

## SUSTAINABLE STRATEGY OF IMPLEMENTING IPR MANAGEMENT IN MERGERS & ACQUISITIONS

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### **Abstract**

The research and development (R&D) field is going through a rapid development and change of strategy. The field is moving more and more away from the classical in-house R&D department which used to be responsible for developing all new products and technologies of a company to a more dispersed strategy. The in-house R&D is now more responsible for the core business of a company and the management has recognized that there is a constant need of finding new business fields and products which the in-house R&D normally cannot provide. Therefore, in the past years the importance of start-ups became more and more clear to most economical players. Established companies recognized the importance of investing in and implementing small external companies, not as a means of stopping the competition but as a means of finding those new products and business fields that a company needs to further grow and remain in the costumer focus. This brought the department dealing with Mergers & Acquisitions (M&A) into a new focus point. When dealing with start-ups the potential investor has to be dynamic and fast about taking the right decision. For that he needs a team of experts that can perform in case of need, a swift and accurate Due-Diligence (DD) over the targeted start-up giving the management a reliable summary on which it can rely when taking investment decisions. Nevertheless, due to the high number of possible targets the DD team needs to work in a resource sustainable way.

The objective of this paper is to identify the right key questions, the right time stages and the right M&A phases for the implementing of the Intellectual Property Rights (IPR) management and more exactly the IPR expert in the M&A DD process. With the help of these, the IPR expert can decide on an economically and time sustainable IPR DD process for the discussed investment types.

The methodology used involves 6 different DD processes which were implemented in the course of 7 years in 2 different global corporations by the writers as well as a literature research of the best practices on the field. It is proposed to create a framework which guides and supports the path to a resource sustainable strategy of implementing the IPR DD.

**Keywords:** Mergers & acquisitions, Intellectual Property Rights, Due Diligence, Sustainable Strategy

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**JEL Classification: A10, A11, D21, M12**

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### **Introduction**

The start-up industry is developing and growing at a very high rate. Many of these start-ups are what is called the “knowledge-heavy industry, where the utilization of intellectual property is often the core business”. (Popp, 2017). So that when looking to invest in such companies it is especially important to invest resources into the IPR DD. There are many reasons for a thorough and well managed due diligence process. In the fast moving market, it is important to exactly know what is acquired and since many of the start-ups are evaluated at very high sums but still don't have a lot of business implementation, the importance of the technical team examining the developed products and of the IPR management in the DD process has grown exponentially. Furthermore, it is important for the buyer to make sure that he is buying a company which is in full control of the IPR that it is using, so that it will not fall in to the risk of buying an empty “egg shell”. A further and very important reason for a good and thorough IPR DD is the possibility that the target has been infringing knowingly or unknowingly IPR owned by third party. In many cases the third party will not sue the small company with the knowledge that it has low funding and possibility of fulfilling any compensation payments decided by a court. Therefore, it will often happen that the third party IPR owner will wait for a stronger investor to come and purchase the infringing company. A good example for such a case was RPost vs. Adobe - “Barely hours after Adobe's acquisition of web-based provider of electronic signature and signature automation, EchoSign, the companies have been hit by a lawsuit filed by US-based rival RPost alleging infringement of 5 of its patents.” (MacInnes, 2011). In this paper we are focusing on the development of an IPR DD frame which seeks to help the IPR expert to conduct an IPR DD which is as resources saving as possible but will still provide the answers to the investor's needs with a special focus on start-up investment or acquisition. Strategies for IPR DD begin with the preparation strategies of the companies that want to find investors for further growing (Storella, 2012) continue into fully developed DD strategies going through every point of the DD (Berens, et al., 2013) and continuing with IP DD checklists which can have very detailed questions and steps considered needed in the IP DD (Due diligence data room , 2017).

## **1. Current approaches and literature provide the right tools**

### **1.1 The right questions**

A properly conducted DD can benefit both seller and buyer and may lead to long-term relationships and business synergies. (Cockburn, 2017).

According to Mr. Cockburn the IPR DD expert should ask at least the following questions and answer them before he can give a good assessment of the risks that are connected to the expected acquisition. The IPR expert should know and understand:

- what the management expects to get out of the transaction.
- what is being bought or sold and the exact obligations to the buyer or seller.
- a full search on the ownership, history and maintenance fees of the IPR, to ensure that rights are still in force and confirm validity of the information presented.
- from the seller of the IPR right details of other IP rights, which may affect or restrict the usage of the IP right in question.

