



ROLE OF INTELLECTUAL PROPERTY IN MERGERS AND ACQUISITIONS

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ABSTRACT

Intellectual Property is an important segment in today's business world. On the other hand, mergers and acquisitions is also nowadays being used as a strategy for growth in this business world. When a merger or acquisition happens all the assets are transferred from the target company to the acquiring company. Within these assets the most important one is the intangible assets. Here comes the reason why Intellectual Property becomes important in any merger or acquisition which the article majorly focuses on. These intangible assets such as trademarks, copyrights and patents, they have to be looked upon to see if they belong to the target company or any third party. To know this, due diligence is required so that any other bad outcomes from merger or acquisition are avoided. Even big companies make mistakes while conducting due diligence which is the reason the articles tries to discuss the importance of Intellectual Property in any merger or acquisition. The article focuses on the role that Intellectual

Property plays in mergers and acquisitions including as to why Intellectual Property due diligence and valuation are conducted, followed by some famous examples concentrating on the merger and acquisition relating to Intellectual Property. Further, the researcher attempts to find what are the issues that arise in a merger and acquisition by mostly relying on doctrinal research. The review of literature available is in the form of journals, articles, newspaper and web links. Thus, the researcher will provide information related to the importance of intellectual property and posit a conclusion for the same.

INTRODUCTION

Mergers and Acquisitions (M&A) have become popular in the corporate world due to its growth strategies in everyday evolving businesses. Comparing M&A in the years 2018 and 2019, India witnessed M&A at an all-time high in the years 2020 and 2021, where more than 80% of deals were closed by first-time buyers.¹ Deals worth \$90.4 billion were struck in the first nine months of 2021 some of them were Tata Sons acquiring Air India and Prosus acquiring BillDesk.² Some successful examples of IP-driven M&As in the Indian context in recent times are of Marico Ltd, one of India's leading fast-moving consumer goods (FMCG) companies. From 1995 to 2018, Marico had successfully acquired various well-known brands, which included SIL from KFL, Hindustan Lever Limited's Nihar, Zed

¹ "India Sees Record M&A Volume In 2021, First-Time Buyers Lead", ET (Dec.21, 2021) available at <https://economictimes.indiatimes.com/news/company/corporate-trends/india-sees-record-ma-volume-in-2021-first-time-buyers-lead/articleshow/88406001.cms>

² Kriti Bhalla, , "From Tatas taking over Air India to Byju's acquiring Aakash — here are the top

acquisitions of 2021" Business Insider India, (Dec. 31, 2021), available at <https://www.businessinsider.in/business/news/tata-air-india-payu-billdesk-piramal-group-dhpl-top-merger-and-acquisitions-ma-of-2021/slidelist/88574247.cms>



Lifestyle's male grooming brand Beardo, Set Wet, Livon and Zatak and certain other personal care brands owned by Reckitt Benckiser.³ Reliance too has been growing its business through M&A especially in the retail, digital and renewable sectors. Nowadays, companies like Microsoft have 90% of the value of the company comprises of IP. Even a company which is not so technology centric will have 20-30% value contributed by the IP.

There are many reasons for a company to merge or acquire other companies, but the most common reason is to maximize the profit of its shareholders. It is believed that two companies would add more value and an opportunity to grow market share when they come together compared to when they operate individually. The success of any merger would depend on how the two or more companies combine while keeping their day-to-day operations running. One of the important rights the acquiring company gets are the Intellectual Property Rights (IPR) of the target company in an M&A transaction. Due diligence is the process of investigating the target company's information regarding the financial, intellectual property, tax liabilities, etc. The ultimate goal of conducting due diligence is to ensure that there are no risks associated with the business transaction. In M&A, purchasing a business without due diligence increases the risk for the purchasing company. The process of M&A involves the transfer of assets, and because of many innovations in the

technology sector, IPR plays a significant role in today's world. Many Intellectual Property (IP) issues are involved in an M&A transaction, and it is crucial to investigate the legal status relating to the company's IP. Hence conducting IP due diligence is very important during M&A.

