Intellectual Property Considerations in M&A Transactions

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Introduction

Intellectual property ("**IP**") assets are considered one of the most valuable assets in global commerce, oftentimes surpassing the value of tangible assets. Yet, discussions surrounding mergers and acquisitions ("**M&A**") transactions frequently focus on a company's physical assets — such as real estate and machinery — while paying insufficient attention to its intangible assets. This oversight can be costly, as IP assets, which gain value as companies build goodwill and traction in the market, often hold immense value and can in the long run, contribute significantly to their market capitalization.

IP assets such as patents, trademarks, copyrights, and trade secrets rank among the most critical resources a company can own. For instance, Google's trademark portfolio is valued at an impressive $44.3 billion with a market capitalization of $164 billion, closely followed by Microsoft's at $36.2 billion with a market capitalization of $204 billion.[1] This underscores the immense economic potential of IP assets, particularly in this era of technology-driven businesses. Given this reality, the careful evaluation of IP assets is crucial in the success of any M&A transaction.

In this article, we explore the key IP considerations in M&A transactions in Nigeria, highlighting common mistakes made in IP acquisition, and proposing actionable strategies for Nigerian companies, to avoid these pitfalls and unlock the full potential of their IP assets during such transactions. The considerations are discussed below.

A. IP Valuation.

When the target company in an M&A transaction owns substantial IP assets, these assets can significantly enhance the asset portfolio of the acquiring company and consequently increase the purchase price of the target company. Thus, careful consideration must be given to the valuation of IP assets. Valuing IP assets can be complex, as their value fluctuates over time due to factors such as the growth or decline in the company's brand popularity, a shift in market trends, or changes in the uniqueness or relevance of the IP. Thus, it is essential to evaluate various factors that may influence the future value of the IP. Common valuation methods include:

(a) Cost-Based Valuation: This approach estimates the value of an IP asset based on the cost required to recreate or develop a similar asset, either internally or externally. It involves two methods: **(a)** the reproduction cost method, and **(b)** the replacement cost method. The reproduction cost method involves estimating the expenses required to create an exact replica of the IP asset, while the replacement cost method calculates the cost of developing a similar IP asset that provides equivalent utility and/or functionality but may differ in form or appearance.[2]

(b) Market-Based Valuation: Here, the IP asset's value is determined by comparing it to the market value of similar IP assets. This involves analysing direct transaction prices of comparable IP assets to ascertain its value. While it may be challenging to find an exact replica of the IP asset, appraisers often use common denominators to determine comparability and consequently, the asset's value.[3]

(c) Income-Based Valuation: This method values an IP asset based on the future income streams it is expected to generate, discounted to its present day value.[4] This process involves projecting the future revenue to be generated by the IP asset, and discounting it by subtracting the costs used in developing and maintaining the IP asset, including labour, materials, and anticipated risks such as economic downturns and shift in market behaviour.[5]

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[1] Upcounsel, "Top Ten Trademarks: Everything You Need to Know", < https://www.upcounsel.com/top-ten-trademarks> accessed 06 December, 2024.

[2] Harald Wirtz, International Journal of Business and Management, "Valuation of Intellectual Property: A Review of Approaches and Methods" <Microsoft Word - IJBM2012-V7N9> accessed December 06, 2024.

[3] Ibid.

[4] World Intellectual Property Organisation "Module 11 – IP Valuation" < Valuation of IP - WIPO.pdf> accessed December 06, 2024

[5] Ibid

B. IP Ownership

Verifying the ownership or clear rights to IP assets is fundamental to accurately assessing the value of the target company in the transaction. Missteps in this area can lead to costly legal disputes and a significant diminution of the IP's perceived and actual value. Clear IP ownership ensures that the target company has the legal authority to use, transfer, or license its IP without any encumbrances.[6] Additionally, it confirms that all registrable IP assets have been duly registered, and that any transfer or assignment of ownership is properly documented and registered where required.[7]Mention should be made of the fact that assignments and license agreements for patents and trademarks must be registered with the Registrar to be deemed valid.[8] Thus, the acquiring company must ensure that all such agreements are duly executed and submitted for registration.

