MERGER CONTROL AND IPR ISSUES

Background

The present paper aims to investigate the issues of Merger and Intellectual Property Right. This paper covers a wider range of topics which as clear implication on protection of intellectual law. How merger control becomes an important variable in functioning of property rights? How IPR issues shape the contemporary merger process? The paper seeks these involving questions. It is mostly based on secondary resources where report and statuary laws of Competition Commission of India is observed empirically. The CCI as a statutory authority ensures that no enterprise should flourish which has intention to indulge in anti-competitive practices (cartel formation, predatory pricing, etc.). Any enterprise cannot be allowed to amalgamate or merge. Further, usually these mergers inherently involve IP transactions which are carried out along with the agreements.

Statuary Mechanism of Merger Control: Competition Commission of India

The Competition Commission of India (Procedure in regard to the Transaction of Business relating to Combinations) Regulations, 2011 oversee the way in which the CCI regulates combinations that cause or are likely to cause an Appreciable Adverse Effect on Competition.

- The merger control regime under the Competition Act, 2002, applies to all combinations that trudge beyond the exempted thresholds prescribed by the Ministry of Corporate Affairs. Thereafter, it is mandatory to take prior approval of the CCI before constituting the combination.
- A "Combination", under the Competition Act refers to an acquisition of control, shares or voting rights or assets by a *person*; an acquisition of control of an enterprise wherein the acquirer has direct or indirect control of the other enterprise in a parallel or identical industry; or a merger or an amalgamation between or among enterprises exceeding the thresholds highlighted in the Competition Act.
- Moreover, Section 32 of the Competition Act confers extra territorial jurisdiction. This implies that whenever an acquisition where the assets on turnover are in India and beyond the financial thresholds, would fall under the purview of merger control mechanisms even when the acquisition or target are not located in India.
- The onus *prima facie* lies on the CCI to ascertain whether a combination is capable of causing or is already causing AAEC in the relevant Indian Market within 30 days of filing for approval. In practice, the combination becomes effective only after expiry of 210 days from the date of notifying

the CCI about the proposed combination; or after the regulator has approved of the combination per se.

India's Merger Control Regime

Acquisitions, merger or amalgamation of enterprises where Jurisdictional Thresholds are exceeded have to comply with the merger control provisions contained in Sections 5 and 6 of the Competition Act and the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011. Following are the current merger control thresholds in India –

Direct Parties Test: India		
Assets	**OR**	**Turnover**
Combined Indian assets > INR 20 billion (approx. USD 298 million/EUR 271 million)		**Combined Indian turnover > INR 60 billion** (approx. USD 814 million/EUR 895 million)

Direct Parties Test: Worldwide & India		
Assets	**OR**	**Turnover**
Combined worldwide assets > USD 1 billion **and** **Combined Indian assets > INR 10 billion** (approx. USD 149 million/EUR 135 million)		**Combined worldwide turnover > USD 3 billion** **and** **Combined India turnover > INR 30 billion** (approx. USD 447 million/EUR 407 million)

Acquiring Group Test: India		
Assets	**OR**	**Turnover**
Combined India assets > INR 80 billion (approx. USD 1.19 billion/EUR 1.08 billion)		**Combined India turnover > INR 240 billion** (approx. USD 3.58 billion/EUR 3.25 billion)

Acquiring Group Test: Worldwide & India		
Assets	**OR**	**Turnover**
Combined worldwide assets > USD 4 billion		**Combined worldwide turnover > USD 12 billion**
and		**and**
Combined Indian assets > INR 10 billion (approx. USD 149 million/EUR 135 million)		**Combined India turnover > INR 30 billion** (approx. USD 447 million/EUR 407 million)

- Transactions wherein the target has assets less than INR 350 crores or turnover less than INR 1000 crores, do not require prior notification to and approval of the Competition Authority. The *de minimus* provisions exempt a majority stake (or a 100% shareholding) acquisition or a merger that is likely to have an effect in the market. These exemptions are allowed till March 28, 2022.

Merger Control: Competition Law and IPR Issues

Merger is one of the most adopted growth strategy by companies and when companies combine their core competencies through Mergers and Acquisitions, 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.

- In the case of *Saraswati Industrial Syndicate Ltd. v. CIT*[1] the Hon'ble Supreme Court has held that "The true effect and character of the amalgamation largely depends on the terms of the scheme of merger. But there cannot be any doubt that when two companies amalgamate and merge into one the transferor company loses its entity as it ceases to have its business. However, their respective rights or liabilities are determined under the scheme of amalgamation but the corporate entity of the transferor company ceases to exist with effect from the date the amalgamation is made effective." Therefore, the rights over the intellectual property also transfer to the transferee company. Hence, it is very important for a transferor company to assess the Intellectual Property owned by the Transferee Company.
- In India, combinations especially in the Technology sector involve motley of IPR Issues because in privately held companies the acquirers have little or no control over the IP related information being shared by the selling enterprise.

