Dealing in IP

Successfully transacting IP as part of the M&A Process

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The importance of intellectual property (IP) in an M&A deal process can often be underestimated, particularly if it is not seen as central to the transaction process.

Regardless of whether the buyer believes the IP to have a material impact on the value of the acquisition target, it is always worth spending time doing appropriate due diligence. This will reveal the full extent of the IP owned by the target and detail any deficiencies that may become apparent.

A structured approach to this research will provide detailed information to investors that could affect pricing, or other key elements of the proposed transaction. Initial due diligence should establish ownership, ensuring a clear chain of title is defined and documented. A series of questions should also be asked about the IP to establish fully transferable ownership rights, free of any encumbrances. Technology IP is often difficult to trace and more likely to be owned by employees of the business or partner firms involved in its development. Due diligence should identify this and ensure that any existing third party claims are resolved prior to purchase.

IP-related legal disputes, either ongoing or pending, will also be revealed by thorough due diligence. This is important since costly legal disputes can prevent an acquirer from implementing their plans fully following purchase.

Once appropriate due diligence has established the nature and status of the IP in the target business, it is time to value it. IP valuations are critical to make sure the correct price is being paid for a business, since patents, trademarks and trade secrets, can often easily be undervalued or overvalued if not assessed by an expert. Accountants are crucial to the valuation process, as are technical experts where the IP is less tangible, such as in the case of computer programs or specific coding.

The common ways to value IP are the cost, market or income approaches; which essentially consider value based on the cost to replace the asset, the income it generates or the value of comparable assets in the market. Whichever is used, it should generate a fair price that reflects the importance of the IP within the wider business.

When an acquirer knows all of the IP in play and its accurate value, they can start to put a purchase agreement in place, confident that they are unlikely to experience any nasty surprises. This is when appropriately tailored representations and warranties are required to ensure the purchase or sale of the IP is indemnified against unforeseen circumstances.

Buyers will push for a warranty from the seller, guaranteeing ownership, and indemnifying the buyer if the IP they believe they have purchased didn't actually belong to the seller. They might also ask for indemnifications against deficiencies in the IP which make it invalid or inoperable. Elsewhere in the contract, clauses limiting duration and geographic scope of the IP are also common, as are clauses protecting source code in the case of technological IP.

In the following discussion, we speak with five IP lawyers with expertise in ensuring IP is transacted successfully during an M&A process. They will go into detail about the points raised here and give their unique jurisdictional view on the IP-related challenges inherent in an M&A transaction.

The View from IR

Thomas Wheeler

Founder

Our Virtual Series publications bring together a number of the network's members to discuss a different practice area-related topic. The participants share their expertise and offer a unique perspective from the jurisdiction they operate in.

This initiative highlights the emphasis we place on collaboration within the IR Global community and the need for effective knowledge sharing.

Each discussion features just one representative per jurisdiction, with the subject matter chosen by the steering committee of the relevant working group. The goal is to provide insight into challenges and opportunities identified by specialist practitioners.

We firmly believe the power of a global network comes from sharing ideas and expertise, enabling our members to better serve their clients' international needs.

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Sergio Leemann was admitted to the Bar in 2009. He is an expert in international and national contract law, IT law, data protection law, advertising and competition law, distribution law, corporate and civil law and has working experience in an international environment.

Before joining Wicki Partners, Sergio was working as a Legal Counsel for an international industrial and retail company in the consumer goods market where he focused on data protection law, IT law, digital transformation, advertising and distribution law, competition law as well as international and national contract law.

Prior to his job as legal counsel, Sergio worked for a law firm in Zurich and Bern as well as a financial institution.

Sergio writes and negotiates in German and English, and understands and speaks French. He is a member of the Swiss and Zurich Bar Association.

ITALY

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Maurizio Ruben is the co-founder of CDR legal formerly Studio legale Ruben e associati.

CDR Legal has been created to combine in one body, many minds and experiences trained in different sectors. The operational fields of the association reflect its partners' skills and qualifications, acquired in the accountancy, taxation, human resource, economic and legal fields.

CDR Law is known as main consultant for large companies and banking institutions, as well as being an ideal partner for small and medium-sized Italian and foreign companies.

Maurizio was educated at the Mc George School of Law, University of the Pacific, Sacramento, CA (Diploma of Advanced International Legal Studies, 1988); visiting foreign lawyer at Kronick, Moskwitz, Tiedemann & Girard Law Firm, Sacramento, CA.

He is a member of the International Bar Association, the Licensing Executive Society and the International Association for the Protection of Industrial Property.

