Under the hammer: are trademark auctions bane or boon?

Whether through bankruptcy proceedings due to recent economic conditions or companies identifying new business models, trademark auctions are more visible now than ever before. Yet there is much to consider before raising your hand to reserve those desirable trademarks.

What do the trademarks CIRCUIT CITY, KB TOYS, SHEARSON, MEISTER BRAU and HANDI-WRAP have in common? The answer is that all were recently offered at trademark auctions. However, while the first two marks were offered as part of liquidations in bankruptcy, the latter three were offered in an auction of marks for which no prior use was made by the seller. In US trademark law, the warning of caveat emptor (‘buyer beware’) applies in both settings, but there are preventive measures that a prospective purchaser can take in order to attempt a more viable purchase. The critical starting point is knowledge of the particular problems presented by each type of sale.

Auctions can be held in any auction venue – including internet auction site eBay, such as occurred when the US Government Bureau of Land Management sold the MUSTANG RANCH service mark that was used for brothels. There are essentially two types of trademark auction. The more traditional is from a bankruptcy estate. A trademark that is not personal in nature (ie, an individual’s name) is part of the bankruptcy estate that may be offered for sale by a trustee in bankruptcy. As stated in Automated Prods Inc v FMB Maschinenbaugesellschaft mbH & Co (34 USPQ 2d 1505, 1994 WL 513626, at 9 (ND Ill September 16 1994) (quoting US Ozone Company v US Ozone Company of America (62 F 2d 881, 885-886 (7th Cir 1933))): “When owned by a bankrupt, except when strictly personal in nature, trademarks and trade names pass with the good will of the bankruptcy’s business to the trustee for the benefit of creditor.”

Trademark offerings in bankruptcy proceedings are based on marks that have been used in the past. Such auctions can generate impressive amounts, such as in 2009 when the CIRCUIT CITY trademark and domain name sold for $14 million and the KB TOYS trademark and domain name sold for $2.1 million.

A new approach in the United States, pioneered by Brands USA Holdings, is the auctioning of previously used trademarks that have subsequently been abandoned and are now the subject of new applications filed with the US Patent and Trademark Office (USPTO) based on an intention to use and for which no current use exists. Brands USA Holdings promoted such marks as “timeless” and stated that the auction (the first of which, organised by Racebrook, was held on December 8 2010) afforded “a brand new chapter” for the purchase of a “great brand”. The initial purchase granted at the auction was “a royalty free, fully paid, exclusive license, including the right to sub license”, with the purchaser obtaining “full ownership” when the purchaser filed a statement of use that was accepted by the USPTO.

The auction offered 170 brands and corporate names. Approximately two dozen marks were sold for an estimated $150,000. SHEARSON (for financial services) sold for $45,000; MEISTER BRAU (for beer and other drinks) sold for $32,500; and HANDI-WRAP (for plastic food wrapping) sold for $30,000. The rest of the marks were sold for smaller amounts, such as $2,000 for COLLIERS (for a general feature magazine) and $1,000 for VICTROLA (a wide array of electronic products and computer-related goods); GENERAL CINEMA (for motion picture projection equipment, cinema services and entertainment) and HOMESTAKE MINING (for mining and related services).

Each of the above types of auction presents challenges that prospective purchasers need to be alert to.

Due diligence, representations and valuation

Typically, in an ordinary trademark acquisition, a prospective purchaser conducts due diligence and negotiates representations and warranties with the seller.

A prospective purchaser will want to determine the good faith of the mark’s ownership and registration, and determine whether the mark is encumbered by a licence or pledged as security. It will also seek representations and warranties from the seller that a mark to be acquired is owned by the seller, and that the mark is valid and free of encumbrances and is not the subject of asserted or threatened claims, or infringed. A prospective purchaser may also want to have a valuation study done of the mark to be acquired, so that it may make a reasoned offer to the seller.

While a due diligence investigation is possible where a mark is acquired in a bankruptcy proceeding, the purchaser must receive the mark ‘as is’, because no representations and warranties are given by the trustee in bankruptcy. A valuation of a mark to be acquired from a bankruptcy estate is also possible, using the typical valuation techniques in the marketplace the market, cost of replacement and/or income approaches.

However, difficulties in valuation are presented because a mark’s value for a company in liquidation is typically lower than the value of a mark that is in use. Moreover, the time afforded in a bankruptcy auction is usually three to four weeks, and obtaining a valuation...
within such a limited timeframe presents practical difficulties.
A greater challenge awaits the prospective purchaser interested in a mark that is the subject of an intention-to-use application. In these instances the only due diligence investigation that can be done is reviewing the file history of the application in the USPTO and learning about the seller’s business activities via an internet search or Dun & Bradstreet report.
A worthwhile valuation study is extremely difficult to obtain – as the mark may not have been used for decades, or ever used for some of the goods/services in the pending application, there will be no recent sales, licensing or other data for comparables upon which a valuation can be based.

