

INTELLECTUAL PROPERTY RIGHTS IN MERGERS AND ACQUISITIONS

WHAT ARE MERGERS AND ACQUISITION?

A merger is defined in the Companies and other Business Entities Act as an amalgamation or consolidation of two or more companies which in turn means the joining of one or more companies into another existing company.¹ The Competition Act goes on to provide that it is the direct or indirect acquisition of a controlling interest by one or more persons in the whole or part of the business of a competitor, supplier, customer or other person.² In the case of **Innsco Africa Limited & Anor v Competition and Tariff Commission**³, the Supreme Court of Zimbabwe explained the types of mergers and held that:

There are three types of mergers recognised under competition law - vertical, horizontal and conglomerate. Vertical mergers are those mergers that take place between two related companies as in the case of a customer merging with its supplier. Horizontal mergers are those that take place between companies that are in direct competition with each other. Conglomerate mergers are those between two or more firms that engage in unrelated business activities with different customer bases. Such entities are not competitors and do not have a customer and supplier relationship.

When a company acquires another company as a whole or in part, it naturally, in most cases acquires the assets, liabilities and human resources of the target company.

WHAT ARE INTELLECTUAL PROPERTY RIGHTS?

Intellectual property refers to creations of the mind, such as inventions, literary and artistic works, designs and symbols, names and images used in commerce.⁴ Intellectual property is an intangible asset which undoubtedly increases the value of a company. In addition, intellectual property plays a vital role in the strategic development of the company as it carries innovation, product value as well as the brand value of a company. Intellectual property that can be owned by a company includes trademarks, patents, industrial designs and trade secrets. Intellectual property rights are the rights given to persons over the creations of their minds. They usually give the creator an exclusive right over the use of his/her creation for a certain period of time.⁵ One of the main characteristics of intellectual property rights is that they are exclusive. This means that they enable owners to have exclusivity that helps to reduce the risks and uncertainties associated with the introduction of a new or improved product into the marketplace.

¹ Section 226 of the Companies and Other Business Entities Act

² Section 2 of the Competition Act

³ SC52-18

⁴ www.wipo.int

⁵ www.wto.org

INTELLECTUAL PROPERTY RIGHTS IN MERGERS AND ACQUISITIONS

Intellectual property plays a vital role in mergers and acquisitions. The intellectual property from the target company will increase the asset portfolio of the acquiring company. This will automatically result in the growth of the company. Furthermore, mergers and acquisitions will provide for technological transfer where the companies can share their technological and trade secrets and business algorithm. This will help the company to expand its business and exploit market opportunities. This in turn, will give the company competitive edge as technological transfer will increase the quality of the product or services it offers. In addition, the merger will pave way for a dominating position in the market through increased sales. The starting point however, in the discussion on intellectual property in mergers and acquisition is the conducting of a due diligence and highlighting its importance in the transaction.

❖ DUE DILIGENCE

This refers to a reasonable investigation about the state of affairs of a business to be acquired, focusing on those matters of the target company which have a material effect on the future of the target.⁶

❖ THE IMPORTANCE OF THE DUE DILIGENCE

The principal purpose of a due diligence is to verify the validity of the postulates being made and to identify caveats that may not have been brought to the attention of the buyer. It is important to note that mergers cater for apportionment of risk and a comprehensive due diligence assists in identifying the risks and adequately detailing them for the benefit of the acquirer. In the context of intellectual property, the purpose of a due diligence is to:

1. Evaluate the value of the target company's intellectual property- a due diligence will assist the acquiring company to have an estimate of the value of the intellectual property that is owned by the target company. Intellectual property valuation may be unpredictable as the profits and losses accumulating to the owner vary from time to time⁷. A due diligence will however, show the trends of the business and provide a feasible estimate of the value of the intellectual property. This will assist in ascertaining the price of acquiring the target company.
2. Identification and verification of the intellectual property asset ownership-a due diligence will also assist the acquiring company to verify the ownership of the intellectual property within the target company. This is

⁶ Luis F Gillman-Due Diligence a financial and strategic approach, Butterworths 2001

⁷ Similar to other assets, intellectual property has the capability to appreciate and depreciate in value.

one of the most important stages in the merger as it clarifies the real benefits that stem from the acquisition of the target company.

An example to show the importance of a due diligence is that of Volkswagen and Rolls Royce. In this particular case, Volkswagen acquired Rolls Royce from Vickers PLC for US\$780 million under the belief that the former's trademark namely; the name of the vehicle 'Rolls Royce' as well as the 'spirit of ecstasy' emblem was part of the assets that it would acquire. Volkswagen only realised after the deal had been finalised that the intellectual property in actual fact was owned by a different entity Rolls Royce PLC, a British jet engine maker which then in turn sold the intellectual property rights to BMW⁸. Volkswagen, due to negligence and failure to conduct a comprehensive due diligence acquired a company enabling it to manufacture cars but could not use the name associated with the manufactured cars. It therefore could not benefit from the value that stemmed from the intellectual property attached to the company.

3. Revealing any litigation or claims made against the intellectual property- a due diligence will reveal if there is any litigation against the target company particularly with regards to its intellectual property. This is helpful in assessing the risk that the acquirer will inherit should they proceed with the acquisition.
4. The scope of protection of the intellectual property and the applicable territory – intellectual property rights are territorial. This means that they can only be protected where they are registered, they do not extend beyond the territory where they are formally recognised as the owner's property. In mergers, due diligence will reveal whether or not the target company's intellectual property is registered and the territory within which the rights can be protected.

NEGOTIATIONS AND CLOSING OF THE TRANSACTION

While most assets are directly acquired in mergers and acquisition, intellectual property brings a two-dimensional approach which both the acquirer and the target company may explore. The options available are licensing and assignment of the intellectual property.

a) ASSIGNMENT OF THE INTELLECTUAL PROPERTY

The first option is that the intellectual property of the target company can be assigned to the acquiring company. This would be 'selling' the intellectual property together with the other assets of the company to the acquirer.

⁸ <https://www.nytimes.com/1998/07/29/business/inbusiness-bmw-to-get-rolls-royce-after-all-by-acquiring-the-name.html>

Assignment of intellectual property refers to the transfer of ownership rights to another person in this case, the acquiring company. The due diligence will have paved way for the sale in as far as the price is concerned. Post the finalisation of the transaction, the intellectual property will be transferred to the acquiring company. The intellectual property rights must be transferred and registered in the name of the acquiring company in every jurisdiction where the rights exist. It is important to highlight that where an assignment takes place, the target company will lose control over the intellectual property.

b) LICENCING OF THE INTELLECTUAL PROPERTY

The second option is licensing and this happens where the target company gives the acquirer the rights to use the former's intellectual property. The target company will retain its ownership rights to the intellectual property. The implications are that the acquiring company will use the target company's intellectual property in the course of its business in exchange for monetary value in the form of a fee or a royalty or both. The benefits of licensing include that it provides passive income for the target company and the drawbacks include the abuse of licencing agreements resulting in infringements and damage the reputation of the brand.

CONCLUSION

Intellectual property plays a critical role in mergers and acquisitions. Intellectual property increases the acquirer's asset portfolio, provides for technological transfer and gives the company competitive edge. The valuation and assessment of intellectual property is done through a comprehensive due diligence which is an important stage in mergers and acquisition. Finally, intellectual property may be assigned or licensed to the acquiring company.

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