INTELLECTUAL PROPERTY ASSETS IN MERGERS & ACQUISITIONS*

By

LANNING G. BRYER**

SCOTT J. LEBSON

I. INTRODUCTION

Understanding how intellectual property rights are involved with mergers and acquisitions is essential given how merger and acquisition (M&A) activity in the intellectual property field has come to dominate, both in volume and in value, merger transactions generally. This situation was true in the 1990s, and it is still true now. The driving force behind a majority of mergers completed during the past decade has been the acquirer's desire to obtain the target's intellectual property assets.

An interesting feature of M&A activity is that it occurs both in boom and bust times. The boom side of the equation was amply demonstrated by the M&A activity during the mid to late 1990's which accounted for a significant percentage of the world's economy. Global M&A activity in the year 2000 was valued at nearly $4 trillion, or a robust 40 percent of the estimated $10 trillion American economy. While economic markets worldwide have slowed significantly in recent years, M&A transactions still occur in less economically vibrant times. Much of this activity takes place when a company, to obtain the economic benefits of consolidation in a particular industry, goes out and starts buying its competitors. In the health care industry, for instance, hospitals continue to merger to acquire the economic clout necessary to force insurers to increase their coverage payments to the hospitals.

Issues pertaining to M&A activity are not simply relegated to large, multi-national corporations. Small and medium size businesses can add significant value and revenue by exploiting the full potential of their valuable intangible rights. In many instances, this means obtaining the necessary financing to acquire established properties and intellectual property rights in order to expand their business or to simply improve their performance and competitiveness. In the alternative, divesting certain intangible assets for a premium at the opportune time can yield significant financial returns for small or medium size businesses. Finally, intellectual property rights have enabled small or medium size businesses in relatively few years achieve large entity status with enormous capital values, such as Microsoft and Sun Microsystems.

The dominating presence of intellectual property in M&A coincides with the emergence of several new intellectual property-oriented M&A considerations. First, M&A activity was originally dominated by the United States. This circumstance, particularly during the 1990s changed with the sweeping globalization of intellectual property-oriented mergers. For example, in 1999 the U.S. merger volume rose to a record 1.7 trillion while Europe's merger volume more than doubled from the prior year to 1.23 trillion. Indeed, the largest hostile takeover ever, and for intellectual property assets at that, did not occur in the

United States but rather in Europe with British Vodafone’s acquisition of Hannesmann of Germany for $183 billion.

Second, because of the difference between tangible assets (such as inventory and factories) in contrast to intangible intellectual property assets, methods ordinarily used to value mergers involving tangible assets do not work well when applied to acquisitions of intellectual property. Despite the fact that M&A’s involving intellectual property have dominated the merger scene for several years, merger participants are still failing to apply appropriate M&A valuation procedures.

Third, it is unquestionable that Europe has established itself as a major player in the global M&A scene. EU competition law has, in turn, become a major determinant in whether mergers of significant magnitude will proceed. In a global economy, it is critical for most companies to be capable of conducting business internationally. Companies must become knowledgeable about other nations' competition laws or their equivalent.

In an increasing fashion, the value and importance of intangible assets are the driving force behind national and international mergers and are playing a greater role than ever before in terms of assets received through mergers, acquisitions and takeovers.[1] Among these intangible assets are the traditional intellectual property assets such as patents, trademarks, copyrights, know-how and trade secrets. More recently included in this category and of ever-increasing importance are mask-works and Internet domain names.[2] In the event of a merger or other type of corporate restructuring, the acquiring party should obtain equitable and record ownership of these intangible assets, or at the very least, acquire the appropriate license to use such intellectual property.

II. MEANS OF ACQUIRING INTANGIBLE ASSETS

It is critical for executives, counsel, accountants and financial advisers to understand the transfer of intellectual property as an essential aspect of a larger transaction, not simply the transfer of intellectual property rights by itself.[3] The transaction should be construed in the context of a sale of an entire business in which those intangible assets are used. Generally, businesses are sold either by the purchase of the stock in a corporation or though a purchase of assets used by the business to be sold. Under either scenario, two basic sets of documents, an “acquisition agreement” and “transfer documents” will be prepared and negotiated.[4]

