HYPOTHCATIONS OF TRADEMARKS

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Inter alia the broad-based issues of intellectual property/assets ("IP") backed funding and lending, which has gained both momentum and prominence in IP rich, developed countries, this paper intends to explore specifically how trademarks and brand assets have played a very encouraging role in such lending and why they are easy to leverage. Extant practices of IP asset/trademark based lending internationally with relevant examples, will be briefly analysed to set the context. In particular this paper will be looking at the system of hypothecation of trademarks as a financing strategy, which seems the favoured option at least in India and the kind of issues that have cropped up. The legal mechanism of hypothecation as a means of transfer of the assets, alongwith the mechanics of assignment of the trademarks in the backdrop of relevant laws/case laws and their ratios, will be discussed. Finally, the paper will touch upon valuation, basis which the worth and price of the trademarks/IP are determined.

The key scope of this paper is to critically examine and evaluate the much touted system of IP based lending/ IP collaterals and to analyse whether this system truly paves the way for a sound and reliable basis of lending and if it can weather the challenges of the lending systems or whether the highlighted pitfalls should be treated as a fair warning of a practice that needs to be properly regulated or to be altogether discarded.

Keywords: *IP assets, IP based lending, IP collateral, Trademark securitisations, brand securitisation, brand valuation, IP sale, IP collateralization, IP financing*

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I. INTRODUCTION

A. *PROPERTY RIGHT – A LEGAL CONSTRUCT*

Recognized since primeval times and expounded well in the Middle Ages by great philosophers like John Locke, Thomas Hobbes and others, 'property' was considered to one of the basic and fundamental[1]. However, a lesser known fact is that property as a legal concept is one of man's most brilliant inventions, an ingenious bit of social engineering, which alongwith the concepts of ownership, entitlement and possession satisfies more human wants and interests than any other single phenomenon on earth and has evolved today to become the centre of economic organisation in civil society. It is this entitlement which forms the basis of the following discussion herein.

Through the ages, the expression 'property' grew in dimensions to encompass different things in different epochs and was gradually classified into the realms of moveable and immoveable. With evolution, a hitherto unknown territory of 'intangible property', distinct and different from the physical and a clearly definable corporeal kind emerged. Ownership and entitlement as purely legal constructs thus came to mean the 'exclusive' enjoyment and control of all objects, things and all that, which could be termed as property. Respect for property and its regulation gave rise to the understanding and rule that there can be no deprivation of property without equitable and adequate compensation, which philosophy has been appropriately enshrined in our Constitution[2].

B. *OWNERSHIP IN IP*

As the value in intellectual creations and 'labour of the mind' was gradually perceived and appreciated, the notion of property alongwith their ownership and commodification, was applied and extended to labours of the mind[3], through State developed protection mechanisms, policies and regulation of the market place. Through the enactment of various legislations, IP laws came into being. Thus, the primary purpose of the award of a patent, copyright, trademark or other proprietary rights, is to legally fence what one creates to fend off predators and publicly proclaim what one owns, as a

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[1]Tuckness, Alex, "Locke's Political Philosophy", The Stanford Encyclopedia of Philosophy (2020 Edition), Edward N. Zalta (ed.), available at https://plato.stanford.edu/archives/spr2020/entries/locke-political/
Natural Rights of a man was a theory expounded by John Locke (1632–1704), who is among the most influential political philosophers of the modern period, in his book, the *Two Treatises of Government*. He defended the claim that men are by nature free and equal against claims that God had made all people naturally subject to a monarch. He argued that people have rights, such as 'the right to life, liberty, and property,' that have a foundation independent of the laws of any particular society; revised Jan. 2016.

[2]The Constitution of India, 1950, Art. 31. Compulsory acquisition of property – (1) No person shall be deprived of his property save by authority of law and (2) No property shall be compulsorily acquired or requisitioned save for a public purpose and save by authority of a law which provides for acquisition of the property for an amount which shall be fixed by such law; and no such law be called in question in any curt on the ground that the amount so fixed is not adequate......;

[3]John Locke, Second Treatise of Government (C. B. Macpherson, Ed.), HACKETT PUBLISHING CO., INC. (Indianapolis), (1980 [1980]).

jus in rem. Its secondary and more compelling objective is to commercially exploit the property legally owned and reap financial rewards from the same. It is this legal dexterity, this right to commodify that changes every now and then the nature of the global market place and is the fulcrum of the content herein.

