive and authoritative list of all IP assets owned, licensed, or otherwise utilized by the target company. This includes registered IP, such as patents, trademarks, registered designs, and copyrights, together with unregistered IP, such as trade secrets, know-how, software source codes, databases, and domain names. This data is typically collected from publicly available IP registers, IP management practices, licensing agreements, and R&D records. It is vital to guarantee that no IP assets are omitted from this inventory, including IP assets that are in the process of registration, assignment, or owned by subsidiaries or affiliated companies.

B. Ownership and Title Verification

Ownership and Title Verification having established the scope of the IP portfolio, the due diligence team proceeds to verify that the target holds clean, unencumbered legal title to each asset. This requires examination of assignment agreements, employment contracts, contractor agreements, and chain-of-title records. The risk of title defects is particularly acute in technology companies where foundational IP may have been developed by employees, contractors, or academic collaborators under arrangements that did not include explicit IP assignment provisions.¹⁶ Any gaps or ambiguities in the chain of title must be resolved through corrective assignments or other legal instruments prior to closing, as unresolved ownership disputes can render the acquired IP legally vulnerable.

C. Validity and Enforceability Assessment

The identified asset is then subjected to a validity and enforceability assessment, where the legal validity and practical enforceability of each asset are evaluated. In the case of patents, it includes prosecution history, payment of maintenance fees, and the possibility of invalidation, which is determined through prior art or post-grant proceedings. In the case of trademarks, it includes registration, territorial scope, and the possibility of cancellation

¹⁶ James Pooley, *Trade Secrets: The Use and Protection of Confidential Business Information* (PLI Press 2013).

or dilution claims. In the case of copyrights and trade secrets, it includes documentation of authorship, originality, and the degree of confidentiality measures adopted, respectively ¹⁷.

D. Review of IP Agreements and Licensing Arrangements

All contracts involving the IP including inbound and outbound licenses, joint development agreements, non-disclosure agreements (NDAs), cross-licensing arrangements, and settlement agreements should be examined for provisions that will affect the ability of the acquirer to continue to utilize those assets after close of the transaction. Of particular concern are change-of-control provisions that will terminate or alter license terms upon acquisition, exclusivity provisions that create barriers to commercialization, and sublicensing restrictions that limit the acquirer from integrating the IP into a larger product portfolio ¹⁸.

E. Litigation and Dispute Analysis

An extensive review of past, ongoing, and potential IP disputes is critical in determining the quantification of legal risks. This includes patent infringement, trademark opposition, trade secret infringement, and regulatory action. Legal documents, court decisions, arbitration awards, and communications with opposing counsel are analyzed to measure the financial and strategic significance of outstanding disputes ¹⁹. In situations involving ongoing litigation, outside legal opinions may be obtained to evaluate the potential for success or settlement. This step also includes an assessment of the target company's history in enforcing their IP rights, which plays a role in determining the overall deterrent strength and marketing appeal of the portfolio.

F. Commercial Valuation and Strategic Alignment

The overall analysis integrates the previous assessments into an assessment of the total value and strategic implication of the IP portfolio to the acquirer; including analysis of how much revenue the IP will generate (through either its direct commercialization, its licensing

¹⁷ Donald S. Chisum, *Chisum on Patents: A Treatise on the Law of Patentability, Validity and Infringement* (LexisNexis 2020).

¹⁸ Robert Goldscheider & Jonathan T. Gordon, *Licensing Best Practices* (John Wiley & Sons 2006).

¹⁹ Mark A. Lemley & Carl Shapiro, *Probabilistic Patents*, 19 J. ECON. PERSP. 75 (2005).

income/royalties, or as a cost avoidance) as well as its estimated remaining useful life and how competitive it is in the planned target market.²⁰ Findings will then be compared with the acquirer's current IP assets and strategic objectives to determine any synergies, redundancies, or integration needs. This analysis directly influences the pricing, deal structure, and post-merger integration planning.