Acquisition Agreement

An Acquisition Agreement is prepared for the express purpose of detailing those terms and conditions under which either the stock purchase or sale of assets will be sold. The purpose of the Acquisition Agreement is to identify the issues essential to the specific transaction, such as the stock or assets, the purchase price, method of payment, date of closing and any conditions precedent which the seller or buyer is expected to meet prior to the “closing” date. Additionally, in the specific context of intellectual property, the seller will usually be asked to make certain representations and warranties in connection with the intangible assets to be sold. The need to list the assets and liabilities is greater in terms of an asset purchase as opposed to a share purchase, since purchasers of assets will typically acquire those assets set forth in the transfer agreement. On the other hand, share purchases will transfer the entire rights in the intellectual property by operation of law. However, regardless of the nature of the transaction, asset schedules in the context of intellectual property play a key role in determining the representations and warranties to be included in the agreement.[5] American agreements tend to focus more specifically upon identification and scheduling of intellectual property and other assets while European agreements tend to emphasize the representations and warranties concerning the validity of the intellectual property.[6] In transactions where certain intellectual property is being used both in the business being sold and in the business that the seller is retaining, it will be necessary for the parties to determine who will maintain "record" title to the specific types of intangible assets. For example, the seller may not be willing to relinquish title to its "house" trademark, but willing to include those marks covering certain product lines as part of the overall transaction. In this context, licensing of the specific mark, either by sale and license back to the seller or by imposing an obligation upon the seller to guarantee the grant of a license to seller post-closing.[7]

The Representations and Warranties to be incorporated into a typical purchase agreement tend to be one of the more heavily negotiated aspects of any purchase agreement. Typically included by a seller in its representations and warranties are statements to the effect that the schedule of intangible assets is complete and accurate, it is the rightful owner of such intangible assets, no liens or encumbrances exist with respect to such intangible assets, the intellectual property does not infringe the intellectual property rights of a third party, the buyer is indemnified, seller will assist buyer in performing due diligence in connection with the intellectual property being transferred and other disclosures such as existing licenses, settlement agreements, consent agreements, ongoing litigation, opposition, interference or other actions which may affect the use of the scheduled intellectual property. [8]

Transfer Documents

Transfer documents are generally executed separate and apart from the acquisition agreement discussed above for the purposes of effecting the sale. If the acquisition is structured as a stock purchase, documents transferring the assets generally are not necessary, instead, documents which transfer the stock will allow the buyer to indirectly become the owner of the assets. In the context of intellectual property assets, very often they will be separately transferred to a holding company and either licensed back to the operating company or become the subject of a subsequent sale to the ultimate purchaser.[9] If the transaction is structured as an asset purchase, the intellectual property assets will be either specifically mentioned in the acquisition agreement or become the subject of a separate bill of sale. However, very often intellectual property assets are the subject of a separate agreement in light of the fact that they require recordal of the new owner in the respective jurisdictions in which they are validly owned and used. Furthermore, the forms and requirements for valid transfers differ from country to country and become a matter of public record.[10] The parties to the transaction should anticipate these contingencies and a separate or perhaps several agreements with respect to intellectual property assets should be contemplated.

Sale of Assets

If a party acquires trademark rights by acquiring a business vis-à-vis a sale of assets, it is not unusual for the transfer agreement to forego specifically mentioning trademark or other intellectual property rights. If a business is sold as a going concern, the intent to transfer trademarks and the goodwill associated therewith is presumed, even though not expressly provided for. An exception to this concept lies in the context of transactions between parent corporations and their wholly-owned subsidiaries. Asset-based purchases in this context will not automatically include intellectual property rights, rather, ownership of the intangible assets will remain with the parent corporation unless the underlying agreement expressly provides for transfer to the subsidiary.[11]

Stock Purchase

In the context of a stock purchase acquisition, ownership of trademarks and other intellectual property still remains with the acquired company. Purchase of shares will not affect distinct property rights in intangible assets or other intellectual property to be properly transferred, although a separate agreement is usually necessary to underscore the parties' intentions.[12]

III. TAX CONSIDERATIONS

Depending upon the scope of the business activities of the purchaser, it may choose not to simply obtain record title to intellectual property assets received in a merger or acquisition, rather, it may choose to sell its newly acquired intangible assets to a third party (which it may or may not own a substantial portion of the shares) and receive a license to use same. Very often, this can be achieved in the most tax efficient manner by placing ownership of the intangible assets in a holding company which then licenses back the assets for use by the operating company.

