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TRADEMARKS

The author presents a detailed, step-by-step procedure for due diligence on a company's trademark assets.

Trademark Due Diligence in Corporate Transactions

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As the world economy emerges from the so-called great recession, businesses are busier than ever acquiring and divesting subsidiaries and business units, trying to obtain the perfect mix of innovation and profitability. Against the backdrop of an increasingly globalized and online economy, the true value of many businesses no longer lies in physical assets, but in the more intangible intellectual property—the trademarks, patents, copyrights and trade secrets—that distinguish the offerings, reputation and caché of one business from another. It is estimated that intellectual property comprises a full 80 percent of the value of most businesses today.

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This article will examine how to evaluate trademark assets as part of a due diligence analysis. Like a review of a company's financial position, the trademark evaluation should provide both a tangible basis upon which to determine the value of the transferred assets and crucial information as to the strength of the company vis-à-vis its competitors.

The first step in undertaking a due diligence analysis is understanding the purpose of the review. Is the company looking to acquire a target to expand geographic market penetration? Is it looking to offer a new product line? Or is it looking to place the business or a unit thereof in the best possible position for sale, and the analysis is thus being undertaken to help place a value on the business and/or cure any alleged deficiencies? Not all due diligence analyses will be conducted the same way, and understanding the purpose of the evaluation goes a long way in ensuring that the proper factors are taken into consideration.

Identifying Trademark Assets

What Are Trademarks?

Trademarks, defined as any source identifying indicia including names, words, numbers, images, symbols, sounds, colors, smells, product shape, packaging, trade dress and the like, are an inherent part of the goodwill transferred in any sort of business acquisition scenario.

Schedule of Trademark Assets

Typically when a company is being sold, the seller will provide a schedule of trademark assets to be included in the transfer, ideally with some type of back-up information such as copies of registration certificates. Such information should be viewed as only the first step in identifying the trademark assets used and intended to be used by the company, owned by the company or licensed to the company.

Marks in Use, but not Registered or Filed

In addition, the review should also include identifying marks that are in use, but have not yet been registered or applied for. To identify such assets, the audit should include a comprehensive review of all advertising, promotional, printed and electronic materials in use by or on behalf of a company, such as print ads, radio ads, television ads, online ads, press releases, press clippings, annual reports, signage, uniforms, vehicles, stationery, forms, packaging, labels, tags, catalogs, brochures, annual reports, collateral merchandise (e.g., giveaways) and the like. It is also critical to review all Internet websites associated with the entity, including all sites associated with a particular product line, service line, and corporate subsidiary, along with any Facebook, LinkedIn, Twitter, Instagram or other social media/networking platforms utilized by the company, either formally or informally.

Go to the Source

Finally, if at all possible, meet with in-house advertising, marketing and sales personnel to learn which brands are viewed as most valuable to the company. Such conversations can also uncover upcoming marketing campaigns and provide an understanding of whether the company has current plans to discontinue any brands. It can also be helpful to meet with outside advertising agencies to determine what new campaigns and initiatives may be in the planning stages.

Portfolio Analysis

Once key trademark assets and markets have been identified and their use analyzed, the next step in the due diligence process is to review the current portfolio of trademark registrations and applications to determine if the trademark assets are adequately protected and to identify the strengths and weaknesses of the portfolio.

Review Trademark Office Records

First, the schedules of trademark registrations and applications should not be taken at face value, but should be confirmed against the records found in the trademark offices of the respective countries, including a review of filings regarding change in ownership, licenses or encumbrances. Review the trademark office records of the various countries in which applications and registrations are owned, to make sure they reflect the current ownership of the marks, whether the records contain any security interests or other encumbrances recorded against the marks and whether the address and state of incorporation information is current. In particular, review the records to determine whether:

■ Foreign franchisees, licensees, distributors and/or sales agents have been recorded as registered users with the trademark office, or whether the appropriate franchise, license, distribution and/or sales agency agreement itself or a ''short form'' agreement has been recorded with the trademark office or other government authorities.

■ Key marks are registered in foreign languages where appropriate (e.g., in Japan, it is may be advisable to also register marks in Katakana characters).

