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The Art of Deal Making: Using External Expertise Effectively

IR Global members collaborate with the Association of Corporate Counsel (ACC) to offer jurisdiction-specific advice on using external expertise effectively. In the following pages, you will hear from professionals in the legal, accountancy and financial sectors who are key to ensuring that an M&A deal is successful providing all parties seek the right advice.

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FOREWORD BY EDITOR, ANDREW CHILVERS

The Art of Deal Making: Using an M&A strategy to power business growth

For ambitious companies eager to expand into overseas markets, often the conventional route of organic business development is simply not fast enough. The other option to invest in or buy a business outright is far quicker but often fraught with unforeseen dangers. And even the biggest, most experienced players can get it badly wrong if they go into an M&A with their eyes wide shut.

If you search for good and bad M&As online the Daimler-Benz merger/acquisition with Chrysler back in 1998 is generally at the top of most search engines on how NOT to undertake a big international merger. Despite carrying out all the necessary financial and legal measures to ensure a relatively smooth deal, the merger quickly unravelled because of cultural and organisational differences. Something that neither side had foreseen when both parties had first sat down at the negotiating table.

These days the failed merger of the two car manufacturers is held up as a classic example of the failure of two distinctly different corporate cultures. Daimler-Benz was typically German; reliably conservative, efficient, and safe, while Chrysler was typically American; known to be daring, diverse and creative. Daimler-Benz was hierarchical and authoritarian with a distinct chain of command, while Chrysler was egalitarian and advocated a dynamic team approach. One company put its value in tradition and quality, while the other with innovative designs and competitive pricing.

Indeed, when you cast your eye over the two companies its mind boggling that either car maker could ever have seriously considered an M&A. Neither sets of managers trusted each other and as the two sides started on the long road of organisational integration, key employees resigned, particularly at Chrysler after Daimler started to dictate working processes. What was the cost? An estimated $38 billion.

Unbelievably, the failure rate of M&As – domestic and international – is estimated to be about 70% or more, according to the Harvard Business Review report. This remarkably high number would have most companies probably concluding that organic business development was the better option for growth after all. No organisation would knowingly want to spend so much time and effort simply to fail – and fail badly.

It's worth noting that integrating two companies, along with their staff, distinct corporate and national cultures, IT infrastructure, and financial and legal regulations is something that needs meticulous planning. Without a clear strategy from the very start of the merger process, it's probably doomed to failure. There needs to be transparency between stakeholder groups and both parties need to have the soundest financial and legal advice from professionals who have deep understanding of national and international M&As.

But before everyone shuts up shop and admits their merger blueprint is destined for the waste paper bin, it's worth looking at this in a little more detail. Above all, be positive.

The majority of M&A failures are publicly traded deals, where losses are eye watering and journalists are eager for a good story. Again, any search on Google will highlight countless high-profile merger failures, but it's far more difficult to unearth the thousands of smaller and mid-market privately run businesses that undertake successful deals, which largely go unreported. These smaller, strategic acquisitions tend to have far greater long-term success.

M&As at the smaller end of the market are never going to be risk free, but they're often a successful tool for powering growth for a business within and across borders. All business initiatives involve risks to reap rewards, but careful planning and using the right professionals for the right part of the transaction will help to minimise risk and ensure the deal is a success.

M&As are regulated in countries across the globe – as you'll see in the following pages, all countries have detailed financial and legal regulations regarding mergers. Tapping into the professionals who understand these issues is vitally important and will help ambitious companes take advantage of business opportunities globally. Some of the advantages of M&As include:

- Tax breaks
- An opening in a new market
- Easier access to skilled labour
- Diversifying a company's portfolio
- Better access to a larger market, and not forgetting that
- Merging is cheaper than setting up in a new jurisdiction.

Despite the Covid-19 pandemic, and despite a slowdown in M&A activity globally, all the indications are that corporate strategists remain determined to use M&As as a means to grow their businesses and access new markets going forward.

In these pages, you'll find a wealth of information from professionals in the legal, accountancy and financial sectors who are key to ensuring that an M&A deal is successful, providing all parties seek the right advice. From warranties and indemnities to IP due diligence and deal financing, IR Global's deal making experts answer questions that ambitious CEOs and business development managers need to understand if M&As are to play a key in their future growth and success.

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IP

IR Global's Intellectual Property group has member firms in 60+ jurisdictions around the world. The group offers unrivalled sector expertise and knowledge, so whether your focus is in Biotechnology, Computers, Electronics or Pharmaceuticals, we have leading Intellectual Property experts who understand the specifics of the IP practice area and the field in which you operate.

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Elizabeth S. Dipchand regularly advises corporate clients on in-depth intangible asset management. This includes IP prosecution, licensing, and transactional work with a particular emphasis on assisting SMEs. In addition to IP management, Elizabeth is an experienced Canadian IP litigator having practiced for many years at the IP litigation groups of prominent Bay Street law firms and regularly coordinates multijurisdictional enforcement efforts.

