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In Practice

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Selling an online retail business

KEY POINTS

- Online retailing is increasing in popularity.
- An online retail business has a unique asset base, often founded principally on intellectual property (IP) rights and customer databases.
- This article provides a check-list of the legal and practical intellectual property and data protection issues an insolvency practitioner selling an online retail business needs to consider.

THE LANDSCAPE

The retail industry increasingly relies on customers shopping via the internet. More than 10% of all retail sales are now made over the internet in the UK, and this proportion is predicted to more than double by 2020.

There have been many high-profile casualties in the retail sector since 2008, with a string of predominantly "high street based" retailers going into administration in the last 12 months. While there are many and varied reasons for this, one of them is that struggling retailers don't develop a viable online e-commerce offering. An article in the *Economist* in the spring of this year, indicated that the speed of delivery of goods is as important for consumers these days as price. Many customers would prefer to order online and then pick up the same/next day at a local store, rather than wait at home a few extra days for delivery. It appears, therefore, that retailers with both physical stores and an online capability (eg, John Lewis, ASDA) are what the customers really want.

IP ISSUES FACING ONLINE RETAIL BUSINESSES IN DIFFICULTY

Once in an insolvency procedure, one unique feature of an online retail business, when it comes to the disposal of its assets, is that it tends to have little in the way of tangible assets. Instead, the main source of value in the company is likely to be intangible assets, including customer databases, the company name and brand and its websites. This does not mean that an online retailer will not have the more traditional (tangible) assets an insolvency practitioner is used to selling: stock, real estate, vehicles and equipment. Nor does it mean the other issues which have plagued the high street retail administrations of recent months will not also be relevant to an online business. For example, does the buyer want to continue any existing supply relationships and if so how can this be achieved? How will gift vouchers (often themselves bought online) or extended warranties (taken out online) be honoured? Not to mention the problem of unfulfilled orders and the status of customer deposits.

But it is the IP rights and customer databases that the buyer will often want to focus on if it is to carry on the business as a going concern. And they are likely, therefore, to be the assets for which the insolvency practitioner will get the most value on a sale.

WHAT IS AN INSOLVENCY PRACTITIONER/ BUYER LOOKING FOR IN AN ONLINE RETAIL BUSINESS?

Data and databases

Any buyer is likely to want to obtain client or customer lists as a priority. This could include names and addresses, and also transaction history and buying preferences of customers. These lists can be very valuable and are likely to be one of the main assets of value that the online retail business has.

It is important to check at the outset who owns this data. A business will usually own the data it has collected from its customers. However, sometimes databases have been licensed in from third parties and in that case, a buyer will need to negotiate a new licence from the database provider if the existing licence is not assignable.

The next question is whether the company can lawfully transfer the customer data to a buyer, which inevitably involves Data Protection Act 1998 considerations. One point that should be checked is what information customers were given at the time their data was collected about how the company would use the data, and whether the customers consented to it being transferred to a third party. Usually the company will have had a "privacy policy", setting out information about how they would use personal data obtained from customers. Customers may also have given consent to use of their data in certain way by ticking a box at the time of making an online order. The consents given by the individual data subjects and the terms of the privacy policy should be checked to see whether the customers consented to allow their data to be transferred to a purchaser of the company's assets. It is important to also check whether the company's privacy policy set out any specific procedures to be followed on transfer of customer data, for example giving customers advanced notice. If so those procedures should be followed by the insolvency practitioner when selling the data.

Even if consent was not obtained from customers to transfer their data to a purchaser of the company's assets, the Information Commissioners Office (ICO) has issued guidance saying that if a business is insolvent, bankrupt, being closed down or sold, customer lists can usually transfer to the buyer, provided certain conditions are met. Importantly, the seller should make clear to the buyer that it cannot use the data for purposes outside those for which it was originally collected. The buyer should notify the individuals about the transfer of the data to the buyer as soon as practicable after completion.

The sale document can be used to record the buyer's confirmation that it will only use the customer data for the purposes for which it was collected and an undertaking to notify individuals of the new ownership of the data within a certain time period after completion. The insolvency practitioner should also ask for suitable warranties and indemnities from the buyer, regarding compliance with data

In Practice

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protection legislation. This is important because the ICO can levy fines for breach of data protection legislation. To minimise the risk of breach (and the associated risks to reputation), an insolvency practitioner should ensure that any data that cannot be lawfully transferred to the buyer, is permanently deleted from the company's hardware before it is transferred to a purchaser.

