IS IPR A CHARISMA FOR COMPANIES DURING MERGER & ACQUISITION ACTIVITIES?

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ABSTRACT

The era has been changed in which a company does not focus on their Intellectual Property rights. In this day and age, companies consider their IP rights as their most valuable asset. With the use of IP rights and by bringing them into the play, it aids a company in getting a strong recognition in the market. Nowadays in developing countries, companies give more importance to their IP Rights because they believe that it ie the most valuable asset for a company can have. By considering this facet, there are many question marks regarding the use of IP rights in case of a merger, amalgamation, or a takeover of a company and to regard IP as an asset to a company.

This paper has varied aims which have been discussed separately in several heads: firstly, the main aim of this paper is to discuss various rights a company can have concerning its IP rights and why IP is considered to be important for the companies; Secondly, the evolution of the IP and the change of motive for M&A activities at every phase; Thirdly, how a company can survive through the various obstacles in the market?; Fourthly, how IP determines the value of the company during M&A activities?; Fifthly, what all issues can arise behind an IP driven M&A; Sixthly, how can the winner's curse become problematic during IP acquisition in M&A activities?; Lastly, it ends with various ways to protect IP during M&A activities and with the conclusion.

INTRODUCTION

Intellectual property rights are given for the creation of the work[i] as a token to protect the intellectual property rights of the author[ii]. IP system aims at the environment in which it strives for a balance between creativity, innovation, and the protection of the rights. IP rights play a major role in economic growth. For the stability and the smoother function of the IP system, there should be no lacuna left and should weigh between the interests of the innovators and the interests of the public.

For the overall growth of the company, understanding and analyzing the IP is very important.[iii] IP rights play a curial role in the company, knowledge of the value contribution by IP, and linking them to the business strategy are the building blocks of success of any entity. Companies' reputation, recognition, goodwill, and brand value are based on their IP rights. IP valuation and IP assessment are considered to be attributes to the development of the company. There is no astonishment to find that IP rights are the new largest assets, which a company can hold in this era.

A company can possess various IP rights, pivot on which work it seeks to protect. The IP breaks in into the play from the second the company hits into the market. Trademarks are given to protect the mark or a logo of the company and they aid in the identification of the brand in the market and it creates the distinctiveness of the brand from the other competitors. Any invention that a company discovers[iv] or can be patented and this helps in having the exclusive rights over the invention subjected to few exceptions. Any formula or a process, which has a commercial value in the commercial sector, which is confidential or insider information that is known only to a handful of people can be protected under trade secrets[v] and to protect the designs of a specific product companies can use industrial designs to protect them. For all the artistic, literature which are the brainchild of the company can be registered under copyright. IP rights should be protected and it is very important for the business of a company because without proper protection of ideas and innovation there is a huge chance of threat of infringement and which costs a fortune. Without proper protection of the intellectual property of a company, there won't be any leap in the business and ultimately the company runs into losses.[vi]

The unravelling ties which jump up are the fate of the IP rights when the company goes for corporate restructuring. With various forms of corporate restructuring, there are heaps of hurdles about IP issues. When a company merges with another company or amalgamates with another company and forming a new company out of that combination or buys a majority of

the shares or the assets and become successful with the takeover of a company the main question at the hand and the question which comes into picture is what happens to the IP rights of the entities?

LEGAL HISTORY OF IP AND M&A

In the late ’80 s, the mergers and acquisitions took place only with the sole reason to revamp their company structure for surviving in the market, but as the days passed the need has been changed from survival to the better growth and benefits of both the companies. Customarily, in mergers and acquisitions, the weaker companies used to opt for either merger or amalgamation with the strong economic companies to attain profits. The weak companies used to merge with strong companies to escape from liabilities and some merged by seeing their IP rights, which started late. Intellectual property rights are not a new-fangled idea, granting of IP rights started way back from the 16th century. Queen of England used to grant royal grants to the creator as a token of appreciation for his/her invention. The case of *Davoll et al. v. Brown*[vii] court held that by giving ownership rights to the creator we can protect the IP rights of the creators and they also stated that by granting these rights it helps to encourage the art and innovation. Moreover, according to article 1 of French law, all the discoveries are considered to be the properties of the author.

The first merger waver took place from 1896 to 1903, in which many of the companies opted for horizontal mergers. In horizontal merger companies of the same industry merge to generate profits. First, these mergers took place among the medical industries.[viii]The first phase of mergers during the period between was considered to be unsuccessful. Because the stock market collapsed in 1903 and government and judiciary bodies ordered that no merger should take place among the companies who are practicing the anti-competitive methods to do the business. And also, through the enforcement of The Sherman Act, many anti-competitive mergers are reducing.