Dan Pollack has a broad practice that includes copyright, licensing, new media and entertainment law with a focus on helping creators maximize the value of their work. Before joining Dipchand LLP in 2018, Dan operated his own law firm, served as General Counsel for a content licensing agency and as in-house copyright enforcement counsel for SOCAN (Canada's leading performing rights organization), and practiced in the IP litigation groups at multinational law firms in Canada and the United States.

Nestled in the heart of downtown Toronto, Dipchand LLP is a boutique law firm focused on Intellectual Property, Corporate Law, Franchise Law and Litigation.

Dipchand LLP's commitment to cultivating strong relationships with our partners and clients result in tailored, strategic advice to guide ventures of all sizes through Canada's dynamic legal landscape. Our clients come from a wide range of industries, from biotech to photographers, all heavily relying on innovation and their intellectual capital to succeed both in Canada and abroad.

QUESTION ONE

What is your best practice approach to IP due diligence as part of the deal making process? E.g. Schedule of IP and establishment of transferable ownership rights?

The prominence and wealth of innovative companies whose value mainly derives from intellectual property has exponentially increased this century. The complexity of the transactions that these innovative clients are now engaged in – from M&As to co-ventures – is compounded by the IP that makes these companies so valuable. With the importance of IP due diligence increasing dramatically, effective IP diligence should start well before the deal appears on the horizon.

Implementing IP diligence is not limited to merely listing assets but involves taking a tailored approach informed by factors specific to the deal and parties. These strategy considerations generally include:

- Industry.
- Operational territories.
- Nature of the parties.
- Transaction/deal structure (share, asset, license, venture).
- Transaction timeline.
- Access to critical people and information.

Regarding the nature and status of the IP, essential considerations include its genesis, development, ownership, exclusivity, registration, jurisdiction, third-party leverage, and carve-outs, not to mention the most critical issue: the materiality of the IP to the business moving forward. Understanding the deal context allows us to craft efficient IP diligence strategies to focus resources on what's essential rather than checking items off a list. In brief, we want to identify the asset and how it is protected (patent, trademark, copyright, industrial design, etc.), if it is registered/unregistered/registrable, and its importance to the transaction.

At Dipchand LLP, we strongly believe in the comprehensive management of both registrable and unregistrable intellectual capital and intangible assets in Canada and globally – namely, their identification, acquisition, maintenance, management, and enforcement. Active management of these assets ultimately streamlines IP due diligence. However, even in situations where this groundwork has not been laid, significant efforts should be devoted to IP due diligence underlying the transaction as it will form the basis of effective IP management moving forward. It's never too late to start!

QUESTION TWO

Which methods of valuing patents, trademarks or trade secrets are most common in an M&A deal in your jurisdiction (e.g. cost, value or market approaches)? Any examples?

Valuing IP in Canadian M&A transactions involves sound judgement and collaboration. Legal counsel is predominantly responsible for IP due diligence, which forms the basis for the valuation by Certified Business Valuators (CBVs), making the collaboration between counsel and CBV critical. Given that most of our clients operate in multiple jurisdictions, this exercise is usually not limited to Canada nor registered rights.

The ephemeral nature of intangible assets compounds the typical challenges of valuation. Registered rights – patents, trademarks, copyrights – are a common starting point in the valuation process to identify what you can legally exclude others from doing. This process will also examine the client's intangible unregistered assets to determine their value, which are generally more difficult to quantify than registered rights. However, note that copyright registration is not required in Canada for potentially crucial assets such as software.

The two common approaches to valuation – quantitative and qualitative – both seek to determine advantages that the client's IP confers over competitors. In the M&A context, quantitative analysis predominates. The three quantitative approaches applied in Canada are similar to many other jurisdictions, namely, the cost approach (IP value measured by development expenditure), the market approach (IP value measured by recent comparable transactions between independent parties), and the income approach (IP value measured by potential future benefits/revenue).

Ultimately, it is the nature and type of often overlapping IP assets (i.e., brand, technology, artistic, data/trade secret, etc.) that will impact this choice. For instance, a technology that is expensive to develop may have an inflated valuation using the cost approach where the market cannot support substantial future revenues. Conversely, the technology may be challenging to value from a market perspective if it is unique without transactional comparables. There is no one size fits all approach for valuing IP in an M&A transaction.

QUESTION THREE

What warranties and indemnities do you recommend putting in place to ensure IP value is fully preserved?

Canada is a common-law jurisdiction that has inherited the principle of caveat emptor where, absent a warranty, the buyer bears the risk in a transaction. This principle holds true in transactions relating to IP and intangible assets. Similar to other jurisdictions, the Canadian "warranty" concept encompasses the promises or guarantees regarding the transacted IP and any latent deficiencies. "Indemnity" provisions govern the damages arising from third-party claims involving a breach of the warranties.