[1]AIR 1991 SC 70

- Therefore, it is imperative for an acquiring enterprise to conduct a detailed due diligence of the selling enterprise related to Patents, Copyrights, Trademarks, and other IPs. The selling enterprise must prepare for the perusal of acquirer/ merging entity all IP related documents, such as-
  a) Patents and patent applications including but not limited to patent numbers, jurisdictions covered, filing, registration and issue date details.
  b) Trademarks or Service marks
  c) Trade Secrets and Business methods
  d) Confidentiality provisions and Assignment agreements for inventions
  e) Technology Transfers and licenses, Software and Databases, and Opens Source Software in use by the selling enterprise.
- With respect to mergers and acquisitions, target parties sometimes conduct intellectual property due diligence investigations. For example, to place itself in a better negotiating position. However, the acquiring party typically conducts the diligence investigations. The intellectual property due diligence investigations should begin before even engaging the target party. The acquiring party should first conduct a thorough review of all publicly available information. They should compile a list of patents, trademarks, copyrights, domain names and other intellectual property assets of the target party. Next, the acquiring party should identify proper ownership in the assets, as well as any liabilities associated with those assets. Liabilities related to intellectual property assets include infringement claims, as well as rights granted to third-parties under any licensing agreements.
- In Mergers and Acquisitions, Intellectual Property Assets can beespecially 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 oftcited cause for M&A failure is intellectual property, in a notoriousphenomenon known as the "*Winner's Curse*" where the Acquiring Firm paysmore 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.[2]Persons suffering may be punished by capital markets, hamstring competitively and constrained by burdensome capital structures. They may also get caught in tedious, expensive IP litigation, and contentious antitrust or jurisdictional issues.[3]
- Ultimately these details would support the acquirer / merging enterprise to evaluate the worth of the selling enterprise.In case of unregistered trademarks or copyrights a transfer may be initiated like any other proprietary right while negotiating the terms of the arrangement under the Companies Act, 2013. Going further, all third party independent contractors who are involved in creation of

[2]M. PARK, MAKING M&A PAY: AVOIDING THE WINNER'S CURSE, CORPORATE STRATEGY (Accenture 2005)
[3]C. BADY AND S. MOELLER, INTELLIGENT M&A 96-98 (John Wiley & Sons, 2007).

Intellectual Property for the selling enterprise should ideally assign it to the acquirer and duly provide a waiver of moral rights.

IP Audits

It is estimated that if Coca-Cola happens to lose all its tangible and physical assets, the brand name "Coca-Cola" and other IP assets would be valuable enough to enable positive cash flow within one year. It is crucial for financial executives, advisers and accountants to comprehend and understand that transfer of intellectual property is an essential aspect of all major transactions and should be audited.

Like its financial counterpart, the due diligence investigation and IP audit helps in amassing necessary information required to understand the business and market of the firm. A good audit would not only ascertain validity and reliability of information but would also help identify the real worth of IP assets. Fundamentally, an IP audit is an essential criterion that should be fulfilled in all M&A as it helps in gaining insight on the information pertaining to creation, maintenance, validity, strength, use and challenges, if any, to IP rights.

IP Audits involve the following steps:-

- Ensure that the company owns an IPR, and in case if any of the IPR is licensed to it, then such a license should be transferable.
- The status of all the pending applications for IPR protection should be determined to ensure the chances of its grant or registration. The conflicting applications filed by the third parties should also be determined
- Legal counsel should be sought to determine if the IPR owned by the firm is infringing someone else's rights or if any other entity is claiming interest in IP rights owned by the firm.
- Ascertain whether any governmental approval is necessary in exploitation of the IPR.
- The security agreements, licenses and contracts should be thoroughly evaluated.

Valuation of Intellectual Property

The company's rich IP portfolio is an indispensable asset. A trademark, for instance, if properly registered and protected, can provide tremendous worth to the company. It is estimated that the value of the "Apple" brand is almost half of its market capitalization. Therefore, a huge proportion of the valuation of a company's business may relate to intellectual property rights, therefore, it is important for a Merging Company to determine the assessment of its IP assets in order to protect the value of those rights.It would not be wrong to say that the value of intellectual property is 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. Factors like Policies of the Government, market scenarios, and internal factors of corporations, Competition laws and the impact of globalization tend to make the valuation of IP difficult. In order to evaluate the IP Assets of a Company, three techniques can be adopted:

- 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.[4]
- 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.[5]
- Value Based on Estimates of Future Economic Benefits,i.e. the purchase price determined from an estimate of past and future economic benefits, called the "Discounted Cash Flow" Analysis of:
    - capitalization of historic profits,
    - gross profit differential methods,
    - excess profits methods, and
    - 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.[6]

Ways of Acquiring IP Assets

- **Acquisition Agreement**- the main purpose of this agreement is to detail the terms and conditions of the acquisition. It identifies the issues specific to the transaction, the purchase price, the method of payment, date of closing and conditions precedent (if any). The seller also makes certain representations and warranties in respect of the assets.

