

INTELLECTUAL PROPERTY: THE DOMINANT FORCE IN FUTURE COMMERCIAL TRANSACTIONS COMPRISING MERGERS AND ACQUISITIONS

*Mandavi Singh**

I. INTRODUCTION

Mergers and Acquisitions (“M&A”) have become the corporate world’s most popular growth strategies, especially in rapidly-evolving businesses like Information Technology, Telecommunication, Business Process Outsourcing and Pharmaceuticals. This strategy now constitutes the swiftest, surest way to acquiring competencies and funds, opening new market avenues, expanding customer base, snuffing out competition, and thus, maintaining and improving profitability.

The consensus is that when companies combine their core competencies through M&A, both tangible and intangible assets of the Target Company are part of the cash flows to the Acquiring Company, and the most significant of these assets is the Intellectual Property.¹ Indeed, in today’s ‘idea economy’, where knowledge is power, Intellectual Property (IP) has become the dactylogram of a company – the unique and continuing identifier of a company and its creations of products and processes of art, literature, music, science and technology through human endeavour.² The world is caught in a frenzy to capture and harvest such assets, through Mergers (which give ownership over assets) and Acquisitions (which give control over assets).³

Also, as IP-based deals have become more mainstream and sophisticated, the willingness to divide and assume risk has increased. Companies and Investors are getting more comfortable with IP financing.

As a result of all of these trends, the rate of M&A transactions has increased dramatically (see Table below)⁴.

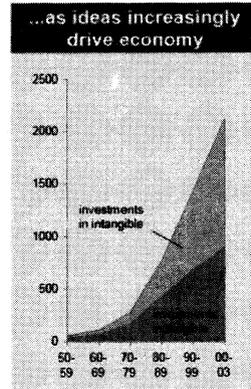
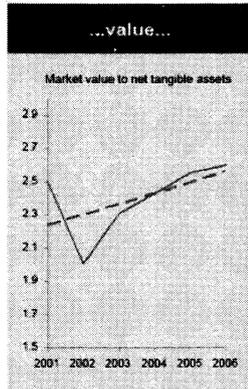
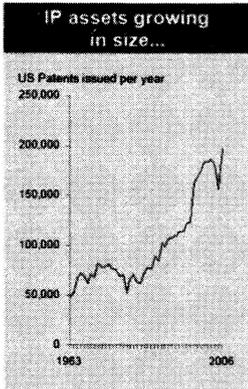
* Student, II Year, NALSAR University of Law, Hyderabad, India.

1. Kelvin King, *The Value of Intellectual Property, Intangible Assets And Goodwill*, 7 JOURNAL OF INTELLECTUAL PROPERTY RIGHTS 245 (2002).

2. According to a recent study by Price Waterhouse Coopers, more than 50% of companies’ net worth is derived from IP, up from 15% in 1965 to 85% today. See P. Walsh, and G. Cohen, *Liquidity in the IP Space- An Overview*, 4 INTELLECTUAL ASSET MANAGEMENT 87(2007).

3. *Supra* note 1.

4. DOING BETTER DEALS: IP AS AN ACQUISITION LENS (The Boston Consulting Group 2007)

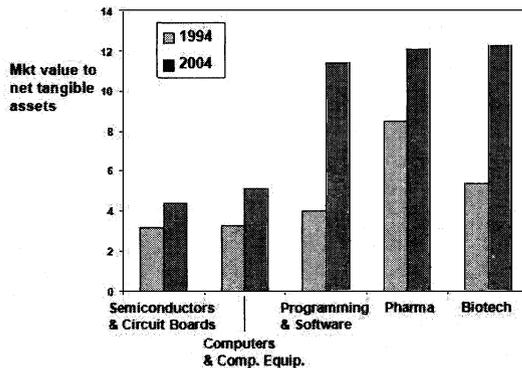


II. HOW INTELLECTUAL PROPERTY DRIVES M&A ACTIVITY

How Intellectual Property Fuels Mergers & Acquisition

Intellectual Property exists as the intangibles of Trademarks, worldwide Patents, Copyright Assignments, Trade Secrets, Geographical Indicators, Domain Names, Registered Designs, Plant Breeder’s Rights, Technology and Know-How—which create value, special rights, profits and generate goodwill and consumer loyalty. Virtually every business uses computer software, owns Trademarks, uses technology, produces branded goods, runs Research and Development cells, creates designs, invents devices and furbishes techniques. The value of the target firm, therefore, becomes dependent on the value of its earnings, assets and Intellectual Property (see Table below)⁵.

