Practice Point

Trade mark warranties in M & A transactions

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The most valuable asset of an acquired company in a merger or acquisition may be its brands, that is, its word and non-word logo trade marks. Nowhere is that more true than in a trade mark-rich industry sector such as luxury goods, including designer apparel, perfumes and cosmetics, jewellery, fine watches, and other fashion goods. Ask any of the dealmakers why they made their acquisitions and inevitably they will return to the 'brand's equity'. Moderate-size merger and acquisition (M & A) transactions in the luxury goods sector continue in 2008, often financed by private equity companies, despite the sub-prime crisis credit crunch.

Trade mark assets, however, are very unusual types of property—fragile, hard to inventory fully, and subject to many problems that can limit their scope and value. This article will discuss how some typical types of trade mark warranties in M & A transactions should be fine-tuned to prevent serious problems and costly surprises.

Key issues

- From a buyer's perspective, an accurate definition of trade mark assets is essential in order to negotiate warranties.
- There are various types of warranties concerning a mark's validity, limitations on right to use, and geographic scope.
- Trade mark registrations can be subject to attack and other problems can lie unnoticed by a seller, which can be unearthed only through meticulous due diligence.

Defining 'trade marks' in the transaction

Buyers and sellers have a mutual interest in accurately defining the trade mark assets included in a deal. If the deal is an asset sale, an accurate definition of the trade mark assets included in the sale is essential. Even if the trade marks pass to the buyer automatically through a sale of stock or a merger, an accurate definition of trade mark assets is also essential to indicate the trade marks to which various warranties apply. Naming all marks can be difficult. Marks can exist without being registered in the US Patent and Trade mark Office (USPTO). Under US law, a company creates protectable common law trade mark rights automatically merely by using the mark in connection with a product or service, regardless of whether the mark is registered. Common law rights are limited to the geographic area of actual use. Typically, a company will register its major trade marks in the USPTO; these registrations will have official registration numbers that can be scheduled in an M & A agreement—but it may not even know all its common law marks.

In an asset transaction, the buyer will wish to ensure that the definition of 'trade marks' includes all trade marks of the seller relating to the business being acquired, including both registered marks and common law marks, so that the buyer will receive all the trade marks that it needs to continue the business. A catch-all clause can include all marks used in the business without listing them individually.

For warranty purposes, for both registered and common law trade marks, buyers will seek warranties of validity and title. However, as explained below, additional warranties are appropriate for registered trade marks, and full warranties for all marks may not be prudent (at least from the seller's perspective). It is therefore usually best to have at least three definitions of trade marks in an M & A agreement: (i) registered trade marks, (ii) common law trade marks, and (iii) all trade marks, which include both registered and common law trade marks.

Types of warranties

Ideally the buyer would like various warranties, including a warranty that all trade marks and similar property (such as company and divisional names) used in

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the business are valid and are owned by the seller, free, and clear of all liens and encumbrances. Such warranties give some assurance that the buyer can continue to use the marks in the business without being sued by a third party for infringement, and that it can prevent others using the marks for the same or similar goods or services. The buyer might also seek assurance that it can expand its use of the marks to related goods or services, as it grows the business, since both common law marks and registered marks cover only particular goods or services. For example, the marks DELTA for airline services and DELTA for faucets are owned by unrelated parties. Sellers will try to resist unrestricted warranties of validity and title, which can be highly dangerous. Buyers and sellers—and their attorneys—need to strike a reasonable balance as to warranties that can be given safely, in light of both legal limitations and the limited availability of information on possible problems.

Is the trade mark valid? This issue requires an understanding of how trade marks can be invalid, even if they are registered. A mark might be invalid if another party has prior rights in the same mark (or name) or a similar mark (or name) for the same or similar goods or services.[1]

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In the USA and many other countries, the rights of a prior party are not cut off by registration of the mark. A US trade mark can also become invalid if it was ever transferred without the goodwill relating to the mark (a 'naked assignment'). An assignment that included the goodwill may still be considered a naked assignment if tangible embodiments of the goodwill such as inventory and customer lists were not included in the sale. A typical naked assignment is an assignment of the mark to a bank to secure a loan, with a promise to re-assign the mark to the borrower after the loan was repaid, which the bank took instead of taking a security interest in the mark. Similarly, a US mark may become invalid if it was the subject of a licence to another party to use the mark, but the licensor (the trade mark owner) did not control the quality of the goods or services sold under the mark by the licensee (a naked licence).

