

Antitrust Angle: Antitrust Implications of Mergers and Acquisitions Involving Intellectual Property

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Much attention is focused, as it should be, on the antitrust analysis of an acquisition of an on-going business or physical assets. The antitrust implications of an acquisition involving intellectual property, however, tend to be overlooked. This can be costly. Intellectual property issues can pose hidden risks and traps for the unwary, but may also present affirmative opportunities to obtain antitrust clearance. The potential implications extend not only to the substantive antitrust assessment of mergers and acquisitions, but also to whether pre-merger filing and waiting-period requirements are triggered and how due diligence is conducted.

As our economy continues to evolve, the importance of transactions involving intangible assets will continue to grow. M&A lawyers are likely to find it increasingly helpful to be aware of the potential implications of antitrust law for transactions involving intellectual property.

Substantive Antitrust Analysis

Intellectual property is likely to have a significant impact on multiple aspects of anti-

trust analysis of mergers and acquisitions. Two of the most important are market definition and evaluation of potential anticompetitive effects.

A. Analysis of Relevant Markets

Antitrust analysis typically begins with identification of the relevant market or markets in which any effects of a transaction are likely to occur. While most transactions

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involve one or more markets for physical products, many transactions also impact ongoing innovation as well as intellectual property protecting that innovation. In a number of transactions, the U.S. Department of Justice (“DOJ”) and the Federal Trade Commission (“FTC”) have placed particular emphasis on analysis of intellectual property rights when defining and analyzing the relevant market. In addition to considering intellectual property rights as part of a relevant product market, the DOJ and FTC have defined technology markets and innovation markets that focus on IP licensing and innovation, respectively.

Product Markets. In traditional markets, firms may compete primarily in the manufacture and sale of physical products. Antitrust analysis often focuses in considerable part on market activities relating to the relevant physical products. Yet intangible assets can have a critical impact on the analysis of such product markets. Intellectual property rights may create obstacles to entry by new firms, thus exacerbating any competition problems. For example, the DOJ decided to challenge the proposed acquisition by Franklin Electric Co. of United Dominion Industries not only because the proposed transaction appeared likely to reduce competition in the market for submersible turbine pumps, but also because Franklin Electric’s patent portfolio appeared likely to deter new entry into the market. After trial, a district court granted the DOJ’s motion for a permanent injunction.¹ Similarly, the DOJ challenged the proposed acquisition by 3D Systems Corporation of DTM Corporation in part because “the two companies held extensive patent portfolios that likely created an insuperable entry obstacle” into the market for industrial rapid prototyping systems.² The matter was resolved by consent decree. Conversely, DOJ decided not to challenge Cinram International Inc.’s acquisition from AOL Time Warner Inc. of assets for the replication of CDs and DVDs in part because the technology necessary for entry into the market was readily available for license from patent pools.³

Technology Markets. Certain transactions may involve a technology market – that is, a market in which companies compete to license rival intellectual property. Complicated situations can arise in industries such as computers, electronics and chemicals,

where intellectual property licensing is not necessarily the primary line of business of the acquirer or the target but nevertheless may be vitally important to competitive conditions. In such instances, intellectual property portfolios may constitute a relatively small portion of the parties’ business, but the DOJ and FTC may define a technology market separate from the product markets in question,⁴ with potentially important consequences for the antitrust analysis.

A leading example is the FTC challenge to a proposed joint venture combining the respective polypropylene businesses of Montedison S.p.A. and Royal Dutch/Shell.⁵ Although the two companies held only a moderate share of the production of polypropylene, they were leading licensors of polypropylene technology to other producers. On a combined basis, the technologies licensed by Montedison (together with its partner Mitsui Petrochemicals) and Shell (together with its partner Union Carbide) accounted for over 80% of all existing and projected polypropylene capacity. The FTC’s consent order required Royal Dutch/Shell to divest its polypropylene assets, technology and licensing business to Union Carbide or another approved buyer.⁶ Similarly, six years later, the FTC applied a similar analysis to the proposed formation of a joint venture by Union Carbide and Dow Chemical. Union Carbide was the leading licensor of technology used in the production of linear low density polyethylene, and developed related metallocene catalyst technology in a joint venture with Exxon. BP was the only other significant licensor of polyethylene reactor technology, and was working with Dow to combine Dow’s metallocene technology with BP’s polyethylene process. The FTC’s consent order required Dow to divest its intellectual property relating to gas phase polyethylene production and to license to BP, with the right to sublicense, its metallocene catalyst technology.⁷