High growth of intangible assets for selected high-tech industries: especially biotech & software



5. Value Creating M&A, VALUE PROPOSITION (The Boston Consulting Group 2005).

Technology-driven M&A transactions can be the corridors to introducing innovations, increasing the speed of new product introductions, and decreasing the cost of R&D through a more efficient allocation of resources to areas of greatest competency. A recent example of the same is found in CleanTech Biofuels, Inc.'s acquisition of the sophisticated technology of Biomass North America Licensing, Inc. through a strategic Merger to convert municipal solid waste into cellulosic biomass and generate electricity.⁶

Mergers not only allow companies to gain access to Patents to desired or valuable products and processes, but also create Patent Pools which integrate patents relating to a particular technology standard, reduce litigation and licensing costs, and increase royalty shares.

Napster started out in 1999 as a free music swapping website and sought bankruptcy protection in 2002 after record companies sued over alleged copyright violations. German corporate behemoth Bertelsmann then captured it in an acquisition of \$8 million in which Napster will charge for its audio-service and pay a portion of the proceeds to artists and record companies.⁷

IBM recently acquired Daksh eServices, the third-largest Indian call centre and back-office service provider, which has revenues of \$60 million, for \$150 million. IBM thus not only gained a core competency, but also Daksh's copyrighted software codes and related intellectual property.⁸

Similarly, Microsoft's hostile Acquisition of Yahoo in 2008 at USD 45 billion is more an acquisition of intellectual property than any tangible assets or human resources.⁹

How IP Valuation is Crucial to M&A Activity

The cinching of any Merger or Acquisition involves three phases:

1. Pre-acquisition;
2. The Deal;
3. Integration;

6. *CleanTech Biofuels Enters Into Agreement to Acquire Technology and Develop Commercial Site*, REUTERS, Jul. 15 2008, <http://www.reuters.com/article/pressRelease/idUS216244+15-Jul-2008+MW20080715>.

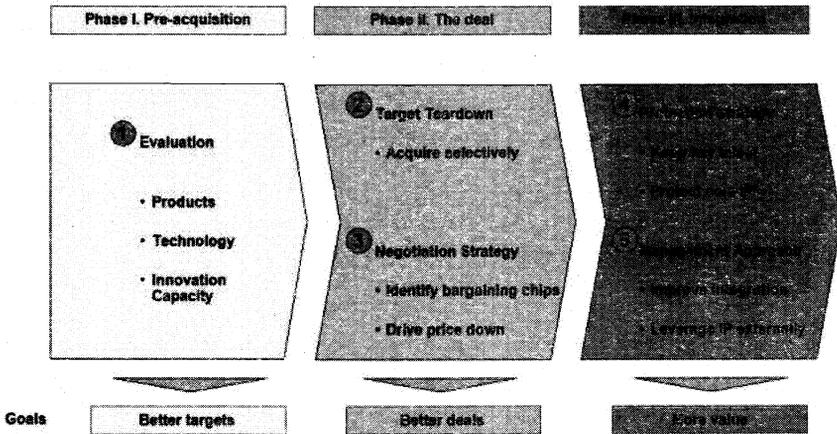
7. Drew Cullen, *Bertelsmann Saves Napster: For What?*, THE REGISTER, May 17, 2002, http://www.theregister.co.uk/2002/05/17/bertelsmann_saves_napster/.

8. *IBM to Acquire Daksh eServices*, THE HINDU, Apr. 8, 2004, <http://www.hindu.com/2004/04/08/stories/2004040804721800.htm>.

9. H. Moore, *Market Reaction: Microsoft's Offer Looks Like a Knockout*, THE WALL STREET JOURNAL, Feb. 1, 2008.

and all the steps to be undertaken are mainly aimed at preserving, leveraging and harvesting of the Intellectual Property at stake (See Table below¹⁰).

