

When acquiring pharma in Russia ... look before you leap

Frank Vellucci and Isaac Safier



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Emerging markets like Russia are of increasing interest to pharmaceutical companies looking to acquire growing businesses. Frank Vellucci and Isaac Safier of Chadbourne & Parke review Russia's improving regulatory climate and warn about some potential pitfalls of acquiring products and companies there.



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As large numbers of pharmaceutical patents are expiring in the next few years and with the overall decrease in available funding because of the credit crisis, many pharmaceutical companies may be examining new strategies to remain profitable.

Cash-rich pharmaceutical companies are looking to make acquisitions of both products and entire companies to take advantage of the low valuations that have been the result of the global economic crisis. Stock prices have plummeted this past year, allowing for lower cost acquisitions both with cash, when available, and with other financing strategies.

As some large pharmaceutical companies are making acquisitions in the US and Europe – such as Roche Holding's \$46 billion acquisition of the remainder of Genentech that it did not already own, Pfizer's proposed \$68 billion acquisition of Wyeth, and Merck & Co's proposed \$41.1 billion acquisition of Schering-Plough – others are finding that acquisitions in emerging markets such as Russia are becoming increasingly appealing.

The current strength of the US dollar against the ruble and the potential for further devaluation has lowered acquisition prices. From a demand perspective, emerging markets such as Russia have proven to be the fastest-growing consumers of

pharmaceuticals over the last few years¹. Importantly, the nationalised healthcare system has resulted in less volatility for pharmaceutical company revenue streams. In addition, the wider acceptability of experimental therapies and testing has allowed for increased drug development to take place. Further recent changes in Russia's health insurance laws and health ministry may also increase development of pharmaceutical products in Russia.

However, the due diligence that must be performed on an acquisition target in Russia is no simple task. In addition to well known political risks, acquiring companies face trademark and patent protection issues, and a lack of transparency in determining corporate ownership.

Danger No 1: trademark protection

Like most intellectual property regimes, Russian law provides that the first to file and register a trademark gets the rights. However, there is no law prohibiting bad faith registrations by parties unaffiliated with the real trademark. Recently, Starbucks famously won a year long legal battle in Russia to do business under their trademark. Starbucks' trademark expired under a provision providing for expiration of trademarks not used for three years following registration. Before Starbucks could re-register their trademark, it was registered by an unaffiliated businessman known for registering famous trademarks and selling them back to their affiliated companies at high prices. Pharmaceutical companies should ensure that trademarks they may want to buy or use in Russia are properly registered and have not expired, in order to avoid the time and expenses of such a legal battle.

Danger No 2: patent protection

When making an acquisition in Russia, of either a pharmaceutical product or company, the acquirer should verify the scope of the existing patent protection. Due diligence of Russian patent protection requires inspection of several Russian

databases and patent registers, as patent protection in Russia is possible under both national laws and regional treaties.

The Federal Service on Intellectual Property, Patents and Trademarks (Rospatent) is the Russian governmental patenting agency. It registers applications for intellectual property, licence agreements and agreements transferring intellectual property rights, and it also issues patents and certificates relating to intellectual property rights. Under Russia's Civil Code, any assignment of patent rights not registered with the state is legally void. Registration is even required for an assignment of patent rights governed by foreign law, as long as the assignment agreement is intended to be performed in the country. Therefore an acquiring company must ensure that every prior transfer of a patent has been properly registered.

Just because a patent is protected under Russian law does not mean there are any protections in the rest of the world. Russian patent law only has jurisdiction in Russia. However, under the Eurasian Patent Convention, which has been ratified by Russia, Belarus, Tajikistan, Kazakhstan, Azerbaijan, Kyrgyzstan, Moldova and Armenia (and joined but not ratified by Turkmenistan), submitted patents can be protected and enforced throughout the territory of the signatories². If a Russian pharmaceutical company has not registered its technology or inventions in any other country, under the Eurasian Patent Convention, or under any other international treaty, then its intellectual property rights will not be protected outside Russia.

Danger No 3: corporate information and verifying ownership

Russian federal tax authorities maintain a Unified State Register of Legal Entities that contains corporate information. However, not all corporate information is publicly available. Article 7 of the Russian federal law on joint-stock companies provides that a joint stock company, the prevalent form of incorporation in Russia, may be open (called an open joint stock company, or "OAO") or closed (called a closed joint stock company, or "ZAO"). Unlike OAOs which make ownership information publicly available online, the share register and other information of a ZAO is not public information and as such, there is no way to verify ownership. The

result is that an element of transparency may be missing either in the ownership of a company or in the business relationships upon which it is founded.

For pharmaceutical companies looking to replace products that have expiring patents and make the most out of the favourable valuations caused by the financial crisis, the benefits of acquiring pharmaceutical companies or development products in Russia undoubtedly outweigh the risks. However, trademark and patent protection issues, the Russian civil code and corporate structures make the use of localised counsel with multinational capabilities a necessity for an acquiring company.

¹ Emerging pharmaceutical markets globally RNCOS, April 2008; ² <http://www.eapo.org>.

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