VOLUME 3 | ISSUE 1

INTERNATIONAL JOURNAL OF ADVANCED LEGAL RESEARCH

MERGERS & ACQUISITIONS: ROLE OF INTELLECTUAL PROPERTY

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I. ABSTRACT

Mergers & Acquisitions, although very complex in nature, have proven to be a key strategy for organizations around the globe to cope up with the dynamic environment we live in. It is a process where two or more organizations/companies form a new company or become a part of a bigger company; for example, in the case where Beats by Dre became a part of Apple.inc or in the case where Oriental Bank of Commerce had merged with Punjab National Bank. The process of mergers & acquisitions is the best bet for big or small companies to secure their positions in the market so they have more time to hop on to new opportunities. While such merging and acquiring happens, all the tangible and intangible assets including the Intellectual Property are most important among these which a single organization now owns. This paper will focus on how Intellectual Property is useful/advantageous in Mergers & Acquisitions, and how it increases the value of companies, its transferring through the use of technology and how it helps growing businesses to attain unique resources.

II. INTRODUCTION

To understand how intellectual property drives mergers and acquisitions, it is imperative to understand the basic notion of both mergers and acquisitions and intellectual property separately.

Mergers and Acquisitions are transactions in corporate finance, in which the ownership of companies, other business organizations or their subsidiary companies are transferred or combined with other organizations/authorities. M & A is a kind of process which incorporates or judges some of the movements within the organizations, such as downsizing or expansion. From a legal perspective, Mergers is a legal amalgamation of two or more legal entities, similarly acquisition is a process where one entity takes ownership of other entity(s) with respect to the other entities share capital assets and alike. Both of these transactions have more or less the same kind of effect which is consolidation of

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assets and liabilities under single ownership. The distinction between a merger and an acquisition is best described in terms of control by the shareholders. Under a legally planned merger, shareholders are seen to enjoy partial control over a combined/merged company/organization, whereas, in an acquisition, it is observed that one party is placed under direct/indirect control of the acquirer party's shareholders.

Coming to Intellectual Property, it refers to the property which does not have a physical form. These properties are a result of sheer human intellect and therefore the name "intellectual" property. Right in rem' is available to the owner of such intellectual property. There are three major kinds of intellectual properties, namely, Patents, Copyrights, Trademarks and Trade Secrets. A company's Intellectual property has more value than the other tangible assets of a company. Intellectual property plays a crucial role in the development of a company as it carries innovation, product value and brand value of a company. Intellectual property is one of the main reasons why lots of companies/organizations are undergoing mergers and acquisitions, so they can gain control and ownership over different unique intellectual properties.[23]

III. DUE DILIGENCE IN INTELLECTUAL PROPERTY

Due Diligence is a process where the commercial potential of a business undergoes research and analysis. Through this process financial viability and feasibility of the business in subject is classified in terms of

assets and liabilities and on this basis examination of the market standing of a business is done. All these findings are then summarized in a report known as the Due Diligence Report.

Due Diligence of Intellectual Property in cases of Mergers & Acquisitions is of great significance specifically where investment in technology and biotech companies is called for.This is because when such an acquisition is demanded, acquirer's main aim is the Intellectual property assets of the acquiree company. The process of due diligence starts with an MOU in whichboth parties willingly exchange important information, such as future plans, liabilities, assets and some documents. While fixing prices, the technological, legal and financial aspects need to be calculated through due diligence.Through a due diligence report the acquirer is made aware of any pending or old litigation matters against intellectual property of the acquiree company. A proper due diligence report not only helps the buyers to be made

[2]Intellectual Property Due Diligence - Intellectual Property – India, Katarki (https://www.mondaq.com/india/trademark/448686/intellectual-property-due-diligence)

[3] INTELLECTUAL PROPERTY: THE DOMINANT FORCE IN FUTURE COMMERCIAL TRANSACTIONS COMPRISING MERGERS AND ACQUISITIONS, Mandavi Singh.

aware of certain cracks in the field, but it also helps the sellers to help track down the wastage of money in the maintenance of unused IPs.