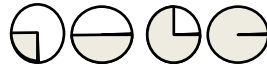
- check out copyright implications
- ascertain if there is any mortgage on the IPR.
- for patents request details of any improvement patents that might exist.
- ascertain whether the IPR is the subject of any litigation or infringement suits.
- significant timelines involved with the IPR such as the duration of the license.
- request details on significant third parties and
- always, always ensure that the seller is entitled to sell the IPR.

This points can be developed to a check point list of questions which the IPR expert goes through and tries to supply an answer to (Due diligence data room , 2017).

### **1.2 The right phases**

To conduct a sustainable IPR DD the expert should understand the nature of the M&A process thoroughly. He should have a good oversight on where exactly the process is standing and where in it he takes his place at the given moment. This is the first dimension of thinking before starting to invest too many resources into the IPR DD process. The M&A process can slightly differ from acquisition to acquisition but in general goes through the following phases (Appelbaum et al, 2000).

- Pre-Acquisition is a phase where in most cases the team and M&A department are not informed yet. This is a phase which is mostly kept confidential and is being discussed mostly only between the management which will eventually decide if and when to start an M&A process for a certain target.
- Phase 1: The screening, preselection and initial contact. In this phase the first teams for the Due Diligence are formed and are approved to already get in contact with the target. Here the management should define the target and the expected business requirements. The teams take over and have a first initial contact with the target, testing some of the basic requirements for continuing the process. An IPR expert should join this team from the beginning to test if the target has any imminent IPR difficulties. In this phase the IPR expert can only test the obvious information about the target. If none of the experts found a major risk, deal breaker or irregularity the M&A process could continue. The management will decide dependently to continue to the next phase.
- Phase 2: Due Diligence & Evaluation. In this phase a full due diligence team is built with experts answering for every field that needs to be evaluated in case of acquisition. Possible fields are: legal, IT, market potential analysis, HR, technical, operations, financial, tax, intellectual property and others. It is the job of the experts to define the level of risk for each of their fields. Each field defines the different risks that might come up and through testing and researching the target company documentations as well any other source of information a level of risk is evaluated. For each of the identified risks a level is chosen depending on the information: low, medium, high or very high risk. The critical very high risks must be highlighted and could if not mitigated be a deal breaker. The average of these can be summarized in one value and if wanted represented by a graphical value:



IPR Risk Level

**Figure no. 1: Possible risk levels per example the IPR**

The IPR expert can also assist with the evaluation of the final price of the target. Using tools like patent value evaluation and analysis tools like Patentsight (\*\*Patentsight, 2017) and Iplytics (\*\*IPLYTICS, 2017) he can estimate the value and strength of the IPR portfolio of the target.

- Phase 3: Signing and Closing. When reaching this phase, the DD team has already presented the results of the DD to the management team which in dependency to the results decided to continue with the acquisition. The IPR expert is responsible to make sure that the final version of the contract includes the correct IP clauses and the IP guarantees provided by the seller are correctly described. It is important to clarify what exactly happens with the IPR and what happens in case something goes wrong over a definite period of time.
- Post-Acquisition: The IPR expert is now responsible for the new subsidiary. Depending on the managerial strategical decision it will be decided if the IPR continues to remain as part of the assets of the subsidiary or if it is more important to transfer these into the portfolio of the parent company. Furthermore, it is now in the responsibility of the IPR expert to check if the information received until now from the seller during DD was correct. In this step the IPR expert will take over the management of the IPR portfolio and new IPR application of the new subsidiary.

### 1.3 The right stage

The second dimension is best described in a publication called Demystifying IP Due Diligence (Bosch and Burgy, 2006) the writers go to the next step and divide the IP DD in a “Three-stage Approach” each with its own questions and points. These stages seek to provide a frame which allow the IP expert to implement a sustainable strategy in the processing of the research and information of the due diligence. This means that by asking the questions in the right stage the IPR expert can decide what time and resource investment would be sustainable for each step of the M&A DD as well as in case of an acquisition to decide what would be the most sustainable and business oriented strategy to implement the acquired IPR in the corporation. “The three stage approach defines the many goals of IP DD into three components for focused analysis”:

- (1) Prioritization of the objectives: The typical information needed at this step is to know what are the business requirements of the management, what is the purpose of the acquisition and what are the expectations on the business field as well as on the IPR field. Accompanied by a definition of the target business and industry the IPR expert can define by this information the boundaries of the due diligence on this stage. This way he will only invest as much resources as needed at the given stage.
- (2) The substantive investigation: The typical information needed at this step is about the products and services involved and after an exact definition of those, finding out if there is existing IP owned by the seller or a third party covering these products and/or services. Depending on which phase of the M&A DD it is, the IPR expert can use tools like freedom to operate researches and prioritizing.