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Peggy Millikin is a registered patent attorney and has been practicing law for 28 years.

She has managed the global intellectual property ("IP") portfolios for a number of international businesses, counselling clients on aspects of portfolio creation and management and also protection and enforcement. She understands that clients are seeking value-driven results and look to optimise their IP spend while making IP assets an integral part of the business or organisational strategy.

Peggy also has lead the IP function on a number of international transactions, where the IP assets at issue were valued at several hundred million dollars, and helps clients enforce IP rights in a competitive market. She has also represented clients in high-stakes litigation and employs creative problem-solving skills to encourage resolution of disputes.

Peggy's technological background spans a range of technical disciplines, from fibre forming, to polymer and glass chemistries, industrial equipment and processes, business methods and software.

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Walid Abou Farhat is a partner at Abou Farhat Law Offices, Lebanon. He has been connected for the past 10 years with various copyright and telecommunication deals, and involved in GSM business in Africa on behalf of Hits Telecom and in Mobile TV deals with 3G3M, a Norwegian investment group.

In 2003 he actively participated in the creation of the first music publishing company in Lebanon "OMP". In 2007 he acted as senior Legal advisor to O-Media of Egypt and actively participated in discussions pertaining to a joint-venture with Warner Group. He has legally assisted Melody Group, Rotana Audiovisual and other key media players in the Middle East and North Africa.

Currently he is retained by telecom Aggregators as ARPU+ (Egypt), Qanawat (United Arab Emirates), Digi Music (Lebanon) and Believe & Yala Music (France). He represents other important publishers whether in the music or literature fields and has been actively involved in workshops with the Copyright Unit at Arab League and WIPO and has conducted several presentations related to collective management and copyright enforcement.

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Justisiari Perdana Kusumah (Justi) is the founding partner of K&K Advocates - intellectual property and has been practising as a lawyer for more than 20 years. Justi has extensive experience in assisting clients and the Indonesian government to secure protection for trademarks, copyrights, patents, trade secrets and industrial designs.

Justi has been continuously advising world-leading software manufacturers, fashion industries, consumer goods, in relation to enforcement and litigation against infringement of trademark and copyright in computer software in Indonesia. His knowledge of IP principles in an Indonesian regulatory context is regularly sought by multinational clients, foreign governments and international organisations. He is widely recognised as a leading IP lawyer and sought by many clients to provide delicate and cutting-edge IP advice and strategies.

Justi has a bachelor of laws and master of laws from Padjajaran University. He was the President of the Indonesia Association of Intellectual Property Consultants (2010-2013), a member of the International Trademark Association (INTA) and the INTA Anti-counterfeiting Committee East Asia & Pacific Sub-committee.

SESSION ONE – DUE DILIGENCE

What due diligence do you undertake specific to IP during the M&A deal process?

Indonesia – Justi Kusumah (JK) The first thing that we usually do is to identify all the IP owned by the specific target company. This involves doing searches at the relevant IP office, to include any trademarks, patents or copyrights owned by the company. We usually extend the audit to also cover the status of each IP and any potential legal action that might be involved.

In addition to that, we will also make enquiries and complete searches at the IP Court just to see whether there are any pending or completed litigation cases involving the target company, with regard to IP in Indonesia.

Going back to the searches at the IP office, we would also attempt to seek information on any potential assignments and or licensing involving the relevant IP, but that would only involve the licences that had already been recorded and not those recently filed for recordation.

Where patents are involved, we would do further searches with the relevant examiner, just to see whether there are any inventions that they have applied for in Indonesia. The IP office in Indonesia does not yet have an adequate database to allow this search to be conducted online.

With regard to the timeframe, that depends on the number of the findings that we discover, and the size of the company.

Italy – Maurizio Ruben (MR) First I try to understand the nature of the target business. If it's an industry, which kind of industry and how that might influence the kind of IP, or the problems we could face.

Secondly I must identify the right person to refer to when collecting data on relevant IP. It could be in-house counsel, professionals or members of the company's management.

I also want to know where I can get the information. It should, of course, be available online, but I think it is really important to talk with interested parties in order to get details about the nature and extent of the patent, or the trademark, or the IP and copyright rights. Issues like the possibilities of extending them abroad, or the pending status of any applications are important. This gives a snapshot of the complete IP assets of the target company.

Then, what we normally do is to get in touch with external lawyers, or in-house lawyers, to have a report of any pending disputes. This allows my client to know if they are buying a challengeable patent or a valid patent and how that might affect the value of a deal.