For example, in the United States the establishment of a Delaware Investment Holding Company (a "DIHC") provides an excellent framework for this model. Typically, title to the intangible assets will be transferred to the DIHC who subsequently licenses the use of the intangible assets to whichever operating entity the purchaser (normally the party who has dominant ownership and created the DIHC) desires the assets to be used by in exchange for a royalty.[13] Not only is the DIHC exempt from Delaware's income and gross receipts tax, but the royalties received by the DIHC are exempt from Delaware taxes as long as the activities of the DIHC are confined to maintenance and management of intangible assets. Further tax benefits exist in that the licensee may be entitled to a deduction for payment of the royalties, depending upon the state or local jurisdiction.

Transactions wherein one company has a presence outside the United States can generate more complex tax implications. Pre-transaction considerations should include whether any tax treaties exist among the respective nations, U.S. federal and state tax requirements and taxation in the foreign jurisdiction.[14]

IV. ANTITRUST

Parties to a merger or acquisition would be ill-advised to ignore the antitrust concerns in the context of obtaining intellectual property assets. In both the United States and Europe, the Justice Department and European Commission have been taking an ever increasing interest in the acquisition of intellectual property rights from an antitrust perspective. Very often, the intellectual property rights aspects of a commercial merger or acquisition are the prominent focus of the pre-merger examination of the proposed combination.[15] In the United States, the Hart-Scott-Rodino Act imposes a pre-merger notification requirement upon parties to a commercial merger or acquisition if the two parties are of sufficient size i.e., \$100 million and \$10 million in sales or assets and the transaction in question involves at least 15% of the sellers assets or has a value greater than \$15 million.[16] The necessary documentation must be submitted to the Federal Trade Commission and the Assistant Attorney General of the Antitrust Division of the Justice Department and the waiting period is thirty days from receipt thereof, not including extensions and requests for further information and documentation.[17] Failure to comply with these notification requirements can result in a civil penalty of not more than \$10,000.00 for each day in which there is non-compliance.[18] As such, great care should be taken with respect to valuation of the intellectual property rights to determine if compliance with the notification provisions of the Hart-Scott-Rodino Act is required.[19]

A. Patents

In the United States, it is clear that a patent holder has the right to sell an exclusive interest in a patent without necessarily violating any provisions in the respective antitrust laws.[20] However, it is under limited circumstances in which patent acquisition, other than through governmental grant, generates potential antitrust implications. For example, in *SCM Corp. v. Xerox Corp.,*[21] the court concluded that where a dominant competitor in a particular industry or market acquires a particular patent or group of patents which, in addition to those patents already owned, afford such a dominant competitor monopoly power in that industry will violate Section 2 of the Sherman Antitrust Act.[22]

As such, one of the overriding factors whereby the acquisition of a patent or patents will result in an antitrust violation is the market power of the purchasing party.[23] In addition, if the intent of the purchase is to eliminate competition within the field, this will leave the dominant purchaser susceptible to antitrust violations.[24] Furthermore, the sale of patents may give rise to Section 7 violations of the Clayton Act.[25]

B. Copyrights

Although copyrights may be purchased in a manner similar to other tangible or intangible assets, thus far there has been no case law in the United States or European Union holding that the mere acquisition and accumulation of copyrights violates any aspect of antitrust legislation. In fact, in the United States, there has even been case law directly on point confirming that no antitrust violation will be found simply by accumulating copyrights in a particular industry or otherwise.[26]

C. Trademarks

The *mere* accumulation of trademarks alone will not suffice to give rise to liability under U.S. or EC Competition law.[27] However, in the United States, *aggressive* accumulation of trademarks can, under certain limited circumstances, create some form of antitrust liability[28] as trademarks have been held to constitute assets within the meaning of Section 7 of the Clayton Act.[29]

D. Competition Law in the European Community

The rules governing competition laws in the European Community are set forth in Articles 81 and 82 of the European Economic Community Treaty. The Commission under Regulation 17 and the national courts of the Member Nations enforces both articles 81 and 82.[30] However, for purposes of merger and acquisition activity, Article 81 is the controlling provision for interpretation of EC competition law. In making its determination of whether a dominant position is created or strengthened, the Commission will take into account such factors as the need to preserve effective competition, the market position of the newly created entity, opportunities available to supplier and users, legal barriers to entry into a relevant market and the interests of consumers.[31] Article 81(3) exempts certain transaction if they contribute to "improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit."[32]