Recent cases involving computer software also involved licensing activities, but the DOJ and FTC did not define separate technology markets because the parties’ product lines and intellectual property licensing activities were inseparable. The agencies defined product markets in a manner that captured the parties’ licensing activities, thus eliminating any need to define separate technology markets. The highest-profile example in recent years was the DOJ’s

challenge to the acquisition by Oracle Corporation of PeopleSoft, Inc. The DOJ and seven states argued that the transaction would reduce competition in the market for licensing of certain high-function enterprise software to large enterprises. Following a lengthy investigation, pre-trial discovery, and 20 days of trial and argument, the U.S. District Court for the Northern District of California held that the DOJ and the seven states had failed to establish that the acquisition was likely substantially to lessen competition in a relevant market.⁸

The FTC has challenged two consummated acquisitions by companies engaged in the development and licensing of software. *Aspen Technology* involved a post-closing challenge to the acquisition by AspenTech, the leading licensor of manufacturing, engineering and supply chain simulation software, of Hyprotech, its closest competitor in the development and licensing of such software.⁹ Similarly, the FTC issued a complaint challenging MSC Software Corporation's completed acquisition of two rival licensors of specialized engineering structural analysis software known as Nastran.¹⁰ Although

none of these transactions was sufficiently large to require a premerger notification, the FTC launched full investigations after it learned of the transactions and ultimately decided to file suit against each of the acquirers in order to force a divestiture. In each case, following extended pre-trial discovery and shortly before trial, the acquirer entered into a consent agreement whereby it agreed to divest the software licensing business it had acquired.¹¹

Innovation Markets. In the absence of licensing activities, the agencies may seek to challenge a transaction that threatens to limit future competition to develop intellectual property. The DOJ and the FTC have formulated the concept of "innovation markets" to describe competition among companies with respect to research and development relating to future products.¹² The concept was first applied with respect to innovation in heavy vehicle transmissions in the DOJ's challenge to ZF Friedrichshafen AG's proposed acquisition of General Motor's Allison transmission business.¹³ The DOJ's complaint cited a ZF Friedrichshafen document identifying two ways for ZF Friedrichshafen to counter greater competi-

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tion from Allison: develop a stronger product line, or acquire Allison.¹⁴ Following the DOJ's challenge, the parties abandoned the transaction.

A leading example of an innovation market analysis can be found in the FTC's challenge to the proposed merger of Ciba-Geigy Limited and Sandoz Limited to form Novartis AG. Although no gene therapy products had been approved for sale by the Food and Drug Administration, the FTC alleged that the research and development of future gene therapies was a relevant line of commerce in which to analyze the transaction. With respect to a number of specific gene therapies, the FTC asserted that Ciba-Geigy and Sandoz "control[led] critical proprietary intellectual property portfolios, including patents, patent applications, and know-how."¹⁵ The FTC alleged that the merger likely would "reduce innovation competition among researchers and developers of gene therapy products," as well as "heighten barriers to entry by combining portfolios of patents and patent applications of uncertain breadth and validity, requiring potential entrants to invent around or declare invalid a greater array of patents."¹⁶ The matter was resolved by a consent decree pursuant to which the merged entity agreed to license gene therapy technology and patent rights to an identified third party, and to license certain specified patents to any interested person at a reasonable royalty.¹⁷ In the late 1990s, based in part on threatened reduction in innovation, the agencies challenged transactions in the chemical,¹⁸ oil exploration,¹⁹ defense²⁰ and aerospace²¹ industries.

The concept of innovation markets has proven to be controversial, and the agencies have refrained from explicitly relying on it in recent years.²² Nevertheless, in several pharmaceutical matters, the FTC has challenged acquisitions that threatened to reduce future competition between one company with a product on the market and another with a competing product under development.²³ Furthermore, a recent action by the DOJ challenging an acquisition involving crop seeds demonstrates that the agencies may still apply an innovation market analysis, even if they do not call it such. The DOJ alleged that Monsanto Company's acquisition of Delta and Pine Land Company threatened to reduce competition in the sale of traited cottonseed in the Southern United States and to delay and deter efforts to develop and

commercialize cottonseed with other traits.²⁴ The case was resolved with a consent decree.

B. Specific Issues Regarding Evaluation of Potential Anticompetitive Effects

Intellectual property rights can introduce an additional dimension to the analysis of whether a proposed transaction is likely substantially to lessen competition. Two issues recently have captured particular attention: (1) the potential combination of patents in the hands of an acquirer; and (2) the possible affirmative use of patents or innovation to establish the absence of any anticompetitive effect.

