Trademarks, which often are confused with brands, designate the origin of the goods and services with which they are or may be associated. The brand is the value embodied within the wider trademark rights discussed below. There is a correlation, as the use of a trademark inevitably imparts the values of the brand, although not always in a monetary sense. But spoil the brand and the value of the trademark suffers. The linkage exists and cannot be severed.

The function of a trademark, it is often said judicially is to act as a certificate of origin. This simple formulation results in a number of important consequences for those interested in trademarks. An apparently simple proposition hides a web of complexities which the financial and legal community can arbitrage in many ways to the benefit of owners. In particular, properly handled, trademarks make an ideal financing instrument of great versatility. This review sets out some of the issues involved in successfully using trademarks as a financing instrument.

IN SUMMARY

− While it is obvious that trademarks need protecting by owners against external users, what is less obvious, but can be damaging is where the use of trademarks are unregulated within a group of companies

− By consolidating all trademark related rights into a single IP holding company, a powerful tool can be created in which the rights in the trademark and other ancillary rights can be exploited to the maximum

− The result of the due diligence exercise is often that many different corporations each own a small part of the total trademark rights.

AUTHOR

Laurence Cohen is a partner in the London office of Latham & Watkins. His practice includes patents (specifically, but not exclusively, in the pharmaceutical and electronics sectors), trademarks (both registered and unregistered), copyright and designs and confidential information. Larry has taken an active role in the Chartered Institute of Patent Agents, Institute of Trade Mark Agents and INTA. Mr. Cohen was also a member of PRISM, which was a High Level Expert Group advising the EU Commission on the frontiers of IP law in the EU.

Properly handled, trademarks make an ideal financing instrument of great versatility says, Larry Cohen, IP partner in the London office of Latham & Watkins

Trademarks - banking a bankable instrument
What rights do trademarks embrace?

Traditionally the term ‘trademark’ has meant a registered trademark. These are rights which are national or regional in scope, such as a US trademark registration or a Community Trademark (CTM). They are granted by national or regional authorities under powers granted by statute. But the common meaning of the term ‘trademark’ is wider and can encompass unregistered trademarks which are protected by the law of passing off in common law countries and by the law of unfair competition in civil law countries. Additionally protection of varying effectiveness exists to prevent the misappropriation of company names and domain names. All of the above forms of protection create valuable but overlapping intellectual property rights.

A brand is the collection of all of the above together with the embodied values or goodwill (in an intellectual property sense) in each of the above.

The overlap is of importance. To be at its most valuable all the rights set out above need to be in the hands of a single entity. At that point money can be lent against those rights and a royalty charged for the use of them. Of course, a royalty can be and often is charged for the use of the registered trademark only; but that is an imperfect way to proceed for two reasons; firstly because any royalty is lower than it theoretically might be if all the rights were consolidated into a single entity, and secondly because the journey to the goal of all of the trademark type rights being consolidated into a single entity enables value to be generated out of the consolidation of the various rights.

The mobility of trademarks

Moreover, some of the trademark rights are mobile, while others are less mobile. They are not like land, plant, or machinery which are more or less fixed to the location where they are to be found. Although there is mobility of labour, that too is more at the top end. Factory workers and back office staff are not inherently easily mobile although their jobs may be more mobile that they would like to admit. All of those are more or less fixed at any point in time in a particular location, and that means, for trademark rights, the owner can be located anywhere on the planet, and still exercise effective control. As a result, the choice of the location of the owner of such rights becomes driven by other factors, of which the most important are the tax regime under which the owner and any licensee operate, whether there is a withholding in any royalty payments by the local tax authorities, and whether a reasonable infrastructure exists to support a trademark holding company.

However, favourable locations are not open to all; they are the preserve of the actual or putative multinational, as only a business which crosses national boundaries has any reason to locate its trademark rights anywhere other than where it carries on business.

The use of a company name is not technically the use of a trademark, and the trademark legislation excludes such use from infringement provided it is in accordance with honest practices in industrial and commercial matters. However, there is clearly a cross-over when the use of a company name can become trademark use in respect of the designation of origin of goods and services. Where that limit lies is a question of fact. In the UK, from 1 October 2008 registered trademark owners will be able to object to UK company names which are too close to trademark registrations. Domain names give rise to similar considerations.

Finally, as noted above, copyright, and sometimes design rights or equivalent need to be taken into account as creating rights which conflict with trademark rights, whether or not registered.

What is apparent from the above is that the rights which affect trademarks are interlinked, and in conflicting ownership can create limitations, sometimes creating the possibility of mutually overlapping injunctions, that is the seeds of mutually assured destruction. Passage of time, leading to acquiescence, whether or not statutory, may make the position of any one party under a trademark problematic with respect to establishing sole rights under the trademark. This destroys value.