M&As are an essential part of a growing economy. They pave the way for growth and survival of the business entities by enhancing synergies and maximizing returns to the shareholders. With M&A, it becomes reasonably necessary to understand what role IPR has in it and the issues that may arise. Hence, the article is divided into four parts. Part I discusses the importance of IP in M&A, Part II discusses the role of IP due diligence, IP warranties and indemnities and IP valuation, Part III focuses on examples of role of IP in M&A, Part VI discusses IP issues in M&A and Part V is followed by a conclusion.

I – WHY TO CARE ABOUT INTELLECTUAL PROPERTY IN MERGERS AND ACQUISITIONS?

According to Oxford Advanced Learner's Dictionary, IP means "an idea, a design, etc. that someone has created and that the law prevents other people from copying."⁴ Intellectual property rights (IPR) are legal rights that arise from the intellectual activity and protect creations/inventions that result in scientific, literary, and artistic fields. IP is considered to have a vital role in the

³ Aakansha Joshi & Sujjan Talwar, "Representations, Warranties, Indemnities and Insurance in M&A" (2020) available at <https://www.lexology.com/library/detail.aspx?g=49cd5fa5-b348-4af5-a9ad1e36e3928f74#:~:text=Simply%20put%2C%20a%20representation!,existence%20of%20a%20certain%20state>

⁴ OXFORD ADVANCED LEARNER'S DICTIONARY, Oxford University Press (10th ed. 2020)



development of the company since it carries the company's brand value. As M&A involves the transfer of assets that includes both tangible and intangible assets so that it becomes a part of one company. The intangible assets include Copyrights, Trademarks, Patents, Trade Secrets, etc. In most transactions, the acquirer would look at the value of the assets owned by the target company. Therefore, one should never question the role that IP plays in selling or purchasing a business. IP asset is often considered a significant component in M&A of the technology sector. IP merger or acquisition provides many benefits such as leading to acquiring unique technology that the other company has. Putting all resources for the innovation of technology is time-consuming, henceforth companies merge lowering the risk of investing in a new technology.

II- ROLE OF INTELLECTUAL PROPERTY DUE DILIGENCE

While doing mergers or acquisition process, preliminary considerations should be taken care of, such as the nature of the buyer, the nature of the target's business, IP assets of the target company etc. Due diligence often clears whether the business transaction would be an asset or stock purchase. In the early stage of IP due diligence, the acquiring company generally looks at publicly available information, such as news articles, the target's and its competitor's websites. The later stage includes asking the target company for the information, including IP licenses, any on-going IP litigation, lists of

registered and unregistered IP and so on. From the perspective of a company acquiring another company and eventually acquiring IP, due diligence with a particular focus on IP helps the acquiring company to assess intrinsic value and more critical status of the IP of the target in all geographies being covered in the M&As.⁵ Some of the factors that contribute to successful IP due diligence are –

- Conducting proper IP Valuations – This is the most important step in IP due diligence. As there is no specific formula to conduct IP valuation, therefore, IP valuations must include all the IPRs.⁶ The target company should maintain an IP register which would include information like the application number of IP, which IP is registered, the status of each IPRs. It is also necessary to mention whether IP has been developed by consultants or independent contractors, or by the employees themselves.
- Clarifying IP ownerships - First and the foremost thing is to identify the key people who know about the IP of the target company. In-house and outside counsels of the target company are needed to be contacted. The appointed counsel must clarify the issues of the undisclosed owned intellectual property. It is done for a reason because it might be that after the transaction is over that the acquiring company does not possess the ownership of the IP assets, or its use might be restricted because of their party interest.