ASSESSING INTANGIBLE ASSETS CAN SIGNIFICANTLY IMPROVE M&A PERFORMANCE



Considering that a vast proportion of the value of a business may relate to intellectual property rights, probably the first thing that should be determined by an Acquiring Firm is the assessment of its IP assets in order to protect the value of those rights. Research has persistently shown that intellectual asset value is not fully understood by businesses – even those whose value is heavily dependent on their IP.¹¹

The negotiation of the final Purchase Price between the seller and buyer can only occur after the credibility of real worth of the target company has been established, through valuation which takes into account the business dynamics of both parties, the rationale for the Merger, industry dynamics, and net likely profits and losses from the synergy. Valuation provides vital information about the economic viability of the acquisition and indicates the levels of present and potential utilization of intellectual property, so that the Acquiring Firm may frame its business development strategies accordingly.¹²

10. *Value Creating M&A*, VALUE PROPOSITION, (The Boston Consulting Group 2005).
 11. A survey by DLA Piper in 2004 of IP-owning businesses found that 38% had never undertaken a formal valuation of their intellectual property. See *How Europe Manages its IP*, MANAGING INTELLECTUAL PROPERTY, Nov. 8 2004, <http://www.managingip.com/Article/1258627/How-Europe-manages-its-IP.html>.
 12. L. PARR AND P. SULLIVAN, TECHNOLOGY LICENSING: CORPORATE STRATEGIES FOR MAXIMIZING VALUE 83 (John Wiley & Sons Inc. 1996).

The valuation is based on dynamic expectations and a dynamic environment, where economic cycles (like changing GDP Growth Rates), stock-market situations and global situations (like wars or terrorism) play havoc with corporate stabilities.¹³

The value of intellectual property is even more volatile. As the value of assets depends on the present value of the future economic benefits or losses that can be reasonably anticipated to accrue to the owner, valuation may yield only relative results. Government Policies, market scenarios, internal work efficiency of corporations, antitrust laws and the impact of globalization also make these Intangible Assets difficult to identify and evaluate.¹⁴

The controversial float of QinetiQ in the UK in January 2006 for public offering occurred due to the extreme difficulty to determine the value of the company, which heavily resided in its intellectual property.¹⁵

However, valuation which is based on careful analysis, experience, professional knowledge, expert advice and keen diligence may well produce near infallible answers. Valuation is an art more than a science and is an interdisciplinary study drawing upon law, economics, finance, accounting, and investment.¹⁶ Such a multidisciplinary investigation for assessment and valuation of the assets by the legal and financial professionals along with the IP-owner is called the “Due Diligence Report”.

How is Due Diligence Valuation carried out?

Due Diligence valuation of IP is crucial to the transaction due to the disparity of information (about net assets value) between the seller and the buyer.¹⁷ It starts with a Letter of Intent or a Memorandum of Understanding, in which the parties agree to exchange requisite information, documents, business plans, stipulating the schedule, mode and deadlines. A Confidentiality Agreement may be contracted if the IP involves certain trade secrets, protecting Attorney-Client privileges.¹⁸

13. T. COPELAND ET AL., VALUATION: MEASURING AND MANAGING THE VALUE OF COMPANIES 128-131 (John Wiley & Sons 2000).

14. *Supra* note 1.

15. *UK to Float Defence Firm Qinetiq*, BBC NEWS, Jan. 12 2006, <http://news.bbc.co.uk/1/hi/business/4604568.stm>.

16. *Supra* note 1.

17. D. McGavock and M. Newell, *Five Critical Questions Your CFO Should Be Asking About IP*, 4 INTELLECTUAL ASSET MANAGEMENT 76, 80 (2007).