Moreover, the fact that all of the rights except copyright and design right are territorial in nature leads to a further limitation on the right of the owner to exploit any particular trademark. The geographical scope of protection is a further issue to be considered.
The intra group problem
While it is obvious that trademarks need protecting by owners against external users, what is less obvious, but can be damaging is where the use of trademarks are unregulated within a group of companies. Competing rights, with all of the problems that can arise are thereby set up. If a trademark is to form the basis of a vehicle for borrowing, then the issue of title needs to be cleared up. Doing so will invariably create added value, which is why this kind of exercise should be more than self-financing. By consolidating all trademark related rights into a single IP holding company, a powerful tool can be created in which the rights in the trademark and other ancillary rights can be exploited to the maximum.

The Steps to realisation of value
The first step is due diligence; identify all trademark type rights, which companies in a group have used those rights, what licenses if any exist, and whether there are any registered rights. What is often found is that there are some trademark registrations, often not used by the trademark owner but by other group members, there may be non trademark use of company names, for example by holding companies or in respect of the financial markets and there may be some domain names, often used by an entity which is not the owner.

Once the process of identification is complete, the next stage is to decide on the location of the company which will be designated to hold the trademark rights. For a UK only company, the choice is limited; there is no reason to go outside the UK. However, for a multinational, and even for a putative multinational, the location of an IP holding company is more open. The choice is driven by tax considerations and by the existence of an appropriate treaty network.

The choice of location immediately gives rise to some difficulties:
• Under UK tax law, a non trading holding company in a tax haven will have its accounts for tax purposes consolidated with that of its parent company under what is called controlled foreign corporation legislation. There are ways in which this difficulty can be overcome, but they are the province of the tax lawyer and not the trademark lawyer. It is not worth holding trademark assets offshore unless there is a tax advantage in doing so;
• Many tax havens do not have double taxation treaties with consumer and manufacturing countries, and as a result, fiscal authorities demand a withholding from any royalty payments. These are not paid gross, but net of the withholding. Although a certificate of withholding is given to the recipient, this only provides a credit against local tax for the tax withheld. That militates against licensing out of a tax haven, as such locations rarely have a good treaty network;
• Transfer of assets, including trademark assets out of a particular jurisdiction usually results in a tax charge; either capital gains tax or corporation tax, depending on local law. Paying significant tax on the transfer of trademark assets is self-defeating.

The difference between the IP and tax treatment of trademark rights
Fortunately, while trademark law will recognise shared goodwill and registered rights which have been used, and thus enforcement against non group third parties is possible and feasible, tax law treats each corporation individually. Thus the result of the due diligence exercise is often that many different corporations each own a small part of the total trademark rights. Taken individually, those trademark rights are often worth very little.

It follows that each of the individual trademark rights in each different company should be valued prior to assignment to the trademark holding company. Usually, with the exception of trademark registrations used or licensed by the owner, these rights have only nominal worth. It is truly a case of the whole being worth more than the sum of the parts. Consolidation of the trademark rights adds value. The services of a professional IP valuer are essential if the exercise is to have credibility.

Because the tax treatment is different from the IP treatment of these rights, it is often possible to move the trademark rights to a holding company in a favoured jurisdiction without incurring much capital gains tax or corporation tax liability.

Favoured locations include Switzerland, the Netherlands and tax havens such as the Isle of Man or one of the Channel Islands. Each location has advantages and disadvantages; the primary disadvantages of tax havens being the lack of a good treaty network to enable royalties to be paid gross, and the need to take into account the effect of the controlled foreign corporation legislation.

What happens if any individual right is too valuable to assign?
It is sometimes the case that a trademark has been used by the owner and has real value attaching to it. In such a case it becomes too expensive to assign. It is often the case that the trademark owner has not registered the trademark in sufficient locations for it to be used under single ownership as an effective group trademark. In such a case commercial exploitation of a group trademark can only be properly enabled when all the effective rights are concentrated in a single company. Value can be compromised by the trademark holding company apply where there is no protection for registration in its own name, and the cost of the transfer of rights then avoided by the other owner granting the trademark holding company an exclusive licence and the latter granting back a world wide non exclusive license.

The next steps - filling out the portfolio
Having transferred what is available, whether by way of ownership or license to the trademark holding company for fair value, the complementary act is to complete any gaps in the registered trademark portfolio, by having the IP holding company apply for trademark registrations in its own name in territories where the group trades or intends to trade and no such registrations exist. Where there are gaps in existing registrations and extra classes or goods should be covered, that is best dealt with once the rights are with the IP holding company, as the giving up by a trademark owner of a right could itself give rise to a charge to capital gains or corporation tax.