When it comes to the practicalities of transfer of the data to a buyer, the insolvency practitioner will need to consider whether the data is in a readily portable format, or whether a migration exercise is needed. This may have an impact on price, given the potential costs involved in such an exercise. If specific software is used to operate the database, this will also need to transfer with the business. However, the company in administration may not own the software and if it is licensed from a third party, there may be either restrictions on assignment, or termination provisions which are triggered on insolvency. In that case, the buyer will need to negotiate a new licence.

Brand

Another vital asset of an online business is its brand. The IP rights protecting the brand are often a valuable part of the business on a sale.

The first step is usually to check whether the insolvent company holds registered trade marks. A company's name, logo, trading name, slogans and straplines could all have been registered as trade marks. Trade marks could have been registered in the UK, as well as other jurisdictions, particularly for businesses with an international customer base. Trade marks are usually national rights, but some do cover multiple territories, eg, Community Trade Marks (CTMs) cover all member states of the European Union.

A considerable amount of due diligence around the company's trade mark portfolio, before an insolvency sale, is common. Often, information held by the company about its trade mark portfolio is either inaccurate or out of date at the point of insolvency. If dealing with a group of companies, it is common for only one company to hold all the trade marks for the group and licence them to other group companies, so it is important to check which trade marks are actually owned by the company in the insolvency procedure.

Trade marks are often subject to security rights in favour of financiers, particularly for companies in financial difficulty. The trade marks may also be licensed to, or from, other group companies. In many jurisdictions, these rights are usually registered at the relevant trade marks registry, but this will not always be the case. In many jurisdictions, there are public electronic registers that can be searched to see whether any such rights are registered against the trade marks; however, the quality of search results can vary by jurisdictions and it can never be guaranteed that public databases are up to date. Insolvency practitioners should not give warranties as to title or encumbrances relying on information listed on the public register.

As well as the sale potentially requiring third party consent, where security has been registered against a trade mark, there is often also a fee imposed to cancel the registration. This will need to be done (and paid for, usually by the buyer) at completion of the insolvency sale. The assignment of the trade marks to the buyer must also be registered, and this will also usually incur a fee.

In addition to registered trade marks, the buyer is also likely to want to acquire any "unregistered" rights that subsist in the company's brand, trading name or logo. The nature of these unregistered rights varies in each jurisdiction, but these are often of limited value and are unlikely to significantly affect the purchase price.

Websites

These are another very important asset of an online retail business. Usually the business will have a main website (eg, Boots.com for sales) and then subsidiary websites for other offerings of the business (such as online photo printing and storing). When selling an online business, it is important to consider the ownership of the website domain name itself, as well as ownership of the content of the website and the software required to maintain and update it.

You can usually identify the registrant of a domain name through free online searches. Common misspellings of business names may also be registered and will be an important additional asset for a buyer.

The website content itself will usually be protected by copyright. Generally retail businesses will have commissioned the content from a third party who, by statute, will own the copyright, unless it has assigned ownership to the company. It is, therefore, important to check the agreement with the content provider, to see whether it deals with copyright ownership.

Copyright will also subsist in the website software's source code, and potentially other features of the software. Again, the software is unlikely to have been developed by the company in-house. It is more likely to have been licensed from a third party, although any bespoke software or modifications may be owned by the seller. Similarly, if the business has any apps, these may have been developed by a third party and licensed to the company.

Often the relevant domain names are the key concern for a buyer, rather than the website content or software, particularly where the buyer has existing resources to develop new website content.

Other IP rights

There may also be other valuable IP in an online business. For example, copyright and/or database rights could subsist in catalogues or other business information. Certain types of businesses are likely to have registered designs or unregistered design rights, eg, fashion or consumer products business. Some businesses may also have a patent portfolio. Due diligence should therefore be conducted to determine whether there are any other valuable intellectual property rights that could increase the sale price.

SUMMARY

The assets of an online business often cannot be "held or seen" when the insolvency practitioner goes on site. However, the customer lists, trade marks and other intellectual property may still be a key source of realising value in the insolvent business.