VI. CASE STUDIES

A. Google's Acquisition of Motorola Mobility (2012): IP as the Core Strategic Rationale

The purchase of Motorola Mobility by Google for USD 12.5 billion in 2012 is one of the best examples of an acquisition by a company in today's technological field that is based on intellectual property. The rise in patent lawsuits against Android smartphone manufacturers that were based on Google's mobile operating system (OS) from Apple and Microsoft posed a major threat to the viability of the Android ecosystem prior to 2011. As a way to address this threat to the ecosystem, Google purchased Motorola Mobility for its intellectual property (IP), primarily its heavy patent portfolio, with more than 17,000 issued patents and over 7,500 pending patent applications.²¹ Google's IP due diligence focused on assessing the strength, validity, and utility of Motorola's patent portfolio (primarily its standard-essential patents for wireless communication).

The acquisition allowed Google to leverage its additional patent holdings to enter into cross-licensing arrangements with others and to assist Android original equipment manufacturers (OEM) in defending themselves against patent claims. When Google sold Motorola's handset business to Lenovo in 2014, it retained the vast majority of Motorola's patents, demonstrating that the IP (not the business) was the primary value of the acquisition.²² This

²⁰ Patrick H. Sullivan, *Value-Driven Intellectual Capital: How to Convert Intangible Corporate Assets into Market Value* (John Wiley & Sons 2000).

²¹ Amir Efrati & Sara E. Ante, *Google's \$12.5 Billion Gamble*, WALL ST. J., Aug. 16, 2011; Vlad Savov, *Google Sells Motorola to Lenovo*, THE VERGE (Jan. 30, 2014), <https://www.theverge.com>.

²² Vlad Savov, *Google Keeps 'Vast Majority' of Motorola Mobility Patents in Sale to Lenovo*, THE VERGE (Jan. 29, 2014), <https://www.theverge.com>; see also Amir Efrati, *Google's \$12.5 Billion Gamble*, WALL ST. J., Aug. 16, 2011.

case illustrates that IP due diligence that focuses on the quality and enforceability of the portfolio and strategic fit is essential for realising the expected benefits of an IP-focused acquisition.

B. Adobe's Proposed Acquisition of Figma (2022): IP Due Diligence in a Regulatory Context

In September 2022, Adobe announced a proposed acquisition of Figma, a cloud-based co-design platform, for \$20 billion, which would have been its largest acquisition ever, though the deal was ultimately terminated in December 2023 following regulatory opposition from the European Commission and the United Kingdom Competition and Markets Authority. Part of the legality of the acquisition involved a great deal of intellectual property due diligence. The due diligence team reviewed Figma's patents, software copyrights, and brand trademarks and assessed how Figma's cloud-native technologies and web rendering technologies provided competitive differentiation.

The review included identifying possible integration difficulties of overlapping Figma and Adobe Creative Cloud technologies and how to align the different licensing agreements. The due diligence team developed mitigation strategies to resolve these difficulties and capitalize on the synergy.

In December 2023, the acquisition was terminated following resistance from regulatory authorities in the UK and EU, who were concerned about the size and power of the combined companies in the professional design software marketplace. The Figma case highlights how robust technical intellectual property due diligence does not shield an acquisition from antitrust scrutiny and that intellectual property portfolio analysis must be compatible with ongoing analysis of competitive dynamics and the assessment of regulatory risks.

C. Nokia's Acquisition of Alcatel-Lucent (2016): Integration Complexity and IP Encumbrances

While Nokia's EUR 15.6 billion acquisition of Alcatel-Lucent in 2016 was done with the intention of building a European telecommunications equipment leader, it serves as an example of what can happen when the IP due diligence process is incomplete. Alcatel-Lucent brought with it a significant number of patents, especially in optical networks and wireless technologies, but also a history of litigation and complexity surrounding its licensing arrangements, as well as disputes over certain key foundational patent titles.²³

When integrating Alcatel-Lucent after its acquisition, it became clear that insufficient attention had been paid to mapping out the encumbrances and ongoing disputes associated with its key patents in the due diligence process. Nokia was left with open infringement claims against it, as well as IP assets with unclear or disputed title, resulting in unanticipated legal costs and delays in achieving the expected synergies due to these ongoing litigations.²⁴ This situation illustrates that the level of detail in conducting litigation and encumbrance reviews should go beyond merely listing patent numbers; assumptions about how to integrate a portfolio acquired through a merger should be stress-tested against the actual legal and contractual status of each patent prior to the closing of the transaction.