A mark may also become invalid through non-use for the goods or services for which it is registered. Under US law if the owner stops using the mark, with no intention to resume use of the mark, then the mark becomes 'abandoned'.[2] The fact that the mark may still be registered is not a defence. The registration is subject to cancellation on grounds of abandonment. In most countries other than the USA, registration of marks can be cancelled following 5 years of non-use in the country concerned.

If possible the buyer, in its due diligence, should investigate these various types of threats to validity of the marks in the transaction. A prudent buyer may try to negotiate not only a warranty of validity but also specific warranties against the threats to validity, such as the mark was never the subject of an assignment or licence and that there was never any period of non-use of the mark, following its initial use, that might be construed as abandonment. As to prior rights of third parties, the buyer could seek a warranty that there are no such prior rights for the same or similar marks or names for the same or similar goods or services.

The seller should try to resist giving general warranties of validity or warranties beyond its knowledge. Especially for relatively new marks, a seller might be able to warrant certain objective facts, for example an assurance that it never licensed any third party to use the mark or never assigned the mark. For older marks, such information may be unavailable. A prudent seller will try to limit all warranties of validity to the best of its knowledge. Even a warranty based on facts to the best of the seller's knowledge raises questions of how thoroughly the seller must examine its files for potential problems deemed within its knowledge. It can take a very thorough examination of a seller's old trade mark files and product sales records to detect problems. A seller will find it hard to be absolutely certain that no prior party in the whole USA has common law rights in a mark or a similar mark or name, for the same or similar goods or services. Prior users of conflicting marks or names may pop up and make claims, years after a mark is adopted. Sometimes such claims arise when the seller used the mark only in one region of the country, and the buyer later expands the use to a different region of the country, where the third party has its rights. This prompts the third party to make an infringement claim. Likelihood of such unpleasant surprises can be reduced by doing 'full trade mark searches' for a particular mark. These searches, prepared by search

1 A prior party's mark or company name or trade name can be infringed by another party's subsequent use of a mark.

2 Lanham Act section 45, 15 USC 1127 (definition of 'abandonment').

firms and reviewed by attorneys, include a wide variety of sources of common law marks and names, as well as a thorough search of registered marks. Outside the USA, searches of registered marks are available. In some countries, additional searching is prudent, although most non-US countries give little or no protection to unregistered marks.

A buyer might seek a warranty that such a full search was conducted by a reputable trade mark search firm then reviewed by reputable specialist trade mark counsel, with no likely problems being flagged. If the seller's response is that no search was conducted, the seller's warranty that it is not aware of any prior mark problem may be of little value.

Buyers typically get some assurance of validity by seeking warranties that there are no pending claims against the seller that its use of the marks infringes the prior rights of a third party. Prudent buyers will also seek a warranty that there are no pending claims by the seller against third-party infringers, since a widely infringed mark may have a lower value. Sellers may offer such warranties on claims as alternatives to unlimited general warranties on the validity of the marks, requested by buyers. It is unreasonable to expect the seller to warrant that no undetected infringements exist, since many small infringements may go undetected. Also, whether a particular use constitutes an infringement is highly subjective. Claims disclosed by sellers need to be carefully evaluated.

Many companies adopt marks intended for short-term use, such as slogans, without full searching.

Sellers may prudently decide to give broad warranties for major marks that they thoroughly searched, registered, and have used without third party claims, while providing only narrow warranties (or none at all) for minor marks adopted without full searching. Many companies adopt marks intended for short-term use, such as slogans, without full searching.

The test of whether use of a mark in the USA infringes another party's rights in a prior mark or name is whether typical consumers are likely to be confused, under all the circumstances of use of the marks by both parties. A seller may be able to warrant, without excessive risk, that a mark will not infringe prior marks but *only* on condition that the buyer continues certain confusion-avoiding circumstances of use of the mark. For example, the buyer's use of a particular product mark might not create confusion with a similar prior mark of another party, so long as the buyer also prominently uses a famous house mark on the product label. Outside the USA, such confusion-avoiding use circumstances are typically less relevant, and infringement risk may be higher if a prior party owns a similar registered mark.