⁵ Yetunde Okojie, “*The Importance of IP Due Diligence in Mergers and Acquisitions*” (2018) available at <https://www.mondaq.com/nigeria/patent/740668/the->

[importance-of-ip-due-diligence-in-mergers-and-acquisitions](https://www.mondaq.com/nigeria/patent/740668/the-importance-of-ip-due-diligence-in-mergers-and-acquisitions)

⁶ *Ibid*



- Confidential Information – In the process of M&A several information are exchanged; some of them are sensitive, for which the parties sign a Non-Disclosure Agreement (NDA). This step takes place before the due diligence. Taking necessary precautions to protect the information is vital in IP due diligence so that there is no misuse of confidential information. The obligations of NDA, however cannot be derived from the IP laws of the relevant jurisdiction; only the contractual laws will function as the backbone of these agreements.⁷
- The most famous case for negligence during the IP due diligence is the Volkswagen and Rolls Royce merger.

INTELLECTUAL PROPERTY VALUATION

After gathering information about the company, the acquiring company does the IP valuation, where the acquiring company has to decide on the cost of capital of the target company. Now when IP valuation enters in the steps of merger and acquisition, sometimes the company may try to negotiate the IP value. Once a company negotiates the value, it goes for due diligence. Some of the factors to be considered for IP valuation include the study of the industry, entry barriers in the industry, market share of the owner, economic condition of the business, profits, possibilities of business expansion, possession of new technologies, concentration and level of competition in the

⁷ Priya Adlakha & Vibhuti Vasisth, “India: IP Due Diligence In M&A- 4 Points to Consider” (2020) available at - <https://www.mondaq.com/india/maprivate-equity/950464/ip-due-diligence-in-ma-4-points-to-consider>

market.⁸ Though it is considered that IP valuation is tricky as it has no proper formula and also because it is an intangible asset. It is crucial to assess the asset's value by the acquiring company, which is why IP valuation is essential.

There are different methods as to how the valuation of Intellectual Property is done- Market-based value, cost-based value, and estimates of Future Economic Benefits. Any of the methods mentioned above can be used to get a final IP valuation. The results of the IP due diligence are relied upon for the IP valuation because they set out in detail the status of the IP portfolio of the target company through the methods mentioned earlier.⁹

INTELLECTUAL PROPERTY WARRANTIES AND INDEMNITIES

While conducting due diligence, the acquiring company may find some information for which they would need some Representation and Warranties (R&W). The acquiring company may want to feel safe and protect themselves if there is any breach. Hence R&W clause is included in the term sheet/letter of intent/memorandum of understanding. For example, some of the warranties may include that the target company is the sole proprietor of the IP in the company or the target company does not violate any third-party IP rights. In cases of breach or misrepresentation, there is an indemnity clause mentioned in the

⁸ Rachit Garg, “Role of intellectual property in mergers and acquisitions” (2020) available at - https://blog.ipleaders.in/role-intellectual-property-mergers-acquisitions/#What_are_Intellectual_Property_Rights

⁹ Supra note 3



agreement, which compensates the acquiring company for the damages that may have arisen due to breach or misrepresentation. Although there is much possibility that claims from third parties may arise, like where third parties who are not happy with the merger or acquisition may bring claims.¹⁰

III – EXAMPLES ON ROLE OF INTELLECTUAL PROPERTY DURING M&A

1. Rolls Royce and Volkswagen- One of the famous cases on IP due diligence is the acquisition of Rolls Royce by Volkswagen. In 1998 Volkswagen purchased all the assets of Rolls Royce, although it was restricted to use the logo. Here IP assets did not include trademark of Rolls Royce. If Volkswagen had conducted due diligence, it would have known that BMW had acquired Rolls Royce logo. BMW and Rolls Royce had an agreement for producing engines for Rolls Royce cars. After many tripartite negotiations Volkswagen and BMW finally came to a settlement, BMW became the owner of the Rolls Royce brand and Volkswagen retained the Bentley trademark. This was also a great example of caveat emptor.
2. Kingfisher Airlines- At one point of time Kingfisher Airlines was one of the most highly profiled airlines. In 2007 Kingfisher merged with Deccan Airlines, this airline was the first airline which was a low- cost airliner

with affordable rates for the middle class people in India. Kingfisher merged with Deccan Airlines, but the only negligence happened in this merger was that the airlines was called “Kingfisher Red”. They completely diluted the trademarks of both the Airlines. People got confused as to what is Kingfisher and Kingfisher Red. Kingfisher Airlines suffered heavy losses and debts and the major reason for that was this merger between Kingfisher Airlines and Deccan Airlines. The merging caused degradation in the brand status of Kingfisher Airlines and the company lost its premium value.¹¹