The very nature of intellectual property and intangible assets adds a layer of complexity in crafting warranties and indemnities into these deals. On the one hand, a buyer's interest should be focused on obtaining the thing or right that was the subject of the contract. But when the items at issue are intangible, it becomes critical to include warranties and indemnities focused on the fundamental aspects of the IP in question. Such warranties most commonly relate to ownership (including ideation, creation, development, acquisition and assignment), registration status and territory, non-infringement, encumbrances, validity and enforceability, legal disputes, and the waiver of moral rights for copyrights. The related indemnity commonly holds the buyer harmless against any third-party claims arising from breach or deficiencies of such warranties before, during, and potentially after the contract's termination.

Conversely, the seller should be wary that their warranties and indemnities do not stray beyond the scope of what is reasonable or reasonably known about the assets. To this end, the warranty language should not be "absolute" but should be drafted to limit their scope to the seller's knowledge, best efforts, and/or what the seller ought to have known. Further, it is essential and common to limit the seller's direct liability in the case of a breach or deficiency of a given warranty.

Top Tips – To Accurately Establish IP Ownership Process

- **Don't Dismiss Unregistrable Intellectual Capital** – All intellectual property and intangible assets should be identified at the outset regardless of the registrability to determine their importance which will dictate the acquisition, leveraging and enforcement strategy.
- **Chain of Title** – records, contracts and documentation that clearly evidences the ownership of intellectual capital at all stages of development from conceptualization through to commercialization, including use by clients and other third parties.
- **Materiality of IP** – Identify the critical IP that is key to the company's operations, revenues and competitive advantages in order to ensure focus on its management and further development is maintained.
- **Considered Registration Strategy** – Just because you can, doesn't mean you should. A considered registration strategy focuses resources on the IP and intangible assets that underpin the company's success now and in the future with a focus on the forest rather than cultivating trees planted in the wrong place.

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Mark Millward is a commercial, technology and intellectual property lawyer with more than 20 years' experience working with SMEs, global corporations, multi-industry conglomerates and government in the UK, Europe, Hong Kong and Australia. Mark's legal expertise covers every stage of the product lifecycle from R&D to IP, procurement and long-term contract negotiations for finance, retail, logistics, healthcare and IT clients.

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Eliza Low is a corporate and commercial lawyer who helps multinational corporations, entrepreneurial business owners and family-owned companies realise their investments and execute strategic acquisitions both locally and globally. Eliza has achieved favourable outcomes for clients on a full range of corporate matters including global carve outs, domestic M&A transactions, IPOs and corporate restructures across industries from IT to energy, FMCG and industrial.

mdp Law is a boutique corporate, commercial and intellectual property law practice based in Melbourne, Australia. mdp Law provides clients with forward-thinking advice and commercially driven solutions, from startup to maturity and beyond. Our multi-disciplinary team of legal specialists have global, top tier backgrounds, commercial expertise that covers every stage of the business lifecycle, and a network of international associates.

QUESTION ONE

What is your best practice approach to IP due diligence as part of the deal making process? E.g. Schedule of IP and establishment of transferable ownership rights?

It is essential to ensure the deal team engages specialist IP counsel at the earliest opportunity. In many instances IP rights underpin the target's business operations. For example, in the production of consumable goods, brand/trademarks are the lynchpin for successful sales, technology companies rely on copyright to protect their source code and manufacturing companies often rely on the monopoly afforded by patents.

Once the nature of the business and the jurisdictions it operates in have been identified it is advisable to create a schedule of all IP owned or licensed to or from the business that allows it to operate effectively. The structure of the schedule generally focuses on the most significant IP first.

The schedule should contain at least:

- Description of IP owned
- Details of IP licensed to or from a third party
- For registrable IP, such as a trademark, details of the registration or application number, relevant dates and jurisdiction
- For non-registrable IP, such as copyright, a detailed description of the asset (such details cannot be obtained from public registers)

Where "licensed" IP has been identified, further due diligence is required. Often the licence agreement terms can obstruct the sale. The licence agreement may prohibit transfer of the licence or termination rights may exist in the event of the sale. The purchaser should also be mindful of the duration of the licence and that the description of the IP is accurate.

For technology companies, in particular, copyright is the key protection for valuable source and object code. Where the target asserts ownership of copyright, due diligence should confirm that code has been developed by employees rather than third party providers. In the latter case, verification will be required to ensure that express written assignments of copyright are in place.

QUESTION TWO

Which methods of valuing patents, trademarks or trade secrets are most common in an M&A deal in your jurisdiction (e.g. cost, value or market approaches)? Any examples?

In the context of an arm's length M&A transaction, the purchaser will most likely focus on two financial components.

The purchaser's advisors will scrutinise the balance sheet from a finance and accounting perspective. IP needs to be capitalised appropriately and in the case of intangible assets, businesses in Australia may attribute separate values for "identifiable" assets such as patents, copyright and trademarks and "non-identifiable" assets such as goodwill. The financial, accounting and tax specialists to the M&A transaction will consider the notes to the accounts to understand the valuation methodology that has been applied (such as acquisition cost or market value). In this context they will normally consider whether the valuation methodology applied is in accordance with the Australian Accounting Standards Board recommendations and other relevant authorities including the Australian Tax Authority and the Australian Securities and Investments Commission. This analysis will not involve the lawyers assisting in the transaction.

