Alternative Uses for IP in Private Company Sales

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Many transactions today are all about intellectual property (IP). It may be the only real asset of any value, but it can serve multiple purposes in modern M&A negotiations. Beyond its obvious place in or out of the shopping cart, savvy negotiators can use various IP rights in place of, and as enhancements to, crucial aspects of the deal itself.

Practicing Law Institute's recent program on Acquiring or Selling the Privately Held Company 2015 featured a session chaired by Ari Lanin of Gibson Dunn. He covered some of the special considerations that come up in the world of carve-out transactions, including inventive uses of IP acquisitions.

What's a Carve-Out?

Carve-outs are similar to a full corporate acquisition, with the obvious distinction being that only a part of the target company is sold. It sounds simple, right? Maybe, but integrating a portion of a target can raise complications.

For example, one difficulty is the risk that the seller may be able to simply recreate the asset. The seller presumably has the expertise to do that. The seller often also has a healthy hoard of cash from the sale.

Needless to say, any buyer with the newly acquired key IP would be appropriately miffed to find that the seller is competing against the buyer. The traditional fix for this problem, of course, are covenants not to compete. But such covenants have drawbacks that may make them less comforting than one might think.

For example, there is often a host of statutory and common law limitations on the scope and effect of such covenants. It can sometimes seem a terribly regulated field, not unlike employment law where one must tread very carefully. As a result, it is worth considering the extent to which key IP can functionally create the effects of a covenant not to compete.

The goal is to bypass or obviate the usual covenant limitations. In the simplest case, suppose that the target division uses a patent owned by the selling parent. Let's say that the buyer purchases the patent.

In the aftermath of the sale, the seller will presumably have no way of getting back into the market without first creating an alternative patent. In a more complex case, there may be no patent for the buyer to purchase. But the seller's know-how, customer lists and other rights to the necessary technology and expertise can have some of the same protective effects for the buyer.

The goal is to take the normal covenant not to compete morass out of the common law and overlay it with hopefully more reliable IP protections. More protections are always better than fewer. And they can often work in tandem, belts and suspenders.

Related concerns arise in Transition Services Agreements (TSAs). TSAs are crucial side agreements that govern how the target division will be run in the period between signing and closing. Early negotiation of a TSA can spell the difference between the success and failure of a deal.

Careful buyers and sellers will think about how to manage the transition. They will identify the assets that have to be transferred, retained, licensed or otherwise split between the two companies. Knowing how the seller plans to separate from the division in the transition period can give the buyer clues about which assets they need. This isn't just to function and run the acquired business. It is also to effectively keep the seller out of the market after the deal is concluded. Likewise, the seller can negotiate for concessions or for a higher price in return for limiting their ability to use the target division's IP. Well-advised buyers and sellers think not only about the assets and conditions, but also the long-term strategic use of rights acquired in the transaction.

PLI's course Acquiring and Selling a Privately Held Company 2015 is available at *www.pli.edu*.