There are three basic methods for valuation of Intellectual Property, which are **Market-Based Value**, in which cost of IP is determined on the basis of market price of a similar property; **Cost-Based Value**, refers to the cost required to replace or remake, but it overlooks the cost of maintenance and the value of time put into it;and; **Value Based on Estimates of Future Economic Benefits**, refers to the purchase price determined by past and future economic benefits.[4]

Due diligence of intellectual property might seem to be a complex process and indeed it is the case. One of the most notorious cases in the history of Negligent Due Diligence is the case of Volkswagen and Rolls Royce in 1998. In this case the biggest carmaker on the planet, Volkswagen acquired all the assets of Royce Rolls Motor Cars Ltd, including the manufacturing rights of the company for $ 790 Million. Butthe problem was even though Volkswagen could manufacture cars for Rolls Royce, it could not use its brand name as all the trademark rights of the name were with another carmaker BMW. By not being careful enough, Volkswagen paid an extraordinary price for the result because now BMW is the sole owner of manufacturing and also the trademark to use the name Rolls Royce and Volkswagen is nowhere to be seen in the picture.This case provides an interesting learning experience in the field of Intellectual

Property Due Diligence for the M&A corporations, especially while considering the rise of M&A in the dynamic world we are living in.[5]

IV. RISKS ASSOCIATED WITH DUE DILIGENCE CONSIDERING TECH INDUSTRIES

Since, in the present dynamic and advanced environment we live in, new tech companies are on a rise by many folds. This has led to many big businesses to acquire small yet rising tech companies, to help them expand, for larger availability of capital, taxation benefits and so on. But the most important reason for acquiring these businesses is the want for IP assets with the main aim to increase the value of IP portfolios of companies.

[4]Role of Intellectual Property in Mergers and Acquisitions (https://taxguru.in/corporate-law/role-intellectual-property-mergers-acquisitions.html)

[5] How to Avoid Another Rolls Royce? IP Due Diligence in M&A Transactions (https://www.ipeg.com/how-to-avoid-another-rolls-royce-ip-due-diligence-in-ma-transactions/)

- At present, acquisition deals are generally risky and they get even riskier when it comes to tech deals considering the complexity of products involved. IP portfolio management is critical, especially when it comes to M&A deals in the Technology Industry. Therefore, it is critical for the senior management of any company to put in more resources in the Due Diligence handling department so that, no negligence is observed in the process. Serious problems in acquisition deals with technology industries and other similarly complex industries with IP portfolios have observed lack of licensing rights, forged investor signatures and alike which could have demolished the post deal integration. All of this is avoidable with a proper IP due diligence process.
- One of the most crucial stepsto be taken as part of due diligence process is to consider Intellectual Property to address and recognize the real owner of an intellectual property. This is because, in many decades, old family- owned companies, ownership of some Intellectual Properties might still be with a family member and in such cases proper documentation is not always available, as the determination of rights in favor of a family member would be complicated to track down. Also, in cases where, many parties, like parent company, subsidiaries and foreign companies could be owners of Intellectual Property(s) and the acquired/target company might just be given
  rights to utilize such IP. Such issues and risks of proper documentation and ownership might arise in a due diligence report concerning intellectual property.
- Other risk is associated with the requirement to check if the Intellectual Property rights are in conflict with any third-party. So in order to avoid such discrepancies, all important Intellectual Property Rights in question should be checked beforehandwith respect to google searches, international patents, designs, trademark databases, in databases of relevant IP offices and alike. This practice should be specifically and strictly followed in cases of new technology, whereother than regular searches, freedom to operate patent searches should be carried out, so that it is ascertained if the new technology/intellectual property can be freely used commercially without violation of IP rights of third parties.
- Another crucial consideration while doing due diligence is the area and conditions of the IP asset. Some items are restricted to specific locations or have restrictions and conditions for use. Such phrases should be specified explicitly and without ambiguity.[6][7]

[6] *Ibid, Pg. 2*
[7] Role of Intellectual Property in an Acquisition or Merger

V. BENEFITS OF INTELLECTUAL PROPERTY IN MERGERS & ACQUISITIONS TRANSACTIONS

Intellectual property is like a treasure trove as it can potentially increase an organization's value by many folds since it is comprised of various blends of businesses. Intellectual Property has other benefits too when it comes to M&A transactions, like tax benefits if IP is donated, giving it to startups in return of equity, abandonment for cost reduction, instead of monetary payment giving IP assets for research & development purposes and so on.

Even though there are so many benefits which arise out of IP in M&A transactions, many organizations are afraid to use IP in such ways as it could lead to patent wars, or because it may create a negative reputation of the firm.