■ The filings reflect the approved practice in foreign jurisdictions (e.g., some foreign countries, such as Brazil, do not allow for co-ownership of trademark registrations).

While some trademark office records, such as those of the U.S. Patent and Trademark Office, provide such information online, it is often necessary to engage foreign counsel to review the records in foreign jurisdictions. In lieu of this step, it may be sufficient (depending on importance and/or value of the foreign portfolio, size of the transaction, whether the trademark office records are in a foreign language and the like) to obtain an affidavit from the foreign counsel that handles the portfolio in that particular country, attesting to the status of the applications and registrations as of the closing date. While not a substitute for an actual review of the trademark documents, such an affidavit could make sense in certain situations.

Form of Marks

Second, examine whether all of the pertinent marks are the subject of registrations or pending applications, and whether all of the pertinent marks are registered in the appropriate form. In particular, consider whether marks are registered in standard characters, meaning they are protected regardless of the type and style of the font used, versus a stylized form, or as one component of a company's logo or design mark. While it is sometimes necessary to register marks in a stylized form to overcome refusals to register based on a lack of inherent distinctiveness or a likelihood of confusion with a prior registration, standard character registrations provide greater protection and should be used whenever possible. Similarly, word marks and logo/design marks should ideally be registered separately from one another.

Also, review logo marks as filed in the European Community to see if it may be necessary to re-file for the logos in color. Under former CTM rules, logos filed for in black and white protected the same mark used primarily in color. This rule changed in July of 2014, which may require new color filings for logo marks.

The review should also include an analysis of current pending applications to determine whether they will likely issue as registrations, and consideration of what steps may be necessary to improve the chances of registering the company's marks.

Appropriate Goods/Services Coverage

Third, determine whether all pertinent marks are registered or pending in connection with the services and products with which they are currently used and will be used in the future. Identify registrations that may be subject to challenge for nonuse, and consider whether it is possible to make use of the mark for such goods or services, or consider filing new applications covering the mark(s) as currently used.

Verify Marks in Use for Registered Goods/Services

Fourth, in the United States and other common law countries that trace their legal heritage to England, trademark rights are acquired and maintained through actual use of a mark in commerce in a particular geographic area in connection with particular goods and services. Registration formalizes ownership and conveys additional presumptions and benefits. Even in non-common law jurisdictions, registrations are vulnerable to cancellation if the mark is not in use.

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Once a list of registered and applied-for trademarks has been compiled, the analysis should include a review of the company's products, services, websites and the like to confirm that the marks identified as registered are all still in use for the covered goods and services (or at least the goods or services most relevant to the sale or acquisition at hand), and are not vulnerable to cancellation based on nonuse. In many countries, nonuse of a mark for three years gives rise to a presumption that the mark has been abandoned. Similarly, if the mark is not abandoned, but is used in a different form or for a different product, the company's registrations may not cover the current use.

Appropriate Jurisdictional Coverage

Fifth, review the trademark portfolio to determine whether pertinent marks are registered or pending in the appropriate countries. Because trademark protection is territorially limited, and laws vary from country to country, a company's plans to expand into a certain jurisdiction can be waylaid by its inability to use and register a key trademark in a new market. In contrast to how trademark rights are acquired in the United States, in many foreign countries trademark rights arise from registration of a mark versus use. If trademark owners do not hold registrations for their marks in such countries, the ability to use a mark in a new market, not to mention the ability to enforce such rights through trademark infringement proceedings, will likely be limited. These jurisdictional differences in how trademark rights are acquired are referred to as ''first to file'' versus ''first to use.''

Ideally, core trademarks should be protected in countries in which the company is rendering or selling, or is planning to render or sell, products or services itself or through subsidiaries, franchisees, licensees, distributors, partners or sales agents. It is also critical to review future expansion plans to see whether the company is protected in countries in which it is negotiating with potential franchisees, licensees, distributors, sales agents and/or partners, or is considering establishing a new subsidiary or affiliate.

Identify Licensed Marks

Sixth, identify marks used under license from third parties or licensed to third parties, review the scope of the license granted and compare this to the company's current and anticipated use of the licensed marks. The terms of license agreements should be reviewed to make sure they are still applicable under current market conditions and/or in the event of a merger or acquisition. Marks licensed out to others should be reviewed to make sure the use has been monitored and that goods/services identified with the licensed marks meet the standards set by the licensor.

