SOMETHING TO CONSIDER WHEN PURCHASING A BUSINESS

Welcome to another edition of Protecting Your Creativity by The Livingston Firm. Each edition of Protecting Your Creativity will discuss various aspects of intellectual property law and related business matters. This edition discusses the importance of conducting an intellectual property ("IP") audit as part of the due diligence performed prior to purchasing a business.

When purchasing a business the purchaser is not only buying tangible assets, such as buildings and equipment, but also intangible assets such as patents, trademarks, copyrights, trade secrets, brands, ideas, products, customer lists, domain names and so forth. Although the phrase "intellectual property audit" suggests a mere counting up of intangible assets and assessing a value based on the number of patents and/or trademarks owned by the seller, a proper IP audit is actually much more involved.

An IP audit is a systematic review of the IP owned and used by a business. The goal of an IP audit is to identify and determine the status of the IP the business is using and/or claiming ownership of. An IP audit also provides valuable information regarding possible infringement issues and/or breaches on the part of the seller or third parties in relation to the seller's IP assets. Thus, the performance of an IP audit is invaluable, as it identifies the seller's core IP assets and the status of those assets, as well as assists the purchaser in negotiating a fair price for those assets.

However, there is a common misconception about IP audits in that they are only necessary if you are purchasing a large business which owns or develops complex patents, or a business that relies heavily on sophisticated trade secrets. The reality is that virtually every business, regardless of its size, utilizes a broad array of IP assets which may include patents, copyrights, trademarks, trade secrets and licenses for same. According to one congressional report, as recently as 1978, intangible assets, such as IP, accounted for twenty percent of corporate assets with eighty percent attributed to tangible assets such as facilities and equipment. Today, that trend has reversed: seventy-three percent of corporate assets are intangible and only twenty-seven percent are tangible. Due to this trend, attorneys and business people need to be more aware that the majority of a company's value lies in the ownership and management of IP.

In addition to identifying IP assets, an IP audit will also disclose the status of the IP and may uncover IP assets that have not been properly protected. For example, patent protection may be limited in terms of the type of patent applied for, the remaining enforceable time left on the patent, the non-payment of maintenance fees and/or what was actually claimed in a patent. Similarly, the IP audit may reveal that the business needs to file copyright and/or trademark registration applications, and/or affidavits of continued use of trademarks. In addition, the IP audit may uncover that the business does not have proper procedures and agreements in place to ensure that trade secrets are kept confidential.

An IP audit will also ensure there are no defects in title to the business's IP assets. The audit may reveal the existence of third parties who may be able to claim joint ownership of patents or other IP assets and who, by virtue of such joint ownership, will be free to exploit those IP assets themselves without the permission of the business. These rights will need to be properly secured and any other defects in title will need to be cured prior to the closing date of the purchase. In addition, assignments of ownership from consultants may need to be secured and properly recorded and rights to works or inventions may need to be secured and/or obtained from employees who claim to be authors or inventors. The IP audit may also reveal deficiencies in license agreements with third parties allowing a business to create derivative works that incorporate elements of works owned by such third parties. Without adequate agreements and/or assignments in place, there will be a cloud on the title of the IP assets the business claims to own.

The above examples are only a small portion of what is reviewed and considered during an IP audit. Of course, the size and scope of an IP audit will depend on the size and type of the business being purchased. However, regardless of whether a prospective purchaser is buying a small family owned pizza parlor or a large industrial company, it is in the purchaser's best interest to know exactly what they are buying so they may make an informed business decision prior to closing. Unfortunately, many prospective purchasers fail to conduct IP audits or conduct ineffective or inadequate audits. Prior to acquiring the stock or assets of a business, the prospective purchaser and the attorney representing the purchaser should insist that a thorough IP audit be performed by experienced intellectual property attorneys to determine the scope and level of IP ownership and protection currently in place and what protection is needed in the future to ensure the investment is worthwhile.

An intellectual property audit is an inherently complex undertaking and should only be performed by attorneys with experience in conducting IP audits. The Livingston Firm specializes in all areas of intellectual property law including patents, trademarks, copyrights, trade secrets, franchising, litigation and business law. As the largest full-service intellectual property law firm in Southwest Florida with over forty years of combined experience.

Thank you for taking the time to read this edition of Protecting Your Creativity. If you are in need of our services then please contact us to schedule an appointment.

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