In the next phase, which is from 1915 to 1929 the mergers took place among the small kind of business, unlike the anti-competitive companies. After World War I the mergers took place between the technological and scientific companies to increase their economy and for the development of the country. From 1964 to 1970, during this phase of M&A, the governmental and the non- governmental banks also started to merge. By the end of 1940, a combination of

different companies in different business lines has also started, which is known as conglomerate mergers.

In the adjoining phase, from 1980- 1990, during this phase the mergers were sponsored by the equities and in this process, the role of banks was eliminated because of the interest rates. During this phase, cross border merges also come into existence. Unlike the preceding phase, from 1991 to 2000 during this phase, the mergers and acquisitions of the companies are very high in number. During this phase, bigger companies like aviation and chemical companies used to merge with the national and international companies. During this phase, the role of the IP rights of the company has come into the limelight. But this came to end by introducing the restructuring of organization laws, anti-acquisition laws, the gulf war, and other factors. Beginning from 2003, in this phase, the deals, which are made by the company, gave immense importance to the shareholders and corporate governance.

Since M&A has seen the light of the day the evolution of the M&A has been unceasing. From phase to phase the rationale for the M&A has been changed and finally, the rich abundant IP rights have become the reason, which drives the companies for M&A. IP rights have become the value indicators of a company in the market. Companies have set their standards and their motivating force in M& A activities to possess the rich IP rights and values in the market sector which the target company does.[ix]

The role of IP for a company is indispensable and it became the key to stand on the upper footage than the other players in the market. From time to time the brand value, trademark, and the goodwill became more and more crucial as it directly attributes to the company.

A FLICKERING SOURCE OF AID: CORPORATE RESTRUCTURING

To combat the competition and for the survival of the company in the market, companies are required to undergo structural modification depending upon the need, which is called Corporate Restructuring. From the verge of winding up, with the aid of corporate restructuring many companies have come back into the market. In an expansion strategy by a company, mergers and acquisitions are always predominant. A merger consolidates different entities into one resulting in the comingling of the assets, liabilities, and rights and comes under the control of one.[x] Whereas on the other hand in the acquisition or a takeover a company generally which is financially stronger than the other will acquire through the shares or the assets and take the

control of the weaker company. An acquisition or a takeover may be friendly or hostile.[xi] They can be a horizontal deal or a vertical transaction in a corporate restructuring. A horizontal deal happens between the companies in the same business line. A horizontal deal has taken place in 1998; a $77.2 billion merger has taken place between Exxon and Mobil, which is the best example for a successful horizontal deal. In a case where the distributors or the buyers merge with the suppliers, it is generally called as a vertical transaction a perfect example of a vertical deal can be a merger which took place in 1993, and it's a $6.6 billion worth merger between Merck, who is a pharmaceutical manufacturer and Medco who is a pharmaceutical distributor.

Another classification of a merger is a conglomerate merger in which a company merges with another in an unrelated and a different line.[xii] The famous demonstration in this area can be through the Daimler Benz acquisition in the sectors of the aerospace industry and the automobile manufacturer. In this, the main motive is to take the aid form the aerospace industry to convert the premium automobile manufacturer into Europe's largest industrial company. The heirloom of such deals is not expressly impressive, but few companies like General Electric have shown some success to an extent. General Electric has shown success until the acquisition of Honeywell.

A company through corporate restructuring can either strengthen its roots by expanding or it can also trim it down. There are several alternatives to cut down, a company may consider cutting it down by selling a division through a divestiture to combat with the losses or can also opt for a spin-off. When a company opts for a spin-off, the shareholders of the original company will generally become the shareholders of the different and separated newly formed entities. Another method which a company cannot is called as equity carve-out[xiii], It's also called as split off in this the company will create a new subsidiary and it subsequently issues initial public offer (IPO) which is less than the entire amount of stock in the unit, thus by doing this the parent company will retain an equity stake as well as the management control within the subsidiary which is formed.

COMPANY'S IP: A FACE VALUE FOR M&A

The *prima facie* cause for many major mergers is due to the burning desire to acquire valuable technological assets like IP that are being developed by the companies. In many of the cases, the technological assets are the unique know-how, the patents, trade secrets, copyrights and

goodwill of the company collectively can be referred to as intangible assets or IP. In a race to acquire the intangible assets often driven many M&A. These assets are often unique and difficult to recreate. Companies, which possess these assets, will win the race generally with the highest profit margins and sustain the competition. They continue to remain in the dominant position until the competitor advances with his technological asset. The Internet has not just sped up the pace for acquiring the intangible assets that the company owns but it also forced radical changes in many nations' laws for IP rights. The allurement by IP will financially drive the profits to the company who are in the possession of these and adds up value to the company. To complete an acquisition, in the background there can be a bidding war between the companies regarding the target company, the company who succeeds will get to acquire the target company.