- (3) Analysis of the results: the final stage is the synthesizing of the results the risks that may have been uncovered need to be scaled and deal breakers have to be clearly pointed at.

## **2. Combination of the existing approaches**

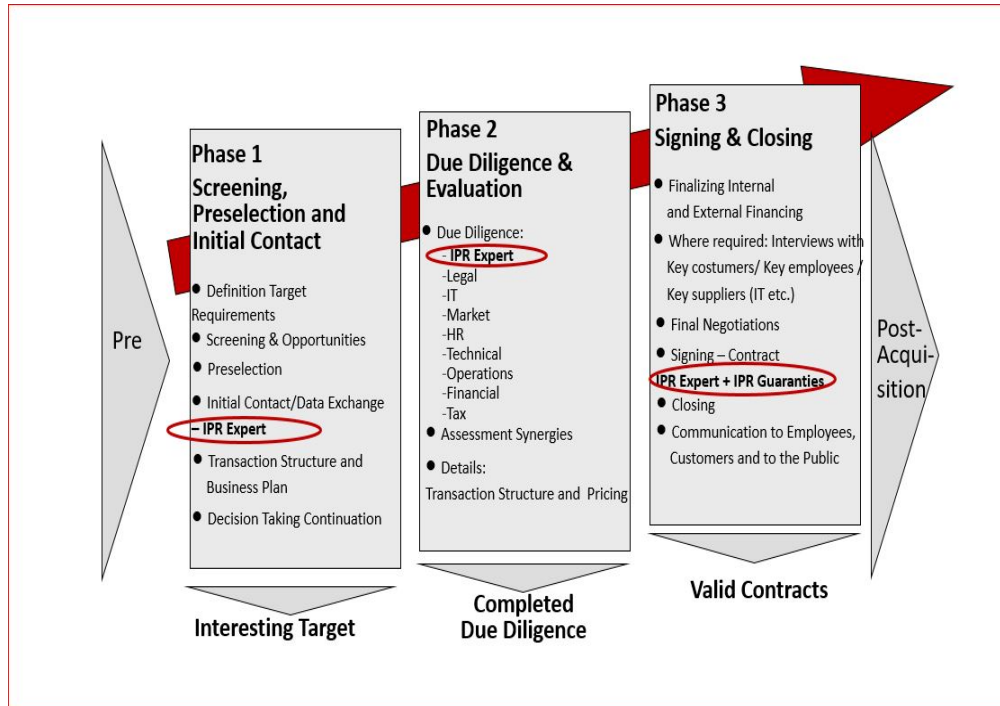
In the research that we conducted in the 6 different DD processes that we had available it came out that each of the approaches delivers a reasonable amount of information when seen from the DD point of view and that they actually manage to respond to a big part of the requirements expected from an IPR DD, but we encountered a main difficulty of scaling the amount of resources which are invested in each of the single IPR DD's.

This meaning, that if the IPR expert will only use a checklist to go through each point and insist on fulfilling all the points on the check list for every DD he will spend sometimes to many resources.

For example, he will do a full FTO research and analysis of the results with average costs of over 100000\$ for a target which is evaluated at 50 million dollars as well as for a target evaluated at 0.5 million dollars.

This would improve when using the "Three-stage Approach" but because he will only look at the DD process as one phase he might invest too much too soon and it may have happened that a deal breaker already appeared from another spot in the first phase of the DD.

**2.1** Therefore, as we already hinted in the description of the different tools we came to the conclusion that a combination of the tools above would be the best alternative for the kind of IPR DD described in this article. In a first step we combined the M&A typical phases with the targets and position that the IPR expert will take. By doing that we are giving the IPR expert an overview of where he is positioned in the M&A DD workflow and what are his responsibilities in each of the phases. The following graphical work flow of the M&A displays this in an easy comprehensible manner.

