

MERGERS & ACQUISITIONS | BY STEPHEN EVANS AND NICOLA BAKER-MUNTON

Intellectual property due diligence in mergers and acquisitions

There are many reasons for entering into a merger or acquisition: company growth; entry into a new technology field; removal of competitors from the market, and so on. Whatever the reason, a merger or acquisition, is an arrangement that seeks to unite the resources, assets and knowledge of two parties for the purpose of creating something of greater value than the two parts. This will only be achieved if there is clear complementarity leading to potential synergy. In order to determine whether this exists there needs to be clear understanding of what each party is contributing.

Intellectual property in the form of patents, designs, trademarks, copyright, know-how and materials are often key assets contributing to that complementarity. Since companies frequently overstate their intellectual property positions it is only through effective due diligence that the real position becomes known and an informed decision as to whether to proceed can be made.

In an economy primarily driven by information and technology it is surprising how often intangible assets such as intellectual property, which often increase in value over time, are overlooked in favour of those fixed assets which are more readily valued by the accountants; and usually depreciate. Intellectual property may form a considerable proportion of the value of any company and this is especially true in the case of early start-up companies who have few if any other assets; just a great deal of hope and promise.

A clear example is the Coca-Cola Company. The value of the tangible, physical assets has been placed at around \$29bn but is far exceeded by their stock market value of more than \$100bn. Thus, a vast proportion of the value of the company presumably depends on the Coca-Cola brand itself, its trademarks and its know how in the recipe, etc.

Several years ago, despite a price tag of £430m and effectively securing the tangible assets to build Rolls Royce cars, Volkswagen failed to obtain any rights to the Rolls Royce brand name. BMW in contrast, who were previously outbid by Volkswagen for the tangible assets, secured the rights to the Rolls Royce trademark – and potentially the most valuable property in the deal – for just £40m. As the markets know, a Rolls by any other name just isn't a Rolls. Subsequently, on completion of the deals, BMW's shares rose while those of VW fell.

These two examples illustrate the importance of understanding the intellectual property of a company and how it impacts on its value. Intellectual property due diligence in M&A requires activity on both sides although clearly the scope of any due diligence will depend on a number of factors: (i) *The value and nature of the transaction* are key since they clearly determine both the risk to the company and the depth to which any analyses should be taken; (ii) *The nature of the rights to be analysed and their number* since this will impact on the amount of work required; and (iii) *Timing*. Completing a very detailed assessment of an intellectual property portfolio can take several weeks. Frequently documents and information

must be gathered from a range of sources, often internationally.

When problems are uncovered during a due diligence exercise it naturally leads to questions in the mind of a partner, investor or the lawyers acting on their behalf. Do you know the strengths and weaknesses of the intellectual property which your organisation holds and how to manage and fully exploit that intellectual property? Many businesses have skeletons in their 'intellectual property closet', but it is how those skeletons are dealt with that can make or break the deal; failure to answer the questions which are asked fully and knowledgeably can also be costly.

Preparing yourself and your organisation to enter the due diligence process can be challenging but is certainly worthwhile. Having documentation and information readily available and accessible, reduces both the time and cost of a due diligence exercise. Preparing your own intellectual property portfolio and freedom to commercialise position will also provide you with an insight into the issues and complementarity you should be looking for in the partner's intellectual property. Furthermore this exercise displays to a potential partner that you understand intellectual property and its importance to the business.

The intellectual property due diligence exercise can be likened to a health check on both parties. Be prepared for these questions being asked of you regarding your intellectual property and prepare questions covering all aspects you need to know about your partner's. The aspects to be covered should include each of the following items to some degree or another:

Identify the intellectual property assets which may be the subject of a transaction. It is surprising that so many companies fail to maintain an adequate record of all of their intellectual property assets. Such assets include not only patents and trade marks but also copyright, proprietary know-how and confidential information. You cannot fully exploit something that you do not know you have. In mergers and acquisitions it is also the hidden value – the Rembrandt in the attic – that partners may seek to take advantage of.

Confirm the status of the intellectual property rights, where applicable, as still in-force or pending. Again this is a basic check which should be carried out regularly to ensure that rights, and value, are being maintained.

Confirm the ownership rights in the intellectual property. Again this is a basic check and one that is frequently overlooked. It is often assumed that rights in intellectual property automatically transfer from one party to another such as from an employee to employer. This is not always the case and agreements must be in place to evidence the flow of ownership rights. For example, if a consultant produces a design for a new company logo it is not always clear who actually owns the rights to that logo – written agreements are required as proof of ownership.

Check the scope of the intellectual property rights to be sure that they do, or will, cover the intended commercial product. Intellectual proper- ►►

ty rights can be used to stop the same or similar products from entering the market helping to maintain a competitive position. On the other side of the coin, intellectual property covering the products of competitors can be an untapped source of licensing revenue. According to Salomon Smith Barney equity analysts, IBM generates \$1-2bn in annual patent licensing revenue.

Verify the validity of the assets to determine whether they have a reasonable chance of being upheld if attacked. Knowing how strong the assets are and having 'proof' of their strength, for example by way of a written opinion from a patent attorney, adds value to an intellectual property portfolio and therefore to the company that holds it.

Is the intellectual property the subject of any legal proceedings? The possibility of becoming involved in expensive proceedings can be a deal-breaker where M&A is concerned. Identify and maintain information regarding the existence of licences or restrictions that may impact on the value of the protection. Don't make the mistake of Volkswagen. Be aware of the terms and conditions of licenses and their transferability.

Identify any third party rights which may prevent commercialisation. Patent rights are often misunderstood – they do not provide a positive right to do anything – a granted patent provides the owner with a right to stop certain actions of others. A small 'intellectual property hold-

ing' company with few other assets was nearly the downfall of the well known Blackberry handheld device. Even a preliminary assessment of freedom to commercialise carried out by a patent attorney could improve the chances of identifying major problems, thereby dramatically reducing the risk that the assets are worthless.

These points are equally applicable whether you are merging, acquiring or divesting intellectual property assets with or without the other assets of a business. Being well prepared will ensure that you present your intellectual property in its best light and can devote the necessary time and resource to investigating the health of the partner's intellectual property.

A full understanding of your own intellectual property strengths and weaknesses and that of your partner will enable you to create a combined intellectual property portfolio and competitive intellectual property position that provides greater value than the sum of the parts and provides a true return on investment. ■

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