UNDERSTANDING INTELLECTUAL PROPERTY IN M&A: ROLE, ISSUES AND CHALLENGES

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Abstract

The concept of Intellectual property (IP) in Mergers and Acquisitions (M&A) has been evolved over the recent years and it has been used as a strategy for the growth of businesses. However, unlike physical assets, intangible assets (IPs) are difficult to transfer from the target company and involves several issues such as third-party ownership, licensing, infringement which may negatively affect such M&A between companies. Therefore, IP requires proper due diligence for proper transfer of rights to the acquiring company. This article aims to understand the role of IPR in M&A and identify the various challenges faced in transferring IPR from the target to acquiring a company with reference to landmark cases involving IP in M&A. Further, it aims to briefly explain the importance of the IP due diligence in M&A.

Introduction

Intellectual Property (IP) are intangible assets formed by the creations of the intellect. Over recent years, IP has grown to become one of the most vital assets of companies around the globe and even plays the centre role in Mergers and Acquisitions (M&A). The rapid growth of technological developments and innovations has led to the steady rise in such intangible assets to protect them from unauthorised exploitation. These IPs including trademarks, patents, trade secrets etc, form a unique/distinct intangible identity and hence, it is greatly valued by companies. Therefore, IP has become an inherent part of businesses especially for growth and success of such companies.

M&A have been utilised by companies to acquire new technologies and growth in the market. These companies find target companies having exclusive access to technological innovations, trademarks and patents and acquire them with the intention of obtaining such resources for further development of products or to venture into new fields in the market. IP is efficiently utilised by companies to hold a competitive edge over other businesses. However, IPR-driven M&A involves several issues and therefore, proper IP due diligence is to be conducted while transferring rights from one business to another. If any default occurs, it may directly affect the M&A and defeat the purpose for which it has been conducted.

Research Issues

Intellectual Property plays a crucial role in M&A as an invaluable asset to the company. However, acquiring any such IPR or transfer of IP to the company requires adequate due diligence. This article aims to understand the role of IPR in M&A and identify the various challenges faced in transferring IPR from the target to acquiring a company with reference to landmark cases involving IP in M&A. Further, it aims to briefly explain the importance of the IP due diligence in M&A.

1 Garishma Dongre, ROLE OF INTELLECTUAL PROPERTY IN MERGERS AND ACQUISITIONS, 30 Supremo Amicus (2022).
2 Kelly K. Li, Navigating Intellectual Property in Mergers and Acquisitions, 9 INT’L IN-House Counsel J. 1, 1-10 (2016).
IPR to be complied with. If there is no proper due diligence, rising discrepancies like third-party licences/ownership, infringements could deeply affect the M&A and could lead to bad outcomes from such transactions. The research article raises the following questions:

1. Whether IPR plays an important role in M&A?
2. What are the issues faced in IPR during M&A transactions?
3. What amounts to IP due diligence during the M&A process?

**Research Objectives**

- To analyse the role of IPR in M&A.
- To identify the various issues involved in the transfer of IP rights during M&A transactions and to understand the importance of IP due diligence.
- To suggest methods to conduct systematic transfer of IP rights and ownership during mergers and acquisition of companies.

**Research Methodology**

Doctrinal methodology is utilised on the proposed research topic and the data will be collected using Secondary sources. The secondary data will be collected by studying journals, papers and research articles published in detail regarding the role of Intellectual property in M&A transactions. This will help us in understanding the lacunae and issues highlighted in our article and analyse challenges involved in the transfer of IPR in M&A transactions. The in-depth study of secondary sources is also expected to depict the impact of having proper due diligence for IPR in such transactions.

**Analysing the role of IPR in M&A**

In a M&A transaction, two or more companies merge together to form a new entity or the ownership is acquired by the company through assets purchase or stock purchase. IP assets are one of such intangible elements in the transaction. It grants exclusive rights to the creators of such intellectual innovations and ensure that they are protected from unauthorised usage and exploitation by third parties. For companies, IPs represents their reputation, goodwill and provides a distinct character to their products and services. Marks, logos, Software, etc, fall within the protection of IPR and is utilised by companies to be distinct from other competitors in the market. Hence, they are directly linked to the company and play a crucial role in its growth and success. Therefore, IP assets play a crucial role in M&A transactions and therefore proper care and diligence is to be taken while transferring such rights.

IP aids growth as it increases the asset value of the company. In the M&A process, acquiring companies find target companies having exclusive access i.e., IP protection, to technological innovations, trademarks and patents and acquire them with the intention of obtaining such resources for further development of products or to venture into...

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4 Garishma Dongre, ROLE OF INTELLECTUAL PROPERTY IN MERGERS AND ACQUISITIONS, 30 Supremo Amicus (2022).
new fields in the market. Hence, this provides a competitive edge to the company in the market and provides a platform for innovation. Nestle had acquired the Rowntree PLC for a sum of $4.5 billion so as to obtain valuable brands such as Kit Kat, Rolo and Yorkie. It also adds to the value of the asset portfolio of the company. This helps to ensure that the company acquires the needed technology to fulfil its objectives in the long run. This is a strategy utilised by companies so as to avoid costs involved in recreating such technology as it might not be feasible by simply acquiring target company having sufficient R&D resources. An example can be observed when Google acquired Motorola mobility so as to obtain its patents through a complete transfer of rights to Google. Involving IP in M&A promotes diversification as it allows companies to branch out to new fields of business. This was observed when Michael Kors had acquired the brand Versace to introduce new product lines and markets with their IP portfolio.