Combination of Patents. Some have argued that the simple transfer of patents from one owner to another may create anticompetitive effects if the new owner is more likely to enforce the patents against third parties. This argument has been rejected by at least one court. In *Eastman Kodak v. Goodyear*,²⁵ Eastman sued Goodyear for infringement of a patent claiming a process for making granules of polyethylene terephthalate. Goodyear filed an antitrust counterclaim alleging that Eastman's prior acquisition of the patent from Zimmer AG was anticompetitive because Zimmer was unlikely to have enforced the patent against Goodyear. The court affirmed dismissal of the antitrust counterclaim, ruling that any harm to Goodyear came from enforcement of the patent, regardless of the identity of the owner; indeed, Goodyear would have suffered the same harm from enforcement of the patent even if ownership of the patent had never been transferred.²⁶

A similar situation may be presented by a company that is able to strengthen its market position, not by means of ownership of a single patent, but by combining patents from multiple sources into a single portfolio. In the absence of licensing activities (which could support analysis of the potential impact on competition in a technology market, as described above), this situation could be analyzed as potential creation of a barrier to entry by new firms.²⁷ Some sources have argued that a company might violate antitrust laws by acquiring patents so as to create a "patent thicket" that deters entry.²⁸ Unless the patents cover competing technologies, however, the basis of such a theory is unclear. A group of patents is capable of deterring entry into a market to the extent that the claims of one or more of the pat-

ents in the group prevent a company from practicing a technology necessary for effective entry. Applying the rationale of *Eastman Kodak v. Goodyear*, the exclusionary power of the patents themselves would appear to deter entry regardless of whether the patents are owned by a single company or a number of companies. Thus, any such theory likely would have to explain why the combination of patents under single ownership is more restrictive of entry than the ownership of the identical patents by more than one owner.

Affirmative Use of IP or Innovation. In certain circumstances, parties may be able to use intellectual property rights affirmatively to persuade a reviewing agency or a court that the transaction would not lessen competition to any greater extent than the enforcement of the intellectual property rights themselves. For example, assume that a patent-holder asserts that another company infringes one or more of its patents; the patent-holder subsequently (in settlement of litigation or otherwise) acquires the alleged infringer. The acquiring company may respond to any allegations that the transaction likely would substantially lessen competition with the assertion that the competition being eliminated is not lawful, as it is infringing, and absent the transaction the acquiring company's patents would permit it to obtain an injunction excluding the infringer from the market. Thus, the transaction would not reduce competition to any greater extent than the natural operation of the acquirer's patents. The DOJ confronted this issue in the merger of Gemstar-TV Guide International and TV Guide, and allowed the transaction to proceed. The FTC also faced this issue in Intel's acquisition of certain assets of Digital Equipment, in which the parties agreed to a consent order.²⁹ Two critical issues remain to be resolved: (1) the level of proof needed to establish that the acquirer's patents would exclude the target, and (2) which side bears the burden of proof – the acquirer, which has the burden to establish any affirmative defense, or the agency or private plaintiff, which bears the ultimate burden of proving that the transaction is likely substantially to lessen competition.³⁰

Analysis of conditions of innovation may also provide opportunities to parties considering a merger or acquisition. Innovation on the part of third parties may provide grounds for permitting a trans-

action to proceed that otherwise might be subject to challenge under the antitrust laws. For example, the DOJ decided not to challenge the acquisition by Arch Wireless, the leading provider of paging services, of Metrocall Holdings, the second-largest provider, despite the parties' combined market share of approximately 67%. The DOJ determined that the transaction was unlikely to have anticompetitive effects because emerging technologies were likely to broaden the alternatives available to customers and provide competition to traditional paging services.³¹

Remedies

Restrictions on competition involving intellectual property raise unique issues with respect to remedies. To the extent that divestiture of the business unit containing the intellectual property, or responsible for the innovation, is feasible, that remains the preferred remedy of the agencies. Divestiture of a business unit or specific assets may also require support in the form of a license of additional intellectual property to ensure that the divestiture will be effective.³² If the transaction threatens to disrupt existing R&D relationships, additional divestitures or licensing arrangements may be necessary to reconstruct competitive conditions. In order to resolve the potential anticompetitive effects in the recent cottonseed case, for example, Monsanto divested not only its own traited cottonseed business but also additional Monsanto cotton germplasm and certain Delta cotton germplasm, together with accompanying license rights relating to Monsanto's Round-Up Ready technology. Monsanto further agreed to modify its existing license agreements to remove restrictions on the ability of licensees to develop cottonseed containing non-Monsanto traits or a combination of Monsanto and non-Monsanto traits.³³

