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VALUATION OF TRADEMARKS AS INTANGIBLE ASSETS IN MERGERS AND ACQUISITIONS: ISSUES AND CHALLENGES *

Introduction

In 2013, the Office of Chief Economist of the United States Patent and Trademark Office released data on Trademark Registrations and Applications. This data termed as USPTO Trademark Assessment Dataset[1], was a detailed information on more than 785,000 assignments and other transactions recorded at the USPTO[2] between 1952 and 2013 involving over 1.49 million unique trademark properties. Because assignments can transfer more than one trademark, and many trademarks are transferred more than once in their active life, the TMA[3] The dataset contains over 4.1 million observations at the property-transaction level. An analysis of 3.4 million registrations issued during 1978-2013 period by Stuart J.H. Graham et al. in their paper[4], revealed the following trends:

a) 31% of the trademarks were reported as being involved in at least one transaction during their life;
b) 21% of the trademarks has a recorded assignment or merger; and
c) 12% were involved in a security interest agreement.

The statistics and trends suggest that in the US trademarks have a higher chance of being traded than US patents. They also suggest that mergers involving the transfer of trademark assets form a large portion of the total merger and acquisition activity in the United States. To be precise, mergers including trademark properties comes up to approximately 19%-28% of the merger and acquisition activity during 1997-2003. As the portion of mergers involving trademarks has risen

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1 These data are available for download at: http://www.uspto.gov/ip/officechiefecon/data.jsp.
2 United States Patent and Trademark Office
3 Trademark Assessment
4 Stuart JH Graham et al., *Monetizing Marks: Insights from the USPTO Trademark Assignment Dataset*, AVAILABLE AT SSRN 2430962 (2015)

over time, it indicates that trademarks are gaining importance as assets in the overall merger and acquisition activity.

Traditionally, asset valuation of intellectual property in mergers and acquisitions and otherwise has been restricted to high-value patent sales and licenses. Such an approach is narrow as it overlooks non-patent assets such as trademarks and fails to take into account the emerging trends of strategies by which corporations are utilizing and commercializing their intangible assets. Trademarks must be viewed as valuable assets and they must be included in calculating the net worth of modern corporations. The market viability and competitiveness of corporations be enhanced if trademarks are evaluated at a fair price in the financial statements.

Trademarks not only enhance the intellectual property protection of corporations when they are paired with patents and other forms of intellectual property, they also yield better returns for them. Therefore, there is a need to study the various strategies and methods that may be employed to value trademarks in mergers and acquisitions of corporations. This paper proposes that trademarks and brands must be valued in order to reap higher profits in mergers and acquisitions.

The paper begins with a general overview of valuation of trademarks in the *first part* of the analysis section. In the *second part*, the paper describes the various methods of valuation of trademarks. In the *third part*, the paper analyzes the trademark issues in mergers and acquisitions. In the *fourth part,* the paper analyzes brand valuation as a concept.

VALUATION OF TRADEMARKS

Trademarks are considered as intellectual capital in this knowledge-driven economy and corporations recognize it as an important asset. Dominance in the market and profit-making depends largely on trademarks. Today, trademarks have gained so much of importance that they have become one of the primary motives for mergers and acquisitions. However, trademarks as intangible assets are still not considered as important as patents. Their value is not adequately understood yet. As a result, trademarks are often under-valued, under-managed and under-exploited. Accounting Standards do not represent the true worth of IPRs[5], let alone trademarks. Professionals who value IPRs of organizations seldom consult each other and there is a communication gap between those who manage IPRs. In order to evaluate the true worth of trademarks, the following issues must be addressed:

a) Identification of various IPRs used by an organization;
b) Value of the IPRs and the level of risk to which they are exposed;

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c) Identification of the owner of IPRs;
d) Various ways in which IPRs may be exploited;
e) Need for insuring IPR risks.

The success or failure of an organization is largely affected by the extent to which it is able to exploit is a trademark and assess the risk associated with it. An organization must attach the same importance to intangible assets as that of tangible assets. The organization must know the value of all assets and liabilities which is owned by it so that it can maintain the value of those assets. Trademarks may be exploited in various ways, namely:

a) Mergers and acquisitions;
b) Joint Ventures;
c) Licensing;

The more trademarks are exploited, the more is the level of risk associated with them.