[4]Dahat, P.R. and Yadav, P.S., 2010. Intellectual Property: The Dominant Force in Future Commercial Transactions Comprising Mergers and Acquisitions.
[5]H. Harish and C. Srividya, Rationale and Valuation Techniques for Mergers and Acquisitions, THE CHARTERED ACCOUNTANT, May 2004, 1228-1230.
[6] Kelvin King, The Value of Intellectual Property, Intangible Assets And Goodwill, 7 Journal Of Intellectual Property Rights 245 (2002)

- **Transfer Documents**- documents which transfer the assets, will allow the buyer to indirectly become the owner of the assets. They are executed separate from the acquisition agreement. The forms and other requirements for valid transfers differ from country to country.
- **Sale of Assets**- If a party acquires business vis-à-vis sale of assets, the intent to transfer trademarks and the goodwill associated with it is presumed, even though it is not expressly provided for. An exception to this concept is in the context of transactions between parent corporations and their wholly-owned subsidiaries.
- **Stock Purchase**- in a stock purchase acquisition, ownership of trademarks and other intellectual property still remains with the acquired company. A separate agreement is usually necessary to lay down the parties' intentions.

Protection of Intellectual Property on Mergers

- In order to ensure protection of the Intellectual Property, it is of primary importance to make sure that such transfer of rights are recorded as after an M&A deal IP rights are to be transferred immediately to the new owner in each jurisdiction where the right exists, otherwise it would be difficult for the new owner to file suits for infringement and may also lead to losses in royalties.
- In order to avoid the court delays, the parties may include Arbitration Clauses in the Agreement, in order to resolve any dispute. Moreover, it is better for the parties entering into a Merger deal to include in the agreement the clause stating as to who will bear the expenses in regard to the filing, renewal, registrations etc. of the Intellectual Property.
- It is also important to include clauses stating that the aggrieved party will get a contractual remedy, most commonly the damages in case of a breach.

The case of Sun Pharma and Ranbaxy

- The Competition Commission of India, in its meeting held on December 05, 2014, approved the proposed merger between Sun Pharma and Ranbaxy, subject to the parties inter alia carrying out the divestiture of their products relating to seven relevant markets for formulations. Further, the Commission also directed that the proposed merger shall not take effect before the parties have carried out the divestiture of the products so specified as per the order of the Commission.[7] Subsequently, CCI gave an affirmative nod to divest seven brands of drugs by Sun Pharmaceuticals and Ranbaxy laboratories to one Emcure Pharmaceuticals in order to conclude their merger deal involving a corpus of about USD 4 Billion. After careful assessment, the Commission noted that Emcure was independent and had no connection whatsoever with the Parties. It was also established

[7] Press Release dated December 8, 2014.

that Emcure was active in sales and marketing of pharmaceutical products in India and that it had the financial resources, proven expertise, manufacturing capability or ability to outsource manufacturing and incentive to maintain and develop the Divestment Products, as a viable and active competitor to the Parties in the relevant markets[8].

- It was touted by various analysts that the collective approximate value of these brands were close to INR 50 crores. At this juncture it is pertinent to note that in events of disinvestments as this, the seller usually receives a brand value in two or three folds the actual value. In this case, the parties did not disclose or confirm the financial inputs in view of the brand value.
- Sun Pharma was directed to divest all its products containing Tamsulosin and Tolterodine under their brand "Tamlet". Ranbaxy on the other hand its brands like Terlibax, Rozuvas EZ, Raciper L, Olanex, Triolvance etc. As per CCI's reasoning, Emcure was an active company in sales and marketing of critical pharmaceutical products and had all necessary resources, expertise, and ability to manufacture or outsource to manufacture its products and act as a viable and active competitor in the relevant market.
- In its press Release dated March 25, 2015, Sun Pharma announced closure of this merger deal with Ranbaxy. This allowed Sun Pharma to significantly expand its R&D capabilities and global presence, especially across emerging markets. It also paved way to enhance product portfolio and market depth in India, US as well as the rest of the world markets. Through this merger Sun Pharma emerged as India's first truly global pharmaceutical company.
- The initial aftermath of this merger has been a positive one. While the two entities had a combined net profit of Rs 2,283 crore in 2013-14, the year before the acquisition, the net profit more than doubled in the next two years, to Rs 4,539 crore in 2014-15 and Rs 4,716 crore in 2015-16. The combined top line rose slightly from Rs 26,620 crore in 2013/14 to Rs 27,744 crore in 2015/16.

Conclusion

The sanctity of innovation and intellectual property in today's business milieu is undeniable. Also, the role of competition law as a preventive anti-competitive weaponry is understandable, to bludgeon the anti-competitive activities that injure economic efficiency and escalates transaction cost.

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