In some circumstances, the agencies may be willing to accept a divestiture in the form of a license to one or more third parties granting rights to use the appropriate intellectual property.³⁴ The number of licensees and the terms and conditions of the license may vary depending on the competitive circumstances. In situations in which the transaction itself has changed the competitive conditions, the agencies may insist that the acquiring party license more than the intellectual property acquired. In MSC.Software's consummated acquisition of its

rival Nastran software producers, for example, the acquirer had incorporated certain features from its rivals' software into its own version and had allowed its rivals' versions of Nastran to stagnate after the merger. As a result, the FTC insisted that MSC Software divest *its own* version of Nastran software by means of two non-exclusive licenses, together with customer files and other necessary support.³⁵

Procedural Considerations

A. HSR Notification

Just as with an acquisition of physical assets, an acquisition of intangible assets must be notified to the FTC and DOJ pursuant to the Hart-Scott-Rodino ("HSR") Act³⁶ if it meets the relevant thresholds. Thus, depending on the size of the parties, the acquisition of a patent or patent portfolio for an amount in excess of \$63.1 million could be a reportable transaction.³⁷ If the transaction requires notification, the parties must observe the statutory waiting period before the transaction can be consummated.

Signing an exclusive license agreement can be a particular trap for the unwary. The FTC considers entering into an exclusive license to be equivalent to an acquisition of an asset, and therefore subject to the reporting obligations of the HSR Act if the relevant thresholds are satisfied. To trigger HSR reporting obligations, a license must be exclusive as to the grantor as well as third parties. A license may be reportable if it is exclusive in part – for example, if it provides for an exclusive territory or an exclusive use. If there is no acquisition price, an exclusive license generally is valued on the basis of the total royalty payments expected over the life of the license.

B. Due Diligence

Intellectual property may also create unique challenges with respect to due diligence reviews. Acquirers generally are experienced in testing a patent portfolio with respect to the strength and breadth of the patents contained therein. Recent examples of antitrust liability arising from misconduct with respect to use of patents may require acquirers to expand the scope of their due diligence. In the *Nobelpharma* case, for example, the Federal Circuit affirmed a finding of liability against Nobelpharma for asserting an acquired patent after learning that the original owner had obtained the patent by means of fraud on the Patent Of-

fice.³⁸ And in a recent consent decree, the majority of a sharply-divided FTC found reason to believe that the acquirer of patents could be liable for attempting to enforce them on terms inconsistent with those promised to a standard-setting organization by the prior owner.³⁹ Thus, an acquirer should consider the degree of due diligence that may be appropriate with respect to the origins of any patents being acquired as well as the standards-related activities of the target or prior owner and the relationship, if any, of those activities to the patents being acquired.

Conclusions

Intellectual property and innovation, although often overlooked, can have important implications for the antitrust review of mergers and acquisitions. Licensing of intellectual property and innovation may themselves constitute markets that are the subject of antitrust scrutiny. Intellectual property portfolios and on-going innovation may also influence the antitrust analysis of related product markets. Proper understanding of these issues can be critical to assessing and avoiding potential risks and pitfalls in a transaction, as well as identifying arguments that may permit a transaction to obtain antitrust clearance.

NOTES

1. *United States v. Franklin Electric Co.*, 130 F. Supp.2d 1025 (W.D. Wis. 2000).
2. U.S. Dep't of Justice and Fed. Trade Comm'n, Commentary on the Horizontal Merger Guidelines at 43 (2006).
3. *Id.* at 44.
4. See, e.g., U.S. Dep't of Justice and Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property § 3.2.2 (1995).
5. *In re Montedison S.p.A.*, 119 F.T.C. 676 (1995).
6. *Id.* at 694-700. The formation of this joint venture and the parties' related conduct also led Union Carbide to file private antitrust and other claims against Montedison, Shell and others. See *Union Carbide Corp. v. Montell N.V.*, 27 F. Supp.2d 414 (S.D.N.Y. 1998).
7. *In re The Dow Chemical Co.*, 131 F.T.C. 600 (2001).
8. *United States v. Oracle Corp.*, 331 F. Supp.2d 1098 (2004).
9. Complaint ¶¶ 18-27, 29, 31-32, *In re Aspen Technology, Inc.*, Docket No. 9310 (F.T.C. Aug. 7, 2003).
10. Complaint, *In re MSC Software Corp.*, Docket No. 9299 (F.T.C. Oct. 9, 2001).

