



## Précis Paper

### Intellectual Property in a Business Sale

A discussion about intellectual property, including the protection of intellectual property as a business asset and the importance of the existence, ownership and registration of intellectual property in selling and purchasing businesses.

#### Discussion Includes

- What is intellectual property?
- Types of intellectual property rights
- Intellectual property and setting up a business
- Intellectual property and running a business
- Intellectual property and selling a business
- Due diligence
- Methods to determine the value of intellectual property
- Takeaways for practitioners

## Précis Paper

### Intellectual Property in a Business Sale

1. In this edition of BenchTV, Steven Brown (Chairman- Etienne Lawyers, Sydney) and Stephen Krouzecky (Principal, Krouzer IP, Sydney) discuss intellectual property, including the protection of intellectual property as a business asset and the importance of the existence, ownership and registration of intellectual property in selling and purchasing businesses.

#### What is intellectual property?

2. The Convention establishing the World Intellectual Property Organisation was established in 1967.
3. It was created to harmonise the different laws in intellectual property around the world and create a cooperative environment in which companies could obtain intellectual property rights.
4. Under the Convention, intellectual property is defined as a body of law which provides rights relating to literary, artistic and scientific works, performances of performing artists, phonograms and broadcasts, inventions in all fields of human endeavor, scientific discoveries, industrial designs, trademarks, service marks and commercial names and designations and protection against unfair competition and all other rights resulting from intellectual activity.
5. Intellectual property manifests itself in terms of intellectual property rights, which are created by law and also in the form of an asset, such as intellectual capital which attributes a value to intellectual property.
6. The types of law which provide for intellectual property rights can be divided into statutory and non-statutory law.
7. Under statute, intellectual property rights are created by registration so you must apply to create the right; that is the right comes into existence due to the existence of a registration system.
8. Non-statutory rights come into existence automatically, so there is no registration system.
9. Intellectual property manifests itself in common law and the law of equity and under contract law.
10. In contractual terms, when referring to intellectual property it is normal to have a definition of intellectual property and this is where the definition can be stretched beyond a pure academic sense.
11. This is a source of some confusion because the contractual definitions embrace elements that would not necessary would normally be deemed to be intellectual property.

### Types of intellectual property rights

12. One type of intellectual property rights are patents. Patents are for inventions and protect processes, methods and products which have an inventive aspect about them.
13. Patents relate to concepts of newness, novelty and 'obviousness' or inventive step.
14. Trade marks are another type of intellectual property right, which protects branding.
15. There are also wordmarks that function as a brand and a logo.
16. Trade marks are registered under the *Trade Marks Act 1995* (Cth).
17. Trade marks can also extend to smells, sounds and anything that can be represented in a written form and in the case of a sound or a smell, how that sound or smell would be notated in some musical score or spectral analysis.
18. Therefore, if it can be represented in a written form then it is capable of constituting a trade mark.
19. The basic definition of a trade mark is some sort of sign that is capable of distinguishing one trader's goods from those of another.
20. Another type of registerable intellectual property is the design right. Registered designs cover the shape or appearance of an article.
21. There is a notional concept that the design of an article can be different from the article itself and it can be a shape, configuration, pattern or ornamentation.
22. Copyright is another type of intellectual property right, however it is not a registerable right in Australia but it can be registered in some countries such as the USA.
23. Most countries have now eliminated the notion of registering copyright as it covers such a broad sphere of works such as artistic works, literary works, broadcast works, cinematographic works, plays and productions.
24. Another type of registerable intellectual property right is circuit layout rights, which relate to semiconductor, fabrication and the semiconductor wafer that is the basis for integrated circuits.
25. Circuit layout rights emulate and extend a copyright type protection to semi conductive works under the *Circuit Layouts Act 1989* (Cth).
26. Another intellectual property right which has become increasingly popular in agriculture is plant breeder rights which can be registered under the *Plant Breeder's Rights Act 1994* (Cth).
27. There is a registration system associated with plant breeder rights and it is for new varieties of plants.
28. Another two forms of possible intellectual property rights are confidential information and trade secret rights, however it is argued from an academic standpoint, that these are not intellectual property.

29. Nevertheless, in most definitions of intellectual property in contracts, confidential information and trade secret rights are often embraced as intellectual property, as is 'know-how'.
30. Intellectual property is seen as an intangible asset as opposed to a tangible asset.