The crux of the transaction - the grant back licence
The next step is for the trademark holding company to grant back to all of the group members a trademark license. The license is wider than mere registered trademark rights. The license would ordinarily be granted for a
running royalty and be granted to all operating companies. Group holding companies should also be licensed, the consideration being that they will use the mark wherever possible to promote its goodwill, the ownership of which remains with the IP holding company.

The appropriate royalty rate is always a matter of difficulty. It should be a true “arms length” rate. However, determining the rate is difficult when the negotiations, which are between parent and subsidiary, are unlikely to be truly arms length. Professional valuation help should always be called in as a number of tests are applied to determine objectively the range of appropriate royalty rates for each operating company. Different rates may apply to different businesses.

The tests commonly used to verify whether the selected royalty rate in any case is appropriate include:
- Evidence from comparable licenses;
- Available profits from the license, which should be split approximately 25% to the licensor and 75% to the licensee;
- Assessment of the benefit to the licensee in taking the license over the base condition (affordability);
- Compliance with transfer pricing guidelines.

Once the royalty rate has been set, the license can be entered into between the trademark holding company and the group members, and a royalty stream established. Typically the licenses will not be open-ended as to time; to allow for changes in market conditions. Five to ten years is a sensible commercial period for a trademark license although termination on reasonable notice is an alternative, albeit less good as it leads to commercial uncertainty, thus depressing value. Also, licenses without termination provisions may not be terminable. One clause that should be included is the right of the licensor to freshen any logo trademark on reasonable notice, as market conditions dictate.

**What happens next - the bankable proposition?**

Once the licence scheme is in place, and the trademark holding company has licensed all of the operating companies, it will receive a steady income stream. There are then a number of possibilities, as that has now set up the ability to securitise the income stream. Since the income stream for the duration of the licenses will have a capital value, the licenses can be sold. This is often done by putting them into a special purpose vehicle. If that special purpose vehicle is in a location in which the capital value of the licenses can be amortised whether by reason of local law as an asset, or by reason of local law relating to intellectual property right acquisitions, then the royalty income can also be sheltered from tax by taking the amortisation over the period of the licence. This increases the attractiveness of this kind of structure, where available.

Whether or not amortisation is appropriate, what has been created is a series of licenses which are an asset with an income stream attached to them, and that can either be used to secure borrowings, or even as the vehicle for repayment of borrowings with appropriate interest.

In assessing whether to use the bundle of licenses as a financing vehicle, banks and other financial institutions will look at the quality of the income stream, and its value. The valuation can be given on a discounted cashflow basis, so that the future royalties can be given a present day value. Allow some margin (called a “haircut”) and typically banks and financial institutions that will look at these kinds of structures will look to lend about 80% of the assessed value. The rating agencies, which are becoming increasingly familiar with this type of transaction, may accord the bundle of trademark rights and the licenses granted there-under a better credit rating than the underlying business, thereby improving the capital to interest ratio.

One issue that always exercises lending institutions in these circumstances is what happens if the underlying entity were to become insolvent. Given that the rights under the trademark granted by the bundle of licenses is likely to be inherently valuable in bringing in business, either for the successor corporation or on a sale of assets, it is highly unlikely that there will be a total loss. Indeed certain organisations conduct intellectual property auctions and sell off trademarks.

The way that this issue is handled is by appointing a reserve manager in case the underlying business does become insolvent so that the intellectual property rights can be dealt with either by continuing the license (which may be necessary for the underlying business to survive at all and to be sold from administration or insolvency, or to realise the value of the underlying assets which are the licenses).

Provision needs to be made to ensure that the structure survives an insolvency of the underlying business. That is one reason for using an intellectual property or trademark holding company; it can be ring-fenced whereas a trading company cannot be ring-fenced so easily. Further the use of special purpose vehicles for holding the bundle of licenses also creates its own ring-fencing. Providing the income continues to come in, then subject to the ‘haircut’ there should always be an excess of income over the payments out for the bundle of licenses (i.e. the borrowings plus accrued interest, although differently expressed) and under those circumstances there is reasonable protection against insolvency.

**Summary**

In summary, trademark rights provide a simple and effective means of creating a vehicle which can be used for actual or potential borrowing purposes. The borrowing can be internal or external and the cashflow is generated and can be used internally and externally: The credit rating of the trademark assets should be at least as good as that of the underlying business, if not better. There is good protection against a disaster of a complete collapse in value, and reasonable protection against a partial collapse.

The downside is that the royalty flows may be disappointing from the underlying business although on a group trademark it is likely to follow the fortunes of the group and so the margin of the haircut needs to be reviewed against the likely performance of the group.

Trademark securitisation represents an efficient way of structuring borrowings under many circumstances and is likely to be a vehicle which is increasingly employed as one of the alternatives to straightforward lending against secured assets.