18. GLENN A. GUNDERSON AND PAUL KAVANAUGH, INTELLECTUAL PROPERTY IN MERGERS & ACQUISITIONS, TRADEMARKS IN BUSINESS TRANSACTIONS FORUM 87 (International Trademark Association 1999)

The Rule of the Thumb is first employed to determine the importance of Intellectual Property of the Target Firm.¹⁹

Subsequently, Due Diligence must quantify the remaining useful life—physical, functional, technological, economic and legal— and decay rates of the IP using 3 possible techniques of the mathematical valuation of Intellectual Property:

1. *Market-Based Value*, i.e. the purchase price determined by market price of a comparable property. This valuation technique is impeded by several factors, such as difficulties of finding property of comparable and compatible value to the IP in hold, special purchasers, different negotiating skills, and the distorting effects of the peaks and troughs of economic cycles etc.²⁰
2. *Cost-Based Value*, i.e. the purchase price determined by the cost to create or the cost to replace. Though this valuation-technique is easy in use, it ignores changes in the time value of money and ignores maintenance. As this method takes into account the cost for building up the business from scratch, it is more suitable in cases of build-operate-transfer deals.²¹
3. *Value Based on Estimates of Future Economic Benefits*,²² i.e. the purchase price determined from an estimate of past and future economic benefits, called the “Discounted Cash Flow” Analysis of: 1) capitalisation of historic profits, 2) gross profit differential methods, 3) excess profits methods, and 4) the relief from royalty. This technique takes into consideration the future earnings of the business and hence the appropriate value depends on historic and potential profitability of assets, projected revenues and costs in future, margin between the branded and the generic equivalents of a product, expected capital outflows, investment prospects, number of years of projection, discounting rate and terminal value of business. Discounted cash flow analysis is probably the most accurate and comprehensive of appraisal

19. The greater the disparity between the Purchase Price proposed by the seller and the value of the Net Tangible Assets, the greater is the value of the Intellectual Property owned by the seller. A. Lanjouw, J. Pakes and J. Putnam, *How to Count Intellectual Property and Value Intellectual Property: The Use of Patent Renewal and Application Data*, 46 JOURNAL OF INDUSTRIAL ECONOMICS 405, 409 (1998). See also Ted Hagelin, *Valuation of Patent Licenses*, 12 TEXAS INTELLECTUAL PROPERTY LAW JOURNAL 423 (2004).

20. *Supra* note 1.

21. H. Harish and C. Srividya, *Rationale and Valuation Techniques for Mergers and Acquisitions*, THE CHARTERED ACCOUNTANT, May 2004, 1228-1230.

22. *Supra* note 1.

techniques, and is hence, generally the preferred option.²³

Any of these methods may be used in Due Diligence to measure the real value of IP being used or required to be used in future, examining legal touchstones like:

- The substantive type of IP assets (whether owned, registered, applied for, licensed, etc.);
- The chain of ownership and control in IP usage (such as invention, purchase, assignment, acquisition);
- Interests of any third parties in IP (such as rights infringed); tax considerations (maintenance fees, tax payments and benefits);
- Validity and viability of rights to the IP (whether rights are transferable, lawful, enforceable);
- *Modus operandi* of IP transfer (schedule and medium of cash flow, etc.);
- Geographical area of the IP usage (market access, target group, etc.);
- Impact of foreign laws on IP transfer and usage (like jurisdictional issues);
- Obstructions to the use of IP (competitors' dominating assets, fees, defects in IP, unsafe employment agreements etc.);
- Need of warranties and recordal of IP rights;
- Past and potential violations of Antitrust Laws; and
- Disputes related to that IP (infringement-issues, pending applications for patents, etc.).²⁴

How Companies Acquire IP Assets

Once the Due Diligence Report has been approved by the parties and a Purchase Price affixed, the Acquisition Agreement calls for a Stock Sale (sale of shares), which constitutes transfer in the eyes of Law. The Assets Sale ensues, but only for the Tangible Assets and non-Intellectual Property Intangibles. The actual IP Assets must be specifically mentioned in the Acquisition Agreement and clearly distinguished during the Assets Sale, or transferred through a separate agreement, because they confer distinct

23. *Ibid.*

24. Arnold B. Silverman, *The Importance of Intellectual Property Due Diligence in Mergers and Acquisitions*, 56 JOM 76 (2004).

property rights and require recordal²⁵ of the new owner in the respective jurisdictions in which they are validly owned and used.²⁶ Intent to transfer Trademark and Goodwill is generally presumed during the Assets Sale, but not in cases where a parent corporation acquires an autonomous subsidiary. Finally, supplemental closing documents are exchanged.²⁷

Timing is critical. It may be the case that the major details of a deal can be turned overnight into a reasonable agreement reflecting the deal.²⁸