II. IP COMMERCIALIZATION

Standard trading and intellectual property monetization/commodification methods typically follow the licensing, franchising, merchandising routes or even outright sales of the property to willing customers. The obvious benefits of such leveraging strategies are to cover risks and costs of property development, access and penetrate new markets and generate rich and steady revenue streams through long-term royalty incomes. The great advantage of IP monetization over tangible assets is that a single intellectual property could be exploited in multiple ways to generate multiple streams of returns and revenues. A patent, copyright, trademark, design, or others of the ilk could be licensed or leveraged to different parties across different countries for different purposes, and thus create separate and disparate royalty streams and income. The phenomenal growth of companies such as Apple, Google and Facebook testify to the case in point and reflect the importance of IP and IP assets in today's economy.

IP backed financing, is an IP leveraging strategy and specifically refers to the usage of IP assets to gain access to market credit and funding. For example, a patent apart from being licensed could also be mortgaged with a bank for raising a loan or a company could borrow money against their growing brand. Another recent development to have successfully captured the imagination of the market place is raising essential funds through auctioning of a one's intellectual assets through specialist IP auction houses[4], like in June 2011 Nortel's 6000 patents were auctioned and Kodaks 1,100 digital imaging patents were auctioned in February 2013[5]. Empirical research has shown that investments in knowledge-based capital (KBC), i.e. intangible assets, have become key drivers of economic growth across countries.

A. *ASSET BASED FINANCING/LENDING*

As a concept and a financial market system, 'asset-based lending' is perhaps age old and money markets are very familiar with the many financial tools and vehicles involve in such financing. Essentially, it means that in exchange of the monies borrowed, the borrower grants to the lender a 'security interest' in its/his/her assets as collateral against the loan. Traditionally, physical assets like immovable property like plants and moveable property like machinery, vehicles etc. have been used as collateral[6] to secure

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[4]Lucinda Longcroft, *Intellectual Property Financing–An Introduction*, WIPO MAGAZINE, 2008.

[5]ABF Journal, *IP Asset Value as Collateral: The increasing Use of Patents as Collateral in Asset based Lending*, January 08,2016, available at https://www.abfjournal.com/articles/ip-asset-value-as-collateral-the-increasing-use-of-patents-as-collateral-in-asset-based-lending/

[6]JOAN F. GARRETT, BANKS AND THEIR CUSTOMERS 99 (1995). "Collateral is a borrower's promise of specific property if a loan is not repaid"; Investopedia defines collateral as "an asset that a lender accepts as security for a loan, so that the lender can seize it if the firm becomes insolvent or otherwise defaults on the loan and resell the same to recoup the losses.

asset-based loans. The worthiness and reliability of the assets, meaning their rates of appreciation or depreciation (in the future, for the term of the loan) using market determined systems of projection, provided/s the lender necessary insights into the asset's security, and which in turn becomes the benchmark to determine the size of the loan to be sanctioned or the fund to be deployed and the related terms of the engagement. The Hollywood film "The Big Short" produced by Paramount Pictures in 2015 was shot in the back drop of the sub-prime crisis in the US[7], and best illustrates the dynamics of the financial engineering and manoeuvres of the banking system involving leveraging of assets for borrowing.

However, in knowledge economies where trade, commerce and wealth creation depends largely on innovations and intellectual asset creation, an emerging trend to be observed is that intangibles are being leveraged through available and established modes of financing by companies rich in IP assets but suffering from cash flow constraints and finding conventional options, unsuitable. Thus, intellectual assets as an asset class provide financial firms with the flexibility in structuring deals, allowing for both debt-and-equity vehicles and hybrid models. It must be mentioned though, that it's not as if the practice of obtaining financing secured by intellectual property, was not heard of.

