

EXPLORING OPPORTUNITIES: ACQUIRING IP ASSETS IN A CHANGING WORLD (GLOBAL)

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Legal Briefings - By **Joel Smith, IP Partner**

As governments around the world take the first tentative steps to ease lockdown measures, people and businesses are beginning to focus on a return to work or at least a resumption of more normal business processes. However, it is clear that a large number of businesses, sadly, will not survive in their current form, as economists predict a severe downturn and probably an extended recession. The crisis will act as a catalyst for lasting change. In the UK, we have already seen major clothing and homeware retailers, such as Oasis, Warehouse, Cath Kidston and Laura Ashley, enter administration. In the US, major department stores, like Neiman Marcus and JC Penney, and fashion empires, such as J Crew, have filed for Chapter 11 bankruptcy. There looks to be a turbulent time ahead for retail and the hospitality industry in particular with Café Rouge just one of the recent commercial victims of the lockdown. Even those businesses predicting a positive return in time fully expect their business model to alter fundamentally, with consumer habits altered irreversibly and the ways their employees need to operate safely changed significantly.

One of the clear themes that is emerging is that some businesses will come back stronger than others, perhaps because they managed to operate throughout the crisis as an essential service, but more importantly because their fundamental business model is sound and they have good liquidity and low debt. This in turn opens up the prospect of opportunities for these companies (and investors) in the M&A space, looking to consolidate their market position, expand into a new territory or leverage or secure other strategic advantages. These opportunities include the acquisition of intellectual property (IP) assets key to business operations or those that will enable expansion into competitors' market territories.

MARKET TRENDS

Currently, in the market place, we are seeing a number of tailored transactions driven by the acquisition of key IP assets. These opportunities may arise from a distressed business entering administration, looking at a pre-pack sale or a formal insolvency process. However, they may also occur where a business takes a strategic decision to strengthen its balance sheet by disposing of "weak" or non-core assets/operations in a particular territory or market segment.

For those with cash reserves or low debt, this can be an extremely favourable time to acquire a brand or core technology, for instance, without the baggage and cost of taking on a businesses' bricks and mortar retail stores, large workforces and the burden of a third party's complex supply contracts. The acquiring business may be able simply to add the new brand to its existing repertoire and make economies by making use of its own manufacturing/supply chain capabilities. Equally, there may be the opportunity to move the brand to online-only retail or target new markets (perhaps those less affected by the Covid-19 pandemic or those that are coming back stronger after the pandemic). This may in turn refresh a tired or heritage brand, or ultimately help access a whole new generation of consumers.

Some businesses may be currently a licensee or supplier of the branded product in a particular market, so these sorts of acquisitions could be more of a defensive play to preserve continuity of their licensed rights and guard against the risk of these rights being terminated and potentially sold to a competitor by an administrator of the licensor. Instead, it gives the current licensee the option to convert and strengthen its existing arrangement, at a favourable valuation, into one of ownership in a particular territory or market segment and to dispense with the payment of on-going royalties.

There may be a further strategic rationale behind the acquisition of IP assets; purchase of a patent portfolio from a competitor may result in settling active patent litigation, or remove a potential threat going forwards to the acquiring party's product line, for example. Such a move may also bulk-up a party's patent armoury and help with monetising the IP through a licensing program or enforcement efforts (including litigation) taken against competitor product lines in the future. For instance, Nortel's tech patent portfolio which was sold by auction to a consortium of Apple, Microsoft and 4 others back in 2011 forms a large part of many businesses' licensing and enforcement programs today.

KEY CONSIDERATIONS

There are some key considerations to take into account in any sale or auction process.