IP Benefits after the Deal

Many companies are afraid to attempt to leverage their IP portfolio for fear of losing their competitive advantage, starting a patent war or gaining a negative reputation for using aggressive IP tactics. But by following a structured process²⁹, companies can generate incremental value from their IP portfolio—a potential goldmine no matter how small a part of the deal³⁰—using a combination of business models:³¹

- IP sale – Sell IP to the highest value user;
- Spin-off – Spin off IP assets as the seed for a startup in exchange for equity;
- Internal licensing program – License patents to obtain a variety of “currencies”;
- IP subsidiary – Set up a subsidiary to focus on patent licensing;
- Traditional patent pool – License essential patents along with others;
- Patent platform – License essential patents through a flexible patent platform;
- Donation – Donate patents to achieve strategic goals and gain tax

25. GLENN A. GUNDERSON AND PAUL KAVANAUGH, INTELLECTUAL PROPERTY IN MERGERS & ACQUISITIONS, TRADEMARKS IN BUSINESS TRANSACTIONS FORUM 90 (International Trademark Association 1999). “With the exception of all-stock deals or relatively similar stock transactions, the assets, including 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.*” in Ladas and Perry, *Worldwide Recordal of Intellectual Property Rights*, <http://www.ladas.com/IPProperty/IPTransfers/IPTran06.html>.

26. GLENN A. GUNDERSON AND PAUL KAVANAUGH, INTELLECTUAL PROPERTY IN MERGERS & ACQUISITIONS, TRADEMARKS IN BUSINESS TRANSACTIONS FORUM 87 (International Trademark Association 1999).

27. K. Wilhelm and S. Zimmer, *The Evolving Asset Class*, 4 INTELLECTUAL ASSET MANAGEMENT 84, 86 (2007).

28. ILYA KAZI, UNITED KINGDOM: IP ASPECTS OF MERGERS, ACQUISITIONS AND DUE DILIGENCE (Mathys & Squire 2008).

29. MAXIMIZING THE RETURN ON INTELLECTUAL PROPERTY (The Boston Consulting Group 2005).

30. *Supra* note 28

31. *Supra* note 29.

advantages;

- Funds and Facilities for Investment in R&D Cells;
- Abandonment – Abandon un-leverageable patents to reduce costs.³²

The most significant of these leverage ideas is the tactic of “licensing” core Intellectual Property Assets by companies to other firms, including competitors. This unconventional strategy would generate enough incremental cash and other financial and strategic benefits to more than offset the potential loss of market exclusivity caused by licensing.³³ For example, Motorola licensed its GSM standard technology to Nokia and Ericsson in 2001, which generated a significant recurring royalty stream and a long-term strategic benefit by helping to direct industry R&D to an area best suited to the company’s position and strategy.³⁴

Intellectual Property and Tax Optimization

Intellectual Property Assets are often a useful means to tax planning and tax efficiency, whether through third-party transactions or through internal strategies like cross-border transfer pricing and IP-holding companies.³⁵

The Acquiring Firm, after obtaining title to an IP asset, may choose to sell it, or license it to another Operating Company, to get tax benefits. The Acquiring Company may also transfer IP ownership to offshore tax havens, so as to “park” the IP until it is ready for the exploitation.³⁶

Entities using and controlling IP assets are incumbent to pay a service tax³⁷, but companies creating and acquiring the IP assets are also privileged to certain tax reductions in lieu of the costs incurred by them, like legal costs, R&D costs, Registration fees, Royalties, salaries, etc, after the year of the Merger.³⁸

Transactions wherein one company has a presence in more than one

32. *Ibid.*

33. D. McGavock and M. Newell, *Five Critical Questions Your CFO Should Be Asking About IP*, 4 INTELLECTUAL ASSET MANAGEMENT 76, 77 (2007).

34. S. Hawkes, *When licensing deals create shareholder value*, 7 INTELLECTUAL ASSET MANAGEMENT, 7, 12 (2003).

35. *Supra* note 33. See also P. Chandra, *Financial Management of Mergers and Acquisitions*, FINANCIAL EXPRESS, April 16, 2007 at 5.