A number of situations demonstrate the importance of adequate documentation. For instance, under Nigerian copyright law, the rights to works created by an individual vest in the individual unless explicitly assigned to another by way of an agreement.[9] Thus, an IP assignment agreement, transferring ownership of copyright in all works created during employment to the company, is essential. Without such agreements, disputes over ownership may arise, especially if an employee or contractor later claims rights to the IP.

Ownership of copyright in collective works can also be particularly challenging. Section 30(5) of the Copyright Act, 2022, provides that an assignment or license by one copyright owner has the same effect as if granted by all co-owners. This provision, where exploited, can lead to disputes if a co-owner has not granted consent to the transaction. If such a co-owner decides to contest the assignment or license, it could result in litigation that undermines the value and usability of the IP asset. To mitigate these risks, it is imperative for the acquiring company to ensure that the individuals or entities licensing or assigning IP to the target company, have full and undisputed rights to do so. This would involve a thorough review of ownership agreements, clear documentation of co-owner consents, and legal due diligence to avoid potential conflicts. Neglecting these issues can jeopardize the transaction and lead to unexpected legal and financial liabilities.

C. IP Due Diligence

IP due diligence involves a comprehensive assessment of the IP assets owned or utilized by the target company. This process typically includes a thorough review of the target's IP agreements, filings, registrations, litigation history, and other relevant records to identify potential risks, such as infringement claims, misuse issues, or encumbrances, as well as opportunities to leverage the IP assets. The target company may also conduct IP due diligence proactively to highlight the strength, value and strategic importance of its IP assets demonstrating how these could contribute to the acquiring company's asset portfolio and overall goals. Conducting comprehensive IP due diligence ensures that the acquiring company understands the full scope and limitations of the target's IP, and better informs the valuation of the target. Failure to perform rigorous IP due diligence can result in unforeseen liabilities, legal disputes, or overvaluation of the target company.

Key considerations in the IP due diligence process includes **(a)** ownership and assignment of all IP rights, **(b)** third-party transfers and infringement claims, **(c)** litigation history and settlements, **(d)**

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[6] In 2019, ZeniMax LLC was awarded $500 million damages against Facebook in a trade secret and copyright infringement case. ZeniMax alleged that its former employee John Carmack unlawfully used its proprietary technology in the development of the Oculus Rift, a product later acquired by Facebook. The lack of clear agreements regarding IP ownership between ZeniMax and Carmack became central to the litigation, highlighting the critical importance of ensuring that all IP is properly assigned and that no underlying claims exist that could later surface to challenge ownership. The Columbia Journal of Law & the Arts "Virtual Reality Infringement Lawsuit Ends in $500 million Damages" < https://journals.library.columbia.edu/index.php/lawandarts/announcement/view/58> accessed December, 07 2024

[7] Chambers and Partners "Protecting Intellectual Property in M&A Transactions: Why Conduct a Proper Due Diligence" <PROTECTING INTELLECTUAL PROPERTY IN M&A TRANSACTIONS: WHY CONDUCT A PROPER DUE DILIGENCE | Article | Chambers and Partners> accessed December 07, 2024.

[8] Patents and Designs Act, 2004, s. 23 and 24, Trademarks Act, 2004, s. 30.

[9] Copyright Act 2022, s. 28

review of assignment, licensing, joint venture/joint development agreements, **(e)** process documentation of all IP rights, and **(f)** encumbrances.[10]

D. Licensing

Ensuring that the target company's IP is free from restrictive licensing agreements or encumbrances is a critical component of IP due diligence. Licensing agreements often grant rights to third parties to use the IP under specific terms, and these agreements can impose limitations that may affect the target company's ability to fully utilize, transfer, or assign the IP. It is important to assess whether the target company uses licensed IP and carefully review the provisions of such licensing agreements. This includes identifying any restrictions on exclusivity, geographic usage, fields of application,[11] or sublicensing rights that may constrain the acquiring company's future plans. Additionally, checking for liens, pledges, or security interests attached to the IP that could limit its free use or transfer is crucial. Encumbered IP may require additional steps to resolve these issues before the transaction can be completed.

