Legal Aspects of Classification of Intangible Assets in Merger and Acquisition Deals in the Telecommunications Sector

Abstract. The article is dedicated to legal aspects of classifying and describing intangible assets in merger and acquisition deals for telecom companies. The absence of proper legal coverage of the issue in Russia leads to considerable discounts on asset value in such deals, which is especially evident because Russia is the leader in their volume among Eastern European countries. An important part of these deals is classification of acquired tangible and intangible assets, intellectual property, including authors’ rights, patents, other components of business model innovations, and their further reclassification.

But today many aspects of digital product creation do not have a detailed and clear description in the Russian legislation, however, they should be clarified and included in the legal documentation for these deals so as to make the most of the deal closing. The starting point of the research in this article is the practical experience of developing professional standards for the creation of intangible assets in content production. Nowadays, the focus in developing professional standards is on the product created, not on the description of the processes involved.

When developing the professional standard for audiovisual translation, the product creation process was analyzed from the point of the activity, which helped to increase the legal protection of created products. The stages of audiovisual product creation and localization were identified and their legal aspects were described.

The legal description of stages of intangible asset production also resulted in defining frameworks for many new professions including game translators, dubbing editors and audiovisual translators.

Annotazione. Статья посвящена правовым аспектам классификации и описания нематериальных активов в сделках по слиянию и поглощению в телекоммуникационной отрасли. Отсутствие надлежащего юридического описания данных видов активов ведет к тому, что в ходе сделок данные активы вносятся в структуру бухгалтерских балансов со значительным дисконтированием, что особенно неприятно в силу того, что Российская Федерация лидирует среди стран Восточной Европы по объему сделок по слиянию и поглощению. Важной составной частью таких сделок является классификация приобретаемых материальных и нематериальных активов и интеллектуальной собственности, включая авторские права, патенты, и другие компоненты инновационного цикла бизнес-моделей.

Тем не менее сегодня многие аспекты создания цифровых продуктов не отражены в законодательстве РФ с достаточной четкостью и однозначностью, при том, что для завершения сделок описания этих активов должны быть выполнены полностью и не допускать разночтений в документах, сопровождающих сделку. Отправной точкой исследования, проведенного в данной статье, стал практический опыт автора по разработке профессиональных стандартов создания нематериальных активов в ходе производства цифрового контента. Ранее акцент в рамках правовой практики делался не на процессах, задействованных при создании, а на конечных продуктах.

При разработке профессионального стандарта для аудиовизуальных переводчиков, создание конечного продукта было проанализировано с точки зрения видов деятельности, результатом которых он стал. Это позволило увеличить правовую защиту всех конечных и промежуточных продуктов. Были выделены этапы создания аудиовизуальных продуктов их локализации и описаны правовые аспекты каждого этапа.

Данный подход позволил также определить правовые рамки нескольких новых профессий, таких, как аудиовизуальный переводчик, переводчик игр и переводчик-укладчик дубляжа.

Key words: corporate law, merger and acquisition deals, intangible assets, professional standards, legal protection, audiovisual product creation, concentration of production

Ключевые слова: корпоративное право, сделки по слиянию и поглощению, нематериальные активы, профессиональные стандарты, создание аудиовизуальных произведений, концентрация производства

This article is dedicated to legal aspects of classifying and describing intangible assets in merger and acquisition deals for telecom companies. The absence of proper legal coverage of the issue in Russia leads to considerable discounts on asset value in such deals, which is especially evident because Russia is the leader in their volume among Eastern European countries. Besides it is noteworthy that in content production within the telecom sector, production companies and broadcasters enter into contractual relations identifying a great deal of the following copyright works as intangible assets: films, series,
musical works, characters licensed for use by third parties. Not only equipment, securities, buildings, etc. are assets in this sector of the economy. For instance, according to Global Licensing Group\textsuperscript{11}, the proceeds from the sale of all the rights to the ‘Masha and the Bear’ Russian cartoon series in 2019 accounted to 330 million US dollars\textsuperscript{12}. The starting point of the research in this article is the practical experience of developing professional standards for the creation of intangible assets in content production\textsuperscript{13}.

The issue of merger and acquisition deals is topical as the integration of markets and business entities will be a natural response in the post-pandemic period coinciding with the economic crisis in developed and developing countries enveloping at an unprecedented rate\textsuperscript{14}. Integration may mean establishment of new legal entities (enterprises, trade, marketing and service centres, regional divisions, innovation testing laboratories, etc.) or merger and acquisition deals representing strategic options for external development. So, now integration is one of the most important growth options for companies.

It is worth mentioning that now mergers and acquisitions address a dual challenge, the high risks at the stage of innovation development and the practical need to obtain additional funding at the stage of ‘monetization’ activities.

The issue of mergers and acquisitions is interesting in terms of economics as the amount of such deals is now growing fast against the background of rapid digitalization of the economy and an increase in the share of knowledge work in the added value and the value of assets. An important part of these deals is classification of acquired tangible and intangible assets, intellectual property, including authors’ rights, patents, other components of business model innovations, and their further reclassification.