36. K. SETH, INTELLECTUAL PROPERTY DUE DILIGENCE IN MERGERS AND ACQUISITIONS (Seth Associates 2006).

37. *Example*: Secs. The Income Tax Act (Act No. 43 of) 1961, sections 10A, 10B, 80IA and 80IB of govern service tax issues on Intellectual Property in India.

38. *Supra* note 36.

country can generate more complex tax implications. Pre-transaction considerations during Due Diligence should include whether any tax treaties exist among the respective nations, parent country tax requirements and taxation in the foreign jurisdiction.³⁹

Alignment between tax benefit and IP strategy may be marked by a tug-of-war (For example, an acquired patent may be structured as a sale to receive favourable capital gains treatment) or a strong consonance (For example, an IP Management Company may provide tax benefits through intercompany licensing arrangements that shift income from higher to lower tax jurisdictions).⁴⁰

III. INTELLECTUAL PROPERTY – THE WINNER’S CURSE

The Risks of Unsound Due Diligence

In Mergers and Acquisitions, Intellectual Property Assets can be especially difficult to accurately value, most notably in rapidly evolving high-tech industries. Failure to execute a sound IP Due Diligence Report has been the Waterloo of many an Acquiring Company. Indeed, the most oft cited cause for M&A failure is intellectual property, in a notorious phenomenon known as the “*Winner’s Curse*” where the Acquiring Firm pays more than market value for an item due to systematically under-estimating their own costs (i.e. over-estimating their own values), and later feels remorse that so much was paid. The curse is common and potentially ruinous.⁴¹ Persons suffering may be punished by capital markets, hamstrung competitively and constrained by burdensome capital structures. They may also get caught in tedious, expensive IP litigation, and contentious antitrust or jurisdictional issues.⁴²

Take the purchase of Rolls-Royce in 1998. Volkswagen acquired the plant, the designs for the cars and a range of tangible assets such as the buildings for a whopping USD 780 million. Crucially, however, it did not acquire the Rolls-Royce name—the intellectual property of the trademark. The latter was acquired by BMW at USD 65 million. Economists argue that since the main asset value is in the brand, BMW got the better deal.⁴³

Viacom recently launched a USD 1 billion action against Google

39. INTELLECTUAL PROPERTY: PROTECTING, VALUING AND OPTIMIZING ASSETS, IP PRACTICE STRATEGY (Analysis Group: Economic, Financial and Strategy Consultants 2007)

40. D. McGavock and M. Newell, *Five critical questions your CFO should be asking about IP*, 4 INTELLECTUAL ASSET MANAGEMENT 76, 78 (2007).

41. M. PARK, MAKING M&A PAY: AVOIDING THE WINNER’S CURSE, CORPORATE STRATEGY (Accenture 2005)

42. C. Bady and S. Moeller, INTELLIGENT M&A 96-98 (John Wiley & Sons, 2007).

43. J. Chevton, *How Much for That Brand in the Window? Thoughts about brand valuation*, http://www.jrcanda.com/art_valuation.html.

following its USD 1.6 billion purchase of YouTube, on the basis that YouTube has infringed its rights. Google's Acquisition had not taken into account the fact that YouTube's business conflicts with the rights of other parties.⁴⁴

Intellectual Property Litigation

Both the cost and uncertainty of outcomes associated with IP litigation have never been higher. IP litigation, particularly patent litigation, has become a mainstream topic in the financial markets.⁴⁵ Lately, changes in company stock prices have been attributed to IP litigation events. For example, once Affymetrix was granted a favourable verdict in a patent case against Illumina, the stock prices of both companies shifted by about USD 88 million in opposite directions.⁴⁶

All too often, IP litigation takes on a life of its own, driven by an emotional "win at all costs" attitude, straying away from sound business and economic objectives to outflank the other side without considering the costs, benefits and risks of various arguments.⁴⁷

The Sanofi-Aventis Pharmaceuticals Mega-Merger is now locked in patent challenges to its three biggest selling drugs, because product clearance and Due Diligence were not carried out in each geographic market. At present, the drug has generated no revenue and the company has exhausted its initial capital and investment opportunities.⁴⁸

Intellectual Property and Jurisdiction Issues

The Acquiring Firm often uses the Intellectual Property Asset in more than one country. Laws governing IP in parent country of the Acquiring Firm, are usually different from the IP Laws in the host country of the Target Company. Such IP assets become victim to multiple foreign jurisdictions. The Courts have to deal with issues on the basis of the merit of IP alone.⁴⁹

44. *Viacom Will Sue YouTube*, BBC NEWS, Mar. 13, 2007, <http://news.bbc.co.uk/2/hi/business/6446193.stm>.