Under Nigerian Copyright law, an exclusive licence of a copyright must be in writing, whereas a non-exclusive licence can be written, oral, or inferred from the conduct of the copyright owner.[12] For patents and designs, licences, exclusive or otherwise, must be in writing.[13] An exclusive licence grants the licensee sole and exclusive rights to use the IP. Conversely, non-exclusive licences allow the licensor to grant usage rights to multiple parties to utilise the IP.[14] In any case, it is the responsibility of the acquiring company to determine the nature of the licence held and granted by the target company and evaluate its potential impact on future business operations, including product rollouts or market expansions.

Thoroughly analysing licensing agreements ensures that the acquiring company gains a clear understanding of the IP's usability, flexibility, and potential limitations. It also prevents unforeseen complications that could undermine the strategic value of the acquisition.

E. IP Integration Post-Merger

In 2006, Disney, a renowned animation company famous for its legacy in the old-fashioned hand-drawn animations, acquired Pixar an innovative animation studio which deviated from hand-drawn animations to 3D computer-generated imagery (CGI). This acquisition is widely regarded as one of the most successful examples of IP integration in the entertainment industry.[15] The deal rejuvenated Disney's animation division and led to the production of critically and commercially acclaimed films like *Toy Story 3, Frozen, and Inside Out*, which solidified Disney's dominance in the animation industry.

The effectiveness of the Disney-Pixar merger underscores the importance of post-merger IP integration. Properly leveraging the acquired IP involves harmonizing it with existing assets, workflows, and creative visions to maximize its value. This requires strategic alignment between the acquiring and target companies to avoid potential pitfalls such as underutilization, resource conflicts, or dilution of creative identity. In the case of Disney and Pixar, successful integration was facilitated by maintaining Pixar's creative autonomy, which allowed the studio to continue its innovative storytelling without disruption. Key leadership transitions also played a pivotal role: Pixar's Steve Jobs became Disney's

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[10] Abou Naja Intellectual Property, "IP Due Diligence – Importance and How to Conduct (Checklist)" https://abounaja.com/blog/ip-due-diligence accessed December 07, 2024

[11] Copyrights Act, 2022, s. 30(2)

[12] Copyrights Act, 2022, s. 30(3)-(4)

[13] Patents and Designs Act, 2004, s. 23(1). Section 33 and 34 of the Trademark Act, 2004 also provides for registered users, implying that the licences must be reduced in writing as well.

[14] Section 34(1)(a) of the Trademarks Act, 2004 requires that the particulars to be provided to the Registrar for registration includes details of whether the licence is exclusive or not.

[15] Study Smarter, "Disney Pixar Merger Case Study" <https://www.studysmarter.co.uk/explanations/business-studies/business-case-studies/disney-pixar-merger-case-study/> accessed December 06, 2024

largest shareholder, while John Lasseter assumed a leadership role within Disney's animation division, bringing Pixar's inventive culture into Disney's operations.[16]

Thus, the acquiring company must ensure that the acquired IP is not only preserved but also seamlessly integrated into the broader operational and strategic framework. Poor IP integration can lead to issues such as inconsistent branding, redundant processes, or even devaluation of the acquired IP.

Conclusion

The place of IP assets in any M&A transaction cannot be overemphasized. The same care and consideration given to tangible assets must be extended to intangible assets, as they possess the potential to significantly influence the future growth of the acquiring company. Neglecting the complexities and potential of IP assets during these transactions can open the acquiring company to significant financial and legal risks, including overvaluation, disputes over ownership, and unanticipated encumbrances. For companies navigating the intricacies of IP in M&A transactions, adopting the strategies discussed not only safeguards their interests but also positions them to harness the full economic potential of their intangible assets. By proactively addressing IP considerations, businesses can ensure their transactions are not just legally sound but also strategically advantageous, laying the foundation for long-term growth.

[16] Ibid.

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