From a commercial perspective, the IP's value is driven by the market, i.e. what does the market think the relevant asset is worth. The arm's length purchaser attributes a value that it is willing to pay for the relevant IP. Whilst the balance sheet is relevant in the context of the transaction, the purchaser is unlikely to be guided or bound by it. Instead, the purchaser will make a calculated commercial decision on how significant the IP is in the context of the relevant business being acquired. For example, in respect of registrable rights such as patents and trademarks, the purchaser will consider how long the monopoly protection will last for and thus what its value is from a commercial perspective.

QUESTION THREE

What warranties and indemnities do you recommend putting in place to ensure IP value is fully preserved?

The preservation of IP value post-completion is supported by the warranties and indemnities contained in the transaction agreement. The purchaser should be mindful that the seller will initially present minimal assurances to the purchaser. From the purchaser's perspective, extensive warranties and indemnities should be sought.

Warranties

The following warranties are recommended but will need to be tailored to the transaction and the nature of the business. Often greater protection is required for a business sale:

- The schedule of IP sets out accurate details of all IP owned or used in conducting the business
- The purchaser will acquire all legally effective IP rights necessary to conduct the business
- The IP does not infringe any third party rights and to the seller's knowledge, no third party is infringing the IP used in conducting the business
- All IP is either owned or appropriately licensed
- The IP owned is not the subject of any security interests
- For registrable IP applications (e.g trademarks), no 'objections' have been raised by the examiner/third party
- For unregistered rights, such as copyright, which has been developed by the target, that the IP has either been created by employees of the company or developed by a third party but effectively assigned
- There is no dispute "on foot" in respect of any IP
- Where IP is not owned by the seller there are appropriate licences in place which will survive completion
- No IP has been licensed to third parties other than in the ordinary course of business.

Indemnities

It is open for the parties to agree whether a seller provides a general indemnity to a purchaser for any breach of warranty, otherwise, indemnities are typically only included to deal with specific issues identified as part of the due diligence process.

Top Tips – To Accurately Establish IP Ownership Process

- In respect of registrable rights such as patents and trademarks, implement independent verification of ownership of those rights by undertaking relevant "searches" of ownership/title and registration details (registration number, jurisdiction and duration of the registration/monopoly) with the relevant intellectual property governance authority such as IP Australia.
- In respect of non-registrable rights, such as copyright, which have previously been acquired by the target company, ensure that such rights have been successfully transferred and documented. Verify contracts to ensure there is an effective assignment which is compliant with law and accurately and comprehensively describes the IP.
- Verify that IP developed by the target company has either been created by employees of the company or, where developed by consultants or other third parties, that an adequate assignment/transfer agreement is in place.
- Seek warranties/assurances of ownership from the seller as part of the sales transaction agreements.

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Brian Buss provides intellectual property solutions including: valuation, profit apportionment, expert testimony, economic analysis, and transaction advisory services for businesses, IP owners, attorneys and licensees.

With core skills in valuation, profit apportionment and financial analysis, Brian Buss leads strategic consulting and expert testimony assignments focused on intellectual properties and intangible assets, including trademarks, copyrights, patents, publicity rights, trade secrets, brand assets and technology assets.

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Doug is a Certified Licensing Professional (CLP), a Google Analytics Certified Individual (GAIQ) and is a current member of the INTA Right of Publicity Committee. Doug has been a named expert witness on 75 cases, deposed 20 times and has provided trial testimony 5 times. Doug specializes in calculating damages for copyright, trademark and publicity rights cases, as well as social media, Internet and defamation disputes.

Nevium specializes in intellectual property valuations and expert testimony. We provide the IP community with a visionary approach to calculating and communicating the financial impact of trademarks, copyrights, patents, brands and intangible assets.

For C-level Executives and In-House Counsel we provide IP valuation and portfolio strategies with a focus on connecting IP to financial performance and using IP to increase profits. For IP litigators we provide expert damages testimony that combines our knowledge of Internet and social media analytic tools with accepted methodologies and concise narratives.

QUESTION ONE

What is your best practice approach to IP due diligence as part of the deal making process? E.g. Schedule of IP and establishment of transferable ownership rights?

Valuation of key intangible assets should be a component of any due diligence process. Today's businesses rely on intellectual property (IP) and intangible assets to generate financial performance, with intangible assets typically accounting for a larger portion of overall enterprise value than tangible assets. An IP valuation improves deal making by providing both seller and buyer a clear picture of the key assets that drive financial performance. With an understanding of the relative values of key tangible and intangible assets, buyers can focus their due diligence on the key assets that will be acquired, and sellers can clearly present and communicate the financial and economic benefits of the assets they have built and developed.

Identification and valuation of key intangible assets at the seller will also focus overall due diligence efforts. Using valuation as a component of transaction due diligence enables transaction advisors to focus on how the most important assets at the target contribute to revenues, cost savings, profitability, and cash flow. As the buyer will become the owner of the seller's IP, a clear understanding and measurement of how that IP generates sales, profits and cash flows is essential in review and execution of any business transaction.