Is the trade mark owned by the seller? Buyers should be wary of marks that have a long history of assignments and security interests (mortgages) and marks that were assigned in bankruptcy.[3] The mere absence of an assignment indexed against a registration in the USPTO does not necessarily mean that no assignment or security interest exists. Recordation of assignments of registered marks in the USPTO is not mandatory.[4] Security interests in registered marks are often recorded in the USPTO but, according to the case law,[5] the USPTO is not the proper recordation venue to 'perfect' a security interest against a mark, that is, to give the secured party a claim in the mark over other creditors if the trade mark owner fails to repay its debt. Rather, the proper venue is the filing office for Uniform Commercial Code security interests in 'general intangibles' in the state concerned, under Article 9 of the UCC. Security interests not recorded in the USPTO may be hard to detect, unless the seller discloses them. The buyer may insist on an unlimited warranty that the seller owns the trade mark free of any security interests, liens, or encumbrances, but the seller may try to limit such a warranty to its best knowledge, especially if it was not the original owner of the marks.

The buyer should also request a warranty that no undisclosed agreements exist containing limitations on the seller's right to use, assign, or license the mark, such as prohibitions against expansion of use of the mark to new products, new trade channels, or new geographic markets, or requirements that the mark be used only in certain ways, such as with a house mark or in a particular logo form. Such agreements are common to settle infringement claims. Any such agreements should be included in a schedule to the agreement, and the buyer should evaluate them to see if they greatly impair the mark's value. Similarly, if the seller's business includes using a third party's mark

3 The prohibition on naked assignments in the US can make it difficult for a bankruptcy trustee validly to assign a mark. See *Marshak v Green*, 746 F.2d 927(2d Cir. 1984).

4 However, an unrecorded assignment of a registered mark in the USA will be rendered void 'against any subsequent purchaser for valuable consideration without notice'. Lanham Act section 10(a)(4), 15 USC. §1060(a)(4). All buyers should record assignments promptly.

5 Eg, In re Roman Cleanser Co. 43 B.R. 940, 225 USPQ 140 (Bankr. E. D. Mich. 1984), aff'd 802 F.2d 207 (6th Cir. 1986).

under a license, such licences should be disclosed and the buyer should seek a warranty that the license is assignable to the buyer, so that the buyer can continue to use the mark. Many licences forbid the licensee to assign the licence without the licensor's approval.

In some countries outside the USA there may be additional threats to validity. For example, in Mexico, the Russian Republic, and Thailand, the trade mark law obliges trade mark owners to record, with the government, licences of trade marks to third parties. Failure to do so can threaten the validity of the mark. In some countries, recordation of title changes of marks (assignments, mergers, changes of owner's name) is mandatory. The buyer should seek a warranty that any licences or title changes, required to be recorded under local law, were recorded. If a seller has a large portfolio of registrations in many countries, it might have deferred recording title changes in order to save expense. The cost to the buyer of making these recordations, after acquiring the portfolio, can be substantial. The buyer may prudently seek a warranty that all such title changes were recorded. If such title changes were not recorded, the seller can negotiate a reduction in the sale price for the cost that the seller will pay for such recordations.

The buyer may also seek a warranty that the seller owns critical domain names, such as the major marks of the seller followed by '.com'.

Personal name marks

When the seller's mark is his personal name, special problems arise. These have caused much litigation, when not properly addressed beforehand. The parties should agree in detail what, if any, use of his or her name the seller can continue to make in the field concerned. A designer of clothing, for example, may use his name as a mark, and sell that mark, but want to be able to use another mark on clothing after the sale *and* to disclose in some way that he or she designed the clothing. The buyer will wish to closely limit or forbid such use. If the seller's business is a family business, the buyer should be alert to the possibility that a relative of the seller, possibly already in the business, may use his or her similar name as a mark and cause confusion in the market place. The buyer may wish to bind such family members to the same use restrictions as the seller, if possible.