Oklahoma, U.S. – Peggy Millikin (PM) There have been some really good comments on how to research around published lists of IP and litigation, and those are all very important.

I'm going to focus on the unregistered IP, however, such as trade secrets. This could include non-commercial software, the management of IP, or how the target company operates. There's a lot of IP that's not listed in the patent or the trademark offices and, for that reason, conducting due diligence around unregistered IP, such as trade secrets, is very intensive and important work.

For example, my client was involved in the glass business and we were forming a joint venture with another company who also made glass. The other joint venture partner had some non-commercial software for R&D around the development of new glass formulations for specific purposes, and we found this through our due diligence on the trade secrets and unregistered IP.

We then did further due diligence around the retained entities in the organisation who needed this unregistered IP and the relevant trade secrets, unregistered copyrights and non-commercial information that would qualify as a trade secret.

When doing this due diligence, we want to know who is using it, how they implement their trade secret policy within the target, and whether they have a formal committee who makes IP decisions. We need to know that their employees and consultants have signed agreements to assign ownership of their IP to the appropriate entity to assess whether or not there are title issues.

It is also important to assess the need for any overlap for use of the IP assets in the operation of the retained businesses, so that licensing arrangements for the retained business can be addressed. This is particularly important when you're representing the selling company, rather than the buying company, because there might be entities within the organisation that still need some of those IP assets to operate their businesses. For that reason, the businesses will have to figure out whether they want to continue to own the IP and license it, or whether they want to sell it and retain a licence for themselves, which could affect the valuation of the deal.

Assessing how the target company operates their IP program, so that you know how sophisticated an entity they are, is useful. You should be able to get an idea of the income producing potential and the bottom line dollar value associated with certain patents or trademarks, to figure into the valuation.

Maurizio Ruben pictured at the 2018 IR 'On the Road' Conference in Toronto

Switzerland – Sergio Leeman (SL) In Switzerland, as in most of Europe, we find that there is more unlisted IP than listed.

The type of due diligence I do actually depends on whether I'm on the selling side or on the buying side. If I'm on the buying side, then the first thing to do is to ensure the seller can actually sell the IP, after all the identification and research is done, and for that we need the whole IP track in the background.

We had a case maybe a month ago, in which my client was acquiring a Swiss healthcare company using an IP box. We discovered that the IP wasn't actually in the company, so the deal was off. It took us quite some time to uncover the full IP track, which showed half of the IP belonged to a university in Poland and half to the person who invented the code involved.

The first thing is to define the goal of the transaction, then identify the IP, and ensure that the seller can actually sell it. Most of the IP you have to identify is not listed and that makes it harder in a large company. It all depends on who has the rights to the IP, and whether they have transferred it to their employer or not, so checking the labour contracts they have in place is also required.

So really, the whole track is important. It's like if you own shares in a company, and the whole track of the shares isn't there. In the end, you don't know who's the actual owner. If you do everything properly in this respect, you'll have an advantage in any negotiations.

Lebanon – Walid Abou Farhat (WAF) Due diligence aims in particular to assess, from a strict legal perspective, whether intellectual property (IP) rights do exist in a targeted company that is the object of a potential merger and/or acquisition. Usually this is an important step to closing a deal, as normally a letter of Intent pertaining to a specific deal shall always be conditioned to a satisfactory financial and legal due diligence.

Such legal due diligence should give answers to a number of questions including;

- Is there any Copyright certificate asserting the existence of a copyright, and has it been issued by a local office or by a foreign office and in this case is the country of that office member of Bern treaty or not?
- Is there a trademark, logo or tradename that have been deposited locally or abroad, and if deposited abroad do they have a priority right locally?
- Is there any patent, and what is the legal regime of the Patent office that has issued the Patent and is it final?
- Is the deal infringing upon trade secrets that remain protected or violating confidential information by disclosing them before term?
- Is there any geographic indication in the deal?

If the deal pertains to technology the questions include;

- Do we have source codes? Are they protected in bit bucket accounts? Who keeps the passwords?
- What is the proportion of open sources versus encoding in such source code?
- Have third parties licensed their Copyright in the source code if any, and what kinds of license agreement have been signed?
- Are the Intellectual Property Rights free of legal encumbrances or ongoing legal disputes?

SESSION TWO – VALUATIONS

How do you go about valuing IP? Has this ever changed the pricing of a deal in your experience. Any examples?

Italy – MR We need to evaluate which kind of IP we are talking about, whether that's a trademark, patent or trade secret.

Of course, if it's a patent or a trade secret, then it's difficult from a legal point of view to have an estimation and evaluation because you need an expert. This could be an accountant or a technical expert who can evaluate the full IP portfolio, and assess the value.

