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by David Ehrlich (and revised November 2, 2003)

Splitting a U.S. Mark

The sale of part of a company's business often presents a difficult problem – how can both the seller and the buyer continue to use the seller's mark for related goods or services without damaging the shared mark under the U.S. trademark laws? U.S. trademark law offers three typical procedures to split a mark in this situation: (1) the seller can assign the mark to the buyer for the pertinent goods (while keeping the mark for the seller's goods), (2) the seller can keep the mark for all goods and give a perpetual license to the buyer to use the mark for the pertinent goods, or (3) the seller can assign the mark to a jointly-owned holding company which licenses both parties to use the mark. None of these procedures is free of problems.

1. Sale of the mark: The procedure that buyers usually prefer is to take an unconditional assignment of the mark for the goods concerned, together with the pertinent goodwill and all pertinent registrations or parts of registrations.¹ Sharing a mark by such an assignment makes trademark theorists uncomfortable, however, because it means that the single mark now represents two independent sources and two goodwills. This is contrary to basic trademark theory in the U.S. that a mark identifies a single source and a single goodwill. When goods are related, such splitting arguably deceives consumers (who may continue to assume that all the goods concerned come from the same source) and might permit an infringer to argue that the plaintiff (the seller or buyer) should lose an infringement suit because it has unclean hands.

¹ Under Trademark Rule 2.171(b), 37 C.F.R. §2.171(b), the buyer and seller may request that a federal trademark registration be divided into two registrations when the seller assigns some, but not all, goods or services in the registration to the buyer.

However, theory has not kept up with practice in the U.S. because such splitting is often done, and, as far as this writer is aware, no recent case law has condemned such splitting. Some case law has approved it by allowing a seller or buyer of a split mark to police its mark successfully in infringement suits. Some cases even remark specifically that the split is not disabling. E.g., *Amana Society v. Gemeinde Brau, Inc.*, 417 F. Supp. 310 (N.D. Iowa 1976), *aff'd* 557 F.2d 638 (8th Cir. 1977). It seems unlikely that a sensible common law court would hold a trademark invalid, or even seriously less protectable than normal, as a result of such an assignment, when the only beneficiary would be an infringer.

A minor practical difficulty is that a new application for the split mark may encounter a blocking citation of the other party's application or registration. However, U.S., examining attorneys will usually drop such blocking citations if the other party consents in writing to the application.

While the seller may regret giving up total control over the mark, and over the goodwill that the mark represents, the buyer benefits by having unconditional ownership of a major business asset, free of any right of control and termination that the seller would have in a license agreement, and free of any need to get the seller's permission to police infringements. The seller benefits by not needing to control the quality of the buyer's goods or by being jointly liable for the buyer's torts, as it would be if the buyer took a license instead of an assignment.

A lawyer drafting a splitting agreement may wish to address such issues as:

1. If there is a uniquely-appropriate domain name for a present or planned website, which party gets the name, and will that party put a link on its website to the other party's website, or use a neutral "gateway" page directing websites to either party's site, as appropriate.
2. What will the rights of the parties be to (1) expand their use of the mark to goods or services not previously sold by either party (such as a vehicle maker expanding into agricultural machinery) or (2) sell or distribute merchandising or promotional

goods, such as baseball caps and T-shirts bearing the mark (and keeping in mind that such goods are now sometimes sold for profit and can provide significant income).

3. What will the rights of the parties be to register their marks for expansion goods or services and promotional goods or services.
4. Will the parties be required to use different logos and different trade dress on products (including licensed and promotional products) or to use disclaimer-type statements on products and in product promotional materials, web sites and the like to differentiate their now-separate goodwills in the public mind.
5. What cooperation, cost-sharing or consultation, if any, will the parties undertake in policing infringements.
6. Will the agreement cover the U.S., only certain countries, or the whole world.²
7. Will either party be required to maintain any specific market position (such as high end or luxury) or level of quality to avoid tarnishing the mark.
8. If the mark is part of the seller's company name or trade name, such as the name of a division, can the buyer use the mark as part of its company name or trade name.

2. A Perpetual License: Another procedure, often preferred by sellers, is for the seller to give the buyer a perpetual exclusive license to use the mark for the buyer's goods, usually in exchange for a single payment for the pertinent business. The license is then royalty-free. The seller retains ownership of the mark, the goodwill and the registrations. That license agreement can address issues numbers 1, 2, 5, 6, and 8 above, which are as pertinent in a license as in a splitting assignment situation. Since, in the U.S., a valid license requires that the licensor control the quality of the licensee's goods or services (with at least an implied right to terminate if the quality is deficient), licensees will insist on extremely weak quality controls and elaborate, multi-step termination provisions, with liberal rights to cure breaches, that make entire

² Foreign law on splitting marks is not necessarily the same as U.S. law. Different arrangements may be appropriate in different countries.

termination very difficult.³ Because U.S. licensing case law has so often approved very minimal quality control, it is possible to draft a license that has sufficient quality control, but that also is effectively non-terminable for alleged breach. That is, it would not be terminable except for the most egregious quality breaches and would give the licensor no ability to significantly control the licensee's use.