45. In a recent survey of Wall Street professionals conducted by CRA International, 75% of respondents indicated that patent litigation exposure was "important" in valuing investment opportunities. Total cost of litigating significant IP cases in the US alone exceeds USD 5 million. *See New M&A Survey Finds IP Assets Growing in Importance in Deal Transactions*, THE WALL STREET JOURNAL, Dec. 10, 2007, [http://www.marketwatch.com/news/story/New-MA-Survey-Finds-IP_story.aspx?guid=%7B875B80D5-50D6-4B41-83A8-EDAF0A6C4CBE%](http://www.marketwatch.com/news/story/New-MA-Survey-Finds-IP_story.aspx?guid=%7B875B80D5-50D6-4B41-83A8-EDAF0A6C4CBE%7D),

46. D. McGavock and M. Newell, *Five critical questions your CFO should be asking about IP*, 4 INTELLECTUAL ASSET MANAGEMENT 76, 79 (2007).

47. Ilya Kazi, *United Kingdom: IP Aspects of Mergers, Acquisitions and Due Diligence*, Strategy Presentation, Mathys & Squire, May 22, 2008.

48. *Sanofi, Aventis to Merge*, PHILADELPHIA BUSINESS JOURNAL, Apr. 26, 2004, <http://www.bizjournals.com/philadelphia/stories/2004/04/26/daily4.html>.

49. K. SETH, INTELLECTUAL PROPERTY DUE DILIGENCE IN MERGERS AND ACQUISITIONS, CONFERENCE PRESENTATION (Seth Associates 2006).

50. *Ibid.*

One way to thwart such hostile jurisdiction issues would be the timely recordal of intellectual property rights,⁵⁰ which would protect the ongoing identity, validity and enforcement of IP Rights and also help to overcome legal difficulties of maintenance, sale, enforcement, licensing, usage etc.⁵¹

Intellectual Property Conflicting with Antitrust Laws

Most Antitrust Laws prohibit M&A Activities which cause ‘substantial’ lessening of competition or which show tendencies towards monopoly in any relevant market.⁵² Many a time, Merger guidelines have evolved to circumvent anti-competition activities, but though they have been influential, they have not been binding on Courts.⁵³

Antitrust issues are more virulent in case of Horizontal Mergers, where firms competing in the same market combine. Here, Courts calculate the Herfindahl-Hirschman Index (“HHI”) depending on the market shares and concentration in the market. HHI beyond a particular level indicate anti-competitive effect, which can be rebutted by Defendant by evidencing otherwise.⁵⁴

Wesley-Jessen Corporation, the leading maker of opaque contact lenses – corrective or solely-cosmetic lenses that change the apparent eye colour of the wearer – sought to acquire its main rival, Pilkington Barnes Hind International. In the ensuing lawsuit over antitrust law issues, Wesley-Jessen was required to divest Pilkington Barnes Hind International’s opaque lens business. It was also required to license certain intellectual property rights to the acquirer of Pilkington Barnes Hind International’s opaque lens business.⁵⁵

Courts are less stringent in cases of Vertical Mergers, where the supplier firm combines with a customer firm, foreclosing rival sellers to such a supplier, and rival customers to such a supplier.⁵⁶

51. *Ibid.*

52. *Example:* Sec. 7 of The Clayton Antitrust Act, 1914 (U.S.A.) is an example of Antitrust Law often in conflict with Intellectual Property Rights.

53. INTELLECTUAL PROPERTY AND ANITRUST HANDBOOK 13-5 (American Bar Association Section 2007).

54. To calculate it, experts take the market share of each firm in the industry, square it, then add them all up. If there are 100 equal-sized firms (a market with close to Perfect Competition) the index is 100. If there are four equal-sized firms (possible Oligopoly) it will be 2,500. The higher the Herfindahl number, the more concentrated is Market Power. *See* S. Rhoades, *The Herfindahl-Hirschman index*, 3 FEDERAL RESERVE BULLETIN 188, 189 (1993).