QUESTION TWO

Which methods of valuing patents, trademarks or trade secrets are most common in an M&A deal in your jurisdiction (e.g. cost, value or market approaches)? Any examples?

The process of valuing IP and intangible assets typically involves one or both of two calculation methods: the relief from royalty method and excess earnings methods. Both methods indicate the portion of profits achieved by the party using the IP that is contributed by the IP asset.

The relief from royalty method values IP assets using the context of a hypothetical negotiation where the IP user pays a royalty to an unrelated IP owner in an arms-length, willing buyer, willing seller IP license transaction. The relief from royalty method typically relies on benchmarks license agreements involving comparable assets. The amount of hypothetical compensation the IP user would be willing to pay, and the IP owner would be willing to accept, is forecast over the remaining useful life of the IP asset and future amounts are discounted to a present value using a discount rate reflecting the required rate of return for the subject asset. Essentially, this method provides an indication of the financial compensation one party would be willing to pay to use the subject IP asset. The amount of compensation, typically a royalty on financial performance, is an indication of the portion of profits expected to be achieved by the IP user that are derived from use of the IP asset.

Excess earnings methodologies focus on quantifying the impact of the IP asset on the party using the IP asset. For business transactions, excess earnings methods provide an indication of the profits achieved by the seller from its ownership of IP. In other words, if the seller owns and uses a recognized brand, an excess earnings methodology indicates the portion of total profits achieved from contribution of the brand assets. Excess earnings methodologies quantify how and when the IP asset is providing pricing power, driving increased sales volumes, and/or reducing costs. For example, a strong brand may not result in high price points or increased unit volumes but can be valuable if the brand reduces the business's overall marketing and advertising expenses.

QUESTION THREE

What warranties and indemnities do you recommend putting in place to ensure IP value is fully preserved?

With advance planning and evaluation, a seller should be able to warranty ownership of its key assets. Equally important, the seller should also be able to warranty ownership of "complimentary" intangibles. For technology assets, complimentary intangibles can be code, test results, trade secrets and other assets that complement and enable use of patented technologies. For marketing assets, complimentary intangibles can be domain names, social media pages, marketing procedures, customer lists and other assets that complement and enable use of registered marks and copyrights.

Through IP valuation buyers and sellers will identify those IP assets that provide the greatest contribution to total enterprise value. Thus, pre-transaction, sellers should confirm ownership of both the key identified IP assets and their complementary intangibles. This process of bundling IP and complementary assets enables more effective and transparent warranties.

Top Tips – To Accurately Establish IP Ownership Process

- For IP valuation, do not rely on only one valuation methodology. Valuation analysts should utilize multiple calculation methodologies and reconcile the differences indicated by each calculation.
- For establishing IP ownership in evaluating marketing assets such as trademarks, brands and copyrights, confirm ownership of domain names and social media sites. At too many businesses, domain name registrations and social media creation were outsourced, and management often assumes these assets are owned by the business. Its never too early to check, confirm and ensure website domain names and social media pages are properly owned by the business.

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A co-founder of K&K Advocates, Risti has broad expertise in the IP area. She has more than 20 years' experience providing assistance for Indonesian and foreign clients in a variety of IP projects. At the firm, Risti leads the IP Prosecution Team and oversees the Commercial IP practice group.

Admitted as IP consultant in 2006, Risti has handled prosecution of trademarks and geographical indications, industrial designs, copyright and patent; and enforcement of IP rights as well as led IP commercial projects, including providing advisory services with respect to franchising, licensing, distributorship, consumer protection, antimonopoly, as well as issues relating to media and data protection/privacy.

Established in 2011, K&K Advocates is widely recognised as one of the prominent law firms in Indonesia, with its main focus on IP. Currently, K&K Advocates consists of five partners, 24 associates, one foreign off-counsel, patents attorneys, and a number of paralegals and supporting staffs. We have strong and dedicated teams to handle both IP prosecution and non-contentious matters, and we have now expanded the practice to also cover general litigation and corporate technology matters.

Our client portfolio extends to cover a diverse range of industries, among which we have been continuously assisting a number of multinational clients on different matters in Indonesia.

QUESTION ONE

What is your best practice approach to IP due diligence as part of the deal making process? E.g. Schedule of IP and establishment of transferable ownership rights?

a. Prioritising the Objectives. This is important to understand the significance of the role IP plays behind the deal, and helps ensure that the due diligence is focused on the particulars of the deal and happens in a timely fashion.

b. Schedule of IP: Preparing an IP schedule that contains a complete and accurate list of all domestic and foreign IP applications and registration. An IP schedule is a crucial part as a base to define, examine and analyse the value of the intellectual property by examining the strength, scope and enforceability of the IP, the ownership rights surrounding the IP and the future potential to be derived from the IP.

c. Ownership and Status of IP: Ownership is often one of the first issues explored in an IP due diligence investigation since it can be a deal-breaker. Therefore, it is important to verify the following information:

- the status and validity (accuracy of the disclosed information) of all IP assets.
- the security interests and assignment clauses of the license agreements (i.e. who are the inventors? Did those inventors properly assign the IP rights?).