V. WORLDWIDE RECORDAL OF INTELLECTUAL PROPERTY RIGHTS.

Trademarks & Patents: Necessity for Prompt Recordal: The intellectual property rights of the acquired company need to be transferred into the name of the new owner in ***each*** jurisdiction where such rights exist. Timely recordal of a change of ownership is critical to protect the ongoing validity and enforcement of intellectual property rights for several reasons. First, if a change of ownership is not promptly recorded, a misconception can arise in the marketplace as to the identity of the actual owner, leading to a possible loss of rights where a trademark no longer functions as a true indication of origin. This is particularly true in the case of well-known trademarks, or in the case of other marks that are extensively used in their particular jurisdiction. Second, the new owner may not be able to prosecute infringements, file oppositions or attend to renewals or annuity payments. For example, enforcement of a patent can only be carried out under the authority of the owner of record or its exclusive licensee. If prompt injunctive relief is required, an undesired delay will result from a necessity to record the transfer of rights. Furthermore, the right of the patent owner to obtain damages for acts of infringement which occurred before the transfer documents were recorded may be lost in certain jurisdictions.

Third, fines and/or penalties may be assessed for late recordal of a transfer. In certain jurisdictions, there are time limits after which it may be too late to effect proper recordal of an assignment.

Fourth, the failure or delay in recording a transfer of ownership may result in a possible loss of royalties. For example, if a license is to be given under a patent, the licensor must be the owner of record. Therefore, a delay in recording the transfer can delay the date when the license agreement becomes effective; this, in turn, can delay manufacturing and/or sales. The resulting loss of royalties may not be recoverable. In a number of countries, a license agreement must be approved by government authorities and, in the license agreement submitted for such approval, the record owner should appear as the licensor. Delay in recording thus delay approval, with consequential loss of royalties.

Fifth, license recordals and registered user entries will no longer be current and may affect the validity of the use by a licensee and/or governmental approval for foreign exchange authorizations for remission of royalties.

Finally, in the event an "equitable transfer" occurs without the requisite official change of "record ownership" at the relevant patent and trademark offices throughout the world, the new owner will encounter enormous difficulties when confronted with the maintenance, sale, enforcement, hypothecation, licensing and/or use of the intellectual property rights. For example, proof of use (where required for maintenance of existing trademark registrations) may not be accepted when used by the current owner unless that party is now reflected as the "record owner".

Separate Documents for Each Jurisdiction is Required.

In order to reflect the new owner of the patent, trademark or copyright as the "owner of record", it will be necessary in most jurisdictions for counsel to prepare separate assignment documents for ***each*** jurisdiction in which such rights exist. In some jurisdictions, a certified copy of a "general" worldwide assignment may be acceptable. Intellectual property statutes exist in most countries of the world and provide a mechanism for the recordal of a change of ownership at a central registry. The form and substance of these documents vary from jurisdiction to jurisdiction, which underscores the advisability for the preparation of separate documents for ***each*** jurisdiction. Such documents must be filed and recorded at the respective local registry. Furthermore, several multicountry registrations systems exist such as the Patent Cooperation Treaty or the Madrid Agreement which have special requirements which counsel must be familiar with in order to properly record a transfer of title. In this respect, it is recommended that the acquiring company engage counsel experienced in the worldwide transfer of intellectual property rights and familiar with the preparation of documents necessary for each jurisdiction.

Transfer of Domain Names

The transfer of ownership of a domain name should consist of no less than three documents; the Acquisition Agreement, a document issued by the relevant domain name registry attesting to the transfer (if such change is not done electronically) and an assignment agreement. The latter two documents may be set forth as exhibits to the Acquisition Agreement or delivered as a post-closing obligation.

The Acquisition Agreement should make certain to address the intersection of domain names and trademark law. In addition to stating the intentions of the parties and transferring the domain name itself, all common law trademark, copyright and other intellectual property rights related to the domain name should be should be subject to the transfer as well. Representations and warranties to the effect that the seller is the sole owner and that the subject domain name is not subject to any claims of infringement or other claims or actions should be made, together with indemnity provisions in favor of the buyer. The agreement should further prohibit the seller from registering or using a similar or related domain name.[33]

Specific reference to the domain name registrar should be made with an affirmative obligation on both the buyer and seller to execute any documents it requires. In most instances, the buyer is responsible for filing any required documents with the relevant domain name registry and this should be explicitly set forth in the Purchase Agreement.

VI. CONCLUSION

As the global economy races towards an information-based economy, the value of intellectual property will continue to play an increasing role as the driving force behind future merger and acquisition activity. Indeed, it is anticipated that intellectual property will be the dominant force in future commercial transactions comprising tomorrow's mergers and acquisitions.

---

*This article has been redacted from the recent book *Intellectual Property Assets in Mergers and Acquisitions*, published in 2002 by John Wiley & Sons publication. This book is available online at www.amazon.com or www.wiley.com.