**The validity of assignments sold at auction**
A trademark is the symbol of a business’s goodwill. As noted by J Thomas McCarthy in *McCarthy on Trademarks and Unfair Competition*: “Goodwill and its trademark symbols are as inseparable as Siamese twins who cannot be separated without death to both.” Under US law, the assignment of a trademark separated from its goodwill is therefore an ‘assignment in gross’ or a ‘naked assignment’, and invalidates the mark.

If a bankruptcy trustee sells the assets of the debtor separately from the trademark, therefore, a mark can be invalidated. There are a number of instances of this. In *In re Jaysee Corset Co* (201 Fed 779, 780 (SDNY 1911)) the trademark was destroyed by a bankruptcy trustee selling a debtor’s physical assets separately from the company’s goodwill; while in *Reconstruction Finance Corp v JG Menihan Corp* (28 F Supp 920, 923 (WDNY 1939)) the trustee’s sale of a debtor’s assets amounted to the destruction of what was necessary to the existence of a business to which good-will, trademarks and trade names might attach.

In *Hough Manufacturing Corporation v Virginia Metal Industries Inc* (453 F Supp 496, 501-502 (ED Va 1978)) the physical assets sold at prior auction of the company were deemed the sale of goodwill and no effort was made by the trustee to continue the business, so the subsequent trademark assignment was held invalid. More recently, in *In re Impact Distribution Inc* (260 BR 48, 54 (SD Fla 2001)), a transfer of a mark without tangible assets was held to be a “most telling sign of an assignment in gross”, and the assignment by the...
debtor prior to bankruptcy and the subsequent assignment of mark to another were held invalid.

The courts, however, are not consistent in requiring an assignment of physical assets. For example, in *Seidelmann Yachts Inc v Pace Yacht Corporation* (4 USPQ 2d 1497, 1989 WL 214497 (D Md 1989), affirmed 898 F 2d 147 (4th Cir 1990)) the assignment of a mark was upheld despite the lack of physical assets accompanying the sale where the debtor unsuccessfully tried to auction the mark with physical assets and then sold its physical assets, but not the mark; rejected two bids for the mark in a five-year period; and then assigned the mark to a *bona fide* purchaser who put considerable money into a joint venture to produce the branded goods. The court, however, did not discuss the effect of an assignment in gross and thus may not have considered the issue. Some courts are not ritualistic in requiring a transfer of physical assets and place greater importance on whether there is real continuity with the past use of the mark; and the modern trend is that a transfer of physical assets is not crucial.

For assignment purposes, *intent-to-use* applications are treated differently from marks which have been used. Under 15 USC § 1060(a)(1) of the Lanham Act, *intent-to-use* applications are not assignable prior to the filing of evidence of use of a mark, “except for an assignment to a successor to the business of the applicant, or portion thereof, to which the mark pertains, if that business is ongoing and existing.” The purpose of this statute is to prevent trafficking in marks.

In an apparent attempt to avoid the problems presented with assignments of *intent-to-use* applications for which no prior use of a mark exists, Brands USA Holdings offered prospective purchasers an exclusive licence with a right to sub-license, after which the buyer eventually could file a statement of use, to have such applications mature to registration. However, this approach presents significant legal issues. The courts are not ritualistic in requiring a transfer of physical assets. For example, in *Lane Ltd v Jackson International Trading Co* (Case 33 USPQ 2d 1351, 1355) it was held that a *bona fide* intention to use must be supported by written documentation such as a business plan. Subsequently, in *LC Licensing Inc v Berman* (Case 86 USPQ 2d 1883, 1892), the TTAB held that the applicant lacked a *bona fide* intention to use the applied-for mark where he had no documents evidencing an intent to use the mark, such as a business plan, and disregarded the applicant’s stated intent to use the mark in the absence of supporting documents.

More recently, the TTAB held that an applicant’s only documents in support of its *bona fide* intention to use were two patents relating to the goods and minutes from annual meetings that vaguely referred to the research and development of products, the filing of trademark applications and the creation of a business plan. The TTAB stated: “the record is devoid of any evidence such as manufacturing efforts, licensing efforts, test marketing, correspondence with prospective licensees, preparation of marketing plans or business plans, creation of labels, marketing or promotional materials, and the like” (*SmithKline Beecham Corp v Omnisource DDS LLC*, Opposition No 9178539, November 29 2010, redesignated as a precedential decision on December 10 2010).

In other cases the TTAB has held there was no *bona fide* intention to use where the applicant’s documentation adduced in support of a intent to use consisted of foreign registrations and printouts from the Internet in a foreign language that were not translated and appeared to relate to different goods (*Honda Motor Co Ltd v Winkelmann* (90 USPQ 2d 1660, 1664)), and where the applicant had neither documents showing trademark searches and investigations, specimens, labels, tags, packaging, advertising or promotional material, nor any documents concerning same or marketing of the goods with which he intended to use the mark (*Boston Red Sox Baseball Club LP v Sherman* (88 USPQ 2d 1581, 1587)).

