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Due Diligence - Inventions

By L Burke Files, CDDP, President, Financial Examinations & Evaluations, Inc (01/08/2012)

I have had the opportunity to have been part of teams that have performed due diligence investigations into one or another given invention. I say opportunity because it is really a treat for me to meet with and speak with those people who are the irrepressible tinkers and thinkers as they work to invent the future.

Last month I was again part of a team looking at an invention. This invention was a significant part of why a company, my client, was looking at this other company as an acquisition target. As I did the work, I had come upon an anomaly. The anomaly was her behavior, the anomaly was the inventor's reticence to discuss her work.

Alarm bells started going off in my head and I had no idea why. Yes, this was out of the ordinary and yes this was not what I expected - but this is no reason for me to be upset. Thus, I put my first impression to the side and I got on with the due diligence research of the laboratory manuals, notebooks and the chain of experiments and observations that led up to the discovery underpinning the invention.

The work was flawless and elegant and very well documented. What the documents failed to contain were the blind alleys, the proposed hypotheses crafted, tested and discarded. These blind alleys are useful in their own right. The blind alleys or failed hypotheses show what does not work, so these failed experiments need not be repeated.

The reduction to practice is a concept aimed at the initial embodiment of an invention. A successful "reduction to practice" event requires that the claimed invention can be clearly demonstrated to work for its intended purpose. A working model would be a strong claim in the process of illustrating the reduction to practice of an invention.

The notes on the research failed in my mind as the notes were devoid of laboratory litter, errors, failed experiments and the inevitable stains from lunches eaten while making notes, coffee to keep working, and lab chemicals. Further, the reduction to practice, absent the failed hypotheses, felt contrived.

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I raised these issues regarding the perfect notes with the CEO of the company and the inventor at the first “all hands” due diligence meeting. I was expecting my Perry Mason moment where the CEO yelled “You suits don’t understand” and she, the inventor, would then drop to the floor in a blubbering mess confessing her scientific sins. Well that did not happen. The CEO and the inventor both smiled and let me know that every night all of the raw lab notes were re-written by the interns with specific instructions not to include the failures, as most investment bankers do not understand failures or the value of the failures. In short, as the CEO said, he had two sets of “invention books” one from the lab and one dressed up to show others. While the answers were the same, the presentation of the clean set of notes was tailored for a given audience. The CEO gave me access to the full raw lab data and I found what I needed to find. The evidence in the raw lab notes, complete with stains, clearly demonstrated that the invention was the result of their efforts and the age-old process of coming to a glorious insight remained true. The glorious insight was at the end of a path consisting of lots of work and lots of blind alleys.

The inventor never did come around to see me and talk about her invention, or anything else for that matter. She came to work and did her research and left. She spoke to almost no one even in the company. The acquisition of the company went through and I have not been called to give testimony in an invention fraud case so I assume all is well. I re-tell this story as an illustration of two key points of due diligence.

The first is the history of an invention. Each invention follows its own path but those paths have similar features. Those features are lots of work, many blind alleys, and many hypotheses tested and discarded before one arrives at the glorious insight and its reduction to practice. The lab litter accumulated is much like the sawdust accumulation when making wooden furniture. It is part of the authentic process, it is there and you just must find it to assure yourself you are in the right place. I have come across inventions with no lab litter. These inventions turned out to be taken (stolen) from other locations such as universities and former employers where the new company/person has tried to pass this perfect work off as work of their own.

The second is the value of the instincts of a professional or expert intuition. These instincts are accumulated through a saturation of deeds and years in a given field. Little clues are accumulated by the professional mind sorted and ordered in the subconscious mind without the owner of the mind even knowing that it is happening.

Effective due diligence blends both types of thinking. Good due diligence thinking is a mixture of intellect, reason and cognition working with instinct, gut reaction, and intuition. All of this effort is aimed on figuring out the right questions to ask.

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