D. Hewlett-Packard's Acquisition of Autonomy (2011): The Cost of Superficial Due Diligence

The USD 11.1 billion acquisition of Autonomy Corporation by HP in 2011 has become a paradigmatic case study of the risks of poor IP and financial due diligence. Indeed, HP has claimed in its post-acquisition allegations that Autonomy Corporation has substantially overstated its revenues and valuation, in part by incorrectly attributing hardware revenues to software license revenues in order to inflate the valuation of its software-related IP assets.²⁵ The absence of thorough IP due diligence in verifying Autonomy Corporation's

²³ Amir Efrati & Sara E. Ante, Google's \$12.5 Billion Gamble, WALL ST. J., Aug. 16, 2011; Vlad Savov, Google Sells Motorola to Lenovo, THE VERGE (Jan. 30, 2014), <https://www.theverge.com>.

²⁴ Marguerite Reardon, Nokia Completes Alcatel-Lucent Acquisition, CNET (Jan. 14, 2016), <https://www.cnet.com>; see also, e.g., post-acquisition integration analyses discussed in id.

²⁵ Chris Nuttall & David McCrum, HP Takes \$8.8bn Hit Over Autonomy Fraud Claims, FIN. TIMES, Nov. 20, 2012

claims of IP ownership and revenues has culminated in a write-down of USD 8.8 billion in 2012.

The Autonomy Corporation case points to a fundamental weakness in the process of IP due diligence, namely the tendency for acquiring companies to conduct superficial due diligence in their haste to acquire a strategic asset. Proper IP due diligence involves not only identifying IP assets but also subjecting the basis upon which IP revenues are being attributed to thorough verification, as well as the legal soundness of IP ownership claims to thorough investigation.

VII. BEST PRACTICES IN IP DUE DILIGENCE

Based on the analysis, there are several normative recommendations regarding how to perform effective due diligence on intellectual property (IP).

1. The IP due diligence process should start as early as possible, best practice recommends at the term sheet stage and should involve a multidisciplinary approach to resource the IP due diligence process. Specifically, it should involve IP counsel, technical specialists, financial analysts, and, if a cross-border transaction, local country counsel to conduct due diligence on the IP.
2. When creating an inventory of IP assets, all IP assets should be included in the inventory and therefore should include all IP assets to the extent possible, including unregistered rights that may not be listed in any public record. For example, many proprietary algorithms or internally developed programs may be substantial competitive advantages; however, if they are not included in the due diligence process, then the value of those algorithms/programs will be lost to the acquirer.
3. When verifying ownership of IP, verification cannot be limited to registration records; in particular, due diligence on the "chain of title" related to the IP should also include reviewing all historical contractual agreements related to the IP being reviewed. This includes all contracts related to founding, assigning IP to employees and contractors, and establishing or creating IP; determining if there are any openly

encumbered IP rights is also something that should be a key area of focus when conducting due diligence on early-stage technology companies.

4. The valuation process should involve the use of multiple methodologies rather than a single approach, with the approach being dependent upon the nature of the IP and the availability of market comparables.²⁶
5. The process of compliance tracking needs to be built into the post-acquisition IP management structure so that the IP does not lapse due to administrative failure.
6. The IP due diligence report needs to be integrated into the overall risk management process for the M&A transaction, with the key findings being factored into the purchase agreement and the purchase price.