But today many aspects of digital product creation do not have a detailed and clear description in the Russian legislation, however, they should be clarified and included in the legal documentation for these deals so as to make the most of the deal closing.

Let us mention that, in industries with such ‘production output’ as a great amount of intangible assets and, in broader terms, intangible ‘products’, including the Russian telecom sector, the main motives for mergers and acquisitions are:

- Acquisition of complementary assets (broadcasting licences, platforms with a greater amount of subscribers and well-equipped cinemas are crucial for the broadcasting, cinema and streaming markets; KARO Cinema Chain may serve as an example\textsuperscript{15}).

- Use of management skills (especially in the film industry, where it is easier to buy a company and keep its management staff. For instance, Lionsgate bought Starz, a company that produced a number of the top Netflix series in 2019\textsuperscript{16}).

- Establishment of partnership or involvement of a strategic partner (synergy of new partners has a positive impact on the great amount of projects targeted for international audience, like in case of acquisition of Aeroplane Productions by Riki Group. Two companies are correspondingly creators of the ‘Fixies’ and ‘Kikoriki’ (‘Gogoriki’) animated series\textsuperscript{17}).

What do content production and broadcasting companies gain from these deals [8]?

Firstly, such deals mean integrating the functions that become overlapping after the companies join, for instance, the functions of marketing, supply, cash flow management. The general efficiency of activities increases meaning operational savings.

Secondly, these deals result in the reduction of costs due to an increase in quality management and coordination of the whole ‘process chain’, in particular

\textsuperscript{11} The Global Licensing Group is the worldwide licensing industry’s leading trade show organizer and media partner. [electronic resource]. Available at: https://www.licenseglobal.com/licensing-events/global-licensing-group (date accessed: November 01, 2020).

\textsuperscript{12} Online version of the Advance Media New York magazine. Article ‘Masha and the Bear: Russian cartoon takes the world by storm’ [electronic resource]. Available at: https://www.syracuse.com/tv/2016/04/masha_and_the_bear_russian_cartoon_popular_world.html (date accessed: November 01, 2020).

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\textsuperscript{14} McKinsey & Company’s official website. McKinsey & Company is a global management consulting firm committed to helping organizations create Change that

\textsuperscript{15} KARO Cinema Chain. About the company. [electronic resource]. Available at: https://karofilm.ru/about (date accessed: October 30, 2020).


\textsuperscript{17} Online version of the Kommersant newspaper. Article «‘Gogoriki’ and ‘Fixies’ become relatives» [electronic resource]. Available at: https://www.kommersant.ru/doc/4266899 (date accessed: October 30, 2020).
due to increase in control over the entire process. Vertical integration leads to better fulfillment of contractual obligations.

The two gains mentioned above are not the only effects of merger and acquisition deals for the content production industry. We should note such efficiency indicators as:
- concentration of production that provides a competitive advantage;
- redistribution of assets to achieve more efficient management;
- financial recovery of companies in general.

What are primary differences between mergers and acquisitions?

In case of a merger, one company buys a stake in another company. This stake does not give to the buyer total control over the target company, but the buyer gains sufficient influence over the company’s management and builds motivation to maximize the profit of the acquired ‘entity’. At the same time, the companies taking part in the merger stay legally independent.

Unlike mergers, acquisitions mean buying the majority stake in the target company. As a rule, if the ordinary shares acquired constitute more than three fourths of all the issued shares, the target company loses its independence in a formal, legal sense.

It should be mentioned that in case of both mergers and acquisitions, the so-called target company represented by its management staff loses its independence in identifying strategic areas of corporate development and in acting on such tactical issues as, for instance, choice of suppliers and buyers of the end ‘product’, establishing product prices and payment conditions, and some other issues.

So, in case of acquisition of the third-party company, it appears to be ready for diversification and (or) change of business activity.

In case of acquisition by an investment company, the possible reason for it may be a certain potential for increase in financial and commercial efficiency of the acquired company.

However, the cases mentioned above require a sufficiently accurate evaluation of assets including the intangible ones.

**Description of intangible assets in merger and acquisition deals, in particular those made in the telecommunications sector**

The term ‘intangible assets’ may be interpreted as ‘corporate wealth of knowledge creating a certain differential advantage’ or ‘competence skills of the company’s employees that they use to better serve the customers’ needs.

There can be different grounds for classification, but we would single out the following essential ‘components’ of any intangible assets:

1. **Human capital** - employees that have necessary knowledge, competence and skills which in most cases may be a determinant of the company’s success in the highly competitive market.
2. **Information capital** - the company that has highly efficient information systems and networks, databases, archives and software.
3. **Organization capital** - the company that is capable of implementing and maintaining required business processes. Organization capital is a tool to join intangible and tangible assets together so that the company’s practices could run smoothly for the company’s strategic development goals to be achieved [9].

The mentioned human, information and organization capitals of the company together are a determining factor for boosting profitability that is the company’s competitive advantage in today’s markets.