Logos and Copyright Registrations

Seventh, as to logos and designs, compare the forms of such marks as registered with the forms of such marks as currently used. Also, consider whether the entity owns copyright registrations that might enhance its ability to enforce its logos and design marks, particularly in foreign jurisdictions.

Evaluate Strength of the Trademark Assets

Eighth, look at the ''strength'' of the trademark assets—the relative scope of protection to which the mark should be entitled vis-à-vis third parties. The strength of a mark depends on whether the mark is inherently weak (for example, because the mark is merely descriptive or is primarily merely a surname), whether the mark has become diluted through third-party use and registration of similar marks or whether the mark is at risk of becoming generic. Such searches can also identify potential infringement liabilities and potential limitations on the ability to use and register the mark.

Chain of Title

Finally, the portfolio should be analyzed to determine whether the assets can be transferred free of any encumbrances. Trademark counsel should work with transactional counsel to identify any security interests, liens, or other encumbrances that may transfer with the marks.

The portfolio should also be evaluated in light of any recent merger and acquisition activity to determine whether the related marks were properly assigned and recorded. In particular, identify any marks that were acquired but do not appear to be in current use.

Additional Considerations

Third Party Agreements/Actions

A due diligence review of a company's trademark assets should also include a review of all agreements relating to third-party use of the company's marks and agreements relating to the sale of the company's products and services—including franchise agreements, license agreements, distributorship agreements and sales agency agreements. In particular, such agreements should be reviewed for any information regarding the ability of third parties to use and/or register the company's trademarks.

To the extent that the entity licenses its mark(s) to third parties, the trademark analysis should include a review of the license agreements, and a review of how the licensees are using the covered mark(s). The analysis should also include a review of the company's quality control provisions, whether the agreements allow for sublicenses, whether the agreements survive a merger or sale of the company and a review of how the licenses generally fit within the company's branding strategy.

The review should also necessarily include a review of all other agreements that relate to the company's ability to use and register its own trademarks. Such documents would include consent agreements entered into so as to ensure that the company's marks would register, coexistence agreements with third parties, settlement agreements entered into to resolve disputes; covenants not to sue, license agreements and the like. An audit should also include a review of the company's prior trademark and false advertising litigation, and a review of all potential, pending and concluded trademark opposition and cancellation proceedings, to determine any possible impact on the future protectability and enforcement of the company's trademarks.

Company Policies

A due diligence evaluation should include a review of policies relating to trademark use and monitoring, and of the procedures in place for complying with the quality control provisions of trademark licenses for both marks licensed out (e.g., the company's marks that it licenses for use by third parties), and licensed in (e.g., third party marks licensed for use by the company). Keep in mind that if a licensor fails to exercise adequate quality control over a licensee, a court may find that the license is in fact a ''naked license,'' and that the licensor has technically abandoned the trademark.

Domain Names

Given the numerous top-level and country code domain names currently available, including in the new gTLD space, it can be difficult, if not impossible, to own all domain names possibly corresponding to a company's names and trademarks. However, the due diligence review should at least confirm what names are owned by the company, and a search to determine whether any entity is operating a confusing website at domain names corresponding to the company's name, core marks and identifying nicknames.

Finally, the analysis should also include a review of the Trademark Clearinghouse registrations owned by the company.

Business Names

Particularly when a due diligence review is performed as part of a business sale or acquisition, the review should include a search of the relevant secretary of state and other corporate registers for corporate names, trade name registrations, assumed names and/or fictitious names registered to the company.

Conclusion

Done properly, a due diligence analysis of a company's trademark assets can help a purchaser assess the strength and value of the portfolio, identify potential infringement liabilities and uncover potential limitations on use of a mark. Conversely, prior to selling a business or business unit, an analysis of the trademark assets can help the seller identify any gaps or protections in coverage that might negatively affect the value of the asset to be sold.

In either scenario, a due diligence analysis helps put the value of the trademark assets properly within the context of the transaction.

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