QUESTION TWO

Which methods of valuing patents, trademarks or trade secrets are most common in an M&A deal in your jurisdiction (e.g. cost, value or market approaches)? Any examples?

To date, there are no applicable regulations and institutions able to assess the value of intellectual property in Indonesia. However, based on developing practices, as intellectual property is categorised as an intangible asset, an IP owner may appoint a Public Appraisal Service Officer (KJPP) to carry out the assessment.

In general, IP assets can be valued based on the following approaches:

a. Income Approach

- The income approach determines the value of an asset in which the valuer, in this case KJPP, will assess the revenues earned by using the IP within a certain period. This valuation technique also converts the amount of potential future income and expenses by using such IP in business activities.

b. Market Approach

- The market approach determines the value of an asset based on the selling price of a similar asset. In practice, KJPP will study the most recent sales of similar assets and make a comparation between such assets. Since each asset being valued may not be identical, various adjustments possibly required.

c. Well-Knowness of IP (especially Trademark)

- For instance, if the mark was considered as well-known, the fair price assessed by KJPP is within the range of + - 5-7.5% of the valuation. Meanwhile, if the brand is not well-known, the fair price is in the range of + - 2 to 5% of the valuation.

We have conducted internet searches where we found several cases that are publicly accessible. There are several cases, one of which is the purchase of PT HM Sampoerna by PT Philip Morris Indonesia for Rp. 18.5 trillion or US$5 billion in 2005; and valuation data on a trademark license agreement between PT Sepatu Bata Tbk and its affiliate Bata Brands S.A. which data can be accessed through the website of the Indonesia Stock Exchange: **https://www.idx.co.id/StaticData/NewsAndAnnouncement/ANNOUNCEMENTSTOCK/From_EREP/201807/89edd1b-f56_9fb2b56cac.pdf**

QUESTION THREE

What warranties and indemnities do you recommend putting in place to ensure IP value is fully preserved?

a. To make sure that the IP is being used properly (to avoid non-use claim – for trademarks). Improper use of the IP may result in the loss of such IP rights.

b. Have all IP data well documented – determine all the IP assets of the business, where the assets are located, the license and renewal terms. These must be properly documented.

c. Establishing a good practice of signing a non-disclosure agreement – this allows a company to share its intellectual property with others without unduly jeopardising that information and, at the very worst, these provide insurance that legal action can be taken if the information is leaked.

d. Keep the information confidential – it is important to keep the idea/invention confidential until it is protected. For instance, if we intended to obtain a patent or design protection, we need to safeguard and maintain secrecy of such information until we have filed the application (i.e. public disclosure may result in the immediate loss of invention patentability unless a patent application has already been filed).

e. Adequate security system – sensitive IP assets should be managed only by those with a need to know. Limit the number of copies of sensitive IP and strongly encrypt and control who has access to specific information.

f. Closely monitoring competitors and IP infringement – it is important to always keep an eye out for anyone who may infringe IP, as this can negatively affect market share and quickly jeopardise the IP value and reputation.

Top Tips – To Accurately Establish IP Ownership Process

- Conducting IP searches prior to filing
- Have a clear consensus of all parties involved in anything IP-related
- Monitoring the progress of IP applications (until registered)
- Register the IP, and make sure to put clear identification if having it published
- Regular market checks – for potential conflicting trademarks and IPs
- Proper underlying agreements, when contracts are involved.

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Alejandro Castro is the Managing Director of Union Andina Intellectual Property Solutions. He is in charge of national and international relationships, providing strategic counsel for the management team and legal department. His practice focuses on trademarks, unfair competition law, advertising law, patents and plant varieties. Likewise, he has experience on cross-border IP litigation issues, specifically on trademarks. Alejandro represents national and international companies on different aspects of their IP assets within a broad range of industries.

Union Andina Intellectual Property Solutions has more than 25 years in the legal market managing portfolios of trademarks and patents nationally and in Latin America. Time has allowed us to represent cases of different legal nuances, which is why we have the legal expertise to achieve the most creative and efficient solutions. We are currently legal representatives of several international companies. Similarly, we have strong relationships with leading European, Asian and US law firms.

QUESTION ONE

What is your best practice approach to IP due diligence as part of the deal making process? E.g. Schedule of IP and establishment of transferable ownership rights?

An essential element before starting an IP audit is entering into a confidentiality agreement that protects the interests of the parties by revealing sensitive information in the negotiation process. In this contract, both the receiving and the discloser party will try to define the elements involved under the concept of confidentiality, the protection mechanisms such as the penalties for breach of obligations, the possibility of applying to court to claim compensation for damages, and determine the term of the contract.

Likewise, if part of this confidential information is considered secret it will be governed by our Andean Community Intellectual Property Regime and National Law and taken as an industrial secret. In this case, in addition to the previously mentioned protection mechanisms, the holder shall have the right to file a complaint with the Commission for Repression of Unfair Competition.