#### Intellectual property and setting up a business

31. Today, the largest corporations in the world, such as Google and Apple do not sell tangible goods.
32. Whilst there are some hard goods sold by Apple, it is the intellectual property which is embedded within the machines that Apple sell, the innovations and knowledge inculcated in copyright, patent and confidential information is where they make their money.
33. Many corporations today, earn their money from their exploitation of intellectual property.
34. Businesses need to recognise the leverage that they might be able to achieve from the intellectual property inherent in the business.
35. Business needs to ask themselves:
  - i. Does the business have things that are trade marked;
  - ii. Have they been properly trade marked;
  - iii. Are they trade marked in all countries the business has markets;
  - iv. Are the processes the business uses able to be protected by copyright or is it simply 'know-how' which is not a right as such;
  - v. Does the business have appropriate copyright registration in the countries which require registration.
36. Many corporations today, earn their money from their exploitation of intellectual property.
37. Businesses must look at whether they can exploit any given design and whether they are adequately protected.
38. Intellectual property can be broken up into elements
  - i. Creatures of statute such as trade marks, patents, registered designs, integrated circuits and copyrights
  - ii. Non-statutory sources such as confidential information and 'know how'
39. If a business does not know what intellectual property capital or intellectual property assets they have, they will be unable to exploit them

#### Intellectual property and running a business

40. Businesses engaged in the sale of products, may sell all of its products under one corporate image, such as Johnson and Johnson or may sell products under numerous

difference images such as Proctor and Gamble which does not sell any product as 'Proctor and Gamble' and instead sells personal care products' inherent logos and names.

41. In most companies, there will be trade marks and possibly patents on the machinery which produces those particular goods, there will be copyright in the advertising materials and the packaging and labeling of the goods and there will be confidential information on how best to market the goods and proprietary formulas within the product.
42. Therefore, whilst a scientist can reverse reengineer the formula of coca cola, they cannot exploit it as it would be infringing Coca-Cola's trade mark.
43. Having the appropriate forms of intellectual property protection can be crucial to a business protecting their position in the market as well as a startup business getting the correct foundation in to become a leader in one or multiple markets.

#### Intellectual property and selling a business

44. Prior to selling a business, the seller must work out what it is they are actually selling.
45. For example, if Proctor and Gamble were selling something, it would be a product.
46. However, if J K Rowling was selling something, it would be her rights in the Harry Potter series. She could also can segment her rights, for example only sell her rights to make a film.
47. Depending on what rights one has, they can license them with a trade mark.
48. If one has trade marks registered in multiple countries it would be possible to license the use of that trade mark to a proportion of those countries to others and retain the rest.
49. In doing this, businesses can use other people's capital to earn passive income.
50. The seller must ascertain what they have, for example do they have trade marks, copyright, registered designs etc and determine the life span of each.
51. Trade marks may last forever if the registration is kept up to date.
52. Whilst patents have a 20 year maximum life span unless it is an innovation patent which typically has a shorter lifespan.
53. The purchaser then must investigate the information provided to them by the seller to satisfy themselves as to what they are buying and whether the amount of money represents a good price for what they are getting.
54. The purchaser must establish whether or not they are becoming the owner of the trade mark or whether they are becoming a licensee of the trade mark.
55. In a case before the Federal Court, a company wanted an educational package with notes and power point slides put together and they did not have anybody in their company with the capacity to do so.

56. They subsequently outsourced the job to a consultant.
57. They did not receive adequate legal advice when putting the consultancy agreement together and so although they were able to acquire the works the consultant produced, they did not take an assignment of the intellectual property rights that is the copyright in that work, therefore when they took it onboard, all they received was implied license of use.
58. The consultant subsequently shut down the consultancy business and was then hired as a copywriter by a competitor of Party A.
59. The result was two educational institutions which were running exceedingly similar programs and Party A sought to take infringement action against Party B for using their material.
60. Proceedings commenced and Party B argued that Party A had a right to use what they have but that Party B were the owners now because when an employee produces intellectual property rights, the employer is the owner of those rights although they are not the author of it.
61. Party B therefore owned the new, revised works and Party A had a license to use the old works but because they did not have a proper consultancy agreement, the works were never transferred over.
62. The facts of the case show that when buying a business it is crucial to understand who created the works and whether they were employees or not.
63. Due diligence in the investigation process is crucial to make sure a purchaser is obtaining what they think they are getting.
64. Just because someone is using something in their business, does not mean that they have ownership of it. They may have a mere license to use it.

#### Due Diligence

65. The best form of due diligence is when the sellers do their own due diligence first and put together a data room.
66. In the past data rooms used to be physical locations however now, a lot of the data rooms are virtual and purchasers have access to the data room online.
67. The lawyers, accountants, patent and trade mark attorneys go through all the contracts to ascertain what rights are there, whether the rights are genuine, how long they will last, whether they are in all the markets needed by the purchaser and if the rights are not protected how they could be protected should the sale proceed.
68. During due diligence investigations purchasers will find out:
  - i. What is there and whether it has been properly protected;
  - ii. If intellectual property has not been properly protected, whether the deficiencies can be remedied;
  - iii. What the costs of any remedy will be;

- iv. Could the protection be expanded in some way and how;
  - v. Are all the markets in which the goods and services being supplied adequately protected and covered.
69. If a logo is registered, who created it is not overly important however if logos are not registered, and a purchaser wants to use them, it is imperative to know who owns them.
  70. If it was produced by an outsourced third party, did that outsourced third party properly assign to the seller, the intellectual property in the material?
  71. As an example, if a receptionist wrote a fiction novel in her spare time, the novel would not be owned by the employer as the authorship has nothing to do with their role as a receptionist.
  72. However, if a Human Relations Manager wrote a Human Relation manual in their spare time that mirrored the process a client had used in their business which had not previously been documented it is strongly arguable that the employer could claim ownership of that work.
  73. This is because the knowledge which was used to create the work was within the scope of employment of the Human Relations manager and therefore is a necessary concomitant of their role.
  74. Ascertaining who did something, when they did it and how they did it is crucial in understanding who owns things.
  75. Ownership is treated differently under each Act for trade marks (*Trade Marks Act 1995* (Cth)), patents (*Patents Act 1900* (Cth)) and designs (*Designs Act 2003* (Cth)).