Trademark valuation is the union of the economic conception of value and the legal conception of property. The value of an asset, tangible or intangible, depends on its capability to produce returns. The fundamental tenant of valuation is: the value of a thing cannot be evaluated in theoretical terms. What can be evaluated is the value of an asset in a specific place, at a specific time and in a specific circumstance. This rule is also applicable to IPRs. In most cases, there will a couple of interested parties and they will value the IPRs based on their individual circumstances. Inability to take the circumstances of the interested parties and that of the owner into consideration will result in improper valuation.

Valuation of trademarks is easier compared to the valuation of other intangible assets. This is because trademarks are protected by The Trademarks Act, 1999[6]. But the valuation of technical know-how, training methods, and systems, technological processes, client lists, distribution chain network, etc., are comparatively difficult. They may be as valuable as trademarks but problematic to ascertain with respect to earnings they produce. Nevertheless, a cautious due diligence must be undertaken by IP[7] lawyers and chartered accountants to identify the true potential of trademarks.

The four main concepts of valuation are as follows:

a) Owner Value;
b) Market Value;
c) Fair Value; and

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[6] Act No. 47 of 1999
[7] Intellectual Property

d) Tax Value.

In the case of Owner value, it defines the price in discussed arrangements and is largely influenced by the owner's view of the price in the event he is divested of the Trademark. Market value assumes that when a similar trademark has realized a particular price, the subject trademark will fetch a price that is close to it. Fair value gives equal weight to both the buyer and the owner. It addresses the fact that the negotiation is not in open market conditions and the buyer and the owner has come to the table legally. The concept of Tax value was a subject-matter of lawsuits across the world since 2000's and is considered as an obscure method. Apart from these concepts, quasi-concepts such as investment value, going concern value and liquidation value are also there which come under the aforementioned concepts of value.

METHODS OF VALUATION OF TRADEMARKS

The widely accepted methods for trademark valuation as well as other IPR valuation fall under three wide groups, namely:

a) Market-based method;
b) Cost-based method; and
c) Method based on estimates of the past and future economic benefits or Income-based method.

Ideally, a valuator will prefer to ascertain the market value of trademarks by referring to comparable transactions. But during the valuation of trademarks, the hunt for a comparable transaction becomes pointless. This is because transactions involving trademarks are only a small part of large deals and the information is made very private. Apart from this weakness, a market-based method is used as a thumb rule in the valuation of trademarks.

The cost-based method evaluates trademarks on the basis of the cost to create and cost to replace a given IP. It presupposes a relationship between cost and value. The primary advantage of this method is that it is easy to apply. The method, however, overlooks the alterations in the time-value of money and disregards maintenance costs.

The method of valuation based on an estimate of past and future economic benefits, also known as Income method, may be divided into four categories, namely:

a) Capitalizing historical profits;
b) Gross profits differential method;
c) Excess profits method; and
d) The relief from royalty method.

Capitalization method evaluates trademarks by multiplying the historic profitability of the mark by a factor based on the strength of the mark. Gross profit differential method is used in brand valuation by considering sale prices and marketing costs. Excess profits method considers the current value of net tangible assets to determine the excess returns which are attributable to the trademarks. Relief from royalty method determines what a purchaser would pay, or was willing to pay, for a license of a similar trademark. Each method has its own demerits, which are not discussed here. Valuation is a skill rather than a science and is founded on the interdisciplinary learning based on economics, law, accounting, and investment.

TRADEMARK ISSUES IN MERGERS AND ACQUISITIONS

During M&A[8], several corporations are of the view that they do not possess any IPRs because they have not registered their trademark. But things such as well-known trademarks, brand-names, trade dresses and domain names form important IP and corporations have rights over them. Appropriate valuation and management of these IPs are crucial in M&A. Otherwise, the seller may face various problems and incur losses. Understanding the role of IPRs in M&A is important considering how M&A activity has come to dominate the economy both in value and volume. The trend in India had started in the 1990s and it has continued ever since. The motive behind most of the mergers which took place in the last decade was the desire to obtain the target corporation's IPRs.