On the other hand, the most relevant IP rights are distinctive signs, patents, copyrights, and industrial secrets. As part of the audit we identify the number of rights involved, the ownership, the validity, the existence of licenses; as well as the existence of contentious procedures and administrative burdens associated with each right.

In the case of distinctive signs and patents, a fundamental step is to verify the resolution granting exclusive rights. In particular, we focus on the description of the classes and the claims granted for distinctive signs and patents, respectively. In this way, we validate whether these rights are in fact in accordance with the terms and objectives of the negotiation.

Copyright and industrial secrets deserve particular attention. For the former, the identification of ownership and paternity will depend to a large extent on the assignment contracts and the physical or digital supports, including blockchain certificates, that allow verifying the creation date; as well as the registration certificates registered with the competent authority, which is optional in our jurisdiction.

QUESTION TWO

Which methods of valuing patents, trademarks or trade secrets are most common in an M&A deal in your jurisdiction (e.g. cost, value or market approaches)? Any examples?

Of the 3 valuation methods, the most reliable is the one focused on the market. However, its execution basically depends on access to information or reliable data of similar transactions. Thus, identifying transactions on patents, trademarks or software that have characteristics that are very similar to the asset to be valued is complex in Peru because it is a jurisdiction where the number of transactions on intangible assets is minimal, and the majority of legal entities are closely held corporations.

Notwithstanding this, the most used valuation method in mergers and acquisitions in Peru is the discounted cashflow approach. In particular, to determine the income attributable to the brand, the royalty saving method is usually applied, for which it will have to take into consideration royalties from other similar brands under the same category of the relevant industry, using a national or international database.

However, in the case of patents and copyrights (software) it will be important to consider the term of validity of IP Rights:

1. Patents: 10 years for utility models and 20 years for patents of invention. In both, the term of protection is counted from the filing date of the application.
2. Copyright: life of the author plus 70 years after his/her death.

Because the licensing of patents and copyrights (software) is less common in the Peruvian market, it will be important to take into consideration other approaches such as the Monte Carlo method that allows generating a series of possible expected values in different probable scenarios, the Real Option Method or the Binomial tree model.

QUESTION THREE

What warranties and indemnities do you recommend putting in place to ensure IP value is fully preserved?

In Peru, the value of Intellectual Property can be ensured by 2 means: administrative actions and legal actions to request compensation.

Thus, Intellectual Property in Peru is regulated at an administrative level making it possible to request precautionary measures, initiate actions for infringement and request corrective measures in the market. These administrative measures have the function of guaranteeing IP Rights. It is important to point out that the administrative authority does not have the power to order compensation. Therefore, it will be necessary to apply to the Judiciary once a consensual resolution is obtained at the administrative authority.

Regarding this last aspect, it is important to point out that in order to calculate the compensation, whether under a contractual or extra-contractual liability regime, it will be important to determine the consequential damage (economic losses on assets), loss of earnings (profits not received due to the damage) and moral damage (possible also for legal persons).

We emphasize that in the FTA concluded with the United States, Peru has specifically committed when it comes to copyright infringements, related rights and trademark counterfeiting. The infringer pays the right holder the profits obtained attributable to the infringement and when determining the amount of compensation, judicial authorities shall consider, inter alia, the value of the infringed-on good or service, according to the suggested retail price or other legitimate measure of value submitted by the right holder.

One of the outstanding points by the Peruvian State is to establish or maintain pre-established damages, which shall be available on the election of the right holder as an alternative to actual damages with respect to infringement concerning copyright or related rights and trademark counterfeiting.

Top Tips – To Accurately Establish IP Ownership Process

- It is important to consider the Andean Community market and analyse the IP Rights status in Colombia, Ecuador, and Bolivia. This will provide a deeper insight when facing any regional negotiations and the chance to identify any roadblocks that could impact the operation.
- For sales/acquisitions of Intellectual Property Assets among companies of the same business group, transfer pricing should be spotted right away. Peruvian Law is aligned with the OECD recommendations, making the complying process reasonable and predictable for companies, ensuring the value of the IP asset within the operation.
- It is relevant to analyse if there is any co-ownership. This fact could delay negotiations because to transfer an IP asset as a unit all co-owners must agree on it. Another related issue is that each owner is entitled to an "ideal quota" and can assign it to external parties without consent of the other co-owners, making it harder to negotiate.

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Karin Klempp Franco, partner at Barcellos Tucunduva Advogados, provides legal advice on intellectual property, information technology, privacy and data protection, corporate law, commercial contracts and M&A to a range of international clients. LL.M. in International Economic Law (University of Cologne, Germany), Ph.D. in Commercial Law (University of São Paulo Law School, Brazil), Professor of Law in Intellectual Property, Contracts, Corporate Law, ADR/Arbitration and Privacy and Data Protection at University Facamp, Brazil. She's a registered mediator, arbiter and specialist at several Brazilian dispute resolution centres specialising on intellectual property. Recognition: Chambers Latin America, Chambers Global, Leaders League, Best Lawyers, Análise 500 Advocacia.