3. Jet Airways – Jet Airways was the country’s second largest international airline after Air India, but we all know they soon became bankrupt; the airline has undergone resolution since. This is a case study relating to IP valuation. Naresh Goyal owned Jetair Private Limited, he later set up Jet Airways. However, the problem that arose was that the trademark was not registered in the name of the company instead, it was registered in the name of Naresh Goyal.¹² The company came out with Initial Public Offering. As non-ownership of the trademark was seen as a risk factor, Jet Airways decided to buy the brands from Naresh Goyal’s Jet Enterprises. The trademark was licensed to Jet Airways by Jetair Enterprises Private Limited. There was an agreement signed between Jet Airways and Jetair Enterprises Limited concerning about usage of trademark and payment of license. For this Jet Airways had to obtain the

¹⁰ Forbes, “21 Key Issues in Negotiating Merger and Acquisition Agreements for Technology Companies” (2020), available at - <https://www.forbes.com/sites/allbusiness/2020/07/03/negotiating-merger-and-acquisition-agreements-for-technology-companies/?sh=21798448ad1d>

¹¹ Ashok Panigrahi, “A Case Study on the Downfall of Kingfisher Airlines” (JMRA) 2019, available at - <https://www.researchgate.net/publication/334319115>

¹² Sanjeev Parshar & Rashmi Aggarwal, “Intellectual Property Valuation- A Case of Jet Airways, Innovative and Critical Times Ahead, an Indian Perspective” (World Academy of Science, Engineering and Technology) 2019



trademark for which registration of trademark was important. Jet Enterprises had to license the use of the “Jet Airways” and related trademarks for use in the other countries and where Jet Airways seeks to operate in the future.¹³ All this happened because Jet Airways had to buy its registered brand so that they can comply with their Initial Public Offering. The IP valuation costed \$ 7.5 million.¹⁴

VI-INTELLECTUAL PROPERTY ISSUES IN MERGERS AND ACQUISITIONS

- Patents that have been issued might have a risk for getting claims of invalidity. They are challenged on the grounds such as where the inventor does not develop the invention and that the invention has already been used for a long time. Again, as mentioned above, these may be third parties or competitors who are not happy with the merger or acquisition announcement. To avoid this, proper and detailed IP due diligence is essential. Such issues may also arise concerning IP ownership. When there is co-ownership with a third party, it can lead to third party claims. There should be an R&W clause in the agreement on IP ownership to avoid this. In transactions where IP is involved, there is a very high risk of exposure to infringement claims to arise. Other IP assets that need to be

taken care of are internet domain names, software and databases, copyrights registered and unregistered, etc.

- Post-M&A, the transfer of the IPR should be done to the acquiring company from the target company. Timely recording in the appropriate jurisdictions of the change of ownership is essential for protecting the ongoing validity of the IP and enforcing the IP rights by the acquirer.¹⁵ If this is not done, some issues might arise such as it can affect the future transactions that the acquiring company would want to enter with a third party, but this would not be possible if the acquiring company is not the proprietor in the timely recordal. Sometimes late recordal leads to delay in the deadline of renewals which the proprietor can only do, but due to the absence of timely recordal the acquiring company will not be able to pay the renewals because it is not the proprietor in the record.
- In a cross-border merger there are governing laws, one of the acquiring company and the other of the target company both have different laws. The acquiring firm primarily uses the acquired IP asset in more than one country. Such IP asset become victims of the foreign jurisdiction.¹⁶ The Courts have to deal with issues based on the merit of IP alone.¹⁷ As mentioned above, such issue also

¹³ *Ibid*

¹⁴ “Jet in 7.5 Million Trademarks, IPR Deal” (2013) Business Standard, https://www.business-standard.com/article/companies/jet-in-7-5-m-trademarks-ipr-deal-105021801071_1.html