There are different methods of evaluation, including cost, income or market-based measures, but technical expertise is very important for all of them.

The expert plays a key role. For example, I just read a paper about the added value of the most important brands in Italy. The value of the Gucci trademark is evaluated at USD16.3 billion dollars, while Ferrari is valued at USD3.5 billion dollars.

So, it's quite important when you are the acquiring party to know exactly what you are buying and the kind of value this represents for your company, or the target company.

Trademarks are easier for a lawyer to evaluate, but for patents and trade secrets you need an accountant or technical person, to check the importance of a specific patent to your portfolio.

Indonesia – JK I agree with Maurizio, that we need to first understand the detail of the majority of the IP owned by the target company.

In Indonesia, there are not many experts available that could provide the support to secure really accurate valuations. It is only a very select few firms that are able to provide such assistance and, in some cases, when we want to separate the IP valuation from the overall audit, it becomes more difficult.

I have been involved in many projects that required quite a large amount of IP research, because it was one of the main assets of the company. It did not change the pricing of the deal, but the result of the valuation allowed us to accurately price the deal before the project proceeded.

We would consider bringing in experts from outside the country to help value IP in a deal, but of course we would first involve a valuation expert from Indonesia.

Lebanon – WAF In MENA, there is an obvious lack of know-how as to how to assess IP rights in a rather learned manner, especially with the traditional absence of specialised bankers and what I call a regulated copyright economy. Therefore, we mainly rely on international VCs and financial experts to evaluate IP that is found to legally exist in a deal.

Oklahoma, U.S. – PM We often involve accountants to determine value, because valuations are so dependent on the tax laws, and we've discovered that our accountants can value the IP differently based upon different circumstances.

They may value IP one way for a buy-side transaction and another way for a sell-side transaction. Then, weeks after the transaction, they might value it a third way for the purposes of reporting taxes, rather than for the deal; and all of this is legal.

It's imperative that you have accountants involved in evaluating, but this is not the only thing we rely on. Sometimes the accountants need information from the legal team or the business in order to give an accurate valuation, and this ties into some of the comments in the last session. It's imperative to know whether the assets are going to be sold outright, or if there are some kind of ongoing connections to them necessary for the operation of the retained businesses.

Maurizio talked about ownership and whether assets have been mortgaged or pledged as collateral; that is imperative to know. Another issue that I've encountered frequently in transactions, particularly with large international companies, is knowing whether those IP assets are going to be needed internally by the selling company. If this is the case, the assets can't be sold outright and that then affects the valuation of the deal.

We do often find that accountants on either side of deals often disagree on the valuation and struggle to come to an agreement. We did a deal once, where we changed the valuation of the deal based upon the value of the IP that was being sold because we had to carve it out and leave it in an operating entity for a plant so that they could continue to use it.

When we then went to flip the company and sell it to another entity, our client didn't want to include the IP, because they still needed to maintain some use of it. When we went to flip it we disclosed this to the buying party, and they then wanted to bring down the sale price because of this existing right in the original selling company.

It just depends upon what the party's goals are, and evaluation of those goals can change, from the viewpoint of the

Peggy Millikin pictured at the 2018 IR Annual Conference in London

buyer or from the accountant doing the work.

Switzerland – SL The client usually puts a value number behind the IP, working together with accountants. I will also work with accountants if I find something in the due diligence that isn't adding up, or something that appears to create a risk of litigation.

Value can depend on the taxation of the different IP in question and the tax law of Switzerland. We have 26 cantons with 26 different tax laws, so you definitely need a tax expert to figure out what to do. Of course if we're talking about international valuations, then it becomes even more complicated.

Usually the valuation number is there because my client sees potential in the IP which might have synergies or scaling effects if they acquire another company that is in the same or a similar field.

The number isn't necessarily what I would put behind an IP, but that is not for me to answer, because I'm not the one making the price.

What I will do though is do some research to see if there is anything that might reduce the price for my (buy side) client. They will be happy, if they don't pay as much at the end, but they know what any IP or any company they are acquiring is worth to them.

We might bring in technical experts to support our view on a valuation, depending on the IP. If it is software code for instance and there is something in there that requires validation, or needs to be confirmed as unique and valuable.

We might also need accounting expertise on hand if the client is going to negotiate pricing as part of the process. It is pretty difficult to value technology, and sometimes you can see a technology firm is overpriced, but if it's something like blockchain that banks need to be part of, then they will often pay more for it.