There always exists a possibility that a licensor who becomes dissatisfied with the deal will use quality control objections in bad faith to harass the licensee, but this can be mitigated by a provision penalizing unsuccessful attempted terminations (such as the licensee can require arbitration and recover all its attorney fees and costs if it wins). There is also an unavoidable risk that a defendant, in an infringement suit or unfair competition suit by the licensor or licensee, will raise the allegedly uncontrolled ("naked") license as a defense. This defense – and the extensive and intrusive discovery that it permits – may lengthen and complicate the suit, and give the defendant settlement leverage. Another disadvantage to the seller is that a licensor of a mark is usually jointly liable with the licensee for product liability claims when the product bears the licensed mark. However, the parties may be willing to accept such disadvantages. If the buyer is buying only a small part of the seller's business, and the parties' bargaining power is very unequal, the buyer may simply have no choice if the seller insists that it will not split ownership of the mark.

Unfortunately, there is another serious risk for the licensee. Under Section 365(a) of Chapter 11, the U.S. bankruptcy statute, a trademark license is not necessarily perpetual if the licensor goes bankrupt. Under that section, the bankruptcy trustee can terminate without cause

³ A licensee will also insist on the right to assign the license with the business and to sub-license, with the licensor having no approval right or a weak approval right.

an "executory contract" (a contract not yet fully performed by both parties) to which the bankrupt is a party, if the trustee decides that ending or re-negotiating the deal is in the best interest of creditors. A trademark license is almost certainly an "executory contract". If the licensor goes bankrupt and the trustee terminates the license, the terminated licensee is then left with no right to use the mark and a breach of contract claim against a bankrupt estate. If the licensee sues the estate for damages for breach and wins, the judgment may be partly or wholly uncollectible. This writer is unaware of any proven way to remove this risk of termination. The trustee's right to terminate cannot be waived prior to bankruptcy.

The statute contains an exception. 11 U.S.C. § 365 (n) gives licensees of "intellectual property" a right to continue the license on the same terms, but "intellectual property" is carefully defined in 11 U.S.C. §§ 101 (35A) to exclude trademarks.

The licensee might try to mitigate the risk by including, in the license, a provision that the licensor will assign the mark to the licensee for the licensee's goods if the licensor fails certain criteria of financial soundness. However, monitoring the licensor to see if it fails those criteria and then trying to compel the licensor to assign the mark would be difficult. In theory, two other unproven ways exist to mitigate the risk. One is for the licensee to take a trademark license for the word mark and a copyright license for an elaborate copyrightable logo that includes the word mark. A copyright is "intellectual property" under the definition in Section 101(35A), so that the copyright license at least can be made non-terminable. This license could not assure that the licensee would have the right to use the logo as a mark, but it would muddy the waters. A second unproven way to mitigate risk of termination is for the licensee to take a security interest in the mark itself under Article 9 of the UCC to cover the licensor's liability for damages from a termination that breaches the license agreement. Whether this would be held invalid as contrary

to the trustee's termination right under federal bankruptcy law remains to be litigated. In any case, one or both of these provisions in a license might convince a bankruptcy trustee that an attempted termination is not worthwhile because it will provoke lengthy litigation and cloud the trustee's right to re-license the mark to a third party.

In some splitting deals, the license term is not perpetual, but only for a few years. This gives the licensee a chance to use the licensor's mark with the licensee's own mark for a few years. This joint use is intended to transfer customer loyalty for the pertinent goods over to the licensee's own mark. A possible licensor bankruptcy is less of a concern in such situations, so long as the licensor is likely to remain financially sound during this transitional period.

3. Holding Company: A third procedure is for the seller to assign the mark to a jointly-owned holding company, which then licenses the mark to both the buyer and seller. If the holding company takes on no obligations that might throw it into bankruptcy and obtains adequate insurance coverage for possible tort liability judgments based on its licensees' torts, then the holding company is probably not at risk of bankruptcy. This arrangement seems best for both parties from the pure trademark point of view, assuming that the split in the holding company's share ownership between buyer and seller and the company's by-laws insure that neither party will be able to dominate the holding company and cause it to use the licenses' quality control provisions to harass the other party. However, this procedure may also be the most expensive in terms of legal and administrative costs, and it may require more sophisticated tax planning.⁴ A future sale of the mark also presents difficult issues.⁵

⁴ For example, even though the seller assigns the mark to the holding company for free, the IRS may impute a value to the mark and treat the assignment as a taxable event, resulting in a capital gain to the assignor and a taxable dividend to the holding company.

David Ehrlich is a 1977 graduate of Harvard Law School and a member of the firm of Fross Zelnick Lehrman & Zissu, P.C. in New York, where he practices exclusively in the field of U.S. trademark and copyright law.

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⁵ Examples are how to divide the proceeds if the parties sell the mark or how to resolve disputes if one party wishes to sell the mark and the other does not.