



A PRACTICAL GUIDE TO INTELLECTUAL PROPERTY AUDITS

An Intellectual Property ('IP') audit is a systematic review of the IP owned, used, proposed to be used or acquired by a company. The goal of an IP audit is to identify all the IP rights owned or used by a corporation and consider appropriate ways to protect it from any form of infringement. It also provides valuable information regarding possible infringement or breach on the part of the company or third parties in relation to the company's IP assets. From the managers' perspective, such an audit identifies company's core assets and allows the business to focus on them. This assists managers to determine strategy for growth and also to optimize output from the already existing array of IP rights owned and used.

If you are responsible within your company for compliance issues, then it is an equally worthwhile exercise to conduct an intellectual property audit. In many cases, particularly in India, executives of a company may not themselves be aware of the IP issues involved in running of their businesses. With enforcement mechanisms in India stepping up, it is not uncommon for companies to obtain orders from courts and conduct raids on other companies in an effort to reduce infringement, particularly in connection with software licences. On many occasions, executives of the company being raided are puzzled and do not know what they have done wrong. It never occurs to them that pirated CDs, DVDs, computer programs, literary works are prohibited despite their common usage. Many businesses operate by pirating other companies' intellectual property, but for them it is not piracy, but just another way of making money!

Conducting an internal IP audit usually involves a multi-disciplinary team of attorneys, management professionals and at times, experts in particular technologies. An audit provides knowledge to the executives of the IP owned or ought to be owned by the company, such as design rights, trade marks and brand names, patents, copyright, domain names etc. It also provides an insight into possible breaches by the company of other's IP rights such as a breach of licences for software or other technologies. The due diligence team would identify information of the company which is core to its business and classify it as confidential information, which all the employees or workers would be duty bound not to disclose to third parties.

The auditors, if required, could also carry out searches, to the extent possible, on the competitors of the company for any traces of IP infringement. When the company is a manufacturer, the auditor could also



check on distributors and dealers for counterfeit products or violation or disclosure of confidential information related to the business of the company.

Once the internal audit is completed, a company would be in a position to determine which of its IP assets to secure and preserve and which to dispose, particularly if a third party appears to have a stronger and more viable claim on such asset. The audit report would also guide the company in registering IP not yet registered by it for the purpose of securing its business activities.

Similarly, if you are looking to acquire a company, it is essential to conduct a comprehensive due diligence exercise to determine the value not just of the target company's tangible assets, but also of its intellectual property. It is critical for the potential acquirer to perform an IP audit as this enables it to gain valuable knowledge on IP ownership and potential infringement by the target company. This is particularly relevant because the acquirer company becomes liable for any infringement once the acquisition is complete. In India, corporate governance standards are much lower than that of companies in the US and Western Europe and the practice of not making disclosures is almost routine.

An external audit is similar in the sense that it also includes identification of the company's IP assets by interviewing managers and reviewing of all contracts, licences and other related documents. All registered IP assets should be verified from Government records. For unregistered IP assets which the target company claims that it owns, searches should also be carried out to ascertain if any litigation proceedings are pending or threatened in relation thereto. With respect to licences and contracts for technical know-how and patents, it is important to determine whether the licences and contracts can be transferred or assigned to the acquirer. If trade marks are being assigned, applications are to be made to the Trade Marks Registry in India to register the assignment. In cases of transfer of technology from third parties, it becomes more so important to ensure the confidentiality of the technology and associated information.

The process of IP Audit involves the following:

1. Initiation: The very first step in the IP audit is to measure the extent of audit to be performed, which depends upon various factors such as the nature of business and size of the company. This is essential so



that there is clarity between the 2 parties and for optimum utilization of resources of time, money and man power.

2. Identification: The next step would be to identify all the IP rights of the company. IP can be classified into various categories such as trade marks, patents, design, copyright etc. Identification is one of the key and time consuming activities because in India it is not easy to conduct comprehensive searches on companies. Most companies are not very transparent and unlike companies of western countries, they are not very eager to disclose all information. IP rights also have to be identified by conducting searches into corresponding registries, courts and other governmental ministries, where records are sometimes dated and files are not easily accessible .
3. Consolidation: The next step is to consolidate the data derived out of identification and determine the action to be performed for every asset so identified. The IP assets would be broadly classified into 2 categories – i) Registered and ii) Unregistered. For registered assets, it is important to know the date when a renewal application is to be made and if any other action is required to ensure its validity. For unregistered assets, it is important to ensure that such assets do not infringe the rights of competing companies. It is not only pending litigation which is crucial, but also the threat of litigation in relation to a company's asset. For this, the co-operation of the target company's managers is essential because while litigation may not have been commenced against the company, the managers would know whether there are potential liabilities for an acquirer in the months ahead.
4. Valuation: After the IP assets are identified, including confidential information, licences, valuations should be assigned to each asset. In case of an acquisition, the final purchase price or the consideration to be paid for the target company can be determined.
5. Transfers: The auditor could thereafter execute documents essential to execute the transfer of IP and would also ensure filings with the concerned registries for the alteration in the record so far as the details of the proprietor are concerned. The agreements would ensure that the target company does not retain any kind of right on the IP.



6. Education: The auditor could also educate the staff of the company about the IP owned and used by the company and also make them aware of the IP legislation of the country. It is essential to educate the staff in respect of effectual protection and enforcement of IP rights owned by the company.

For an IP audit to be successful, co-operation of managers is essential. Further, it is crucial that full disclosures are made regarding the target company's activities. A comprehensive IP audit enables the party conducting the exercise to identify hidden risks, determine values and take informed decisions on potential transactions. It is an indispensable tool which the company ignores at its peril and undertakes to protect and secure the core of its business activities without which it won't be able to keep pace in a highly competitive but lucrative market like India.

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