Ownership of a large amount of intangible assets (high-quality customer base, special management practices and technologies, research experience, professionals with unique skills, high-potential copyright works) had a positive impact on the cumulative non-ordinary return of the companies almost in all merger and acquisition deals initiated in 2009–2020 within the BRICS markets, including the Russian Federation18.

Let us note that if the acquiring company in a high-technology sector has a large amount of intangible assets, given that merger is carried out according to the law, this helps that company use the assets in the acquired company and avoid, in particular, ‘reverse toxicity’, when, say, bad (outdated) business and sales organization practices are spread in the acquiring company slowing down its growth and ‘poisoning’ the up-to-date organizational culture [6].

As for the practices in the telecom industry where intellectual property and intangible assets are of great importance, the financial recovery processes started with the help of merger and acquisition deals are directly related to legal aspects of describing such property and assets as this influences the entire business planning procedure.

This is related to the unique characteristic of such property and assets. The conflict between facilitating the creation of intellectual property and providing access to it, that has been found out during a common economic analysis by the intellectual property institute, is based on the correlation between the fixed and variable values of such property. Creation of intellectual property is expensive, but the expenses incurred by the creator of such property stay unchanged in relation to the product ready for manufacturing, and they are a fixed amount. Unlike the expenses incurred in relation to creation of intellectual property, the expenses changing along with the cost of the end

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18 The Institute for Mergers, Acquisitions and Alliances (IMAA) is a not-for-profit think tank for Mergers & Acquisitions which pursues research and provides educational certificate programs, workshops, resources, and expert knowledge in the field of M&A.

product, i.e. those related to sale of intellectual property to customers, are often quite low, they are less than the fixed expenses. If the produced content is distributed via social media and the web, the variable expenses and, hence, the margin value often tends to zero in case of a high interest of target audiences.

So, the margin value (i.e. the market value) of intellectual property depends on the following:

- **Existence of a brand** for which the customer is ready to pay a higher added value and which should be described in detail from the legal point of view not only as an asset, but as an element in the procedure of its use;

- **Legal protection of all the components of intellectual property** (original methods, patents, inventions) and all the contributors to the creation of intellectual property (‘collective authorship’) identified according to the Russian civil law.

Lack of proper legal interpretation of the brand use and structured complex protection of intellectual property leads to the following issues:

- Inability to ensure independent fast growth of businesses creating intellectual property due to low margin value and low profit share, in simple terms, due to the distribution of pirate copies.

- Lack of investment potential of Russian companies creating intangible assets and intellectual property as the lack of proper legal interpretation does not allow for a proper evaluation of their value in terms of the deals.

- Weak position of Russian companies in terms of merger and acquisition deals, especially those involving foreign partners due to greater legal certainty and complete description of the structure of intangible assets belonging to foreign companies [5].

We would like to dwell on development of professional standards, one of the most important ways to provide complex legal support for classification of intellectual property in the telecommunications industry.

Let us consider the example of developing a professional standard for audiovisual translators as one of the authors of the article was actively involved in the process.

The professional standard for audiovisual translation is crucially important as the translation quality and the level of professional expertise have a great influence on the marginal value of the Russian export television and film content. Today federal and regional authorities pay much attention to boosting the export in this field, but banking chains and finance companies, for instance, do not really understand how to deal with the created intangible assets and run merger and acquisition deals between Russian and foreign producers of this content.

This is due to absence of formally documented professional standards for a certain number of professions involved, for instance, in the production of animated products being very popular in the global market, such as the animator, character designer, localization translator.

Nowadays, the focus in developing professional standards is on the product created (for instance, the translated content), not on the description of the processes involved. There is a conflict of law in the field of film localization: if the end product of translation is, for example, a dubbed audio track or a subtitle track, but, apart from the translator, an actor, a sound engineer and a subtitler were involved into their creation. Neither of these professions is regulated by professional standards (unlike similar foreign professions). Foreign standards describe in detail the processes of creating the product and the functions of a translator and other professions that have not been described previously.

When developing the professional standard for audiovisual translation, the product creation process was analyzed from the point of the activity, which helped to increase the legal protection of created products. The stages of audiovisual product creation and localization were identified and their legal aspects were described, which allowed to specify them clearly as intangible assets [19].

This, in particular, has had a positive impact on the proceeds from sale of Russian animated content in the global market [20].

The respective figures of sales of other products have also grown substantially (products by Sreda Production Company, Yellow, Black and White Group) [21].

Besides, even in the crisis and post-pandemic conditions, merger and project co-production deals in this sector are still growing in number in Russia due to increase in legal transparency of such assets.

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Summary

Describing intangible assets in legal terms is a crucially important task today, that has to be studied more thoroughly, in particular, in relation to the legal environment in Russia, the country becoming one of the leaders in the global content production market and remaining, as we have already mentioned, a leader in the amount of merger and acquisition deals among Eastern European countries. At present, the structure of circular flow of the economy and production is getting more complex as it is involving intangible assets in view of the newly identified needs. All new intangible assets are involved into the circular flow, become the goods, acquire the respective legal status and, finally, become an important asset of an individual or a company.

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