SESSION THREE – REPRESENTATIONS & WARRANTIES

What representations and warranties do you include in a contract with regard to IP? Do you negotiate differently depending on which side you are representing?

Oklahoma, U.S. – PM It is very different when you're representing the buyer than it is representing the seller. The seller typically wants as many representations and warranties as possible, however the buyer wants to give as few assurances as possible.

The seller looks for representations regarding title and ownership, and often the buyer must warrant title regardless, because a seller typically must warrant what is being sole. There may be some instances when a quitclaim is appropriate.

Sometimes, we can soften the effects of reps and warranties by making them knowledge-based, meaning that the purchase agreement defines what is meant by "knowledge", for example, the personal knowledge of the executive entities who are handling that aspect of the deal. Typically, a seller must warrant title and ownership, to some extent, but these can be softened with knowledge qualifiers or quitclaim limitations.

There are other IP reps and warranties. For example, some buyers ask for reps that the IP has been prosecuted and is free of defects such that there are no deficiencies that would make the IP invalid or inoperable. That is a very dangerous rep and warranty to make, especially from the seller's point of view.

The buyer will push for this, but the seller should resist it because there are so many pitfalls in IP prosecution that unfortunately it is easy to do something during prosecution that could result in the inoperability or invalidity of one of the IP assets. This is something that the attorney prosecuting the IP would do and the buyer may not even know about it, or the seller may not even know about it because they don't know what to look for.

The attorney might have done something as simple as not signing the document properly before the patent office or the trademark office. If you get into litigation, the litigation attorney is going to look for irregularities, make an issue of it and try to invalidate the asset. That's when you need to have indemnification.

If it's income producing IP, the buyer should have some kind of indemnification for a period of years following the closing date, to the effect that if there's a major defect in the IP, or if a warranty is breached, the indemnities kick in.

Switzerland – SL I think dealing with IP is pretty similar in the US, Switzerland or Europe. Of course the seller wants as much on the warranties as they can get, while the buyer wants to get rid of them. That's the goal.

The clauses in a contract can differ though, and depend on the negotiations you are actually in and on the assets you're selling and in what field.

Sometimes you can get an indemnity clause for ten years, while sometimes it might just be two months. In software development, for instance, indemnities are really short because it's a fast-changing environment. It's about safeguarding whatever you can as a buyer.

I can't say anything generally because it depends on the deal and some clauses that would be accepted in one deal, would never be accepted on other deals.

Indonesia – JK When we do an IP due diligence, especially in the M&A context, it's very rare to have specific representations and warranties, because usually all the warranties are about the sale and purchase of the shares themselves. There is usually a very general clause that can also be considered to have covered the representations and warranties for IP.

Even if we have specific IP representations and warranties, I think they are very general, covering issues such as making sure the seller has the proper ownership over the IP, and has all the registrations in place in Indonesia, especially for the registrable IP.

For some cases, we also need them to represent that they have obtained all the approvals, be that corporate approval, or sometimes approval from the authorities, for protection, especially with regard to the IP. For assignment of IP in our company law, we have a threshold for value.

We always ask them to guarantee that there is no dispute over the IP, even though we are also conducting separate searches to find out whether they have IP disputes, whether in court or in the trademark or patent office.

Lebanon – WAF Regardless of the side of the representation, we make sure in such deals to insert typical clauses related to a variety of aspects;

A hold harmless clause, warranting that IP does not infringe upon third party rights and indemnifies the buyer and its directors and representatives from such liability, reasonable attorney's fees and court expenses.

Whenever legally accepted, we will add a limitation on the liability, and a clause detailing IP geography and duration; including the legalities under which they are either deposited and/or registered.

Sergio Leemann pictured at the 2017 IR 'On the Road' Conference in Singapore

Liquidated damages in case of IP infringements are important, as are specific clauses with regards to licenses that may exist.

Specific clauses to maintain and protect a source code are important in technology transactions, while an earn out clause should be included if the deal's object is an acquisition with the aim to expand in a specific market through the merged entity.

Italy – MR If I'm representing the buy-side, I am always more adamant in negotiating warranties and representation clauses if the IP rights are at the core of the business my client is trying to buy. If it's just ancillary, then maybe there are other items in which I should be a little bit tougher

From the seller's side, I would ask the management to be very confidential in not disclosing the negotiation. It could happen that some kind of disturbance or torpedo action comes from a competitor who is not happy with the deal. The prospective buyer then knows the important actions that took place during the negotiation. I'd be careful in such a situation and I'd be asking my seller to settle the deal quickly, because of the added risk.

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