In the auction model of Brands USA Holdings, the same entity filed intent-to-use applications for the auctioned SHEARSON, MEISTER BRAU, HANDI-WRAP, COLLIER, VICTROLA, GENERAL CINEMA and HOMESTAKE MINING marks, which begs the question of whether that entity had a *bona fide* intention to use those marks for such a diverse range of goods and services at the time the applications were filed.

Another legal issue presented by Brand USA Holdings’ approach is a seller giving a licence with the purchaser obtaining ‘full ownership’ when the purchaser files a statement of use that is accepted by the USPTO.

Ultimately, trademarks have two functions: they indicate source and are a badge of quality. The law places an affirmative duty on a trademark licensor to control quality so that the public will not be deceived. A licence without quality control is termed a ‘naked licence’, and the naked licensing of a mark is a fraud upon the public which may result in abandonment of the mark.

Moreover, in order for an intent-to-use trademark applicant to receive the legal benefit of a licensee’s use to support a trademark application, the use must be controlled. The majority view of the courts is that actual control is required. While Brands USA Holdings’ approach does not specify whether quality control is to be exercised in a licence to be granted by a seller, if actual quality control is not exercised, the purchaser may be receiving nothing legally sustainable.

Indeed, it is in the interest of a prospective purchaser to have quality control exercised by the assignor of an intent-to-use application so that the effect of a naked licence may be avoided. The terms of the licence should thus be carefully drafted to prevent naked licensing of the mark.

**Possible abandonment**

The issue of possible abandonment arises when acquiring a mark from a bankrupt debtor. Since no use has been made of a mark that is the subject of an intent-to-use application to be acquired, the issue
Conduct a trademark search to determine whether the mark under consideration is available for the goods/services of interest and whether use of the mark might infringe on the rights of others. Be sure to check the prosecution history of the mark to be acquired. If conducting a valuation of a mark in a bankruptcy estate, understand that the results may be inaccurate. Try to obtain representations and warranties regarding the seller’s ownership of the mark (and domain names, if applicable), the validity of the mark, the lack of prior assignments, existing licences or other encumbrances on the mark, the lack of threats of infringement against the mark and non-infringement of the mark by others. Try to obtain some physical assets associated with a mark that has been used, so that there is physical evidence of goodwill of the mark being transferred. Additionally, if acquiring an intent-to-use application: research the applicant to see whether the mark and goods/services for which registration of the mark is sought fall within its business activities so that a reasoned determination can be made as to whether the applicant has a bona fide intention to use the mark; determine whether the applicant has a written business plan or other written indicia of a bona fide intention to use the mark; if taking a licence before assignment, carefully draft the licence with the applicant to ensure that quality control is provided for and to have the applicant exercise quality control; obtain an undated assignment for subsequent recordation with the USPTO; and file a trademark application for the mark acquired for the goods/services of interest to the purchaser, so that if the seller’s underlying application is attacked, the purchaser has a fallback position.

Best practice summary

If there are intervening users, then the reasons for non-use must be explored, as there are cases holding that where there was no intention to abandon by the trademark owner, no abandonment occurred, despite periods of non-use for more than the statutory period in 15 USC § 1127. For instance, after New York State withdrew from the mineral water business and thereafter sought to sell it for seven years, a lower court’s decision that there was no intention to abandon the trademark was affirmed, with the facts “completely inconsistent with an intent to abandon the mark” (Saratoga Vichy Spring Co Inc v Lehman (625 F 2d 1057, 1044 (2d Cir 1980)). In Star-Kist Foods Inc v Rhodes & CoW (769 F 2d 1393, 1396 (9th Cir 1985)) a lower court’s finding was affirmed that a three-year period of non-use – at a time when the statutory period was two years – due to the unprofitability of importing the goods into the United States and an intention to resume use when the market became profitable did not result in abandonment.

Contractual considerations

Acquisitions of trademarks by auction from bankrupt debtors are straightforward. The trustee in bankruptcy will honour the transaction to the highest bidder and the purchaser is assured of obtaining that which was bid upon. However, a prospective purchaser should exercise greater care when obtaining a trademark from a non-bankruptcy auction. It should ensure that there is no risk of an auctioneer receiving moneys and transferring them to the owner of the mark to be sold before receiving an assignment or exclusive licence, and should therefore utilise the services of a reputable escrow agent to avoid this problem. It should also obtain a contractual commitment from the seller not to use the same or a confusingly similar mark for the same or related goods, or induce others to do so.

If, as in Brands USA Holdings’ approach, the burden of filing a statement of use falls upon the purchaser, the seller must be contractually obliged to execute a statement of use based on the purchaser’s licensed use of the mark, and contemporaneously provide an undated assignment which the purchaser may date at some time in the future and record with the USPTO. Ultimately, the particular challenges faced when buying trademarks at auction are dictated by the circumstances surrounding the sale, but the potential pitfalls are many. Therefore, it is critical to ensure that the auction strategy minimises the risks involved.

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