55. Wesley-Jessen was required to issue to the company acquiring Pilkington Barnes Hind International’s opaque lens business “a non-transferable, irrevocable, non-exclusive, royalty-free license under the patents listed in Appendix B of this Order to manufacture, import, offer for sale, use and sell Opaque Contact Lenses in the Licensed Territory.” *See* Wesley-Jessen Corp. v. Pilkington Visioncare, Inc., 123 F.T.C. 4 (1997), 7, Para. L.

56. L. BRYER AND M. SIMENSKY, INTELLECTUAL PROPERTY ASSETS IN MERGERS AND ACQUISITIONS 186 (John Wiley & Sons 2002).

The European Court of Justice recently adjudicated that the Sony-Bertelsmann Merger to combine their music units into world's second-largest record label was flawed because it was violating antitrust laws.⁵⁷

Antitrust issues are accentuated in cases of Patents, which grant a "limited monopoly", where use of products and processes extends over a limited time only, but to the exclusion of all other competitors. Courts have held that as only those Patents would be violative of Antitrust laws which have been unlawfully acquired (like fraud on the Patents and Trademarks Office) or which have been improperly enforced (used in excess of their limitations), as then they would be running counter to the Antitrust principle of free and open markets.⁵⁸

Such Antitrust difficulties can be overcome by timely and accurate Due Diligence.

Solution to the Winner's Curse: Refocusing of Due Diligence

Globally, across all industries, 25% of Mergers fail to achieve projected revenue synergies falling more than 75% short.⁵⁹

One major cause of the failure of a Merger is due to the erroneous focussing of Due Diligence on historical information rather than the future potential of free cash flows. Most companies only focus on what is readily and already visible in the marketplace—such as past financial performance; current market share and margins; historical growth rates,⁶⁰ and not the future value creation potential. In order to identify *better targets*, make *better deals* and extract *more value* from M&A,⁶¹ companies must shift their focus to the things that will create value in the future, including:⁶²

- Current products – strength and sustenance of the company's product position, market share and margins.
- Product pipeline – strength of the company's product pipeline and future market-capture capacity.
- Technology position – strength of the company's financial and IP-based position in the key future technologies

57. *See Bertelsmann Sony Corporation of America v. Impala*, European Court of Justice Case C-413/06 P. *See also EU Court says Sony and Bertelsmann Merger Approval was Flawed*, THE INTERNATIONAL HERALD TRIBUNE, Jul. 10, 2008.

58. *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195 (2d Cir. 1981), (cert. denied).

59. J. Hendrickson, et al., *Combating the Winner's Curse*, 10 PUBLIC UTILITIES FORTNIGHTLY 62, 67 (2006).

60. MAXIMIZING THE RETURN ON INTELLECTUAL PROPERTY (The Boston Consulting Group 2005).

61. *Ibid.*

62. *Id.*

63. *See Supra* note 60.

- Innovative capacity – capacity of the company to produce critical innovations and collaborations in the future⁶³

IV. CONCLUSION

There is great diversity across the size of deals, the sectors, as well as the investors in M&A Activity. Over recent years, a plethora of ways to turn IP rights into money has been growing increasingly popular. Licensing and technology transfer, the emergence of Merger-Auctions, direct sales, tax-efficient IP-planning, online IP exchanges, and most importantly, strategic M&A Activity, have broadened Intellectual Property Rights owners' options considerably.

A major component of the fuel of this growth is IP Financing– liquidity in the private equity and hedge fund markets – which continues to grow, ensuring the future health of IP-related alliances.⁶⁴ The financial community is waking up to the benefits of generating additional funding on the back of patents, trademarks and copyrights. For IP owners looking to make their assets sweat, therefore, the range of options is greater than ever before.

Indeed, it is anticipated that intellectual property will be the dominant force in future commercial transactions comprising tomorrow's Mergers and Acquisitions.

64. *Intellectual Property Financing–An Introduction*, WIPO MAGAZINE, Sept. 5, 2008, http://www.wipo.int/wipo_magazine/en/2008/05/article_0001.html.