¹⁵ Vaibhavi Pandey, “India: Recordal of Change in Ownership After Subsequent Mergers: An IP Perspective” (2014) available at <https://www.mondaq.com/india/trademark/310728/recordal-of-change-in-ownership-after-subsequent-mergers-an-ip-perspective>

¹⁶ Mandhavi Singh, “Intellectual Property: The Dominant Force in Future Commercial Transactions Comprising Mergers and Acquisitions” *IJIPL*, 183-184, (2009) available at https://www.lowenstein.com/media/5735/savarepluss-terba-don_t-open-yourself-to-problems-westlaw-mergers-acquisitions-4142020.pdf

¹⁷ Holland & Knight, “United States: 10 Key Intellectual Property Issues For M&A Deals” (2016) available at <https://www.hollandknight.com/insights/publications/2016/07/10-key-intellectual-property-issues-for-m-a-deals>



requires timely recordal of IP for the protection of IP assets.

- Chances of anti-trust issues arising cannot be said to be nil; in case of horizontal mergers, chances of anti-trust issues occurring are more because horizontal merger comprises of two entities belonging to the same industry merging. The anti-trust issues are generally related to patents. Courts have held that as only those Patents would be violative of Anti-trust laws that have been unlawfully acquired or improperly enforced.¹⁸ Thorough IP due diligence is required to find if the IP is violating any anti-trust law.
- The target company would always want the R&W clause to be limited, while on the other hand acquiring company would want the indemnity risk and closing risk to the target company. Therefore, the R&Ws relating to IP should be clear as possible so that there are not any breaches that may cancel the deal. If the R&Ws are not clear, that could also be the start of issues occurring.
- Open-source software (OSS) is software by which the source code is usually made available to the public for modification or enhancement. OSS issues often occur in mergers or acquisitions of technology companies. During the M&A process, the acquiring company might want the target company to disclose the software used for the license of the products under OSS.¹⁹ The acquiring company wants assurance through warranty regarding OSS, because it is not user-friendly and imposes restrictions on the

acquiring company's right to distribute target company's product. Many issues can arise from OSS. Fundamentally, open-source issues impact a merger or acquisition transaction because buyers need to know what rights and liabilities are being transferred, if open-source code is disclosed during due diligence, the acquiring company will need to determine the effect open-source code has on the risks being evaluated by it in the proposed transaction.²⁰

- IP issues may also occur in other agreements, so it is better to review IP agreements as well as other agreements such as Research and Development (R&D) contracts, software development agreements, etc.

Therefore, In M&A, IP acts as the dominant force as it brings many issues. Some consider third-party infringement litigation as the risk factor resulting in monetary damages, affecting the company, and occasionally leading to bankruptcy.

V – CONCLUSION

The article discussed the role of IP in M&A. Part I focused on why IP is looked upon in M&A transactions which included IP due diligence and IP valuation. Part II focused on the issues faced relating to IP in M&A transactions. Therefore, it can be said that IP plays a massive role in M&A transactions because, if not looked into could bring many issues that would result in calling off the deal or could bring issues post-merger or

<https://www.mondaq.com/unitedstates/trademark/546180/10-key-intellectual-property-issues-for-ma-deals>

¹⁸ Id at 12

¹⁹ Matt Savare, Bryan Sterba & Freeman Lewin, “Don’t open yourself to problems: Open source technology and M&A due diligence” Westlaw

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<https://www.lowenstein.com/media/5735/savareplusterbera-dont-open-yourself-to-problems-westlaw-mergers-acquisitions-4142020.pdf>

²⁰ Id at 15



acquisition, like the example given above of the merger of Rolls Royce and Volkswagen. As the world keeps moving to become more innovative centric IPR values keeps on increasing in day-to-day business operations. Due diligence, especially IP due diligence, is essential for M&A, so the issues mentioned above could be avoided. To conclude, doing a thorough IP due diligence in M&A transactions is the road to successful Mergers and Acquisitions.

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