In November 1999, Warner-Lambert announced a merger worth $67 billion with American Home Products. On the same day Pfizer, Inc., made an announcement and proposed a $72 billion offer for the acquisition of Warner-Lambert in a hostile bid with the sole intention to prevent the merger between Warner-Lambert and American Home Products. When the push comes to shove, Pfizer has won the war leading to a final bid of $93 billion. The sole reason for the acquisition by Pfizer is only due to the team of scientists, know-how, portfolio of patents, their labs, which can aid in creating many breakthrough drugs. Companies are on a frantic race to win genetic discovery and to create and pinpoint new blockbuster drugs. [xiv]

A large number of mergers are worth billions due to the IP assets that they possess. The multi-billion-dollar merger fights between the companies are to win the battle for the best talent. The main importance of IP has been increasing especially in the pharmaceutical segment is because of the exclusive rights on the products. In order not to lose the exclusive right on the products many giant pharmaceutical companies merged or joint ventured to share their exclusive rights over the patent or their technological know-how. A Huge Merger between two giant companies or alliances to combine their major drugs into blended drugs can extend the patent life of the product. The war for the top innovations, the know-how, team of intellectuals not just limited to the biotechnology segment but it is occurring in all the segments. Often these merger fights are to conquer the unique assets the target company holds and to stand in the most secured area with a competitive advantage.

THE FALLACY BEHIND IP MOTIVATED M&A

The foremost reason, which drives any company for any corporate restructuring, is growth. The growth of any company is through internal growth initially but the mergers and acquisitions act as a fuel to speed it up. To achieve the competitive goals the easier alternative way is either to merge or acquire the necessary resources. To acquire the resources a company can pay a premium but to reduce this expense and for the internal growth, a company can opt for a merger or an amalgamation. In the vast majority of the cases, the growth of a company is significantly faster through mergers and acquisitions when compared with the internal means excluding the exceptions.

Another main motive for a merger is to obtain the synergistic benefits. This means that the combination of two different companies will yield more value than the value of the sum of the two firms if they are independent. The main complication here is that it's often hard to analyze the synergetic gains after the merger. A classic example of synergetic gains can be when a company through a merger can combine its research power with another company's marketing skills, which will increase the revenues because of the combination. Research states that any unrelated diversification will lead to poor results but any merger or acquisition in the acquiring firm's main line of business has led to an impressive track record.[xv]

To keep up with the rapid pace of technological developments in the market the technology sectors require intellectual property. There is no standard formula, which will guarantee the success results out of a merger or acquisition. There are a handful of examples in which a model has failed miserably like BMW- Rover acquisition or Daimler Benz acquisition with Chrysler. Deals, which are motivated because of intellectual property rights, have a unique set of challenges. Physical assets are easier to evaluate but an intangible asset is difficult to evaluate. A company opting to acquire the real estate assets of a target company can come up with an object of valuation but whereas the intellectual property assets are often harder to value. In the evolving hi-technology sector it is at most difficult to anticipate the demand of the customers and the responses by the competitors who are working on a similar line. Particular value can be assigned to any tangible asset but coming to an intangible is a particular value cannot be fixed against an intangible asset, often a company buys an IP for a worth much more or else for a worth much less because it's rapidly changing nature. The art of detangling the knot of evaluating the IP assets is much complicated and highly uncertain.

Following the footprints of high-tech firms, even traditional companies have started rapidly by using merger and acquisition as a means to acquire the IP of other firms. It's pertinent to mention that even the companies which have grown based on their internal culture of constant innovation and development and through its research and development by default on their own, have also started adopting M&A to continue to keep the pace with the other companies across the globe. Even based on the cost efficiency it is easier for a company acquired a technology rather than investing in an attempt to recreate the IP internally whose success rate is unpredictable. To regain the financial pace in the terms of growth the IP which is internally generated should be coupled with the IP from acquired companies. The prime focus of the companies internally and externally is that the future growth should be driven by 'three engines': bolt-on acquisitions to an existing business, brand new cutting edge IP brought in mergers, and the continuing IP being created through traditional businesses.[xvi] IP growth continues to be the central core of the development of any company. The *modus operandi* for the development of IP has been reduced to a combination of internal R&D equipped with acquired companies' IP resources.

WINNERS CURSE IN M&A: UPSHOT IN IP APPROPRIATION

In many bidding wars, the buyer usually wins because the buyer pays relevantly more than the other bidders. By bidding the highest for the target company they might end up not being able to achieve even its minimum rate of investment in the target company. If the investment is too intense then it leading to winners curse in the M&A. Conventionally the combined entity should achieve the necessary synergies to be more profitable than the individual but under the winner's curse, the combined entity post-merger or amalgamation will not be able to achieve more synergies than the individual companies before the M&A. According to the study, approximately 80 percent of the mergers and acquisitions have failed to achieve the required rate of return.[xvii]

Among the various reasons for the non-successful M&A, one of the main and the most usual reasons for the failure of the merger is the payment of excess premium on the stock market price of the target company. The winners curse is the problem in many M&A but the drastic effect that can be seen is on the companies whose main motive for M&A is based on the intangible assets or the IP. The key reason for this difficulty lies in the valuation of the assets. As the coin has two faces the winner's curse is a problem for the company, which is acquiring

the target company, whereas the target company is at the advantage because it is over evaluated. Companies whose crux of the business and their financial growth is based on their knowledge assets, IP, social capital are often over evaluated.