**Lanning G. Bryer is the Director of the Mergers, Acquisitions and Licensing Group in the New York office of the international intellectual property law firm of Ladas & Parry. Mr. Bryer can be reached by e-mail at lbyrer@ladasparry.com. Scott J. Lebson is an associate in the New York office of Ladas & Parry. Mr. Lebson can be reached by e-mail at slebson@ladasparry.com. Further information about intellectual property law or Ladas & Parry can be obtained by visiting their website at www.ladas.com

[1] *See* Tannenbaum, William A., *Patent, Copyright and Domain Name Intellectual Property Due Diligence for Mergers and Acquisitions*, L.J.X., May 25, 1999.
[2] *See* Semiconductor Chip Protection Act, 17 U.S.C. §901(a)(2)-(a)(3), for a definition of mask work.
[3] *See* Glenn A. Gunderson & Paul Kavanaugh, *Intellectual Property in Mergers & Acquisitions,* Trademarks in Business Transactions Forum, International Trademark Association, Sept. 16-17, 1999, at 87.
[4] *See* Gunderson & Kavanaugh, *Intellectual Property in Mergers & Acquisitions,* at 87.
[5] *See* L.M. Brownlee, *Intellectual Property Due Diligence in Corporate Transactions,* §13.35, West Group, (1998).
[6] *See* Gunderson & Kavanaugh, *Intellectual Property in Mergers & Acquisitions,* at 87.
[7] *See id.* at 88.

[8] *See id*. at 90. This list is not intended to be exhaustive, but rather, representative of certain representations and warranties normally associated with the sale of intellectual property.
[9] *See id.*
[10] *See id.*
[11] *See id.*
[12] *See id.*
[13] *See* Sari Ann Strasburg, *Holding Company Issues – Who Should Own the Intellectual Property,* Trademarks in Business Transactions Forum, International Trademark Association, Sept. 16-17, 1999, at 98.
[14] *See id.* at 101.
[15] *See* Robert A. McTamaney, *Antitrust and Intellectual Property Rights: The Devil is in the Details,* N.Y.L.J. Feb. 2, 1998, at 5.
[16] *See* 15 U.S.C. §18a.
[17] *See* 15 U.S.C. §18a(b)(1)(A).
[18] *See* 15 US.C. §18a(g)(1).
[19] *See* McTamaney, *Antitrust and Intellectual Property Rights: The Devil is in the Details,* at 5.
[20] *See* United States v. Gypsum Co. 333 U.S. 364 (1948).
[21] *See* 645 F.2d 1195 (2d Cir. 1981), *cert. denied*, 445 U.S. 1016 (1982). Additional cases with similar holdings include Kobe, Inc. v. Dempsey Pump co., 198 F.2d 416 (10th Cir. , *cert. denied,* 344 U.S. 837 (1952); U.S. v. Besser Mfg. Co., 96 F.Supp. 304 (E.D. Mich 1951, *aff'd,* 343 U.S. 444 (1952). *See also Von Kalinkowski on Antitrust*, §73.01(2).
[22] 15 U.S.C. §2.
[23] *See Von Kalinkowsky on Antitrust*, at §73.01[2].
[24] *See* United States v. Parker Rust-Proof Co., 61 F.Supp. 805 (E.D. Mich. 1945).
[25] *See* 15 U.S.C. §18.
[26] *See* Lawlor v. National Screen Service Corp., 270 F.2d 146 (3d Cir. 1959), *cert. denied*, 362 U.S.922 (1960).
[27] *See e.g.,* FleerCorp. v. Topps Chewing Gum, Inc., 658 F.2d 139 (3d Cir. 1981), *cert. denied*, 455 U.S. 1019 (1982); Oak Distributing Co. v. Miller Brewing Co., 270 F.Supp. 889 (E.D. Mich. 1973).
[28] *See* L.G. Balfour Co. v. Federal Trade Commission, 442 F.2d 1 (7th Cir. 1971).
[29] *See* United States v. Lever Bros. Co., 216 F.Supp. 887 (S.D.N.Y. 1963). See also Von Kalinkowski, at §73.01[2].
[30] Council Regulation 17 enables the Commission to enforce articles 81 and 82.
[31] See Regulation 4064/89 at Article 2(1).
[32] See Article 81(3), which further provides that these exemptions only exist if the resulting benefits do not "(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."
[33] See Peter J. Ansel, *Domain Name Deals Demand Diligence in Drafting,* N.Y.L.J, August 27, 1999, p. B11.