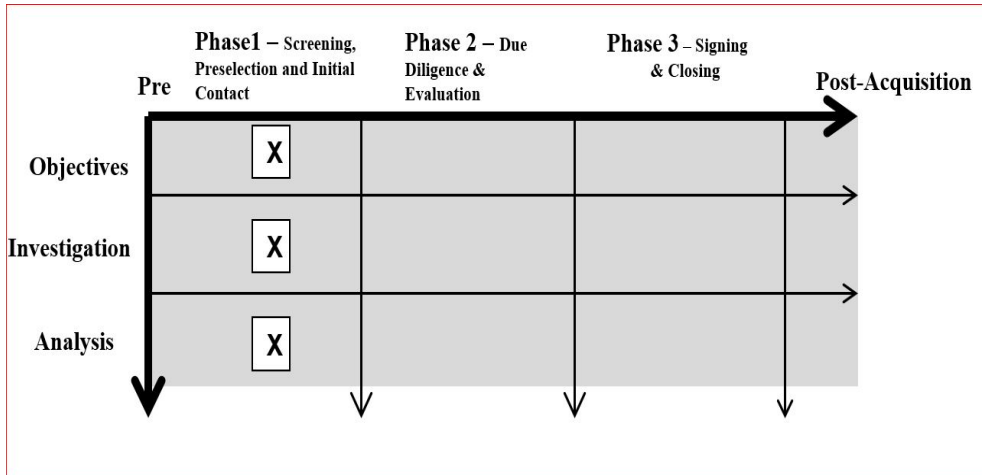


**Figure no. 2: M&A workflow the acquisition part and IPR expert positioning**

Source: (Appelbaum et al, 2000) and research conducted by the authors in 6 different DD cases

Seeing this we have actually noticed that the IPR DD is conducted in a two dimensional time and workflow with the M&A process being the first dimension

2.2 The second dimension of the IPR DD defines the many goals of the IP due diligence itself. In the second dimension we implemented the three stages that should be worked through each of the phases of the acquisition phases described in the upper part. (Bosch and Burgy, 2006)



**Figure no. 3: IPR Due Diligence workflow**

Source: (Bosch and Burgy, 2006) and research conducted by the authors in 6 different DD cases.

With this we created a fully new frame for the IPR expert to approach an IPR DD which is sequenced and which allows him to scale the investment into the DD depending on what phase and step he finds himself in and offers the possibility to stop the DD at clear defined points.

**3.0** After the combination of the two dimensions we have added the check list and combined it into the stages and phases approach. Now the IPR expert has the tools to go DD phase after DD phase and during these phases over the 3 stages each with dedicated lists of questions and to-do's. He can now exactly decide how far does he needs to go on with the DD to supply the exact information needed for that exact phase and noting more. This way he will only invest the for that phase and stage needed resources and manage an economically sustainable IPR DD differentiating from case to case in a structured easy controllable manner. He can report to the management at any given point, offering new possibilities of controlling the IPR DD and extracting useful information already during the process.

**Results**

We in the 6 different DD cases we have used each of the tools separately and finally when in the last ones we had the developed approach described in this article. We implemented this new combined IPR DD approach and the results were very positive.

DD Case	Company assessed value	Tools used	Results	Investment in DD IPR
Startup on IT field	12 Million US Dollar	IP Due Diligence Checklist	Buy -The results of the IPR DD where positive but the investments grew to very high sums	~250.000 US Dollar
Startup on IT field	3.5 Million US Dollar	IP Due Diligence Checklist	Deal-Breaker - The results of the IPR DD where positive but the investments grew to very high sums	~75.000 US Dollar
Startup on IT field	50 Million US Dollar	IP Due Diligence Checklist	Deal-Breaker - In early stage discovered but due to the approach already too many resources invested	~30.000 US Dollar
Startup on IT field	5 Million US Dollar	Three-stage Approach	Buy – an improvement of the DD costs but still very high	~30.000 US Dollar
Startup on IT field	15 Million US Dollar	Three-stage Approach	Buy – an improvement of the DD costs but still very high	~30.000 US Dollar
Startup on IT field	5 Million US Dollar	Combination	Deal-Breaker – a clear improvement of the process. We invested only a small amount of resources before the deal-breaker came in.	~5.000 US Dollar

### Conclusions

Through the graduate implementation of the different tools into the final one and the testing that took place at each step we could observe a steady improvement of the results achieved during the DD IPR processes. The quality of the results and with them the information supplied by the IPR expert to the management grew and the amount of time and money invested to reach these results was diminished to a level allowing the management to freely rely on the IPR DD without the fear of investing too many resources when it is implemented into the due diligence team. We have also noticed that there is a further factor which influences the amount of resources used in the IPR process: the risk mitigation. The risk mitigation can be seen as a kind of insurance for the decision takers e.g. the manager that needs to decide if an investment can be done or not and is a further factor that can swallow a big amount of resources. Here we are continuing our research and with the target of establishing what level of risk mitigation is acceptable depending on the amount of resources that need to be invested to reach that level of security. This taking to mind that in IP legal matters it is very hard to reach a 100% mitigation of the risks because of the high amount of information that needs to be processed as well as the high complexity of that information.



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