Even when the investment bankers or experts value a firm whose main assets are its IP, even they face major difficulty in the evaluation of the intangible assets in a merger or amalgamation. Time and again they are drawn back with many hurdles while assessing financial measures of performance, its returns on sale, returns on assets, or equity. Generally, these are based on the past performance of the company and there is no accurate measure to find the value of the IP post-M&A. Over and over the future potential of the IP is based on the assumptions. Even though the strongest company that has a huge team of R&D, plenty number of patents, know-how, new technology, copyrights, yet the evaluation of the IP should be made very cautiously even the assumptions while assessing the value of IP in the future should be backed up with a proper reasoning and a fundamental analysis. Even after taking safeguarding at every step of valuation, there are many cases in which the M&A is not successful which led to a failed merger and loss that cannot be substituted.

A paradigmatic valuation of IP in M&A was Quaker Oats and snapper. Quaker Oats purchased Snapple for $1.7 billion outbidding coca-cola.[xviii] Quaker approached snapper with confidence and urgency. Developing Gatorade into a Powerhouse national brand based on the confidence of the Quaker on their impressive record in the brewing market by executing a well-structured plan. By replicating Gatorade's success is a milestone in the Quaker Oats corporate life. The motive behind this was Snapple was a beverage company and with unique patents, trade secrets, good brand value, trademarks, and a very good growth rate in the market. Based upon these IP quicker oats went ahead with the purchase. The basic strategy used in purchasing Snapple was to use the strength of Snapple's distributors to help Gatorade and use the Gatorade's strength in the supermarket to help Snapple. After many meetings with the distributors they resisted the proposal made by Quaker and Quaker couldn't force them. Snapple's unique brewing technique was reversed engineered and infringe by other competitors. Moreover, the market has become so overcrowded selling the imitation of Snapple that it led to a huge reduction in the sale of the Snapple. Later after huge yearly investments, Quaker Oats sold Snapple at $300 million to a small beverage company. The acquisition of Snapple by Quaker oats remains a blunder whereas the mistakes in the valuation of IP are still common even today.

SHIELDING THE PACT

Post-M&A, the IP rights should be transferred or shared to the new owner immediately based on the agreement. If the IP is not transferred in time, there is a huge possibility that there can be any infringement in the new territory and the new owner will not have *locus standi* to bring an action in the court or to sue the other party for infringement and it will be a huge loss of royalties to the companies, this generally occurs in the case of cross border mergers. A Non-Disclosure Clause is a mandate which is to be included in the agreement, as this clause will act as immunity against any infringement and it is crucial in the cases where the merger is cancelled at a later stage. Including an arbitration clause will help in the settlement of the disputes related to IP, through this clause the parties can settle the disputes outside the court which saves a lot of time and the relation between the companies. A well-designed analysis and a decision on the payment of the future costs pertinent to payment for the filing, renewing of the IP, maintenance, etc. should be necessarily negotiated beforehand to avoid the disputes at the later stage. The warranties and the liabilities should be mentioned in the agreement and there should be no ambiguity about these. Based on these agreements a party can claim their damages if there is any breach in the agreement, so the terms, the cap on the maximum payment, mode of resolution should be decided well in hand. They may even include a clause that protects the rights and obligations of the company with the other party before the M&A. Prior M&A parties should appoint appropriate experts and prepare a due diligence report for M&A as it aids in analyzing the asset values of the companies.

CONCLUSION

The assessment of the company is based on its tangible and intangible assets. During the M&A the assessment of both the tangible and intangible should be considered, but the valuation of the IP down the lane should be done with due care and very vigilantly as it is highly based on the assumptions. IP rights play an important role during M&A activities. These act as the cornerstones of the development of a company. Companies opt M&A with a motive and it's been evolving continuously since the start.

In this day and age, the intention behind many of the M&A is the company's IP and their attributed rights, goodwill, benefits, profits, and privilege of standing in the dominant position

in the market avoiding competition holding IP rights. The M&A process should be done only after proper due diligence.

It is predicted that in the future IP will become a dominant force in business deals consisting of future mergers and acquisitions.

> *"The only thing you own is what you create, and the only thing you can create without needing someone else to give you raw materials first, is intellectual property".*
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> - Caliban Dark Lock.

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