#### Methods to determine the value of intellectual property

76. There are a number of methods which can be used to determine the value of intellectual property.
77. The market place method, which is probably the most reliable method, is what a willing buyer is prepared to pay to a willing but not overly anxious seller.
78. Net present value methodologies can be used as can the use historical records.
79. The net present value calculations appear exceedingly scientific, robust, corporate finance theory and valuers use them often however the challenge with them is they are all dependent upon the assumptions used in putting in the figures.
80. The raw material for a net present value calculation is how much the good or service will sell for and what revenue it will yield over any fixed period of time. Unless the business is a mature business with past figures to rely upon, these figures will generally be an assumption.
81. For example, it was a gamble when Apple released the Ipad as to whether it would be successful or not. It turned out to be highly successful. This can be compared to the Iwatch which seems to have been not as well taken up as the Ipad.

82. If one were to assess the value of the Iwatch before it went on the market by using net present value calculations and the success of the Ipad as an assumption, one would have a very high figure.
83. It is important to remember that there are methodologies which may be used for valuing a business however there may be different methodologies to be used to value intellectual property.
84. Intellectual property is broken up into constituent elements and when you look at a business, intellectual property and its constituent elements are part of the business as a whole and are separate and distinct from the good will.
85. The good will is the entirety which encompasses how all of the parts work together.
86. For example, Proctor and Gamble as a whole has a particular value however within Proctor and Gamble, 'Gillette' has a value of its own.
87. As a result, Proctor and Gamble is able to sell off Gillette whilst keeping its other lines.
88. When ascertaining the value of Gillette, one would look at the trade marks of Gillette, the designs of its razors and the design of its blades and ultimately assign value to each of these aspects.
89. Therefore one could value the trade mark of Gillette and that would be a constituent of the overall goodwill of Gillette as a business
90. Goodwill is a higher value than the constituent trade mark, registered design values themselves.
91. From a purchaser's point of view, if you can ascertain the value of intellectual property, you do not pay stamp duty on the particular value.
92. Therefore if a value is placed on a trade mark or a patent, then those amounts are subtracted from the total purchase price and stamp duty is not paid on those particular parts of the purchase price.
93. Whether one is kick-starting a business or simply has an idea, it is important to start looking at what intellectual property is and how to protect it, from the very beginning.
94. This is because if you discuss an idea with someone you do not have a non-disclosure agreement with, you could lose that idea to them.
95. Having regular intellectual property audits is important in making sure that registrations are in order and that they are up to date.

#### Takeaways for practitioners

96. Be proactive with your clients and ensure that they know that being proactive is about them and protecting their interests.
97. Taking steps proactive steps to get protection is better than suing for infringement.
98. However, you cannot get protection without knowing what needs protection.
99. It is important for lawyers to educate their clients what the constituent parts of intellectual property are and what the particular creatures of statutes are for the



registration of trade marks, patents registered design and copyright and what the common law, confidential information aspects are

## **BIOGRAPHY**

### **Steven Brown**

Chairman – Etienne Lawyers, Sydney

Steven was admitted as a lawyer in 1983. With over 30 years experience in the law, Steven has extensive knowledge in the areas of intellectual property, misleading and deceptive conduct and trade mark valuation. He has lectured at UTS in Corporations and Securities Law and Macquarie University in Banking Law Course. Steven regularly chairs and speaks at many legal and business conferences in Australia and overseas.

### **Stephen Krouzecky**

Principal – Krouzer IP, Sydney

Stephen is an experienced patent and trade marks attorney with 40 years experience in dealing with intellectual property practice in Australia and internationally. He is founding principal of the IP attorney firm Krouzer IP and managing director of KPI Synergies Pty Ltd, a consulting business specialising in IP strategy and commercialisation. He is currently the President of the Federation of Intellectual Property Attorneys (FICPI) Australia.

## **BIBLIOGRAPHY**

### **Legislation**

*Trade Marks Act 1995 (Cth)*

*Patents Act 1900 (Cth)*

*Designs Act 2003 (Cth)*

*Circuit Layouts Act 1989 (Cth)*

*Plant Breeder's Rights Act 1994 (Cth)*

### **Convention**

Convention establishing the World Intellectual Property Organisation, opened for signature 14 July 1967 (entered into force 10 August 1972)