Geographic scope of trade mark rights issues

A company that owns a trade mark in one country does not necessarily own the mark in other countries. Trade marks are territorial, created by the national laws of individual countries (a notable exception being the Community trade mark, valid in all European Union Member States). A registration of a mark in the USPTO relates to trade mark rights only in the USA and its territories and possessions. Most countries have trade mark registration systems. In many of them, unlike the USA, an unregistered mark is not protectable.[6] A seller in the USA may have no rights at all in its marks outside the USA, and third party registrations in foreign countries may make the mark unavailable for the buyer's use in many countries.

Therefore, it is essential to the seller that trade mark warranties be limited geographically. A seller that has searched and registered its marks in the USA, and has not searched and registered its marks in other countries, will certainly wish to limit its warranty of validity and non-infringement to the USA. Indeed, if a seller has only used its mark in one region in the USA, and not in the whole USA, it might wish to limit its warranty to that particular region.

If a buyer is purchasing a business in which the marks are used in multiple countries, then the buyer should seek warranties that cover all the countries of interest, and possible desired expansion countries. The buyer's due diligence should include a careful evaluation of the risks and additional costs necessary to secure the mark in desired expansion countries. It is common for smaller sellers to export branded goods to particular countries without full searching and registration of the marks in those countries, and to take the risk that their use will not infringe. This is understandable given that the costs of searching and registering marks can be thousands of dollars for each mark in each country.

A seller's registration for a mark in a country outside the USA does not necessarily give exclusive rights to use that mark in that country. Many countries do not search existing registrations before they grant new registrations for marks and do not refuse registration based on prior registrations of others. As a result, there may be conflicting registrations and the rights of the various owners might be resolved only after litigation. This risk of such litigation can be reduced by the seller or buyer

6 A minor exception is that some countries protect 'famous marks' without registration, but prudent trade mark owners prefer to rely on registration to protect their rights. Protection of famous marks in major countries is discussed in detail in *Famous and Well-Known Marks* by Frederick W Mostert (International Trademark Association, 2nd edn, 2004), to which the author contributed the chapter on US marks.

conducting searching, through private attorneys, in the trade mark Registers of the countries concerned.[7] As in the USA, a buyer would be prudent to seek a warranty that such searching was done and counsel cleared the mark, before the buyer relies on a mark being available for use, without excessive risk, in that country.

Special problems arise if a seller keeps a mark for some goods but sells the same mark to the buyer for other goods, so that both buyer and seller use the same mark. These are discussed in a previously published article by this author, 'Splitting a US Mark', available on the frosszelnick.com website.[8]

Special issues for International Registrations

Under the Madrid system, most countries allow their nationals to obtain an International Registration (IR) for a mark, based on a home-country application or registration, and obtain 'extensions' of the trade mark to other countries participating in the Madrid system, at a lower cost than registering the mark in each individual country. Many companies have used this system in lieu of obtaining national registrations. The IR and national extensions can be assigned, but only to a national of a country participating in the Madrid system. Many countries, including some tax haven jurisdictions and most Latin American countries, are not members of the Madrid system. Their companies and nationals cannot validly receive assignments of IRs and national extensions.

US registration issues

Registrations of marks in the USPTO create powerful legal rights beyond those created by mere use of the mark. The most important of these is that a registration, from the time of filing of the application to obtain such registration, reserves the owner's right in the mark throughout the country (assuming that the application eventually matures to registration). Since 1989, it has been possible to apply for registration based on an intention to use the mark in the future, instead of actual, current use of a mark in the US. Registration is granted after use of the mark begins and proof of use is filed. The intent-to-use (ITU) application prevents third parties who use the same or similar mark, for the same or similar goods, *after* the filing date of the application, from obtaining common law rights. Thus, if such subsequent users exist, it may be important to maintain the early priority date created by the federal registration, and that the registration be valid, to prevent the subsequent user from having superior rights.

The buyer will wish to include a schedule of all federal trade mark registrations in the agreement and to receive a specific warranty that all scheduled registrations are valid, were properly maintained, and are owned by the seller.[9] Before giving such a warranty, the seller must keep in mind that, as mentioned above, registrations can be subject to attack, on various grounds, such as naked assignment, naked licensing, abandonment, and prior rights of third parties, which can also be asserted against common law marks. There are also potential problems unique to registered marks. Such problems can lie unnoticed in a seller's files, being unearthed only through meticulous due diligence, encouraged by a buyer's requests for warranties.

