



Minding the Store: IP Audit as a Tool for Business Management

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It is axiomatic in the business world that a typical company prizes most highly its people, followed closely by its intangible assets. Physical assets rank a distant third. Some estimate that 75 percent of a typical company's assets are non-physical. Few would doubt the value to Coca-Cola Company of its soft drink formula (a trade secret) and its brand (exemplified by its stylized Coca-Cola trademark). The importance of intangible assets is perhaps even greater for small to mid-sized companies. An *ad hoc* approach to management of intangible assets becomes less viable as a business matures. It would be unthinkable for a business to not have a grip on the physical inventory in its warehouses; it is no less unthinkable for a maturing business to lack a grasp of its intangible assets. The first step in management of those intangible assets is the intellectual property audit.

An intellectual property audit is a systematic review of the company's intellectual property and procedures for identifying, processing and managing its intellectual property. The intellectual property is not limited to simply that created by the company's employees. Instead, it extends to all intellectual property created, owned, used, licensed or otherwise exploited by the company. Ideally, the IP audit is done on a periodic basis rather than as a "file and forget" endeavor. Because the IP audit provides a snapshot of the company's position, its value is related to its timeliness. Forward-thinking management will not wait until a specific event triggers the need to conduct (or update) an IP audit, because having a current snapshot of the company's intellectual property position can give the company the ability to move quickly to exploit business opportunities such as acquisitions or mergers.

Importantly, an IP audit is a step toward better asset management. It can simply be an important tool in on-going management of the company's assets, used to set policies, exploit opportunities, and cut costs. On occasion, however, specific events can drive an IP audit. Those events can include:

- Buying or selling a business or business unit;
- Soliciting angel investors or venture capitalists;
- IPO or other stock offering (where, for example, valuation of intellectual property is important in setting an offering price);
- Joint ventures (where it is important to know what intellectual property the company is bringing to or withholding from its contribution to the joint venture);
- New management (where the new management needs to get its arms around the company's true position);
- Significant financial transactions (for example, where a lender seeks a security interest in the company's intellectual property assets and requests a warranty that the intellectual property is not previously encumbered);
- Planning for other significant corporate events, such as bankruptcy filings, significant layoffs, or plant closings;
- Enforcing or defending the company's rights (including responding to challenges by Business Software Alliance, Copyright Clearance Center, Software & Information Industry Association and similar entities).

The Audit Team

In addition to the Varnum resources that the team leader will marshal, the team should also include one or more representatives of top company management. Frequently, this is the company's in-house counsel. It is important that there be management participation. No outsider (even an experienced attorney familiar with the firm) will be in a position to fully grasp the company's operations.

Client representation should also include one or more business or technical persons. Team members often include heads of key departments such as technical (R&D), marketing, and human resources. Depending upon the scope of the IP audit, the audit team might include others (such as CEOs, CFOs, division heads, and others).

Varnum's audit team representation will include a team leader experienced in dealing with patents, trademarks, copyrights, trade secrets, and other intellectual property as well as disciplines such as licensing, e-commerce and software.

The Audit Process

The first step in the IP audit process is a strategy session to plan the audit. The audit plan should define the scope (which could be narrow or extensive, depending upon the purpose of the audit). The audit plan will set priorities, determine a schedule, identify budget constraints, and determine issues such as whether the process will include an effort to assign values to the intellectual property.

The audit itself systematically reviews the company's intellectual property and explores the process used by the company to create, identify and protect such property. Intellectual property can include inventions (patented or not), trademarks and service marks (whether registered or unregistered), copyrights (registered or unregistered), trade secrets, domain names, contract rights (including contracts with independent contractors and employees), and licenses (whether the company is licensor or licensee). A thorough IP review will include the marshalling and review of many documents (including contracts, licenses, assignments, policies, and chain of title documents).

The thorough IP audit, however, should not simply be a matter of shipping boxes of documents off to a lawyer's office and awaiting a response. Interviews of key employees, contractors and, in some instances, former employees/contractors, are typically required. Where efficient, questionnaires can sometimes be used. On-site inspections of security procedures, plant processes and other business operations can be critical to the IP audit.

Depending upon the scope of the IP audit, independent searching (such as patent or trademark searching in the United States Patent and Trademark Office or in foreign patent and trademark offices) may be conducted. Indeed, a company's knowledge of its own intellectual property position is often inaccurate because of incomplete record-keeping or loss of institutional knowledge through turnover or rapid growth.

The IP audit ideally will assess the ownership of the identified intellectual property. Have inventors assigned their invention rights? Have independent contractors assigned their copyright interests? Have software licenses been properly renewed? These and other IP ownership questions will need to be resolved. The IP audit will identify steps that need to be taken to fill, to the extent possible, any gaps in ownership. Likewise, gaps in ownership of IP may help company management identify need for new or revised policies and practices by the company.

Even if the company owns or licenses all of the intellectual property it uses, the audit should determine whether it is adequately protected (for example, by patents, trademark registrations, copyright registrations, confidentiality agreements, written license agreements and the like). In some instances, the audit can identify gaps in enforcement of those protections. If the company does not

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own the intellectual property being used (and the gap in ownership cannot be filled or licensed), management will be in a position to assess the risk and consider changes in operation to minimize the risk of infringement claims against the company. Depending upon the scope of the audit plan, the audit may include a valuation of the company's intangible assets.

Means to an End

The deliverable of the IP audit is typically a report or database from the outside counsel to the company management. That deliverable, however, is simply a tool to be used by the company management in overall management of the company's intangible assets. Thus, the IP audit ideally ends with a "next steps" plan by the audit team for addressing the issues uncovered in the IP audit. Those "next steps" may include revised policies, procedures, cost-cutting by elimination of maintenance of unneeded registrations or patents, protection of important (but currently unprotected) intellectual property assets, enforcement of intellectual property rights where infringement has been identified, and remedial steps to fill any gaps in the company's existing IP rights.

Importantly, the "next steps" plan can involve steps to better exploit existing IP assets (for example, through a licensing program). Properly done, an IP audit is a first-step tool for better minding the store.

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