INCREASE IN VALUE OF THE COMPANY'S PORTFOLIO: One of the benefits arising out of IP asset Mergers and Acquisitions is the value it adds to the portfolio of the acquiring firm.Companies must examine if their present portfolio satisfies the requirements to accomplish their current company objectives in order to achieve constant market growth. In this dynamic and volatile market environment, it is not always possible to innovate something new; therefore, companies must look for new opportunities and offerings by acquiring existing innovation by other companies to expand their product portfolio and maintain their market leadership. This will be accomplished by establishing IP rules and solutions in order to find unique inventions that can contribute to the company's anticipated growth.

*TRANSFER OF TECHNOLOGY:*Technology may be transferred from one firm to another through mergers and acquisitions. The firms exchange their technological secrets, business algorithms, and so on, which helps both the companies to build their businesses. Companies may take advantage of market possibilities and fully use intellectual property via technology transfer.

*UNIQUE CAPABILITIES:*Companies have long desired a grip in the market. They are continuously looking for a dominant position in the market over their competitor. One of the most important instruments for this is the purchase or merger of a competitor's distinctive invention or talents in order to get an advantage over others. It alters the firm's whole vision while also developing a distinct and efficient business strategy for the new organization.

(https://www.legalserviceindia.com/legal/article-2693-role-of-intellectual-property-in-an-acquisition-or-merger.html#:~:text=Intellectual%20property%20assets%20are%20the,such%20as%20merger%20and%20acquisition.)

DIVERSIFICATION: Acquisitions and mergers can aid in the exploration and enhancement of various business areas. It makes it easier to enter a new line of business. Because it is easier to start a firm with pre-established resources, it lowers operating costs and develops a diverse asset portfolio for the organization. It provides up new avenues for greater market transactions, rewards, and recognition.

GROWTH: The fundamental purpose of implementing any company strategy is to encourage growth and development, leading to profit maximization in order to accomplish the intended goals. The purchase or merger of an intellectual property asset adds to the company's growth potential by obtaining fresh and competent technologies. It ensures that the company's product selection is kept up to date with market

demand. A corporation must assess its current intellectual property asset portfolio to see if it fits the standards and is in accordance with the company's goals.[8][9]

VI. SOME EXAMPLES

Mergers not only help corporations to obtain access to valued patents for valuable goods and processes, but also, they help in forming Patent Pools that combine patents linked to a certain technical standard, minimizing litigation and licensing expenses, and enhancing royalty sharing.

In 1999, Napster began as a free music exchanging service and filed into bankruptcy in 2002 after being sued by record labels for alleged copyright breaches. Bertelsmann, a German conglomerate, later purchased it for $8 million, in which Napster would charge for its audio-service and pay a percentage of the revenues to artists and record labels.

IBM paid $150 million for Daksh e-Services, India's third-largest call center and back-office service provider with $60 million in sales. Thus, IBM inherited not just a core skill, but also Daksh's copyrighted software codes and related intellectual property. Similarly, Microsoft's aggressive takeover of Yahoo in 2008 for $ 45 billion mainly was an acquisition of intellectual property rather than real assets or people resources.[10]

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[8] *Ibid, Pg. 3*

[9] Role of Intellectual Property in an Acquisition or Merger (https://www.legalserviceindia.com/legal/article-2693-role-of-intellectual-property-in-an-acquisition-or-merger.html#:~:text=Intellectual%20property%20assets%20are%20the,such%20as%20merger%20and%20acquisition.)

[10] INTELLECTUAL PROPERTY: The Dominant Force In Future Commercial Transactions Comprising Mergers and Acquisitions, Mandavi Singh (https://pdfslide.net/documents/intellectual-property-the-dominant-force.html?page=1)

VII. CONCLUSION

Intellectual property assets are the company's intangible assets that play an important role in the company's growth and contribute significant value to the asset portfolio. It is one of the reasons why corporations purchase IP assets and go through the rebuilding process, such as merger and acquisition. It aids in creating a diverse asset portfolio, acquiring of new competencies, and exploring more market choices, all of which

speed up the growth pace and make it easier to achieve the intended company goals. As a result, Due Diligence and IP appraisal must be performed correctly so that the transaction is not pointless and iscompleted successfully. Without question, intellectual property is becoming a major element in M&A deals.