VIII. COMMON PITFALLS AND STRUCTURAL VULNERABILITIES

Despite the availability of established frameworks, IP due diligence is liable to make several structural errors. An incomplete asset inventory is the most common structural error – not identifying unregistered IP or tools developed internally, or IP that is being maintained in the name of a subsidiary company. In a complex corporate structure where the movement of IP has occurred across multiple entities without any consistency in documentation, this error increases the risk of undervaluing both the assets themselves as well as the company as a whole.²⁷

A second continual recurring structural error is the failure to adequately investigate both ownerships, as well as encumbrances. The complex nature of ownership, with joint ventures, co-ownership claims, historical assignments without a clear path of succession, can leave an acquirer with a title that can be challenged in court. The Nokia-Alcatel-Lucent case illustrates how once a title becomes subject to litigation from another party, there will often be significant costs associated with the loss of the companies' projected future

²⁶ SMITH & PARR, *supra* note 3

²⁷ Raymond Millien, *Pitfalls in IP Due Diligence* (presentation at Intellectual Property Owners Ass'n Annual Meeting, 2012).

synergies, and potentially greater ongoing costs as part of the new acquirers' acquisition cost than anticipated at the time of their purchase.²⁸

Thirdly, failures in the maintenance of IP rights, such as the failure to recognize patents or trademarks that have become invalid due to non-payment of fees, may lead to the permanent loss of important rights. Once rights have become invalid, they cannot be reinstated, and this directly impacts the strategic importance of the acquisition. Fourthly, the lack of consideration of potential litigation risks, including outstanding cases, potential cases, and the target company's history of enforcing IP rights, may expose acquiring companies to financial penalties, operational challenges, and regulatory challenges that may negatively impact integration.²⁹

Lastly, the increasingly complex nature of cross-border IP transactions has introduced new compliance risks, including export control breaches, data privacy breaches, and stamp duty breaches, which cannot be addressed by generalist due diligence processes but instead demand specialized legal expertise to mitigate the risks involved. Acquiring companies that do not resource the review of these complex issues appropriately do so at significant legal and financial risk.

IX. CONCLUSION

Over the years, the role of intellectual property (IP) due diligence has changed from being just one part of M&A to the most important factor in the transactional valuation and success of the transaction after the completion of the acquisition. As more intangible assets make up the bulk of the value of corporations and as the law governing IP rights becomes increasingly complicated, M&A professionals must develop the ability to perform a comprehensive, thorough, and strategically sound review of the target's IP rights as a requirement of their practice.³⁰

²⁸ Marguerite Reardon, *Nokia Completes Alcatel-Lucent Acquisition*, CNET (Jan. 14, 2016), <https://www.cnet.com>; see also, e.g., post-acquisition integration analyses discussed in *id.*

²⁹ Raymond Millien, *Pitfalls in IP Due Diligence* (presentation at Intellectual Property Owners Ass'n Annual Meeting, 2012).

³⁰ LEV, *supra* note 2.

The case studies that have been discussed in this paper indicate that if IP due diligence is done properly, the value created can be immense; an example of this is the acquisition of Motorola's strategic patent portfolio by Google. On the other hand, if IP due diligence is not done properly or completely, then the consequences can be devastating; a good example of this is the case between HP and Autonomy. The common link among the high-profile failures that occurred in the world of IP due diligence is that the complexity of the target company's IP position was not sufficient to match the depth of the acquiring company's due diligence.

In the future, IP due diligence will continue to be impacted by the increasing speed of innovation driven by artificial intelligence technologies, the increasing prevalence of open-source software dependencies, and the increasing breadth of international data protection laws.³¹ Those acquirers that invest in best-in-class IP due diligence services and effectively integrate IP due diligence results into the structuring and post-merger integration process will be the ones that realize the full potential of innovation-driven transactions and minimize the risk of legal and financial pitfalls. Indeed, in a world in which intellectual property is the most valuable asset that a company can own, due diligence is not only good business practice it is essential business practice.

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³¹ World Intellectual Property Org., World Intellectual Property Report 2023: The Geography of Innovation (2023).

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