Established in 1954, Barcellos Tucunduva Advogados has tried and true experience in business law with a work ethos based on seeking practical results for the client. The firm is distinguished by its professionals' high level of qualification and excellence in their work that aims to find the best solution for clients' specific needs. The firm has been ranked in several national and international – most recognised firm lists for numerous years.

QUESTION ONE

What is your best practice approach to IP due diligence as part of the deal making process? E.g. Schedule of IP and establishment of transferable ownership rights?

Intellectual property can dramatically increase the value of a company and turn a medium-sized company into a leader. In certain circumstances, the IP itself is the reason for a deal, for example when the target has built a reputation or developed a cutting-edge technology. Hence, there is no doubt about the importance of identifying the main intangible assets of the target company and if they are sufficiently protected.

The scope of an IP-oriented due diligence must include information related to the target's IP according to a checklist prepared by the support office. This includes a schedule of registered and pending trademarks and patents, copyrights, software and algorithms, if there are any existing IP license agreements and supporting assignment documentation, and lists of registered domain names and relevant unprotected know-how and trade secrets, among others depending on the company's core business.

Understanding the core business and technology employed for its activities is paramount for the IP due diligence. The due diligence team must analyse the information and documentation provided and conduct additional checks and searches as applicable to ensure the information is complete. It is important to establish sufficient evidence of ownership of IP, which may be tricky for long-acquired rights and for technology initially developed by one of the shareholders that was incorporated in the company´s business, for example. The search in a due diligence is for risks and threats to IP ownership, use and enforceability. The report compiles the risks that may be found, as well as mitigation and asset management suggestions, like the execution of IP assignment instruments, non-compete agreements and royalty-free license agreements recognising a factual situation. Losing the registration of a trademark or patent, or the right to use certain technology can make a business unfeasible and end a buyer or investor's interest in a target company.

QUESTION TWO

Which methods of valuing patents, trademarks or trade secrets are most common in an M&A deal in your jurisdiction (e.g. cost, value or market approaches)? Any examples?

Despite the practical difficulty in valuing intangible assets due to the range of variables affecting their worth, there are some common strategies in Brazil for their valuation to lessen future uncertainty and the discrepancy of results. The main methodologies used for Brazilian deals are based on expected income, market value and/or costs for development. In income-based methodologies, the asset value is a function of how much the rightsholder could reasonably expect to receive upon licensing the IP to a third party, on the profit necessary to attract an investor, on the capitalisation of future profit flow premiums attributable to IP or on the profits earned by the use of the IP itself. When based on market value, the methodologies use the profits derived from exploitation of the IP or its expected turnover in certain market conditions. Finally, the cost-based valuation methodologies start from an estimate of the amounts and resources invested in the development of the asset. There is, however, no one correct or preferred methodology. The choice relies on the parameters used by the company to calculate the values of its assets, context and specificities of the case at hand, which may deem one or more bases for valuation more adequate than others. Other than that, in Brazil it is very likely for market researchers, analysts and rankings to base their conclusions on information of profitability of the company and the contribution of certain intangible asset to these numbers (i.e. income-based methodologies). For example, according to the Brazilian version of the BrandZ ranking, the most valuable Brazilian brand is "Itaú" (finance), currently valued at US$8.2 billion, according to Kantar based on Bloomberg data.

QUESTION THREE

What warranties and indemnities do you recommend putting in place to ensure IP value is fully preserved?

Other than due diligence accompanied by specialised lawyers to validate the IP information sent by the target company, it is important to accommodate the risks of the deal through appropriate documentation. Representations and statements of responsibility of the target company on the lawfulness of the IP, its validity and absence of disputes regarding ownership is a must-have. The company should also be queried to sign-off registered IP rights, such as trademarks and patents, in a separate document to expedite annotation of the assignment at the Brazilian Patent and Trademark Office to the acquiring company. The company and their shareholders, if feasible, or owners should also be bound to specific duties to compensate the new rightsholders in case of a dispute arising for ownership of rights or a suit to invalidate their registration, as well as any other risks found out during the due diligence. Non-compete, non-solicitation and specific confidentiality duties may also be helpful to ensure the protection of the value of intangible assets, especially when dealing with know-how and trade secrets.

Top Tips – To accurately establish IP ownership process

- Know which IP is subject to protection through a registration process (patents and trademarks), through secrecy (trade secrets), or upon simple creation and use (copyrights and trade dress).
- Clearly establish the chain of assignment of rights from the developer(s) all the way through the present rightsholder since most kinds of IP require written agreements and annotations for full effect of the assignment.
- Keep in mind that written agreements are needed for a company to fully own the copyrightable works of their employees, even if the creation of copyrightable works is included in their job description.
- Be active in the protection of the trademark and patent portfolios, registering all appropriate variations of the trademarks for all applicable goods and services, and all relevant additions to patented inventions.
- Keep trade secrets confidential and use nondisclosure agreements, clear labeling of confidentiality and adopt information security best practices.

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