The valuation methods used for M&A dominated by tangible assets are not compatible with M&A involving IPs. Most corporations are inadequate in applying appropriate valuation procedures to M&As based on IPs. During M&A or other type of corporate restructuring, the acquirer must acquire equitable and recorded ownership of IPs or acquire a proper license to use the IP. It is very important for executives, financial advisors, and accountants to appreciate that trademarks are an essential part of large transactions, not merely the transfer of trademark rights alone. The contract should be made in the perspective of the acquisition of an entire business in which the trademarks are used. Usually, M&A takes place either by the acquisition of shares or by the acquisition of assets. In both cases, two elementary documents, namely, an acquisition agreement and a transfer document will be drafted and deliberated upon.

a) Acquisition Agreement –

The purpose of an acquisition agreement is to enumerate the terms and conditions under which the purchase of stocks or the purchase of assets will take place. In the case of trademarks, the seller will provide representations and warranties in connection with the trademark being

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purchased. The urgency to enumerate the assets and liabilities is bigger in the case of an asset purchase in comparison to sharing purchase since the purchaser will acquire the assets on the basis of the agreement rather than by the operation of the law. Asset schedule lays down the representations and warranties of the trademark which will be included in the agreement. In cases where trademark will be used both by the entity being sold as well as the entity being retained by the seller, it is important for the parties to decide as to who will manage the title to the trademark. For instance, the seller may not agree to sell the title to the house mark, but may agree to include selected trademarks relating to specific product lines as part of the corporate restructuring. In such a case the seller may either sell or license the marks, prior or subsequent to the sale. Representations and warranties are often the bone of contention during negotiations.

b) Transfer Document in case of Sale of Assets –

In case a corporation acquires trademark through acquisition by the sale of assets, the transfer agreement will exclude the trademark. When a business is sold as a going concern, the intention behind the transfer of trademarks and the goodwill associated with it is presumed but not expressly mentioned. Transactions between the parent company and its wholly-owned subsidiaries are exceptions in this case. Then the asset purchase will not automatically include the trademark rights as the ownership of the trademark will remain with the parent company unless there is an agreement which expressly provides for a transfer to the subsidiary.

CONCLUSION

A corporation has to invest a lot of money, time and resources to create, grow and popularize a brand or a trademark during its course of business. Hence, brands are no less important than the human resource, knowledge, etc. They help to create a premium for the goods and services which enhance the returns or profits of the corporation. In fact, in some cases, without the brand, the goods or services lose their importance. To reap full benefits from the trademarks, they must be valued carefully. Although there is no standard method of brand valuation, Wagner A. Kamakura et al. in their paper[9], suggest a method of trademark valuation which is based on the behavior of the consumers at various stages of the decision-making process. Professionals are not sure as to how to evaluate brands. This is due to the lack of understanding of the appropriate accounting treatment of trademarks. The paper written by A. Seetharaman et al., highlights the problems faced during valuation of brands in financial statements.[10]These problems are analyzed through an

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[9] Wagner A. Kamakura & Gary J. Russell, *Measuring brand value with scanner data*, 10 INT. J. RES. MARK. 9–22 (1993).
[10] A. Seetharaman, Zainal Azlan Bin Mohd Nadzir & S. Gunalan, *A conceptual study on brand valuation*, 10 J. PROD. BRAND MANAG. 243–256 (2001), http://www.emeraldinsight.com/doi/abs/10.1108/EUM0000000005674 (last visited Feb 12, 2016).

empirical study. Some of the benefits of measuring brand value have been enumerated in the paper of Walfried Lassar et al.[11]The benefits are substantial and the findings are based on empirical study. The importance of trademarks valuation has been stated in Pablo Fernandez's paper.[12] The paper reinforces the proposition put forth in this paper that trademarks must be valued and they must be valued carefully and skillfully.

[11] Walfried Lassar, Banwari Mittal & Arun Sharma, *Measuring customer-based brand equity*, 12 J. CONSUM. MARK. 11–19 (1995), http://www.emeraldinsight.com/doi/abs/10.1108/07363769510095270 (last visited Feb 12, 2016).
[12] Pablo Fernández, *Valuation of brands and intellectual capital*, AVAILABLE SSRN 270688 (2015), http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=270688 (last visited Feb 12, 2016).