One major problem is fraud due to over-claiming on goods or services. There are various bases for USA and foreign companies to obtain registration of marks in the USA. A detailed discussion of these is beyond the scope of this article. However, all types of USPTO trade mark registrations require, either as part of the initial application process or as part of later required maintenance filings, a document signed by the owner stating that the mark is in use in the USA for all the goods or services claimed. If the mark is in use in the USA only for some of the goods or services claimed in the registration, then the excess goods or services must be deleted in that signed document. The USPTO administrative tribunal has recently declared many US applications or registrations to be *entirely* invalid on grounds of fraud because the owner falsely claimed that the mark was in use for all the goods, when it was actually in use in the USA for only some of the goods.[10] The fact that the use was claimed inadvertently or carelessly was held not a defence. Many registrations are vulnerable to cancellation on grounds of this type of fraud, especially those obtained by foreign companies unaccustomed to the use requirements of US law. If a registration is cancelled, the owner can rely only on its common law rights in the mark, which may have a later date or cover only part of the USA.

7 The searches by government Trade Mark Offices vary widely in quality, and cannot be relied on to find all problems. Also, even countries that refuse registration, based on prior registrations, can sometimes miss pertinent marks in their searches. In that case, the prior registrant can cancel the seller's registration.

8 *Thomson & Thomson Client Times*, Spring 1999.

9 In the USA and most other countries, trade mark registrations must be renewed every 10 years by filing a form and paying a fee. An additional use declaration must be filed during the 6th year of the registration in the USA.

10 Eg, *Medinol Ltd. v Neuro Vasx Inc.*, 67 USPQ2d 1205 (TTAB 2003).

A prudent buyer may request a specific warranty that all claims of use of a mark in US applications or registrations were true and accurate for all goods and services claimed in that application or registration. If the seller cannot give such a warranty as to a particular application or registration, the buyer should consider the consequences of the possible invalidity of that application or registration, such as a third party having superior rights.

Another invalidity issue in trade mark portfolios is improper assignment of an application based on ITU. Under section 10 of the US trade mark statute, 15 USC, §1060, an application based on ITU *cannot* be validly assigned before the product is launched and proof of use is filed in the USPTO. The only exception is that section 10 permits assignment of an ITU application to a party that simultaneously takes title to the ongoing business to which the mark relates. The author's experience is that many ITU applications have been assigned improperly in violation of section 10.[11] As a result, such ITU applications are vulnerable to attack, even after they have matured to registration. A prudent buyer would request a specific warranty that all assignments of ITU applications complied with this rule.

Duration of warranties

Typical M & A agreements include warranties but limit their duration, often to a few years. A prudent buyer will try to negotiate trade mark warranties unlimited in time, given that some of the trade mark problems mentioned above may come to light only many years after the transaction closes. For example, there is no statute of limitations on fraud attacks on applications or registrations. Prudent sellers will wish to limit the duration of the warranties, and may argue that the likelihood of attacks by third parties diminishes over time. In practical terms, marks already used throughout the USA for years are unlikely to be subject to third-party prior to rights infringement claims. Also, under the doctrine of laches, parties who unreasonably delay in making claims may face limitations on the right to make such claims.

Limitations on breach of warranty claim amounts

Potential damages for breach of trade mark warranty are large. If an unexpected trade mark problem causes a buyer to pull a product after a launch, damages from lost sales and wasted advertising expense can total millions of dollars. Damages might even exceed the value assigned to the marks in the acquisition of the entire business. With this in mind, sellers will wish to place reasonable limits on the amount of the damages for breach of trade mark warranties. Buyers will wish to resist such limits. In any case, sellers will certainly wish to control the defence and settlement of any claims on its warranties, and to receive immediate notice of such claims, in order to mitigate damage. Trade mark infringement claims can often be settled by a promise to stop using the infringing mark after inventory is sold off.

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11 The USPTO administrative tribunal held an ITU registration invalid for this reason in *The Clorox Co. v Chemical Bank*, 40 USPQ2d 1098 (TTAB 1996).