11. Decision & Order, *Aspen Technology* (Dec. 21, 2004); Decision & Order, *MSC.Software* (Nov. 1, 2002).
12. See U.S. Dep't of Justice and Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property at 10-14 (1995).
13. Complaint ¶ 35, *United States v. General Motors*, Civ. No. 93-530 (D. Del. Nov. 16, 1993).
14. *Id.*, ¶ 37.
15. Complaint ¶¶ 16-19, *In re Ciba-Geigy Ltd.*, 123 F.T.C. 842 (1997).
16. *Id.* at ¶ 31d, 31f.
17. *Id.*, Decision and Order §§ II, III.
18. Complaint ¶ 11.f, *In re MacDermid, Inc. and Polyfibron Tech., Inc.*, Docket No. C-3911 (F.T.C. Feb. 8, 2000).
19. Complaint, *United States v. Halliburton Co.*, Civ. No. 98-CV-2340 (D.D.C. Sept. 29, 1998).
20. Complaint, *United States v. Lockheed Martin Corp.*, Civ. No. 98-CV-00731 (D.D.C. Mar. 23, 1998).
21. Complaint, *United States v. AlliedSignal Inc.*, Civ. No. 99-CV-02959 (D.D.C. Nov. 8, 1999) (parties were competitors in the manufacture and sale of inertial systems as well as in the development of a micro-electro-mechanical inertial measurement unit).
22. See, e.g., Statement of Chairman Timothy J. Muris on the matter of Genzyme Corporation / Novazyme Pharmaceuticals, Inc. (Jan. 13, 2004).
23. See *In re Allergan, Inc. and Inamed Corp.*, Docket No. C-4156 (F.T.C. Apr. 21, 2006); *In re Teva Pharm. Indus. Ltd. and IVAX Corp.*, Docket No. C-4155 (F.T.C. Mar. 7, 2006); *In re Johnson & Johnson*, Docket No. C-4154 (F.T.C. Dec. 27, 2005); *In re Amgen Inc. and Immunex Corp.*, Docket No. C-4053 (F.T.C. Sept. 6, 2002).
24. Complaint ¶ 42, *United States v. Monsanto Co.*, Civ. No. 07-CV-00992 (D.D.C. May 31, 2007).
25. *Eastman Kodak Co. v. The Goodyear Tire & Rubber Co.*, 114 F.3d 1547 (Fed. Cir. 1997).
26. *Id.* at 1557-1558.
27. See DOJ discussion of 3D Systems/DTM Corp. in the Commentary on the Horizontal Merger Guidelines, *supra* note 2; see also *Ciba-Geigy*, 123 F.T.C. 842 (consent decree resolving allegation that combined patent portfolios would heighten barriers to entry).
28. J. Thomas Rosch, "FTC Litigation at the Antitrust/Intellectual Property Interface" at 13-16 (Apr. 26, 2007).
29. *In re Digital Equipment Corp.*, 126 F.T.C. 1 (1998).
30. See Rosch, *supra* note 28, at 12-13.
31. Press Release, Department of Justice Antitrust Division Issues Statement on the Closing of Its Investigation of Arch Wireless' Acquisition of Metrocall Holdings (Nov. 16, 2004).
32. Competitive Impact Statement § III, *United States v. Monsanto* (May 31, 2007).
33. *Id.* at §§ III.A, III.B, III.C, Proposed Final Judgment §§ IV, V and VI (May 31, 2007).
34. See Decision and Order §§ II, III, *Ciba-Geigy Ltd.*, 123 F.T.C. 842.
35. Decision & Order, *MSC.Software Corp.* (Nov. 1, 2002).
36. 15 U.S.C. § 18a.
37. The HSR Act currently requires notification of an acquisition of voting securities or assets valued at \$63.1 million or more, if the parties have revenues in excess of \$126.2 million and \$12.6 million respectively, or of voting securities or assets valued at more than \$252.3 million regardless of the size of the parties. 15 U.S.C. § 18a(a); Fed. Trade Comm'n, Revised Jurisdictional Thresholds for Section 7A of the Clayton Act, 73 Fed. Reg. 5191 (Jan. 29, 2008).
38. *Nobelpharma AB v. Implant Innovations, Inc.*, 141 F.3d 1059 (Fed. Cir. 1998).
39. See, e.g., *In re Negotiated Data Solutions LLC*, Docket No. 051-0094 (F.T.C. Jan. 23, 2008); see also Opinion of the Commission, *In re Rambus Inc.*, Docket No. 9302 (F.T.C. Aug. 2, 2006), Final Order, *id.* (Feb. 5, 2007); *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297 (3d Cir. 2007).

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