1. Where a buyer is looking to acquire from administrators, the process will move very quickly. There are likely to be a number of potential interested parties, ranging from trade to private equity. It is unlikely that the administrators will give any exclusivity period (or it will be limited), as speed is critical to the administration process.
2. In terms of the process, the administrators (or the company) will provide limited (or no) opportunity to carry out traditional due diligence, through a data room, requests for information and management presentations. The buyer will be reliant largely upon their own evaluation of the IP assets, including carrying out their own IP ownership searches, as well as freedom to operate searches.
3. The acquisition documentation, often an asset purchase agreement, will provide no warranty (or indemnity) protection in respect of the IP assets, so there is no contractual comfort about defects in title, other existing licensees or the risk of third party infringement claims.
4. There will typically be no recourse against the administrators in their professional or personal capacity for any representations made or the work they carry out as part of the transaction.
5. Valuation of IP is an important area, where often the business is best placed to judge their pricing in their given market. However, professional assistance is also at hand from expert IP valuers (whether from specialist outfits or the expert valuation teams of the big accountants) to benchmark proposed valuations against empirical data.
6. Often, the asset purchase agreement will have a linked IP assignment to transfer the legal title to any IP assets. This is fairly straightforward where patents, registered trade marks or registered designs are concerned, as these may be listed in a schedule by registration or application number. However, issues do arise where the critical IP assets are software-based or other creative works, such as algorithms, or know-how, product dossiers or databases, that are protected principally by copyright, database rights, trade secret or confidential information protection. In such cases, it is sensible to describe the IP asset as far as possible and in as much detail as practicable within a definition or schedule to the asset purchase agreement or IP assignment. However, the buyer may also need to ensure that there are arrangements for a physical or electronic handover of code, software or data files or critical manuals. This may need to be backed up by agreed access to escrow arrangements for source code held by third party escrow agents.
7. Where a transfer occurs, for registered rights, it is easy to record the change of proprietor with the various local Intellectual Property Offices (IPOs) concerned. However, where the rights are unregistered, it is harder to put the world on notice, where recordal is not possible. However, there may still be other industry or trade bodies, where the change of ownership may be noted.
8. If the IP assets are sold, but are subject to an existing granted licence, that licensee will be concerned to ensure that the buyer honours the terms of that existing licence. If the licence cannot be terminated upon an insolvency event by the licensor in respect of its own insolvency, administration or financial position, then there is still the possibility that the insolvency practitioner may look to disclaim an existing licence as an onerous contract, especially, if there is no further financial value or benefit in it to the licensor through payment of on-going royalties. However, that is an extreme measure for an insolvency practitioner to take and unusual. If not recorded already, then the existing licensee should try to put itself in the best position by ensuring that the licence is recorded immediately at the relevant IPOs in respect of the relevant patents or registered trade marks or designs, such as to put the new owner on deemed notice. The existing licensee may also want to communicate with the new owner to put that owner on express notice of the terms of the existing licence and their rights.
9. Particular issues may arise, where ownership of a brand or technology is split by territory or region. It may cause issues going forward, opening up the possibility of parallel (grey) imports from one territory to another, such that the buyer faces unforeseen competition in the market in which it has the exclusive rights to the brand or patented technology. Similarly, with brands, there are often concerns that the uniformity of the brand globally may diverge, as different owners exploit different brand positioning or images. Not only can this confuse consumers (who assume that brands are always owned globally), but can potentially lead to challenges that the trade marks may lack distinctiveness, where owned and managed by different proprietors. The answer may be to regulate these issues proactively, by entering into a co-existence or delimitation agreement at the time of sale between the buyer and seller (or other buyers). This should address issues such as: (a) one party not registering new trade marks outside their territory; (b) sale into other parties' territories, whether deliberately or permitting parallel imports (so-called active, rather than passive sales); (c) use of country specific domains, URLs and social media handles. This may also include parties adhering to a basic brand manual, common in franchising arrangements. All of these steps can be a sensible way to address potential issues, before they arise, to try to minimise the prospect of future disputes and strengthen a buyer's position if a dispute arises. It may also be sensible for the parties to consider collaborating on brand image and styles for each season, especially in fashion, including for a buyer to have access to any historic design or fabric catalogues.

FORWARD THINKING

IP assets remain a critical part of most M&A transactions, whether acquisitions or disposals, joint ventures or collaborations or licensing deals. However, even in the immediate term, there is already an increasing focus on targeting asset deals involving key technology or brands (reflected by patents or trade marks in particular) for the reasons suggested in this article. These bring unique challenges and considerations for those both acquiring and disposing of such IP assets.

Our commercial IP team is uniquely placed to help advise strategically upon asset deals involving critical IP, working as part of our market leading corporate and project teams.

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KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



JOEL SMITH
PARTNER, HEAD OF
INTELLECTUAL
PROPERTY - UK,
LONDON
+44 20 7466 2331
Joel.Smith@hsf.com



KRISTIN STAMMER
PARTNER, SYDNEY

+61 2 9225 5572
Kristin.Stammer@hsf.com



LAURA DEACON
OF COUNSEL,
LONDON
+44 20 7466 2045
laura.deacon@hsf.com

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