Issues involved in IPR in Mergers and Acquisitions

With the steady rise in importance of IP, the need of proper and adequate IP due diligence was also brought to light. The process involves several issues which is necessary to be addressed prior to any formal transfer of rights and liabilities of IP. It is important to identify whether the IP assets are actually owned by the target company or whether it is licensed from another company/person. If it is owned by target, the asset can be directly transferred to the acquiring company, provided that the renewal, registration, fees etc. are thoroughly maintained. However, if a license is involved so as to utilise the IP of another third party, it requires explicit permission from the owner of the IP. The company may also decide to forgo the acquisition and licence the IP rights from the actual owner which is more cost-effective. An example could be observed in the case of Jet Airways where the trademark was not held by the company but rather by its owner Naresh Goyal and it was required to be brought back for a valuation of $7.5 million.

IPR involves a major issue of valuation as there is no straight formula to calculate the value of IP assets. It is to be estimated carefully with the help of experts having knowledge on estimating monetary values of IPs. However, it can be done based only on a proper due diligence report consisting of the evaluation of past and future revenue estimates, competitions in the market, protection granted by the trademark etc. As

10 Kelly K. Li, Navigating Intellectual Property in Mergers and Acquisitions, 9 INT'L. IN-House Counsel J. 1, 1-10 (2016).
11 Garishma Dongre, ROLE OF INTELLECTUAL PROPERTY IN MERGERS AND ACQUISITIONS, 30 Supremo Amicus (2022).
mentioned before, IP is vital to companies in the present market. In the fight for survival in the market often target companies with IP assets may be put forth for bids and several individuals may raise high stakes to obtain such rights. However, these valuations may exceed way beyond the reasonable valuation for the assets. In many cases, the combined entity, instead of being profitable, may rather fail. This phenomenon is known as Winner’s Curse and the major reason for such failure is the overvaluation of the target company. This was observed when Quaker Oats acquired Snapple for $1.7 billion so as to outbid Coca-Cola.13

The landmark case of Volkswagen and Rolls-Royce motors14 was one of the biggest failures due to the lack of proper due diligence for IP transfer. Rolls-Royce had split into two entities in 1973- ‘Rolls-Royce Motor Cars’ (automobile) and ‘Rolls-Royce PLC’ (airplane engines). The former company was acquired by Vickers who had planned to sell the company to BMW. However, Volkswagen presented a more attractive offer and acquired the company for about $800 million, assuming that the company held the IP rights for its name ‘Rolls-Royce’. However, it was thereafter identified that the trademark rights for the same was held by ‘Rolls-Royce PLC’, which was later acquired by BMV AG. After the split of Bentley, an agreement was reached where BMW become the sole owner of Rolls-Royce, while Volkswagen acquired the Bentley trademark. This case is a sole example to showcase the vital importance of due diligence in IPR for M&A transactions.

**IP Due diligence**

IP Due diligence is an essential requirement while acquiring target company’s IP assets. Through this the acquiring company is able to obtain all the information regarding the target companies IP assets. It ensures that the acquiring company is completely aware of any risks along with the rights which are transferred upon acquiring the target company. The in-house counsel along with experts may be employed to evaluate and check all the IP assets laid out by the target company. With this process, companies can evaluate the benefits and liabilities and decide as to whether the target company should be acquired or not. Further, due diligence enables the company to identify if there is any litigation proceeding, registration issues or third-party licences involved in the target IP assets. This brings transparency and avoids any hidden details which may hamper the M&A process or defeat the purpose of the same.

The due diligence process will also bring to light any infringements by third parties of the target IP assets and any such legal liabilities involved in acquiring the IPs. Further, proper representations and warranties are also to be undertaken by the companies so as to hold the target company liable in case of any misrepresentation or concealment of hidden fact. The target and acquiring company may also ensure confidential information such as

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15 Kelly K. Li, Navigating Intellectual Property in Mergers and Acquisitions, 9 INT'L. IN-House Counsel J. 1, 1-10 (2016).
trade secrets are not disclosed through a tight-knit non-disclosure agreement to prevent any misuse of such data in any case.

**Conclusion**

Intellectual property plays a crucial role in M&A, especially in raising asset portfolio of the company. Through this process, the acquiring company can obtain innovative and unique IPs of target companies and hold a competitive stance in the market amongst other businesses. However, in several cases, due diligence and proper care is not instituted while looking at IP assets. The instance of Volkswagen has depicted how due diligence is crucial to the M&A. Hence, last-minute issues such as licences, third-party involvement, infringement and valuation of IP assets are indispensable while acquiring IP assets and may severally affect the M&A process if not dealt with. With due diligence, there is complete transparency between the parties and hence, both the companies are aware of their liabilities and are provided with adequate opportunities to clarify any issues with the target company. In-house counsels also play an important role in conducting the same by identifying the IP assets and ensuring the documents as well as required performance have been conducted. They should evaluate the situation and aid companies in making decisions regarding the M&A, especially related to risks and legal liabilities involved in acquiring the assets. It is necessary to understand and detect these problems early on so as to avoid any hindrance or rather defeat of the entire M&A process.

**References**

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