Lavery CAPITAL

NUMBER 5, SEPTEMBER 2015

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Legal newsletter to investment fund / venture capital fund promoters, managers and investors

LAVERY CAPITAL: A LEADER IN MONTREAL IN THE PRIVATE EQUITY, VENTURE CAPITAL AND INVESTMENT MANAGEMENT INDUSTRY

Creating and setting up private equity and venture capital funds are complex initiatives requiring specialized legal resources. Lavery Capital has developed enviable expertise in this industry by working closely with promoters to set up such structures in Canada and, in some cases, the United States and Europe, in conjunction with local firms. Through Lavery Capital's strong record of achievements, the firm Lavery sets itself apart in the legal services market by actively supporting promoters, managers, investors, businesses and other partners involved in the various stages of the implementation and deployment of private equity and venture capital initiatives.

INTELLECTUAL PROPERTY DUE DILIGENCE IN AN INVESTMENT CONTEXT

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A due diligence analysis of intellectual property rights is an important step when acquiring or making a significant investment in a business. It is particularly important in the case of a technology business, where IP rights are assets that account for almost all the value in a business. A due diligence analysis provides a more accurate picture of those assets and of any potential problems associated with them.

Various types of intellectual property can be the object of a due diligence analysis. Most often it is trademarks, patents and trade secrets that are assessed, although copyrights can be involved as well, such as when a business has rights to the source codes of a computer program. However, it should be kept in mind that all forms of intellectual property require careful consideration.

In Canada, trademarks can be assigned under the *Trade-marks Act*[1], whether they are registered or not. It is therefore important to trace the trademark's chain of title back to when it was first used. If the trademark is registered, it will also be important to determine whether the goods and services declared at the time of registration adequately match the operational reality of the business as well as whether the reported date of first use is correct. In fact, a registration can be invalidated if the actual date of first use is found to be later than the date that was declared.

With respect to patents, a distinction must be made between pending applications and patents actually granted. If a patent application is pending, it is important to review any correspondence received from the patent offices, notably for any indication that the patent will not be granted or that its scope will be restricted. If the application was filed under the *Patent Cooperation Treaty* (PCT), it is advisable to analyse any preliminary opinions issued under the framework of this treaty. Since a patent application is predominately a technical document, it might be necessary to ask an expert in the field for his or her opinion concerning the scope of the invention. While a patent that has been issued is presumed valid, it remains essential to assess its scope in relation to the invention the business is exploiting commercially.

[1] R.S.C. 1985, c. T-13.

Patent rights generally belong to the inventors, unless a written agreement provides otherwise. In consequence, any agreements signed with the inventors should be examined.[2] In this regard, there are two situations that should be avoided. The first one is the situation where various inventors have assigned their rights to more than one business, thereby putting those businesses in a co-ownership situation that is difficult to manage. The second one is the situation where the inventors declared to governmental authorities that they are not, in fact, the true inventors. A patent obtained without designating the correct inventors could be impossible to enforce or perhaps even invalid altogether.[3] Lastly, if the patent or patent application is the subject of successive assignments, one must make sure that each assignment has been made in writing in accordance with the requirements of the *Patent Act*.[4]

The *Copyright Act*[5] contains a presumption that any work (including source codes for computer programs) made in the course of employment are the property of the employer. However, there is no such presumption if the work was made by a subcontractor or a consultant, so more extensive verification is needed in such cases. In a noteworthy decision, the Ontario Court of Appeal recognized that an arrangement of computer program elements can be copyrighted even if the elements themselves cannot be protected individually.[6] Furthermore, although it is not mandatory to register a copyright, any assignment of copyright or any licence granting an interest in a copyright will only be valid if made in writing by the copyright owner, which should also be subject to verification.

As for trade secrets, a business cannot derive any economic benefit from the information unless it is truly secret. Hence the importance of verifying any confidentiality and non-competition agreements as part of the due diligence process. It could also be essential to verify which measures are in place to protect the secrets. Such measures can include IT restrictions that prevent employees who are not involved in a project from accessing certain files, or "need to know" restrictions that partition knowledge between various divisions or business units.

Lastly, the purchaser or investor will need to verify that there are no administrative or judicial proceedings which could affect any intellectual property rights and that there are no third party infringement claims that have been made either verbally or in writing.

At times the due diligence analysis might lead to the abandonment of the investment project altogether. In other cases, the due diligence allows for corrective measures which the vendor of the business will need to implement in order for the sale to proceed, or which the buyer of the business will want to put in place in order to protect its investment in the long term.

[2] For example, see *Élomari* c. *Agence spatiale canadienne*, 2004 CanLII 39806 (QC CS).

[3] For example, see *Ethicon, Inc.* v. *United States Surgical Corp.* 135 F.3d 1456 (U.S. Fed. Cir. 1998) and *Pannu* v. *Iolab Corp.*, 155 F.3d 1344, 1351 (U.S. Fed. Cir. 1998).

[4] R.S.C. 1985, c. P-4.

[5] R.S.C. 1985, c. C-42.

[6] *Delrina Corp.* v. *Triolet Systems Inc.*, 2002 CanLII 11389 (ON CA).

MAJOR CHANGES ENABLE REGISTERED CHARITABLE ORGANIZATIONS TO INVEST IN LIMITED PARTNERSHIP UNITS

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The federal budget presented on April 21, 2015 (the "**Budget**") contains important measures enabling registered charitable organizations and private and public foundations (hereinafter collectively referred to as "**Registered Organizations**") to invest their funds in units of a limited partnership.

Prior to announcing these measures, the *Income Tax Act* (Canada) ("**ITA**") prohibited such investments by Registered Organizations because, by investing in a limited partnership, they were considered to be operating the limited partnership's business. The consequence of making such a prohibited investment was that the Registered Organization's registration could be revoked and, thus, that they could lose their income tax exemption and their ability to issue receipts for donations.

According to the measures announced in the Budget, the ITA will be amended to provide that Registered Organizations are not considered to be operating the business of a limited partnership because they have invested in the units of such an entity. These changes will apply to any investment made by a Registered Organization in a limited partnership on or after April 21, 2015.

It is important to note that the proposed changes only apply when a Registered Organization becomes a member of a limited partnership if the following conditions are met:

1. The enabling legislation governing the limited partnership provides that the liability of members of the partnership is limited;
2. The member deals at arm's length with the general partner; and
3. The total fair market value of the interests held by the member and by any persons or partnerships with whom it is not dealing at arm's length, does not exceed 20% of the fair market value of all the interests held by all of the members of the partnership.

These changes will give Registered Organizations greater flexibility in the range of investments they can make.

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