> "One well -known instance of using IP as collateral to secure financing occurred when Thomas Edison used his patent on the incandescent electric bulb as collateral to secure financing to start his company, the General Electric Company" [8]

Thus, the potential of IP as collateral offering financing opportunities to companies with valuable IP assets and seeking alternative sources of capital is not really new or recent. It is also important to note that the financial mechanisms of funding and lending are different and disparate and that lending is an integral function of funding/financing, with each having a unique role and function to perform.

B. IP- BASED FINANCING/LENDING

By the late 20th century IP financing had caught on, and today IP owners seeking financing typically do so on the strength of their valuable patents, copyrights, trademarks, designs, trade secrets, goodwill or brand. Though the system as a whole has been more predominant in the developed economies, the past few decades has witnessed an upsurge in IP based funding and lending in India, particularly those involving trademarks and brands as collaterals for securing the funds/loans. As industries promote and invest in new technologies, novel media platforms and other creative pursuits, the resultant intellectual capital has become a valuable asset class. The reason why IP financing has gained traction globally is because the intangibles and IPRs of a company reveal a lot about the company, its business, technologies, management and approach, without having to dig for them. The greater attraction of course lies in the legally protected IPRs of the company, whether single or a portfolio, that not only contributes to its

[7] THE BIG SHORT (Paramount Pictures, 2015). Filmed on the US Subprime crisis features an eccentric hedge fund manager who discovers that the US housing market, based on high-risk subprime loans, is extremely unstable. Anticipating the market's collapse in the second quarter of 2007, as interest rates would rise from adjustable-rate mortgages, he proposes to create a credit default swap market, allowing him to bet against market-based mortgage-backed securities, for profit.

[8] ANDRE J.MILLARD, EDISON AND THE BUSINESS OF INNOVATION 43-46 (1990).

economic strength through present and future revenue pipelines but also provides a scope for further exploitation.

Based on the same, strategies in IP based financing, range from the traditional form of lending to mezzanine debts with equity conversion clauses, and lenders and investors keep devising many novel and bespoke forms of IP asset-based financing, constructed on the borrower's specific capital needs and quite similar to their tangible counterparts. Organization for Economic Cooperation and Development (OECD) in its publication "*In Enquiries into Intellectual Property's Economic Impact, 2015*"[9], has observed that the main debt financing models connected to the exploitation of IP are broadly as follows:

1. Mainstream IP-backed lending: where IP is pledged directly as collateral in loans. When using IP as collateral, the borrower in effect promises to give up his rights in the IP if he does not repay the loan. The entire purpose of obtaining a security interest in lending is to be able to liquidate the asset for repayment of the loan in the event of the borrower's failure to repay. Even, the rights to IP-generated income accruing in the future like royalties can also be transferred against an upfront loan. For example, a loan can be secured against the stream of revenues derived from licensing agreements, which typically involve portfolios of trademarks, patents and/or other IPs like copyrights etc.

2. IP Securitization: wherein an IP asset or the rights to its projected revenues (e.g. from royalties) are housed in a special purpose vehicle (SPV) created expressly for that purpose, which in turn issues securities in the capital markets against the asset.

   > "This way, lending institutions can eliminate the risk of holding IP assets while the IP owner can obtain more favourable funding conditions. This is because the securities issued by the SPV are in theory, separated from the firm's risk and therefore the firm can receive more favourable credit ratings"[10]

   It is to be understood that the IP owner securitizing its assets is not borrowing money, but in effect is selling a stream of anticipated cash flows that would otherwise accrue to the owner of the IP assets; which is in contrast to providing security it is against the IP owner/borrower's established cash flows.

   Further, as the original owner is no longer the legal owner of the sold assets, the burden of repayment is shifted away from the original owner to the SPV[11]. The main purpose for creation of an SPV is to ensure that the obligations of the new entity remain secure and that its assets actually achieve bankruptcy remoteness, meaning that the SPV is not impacted even if the parent company goes bankrupt. As a system, securitization has been quite prevalent in the developed economies and is rapidly gaining ground in India. A

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[9]THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT ('OECD'), *Enquiries into Intellectual Property's Economic Impact*, (2015).

[10]Federico Munari & Raffaele Oriani, *Patent Securitization* in THE ECONOMIC VALUATION OF PATENTS: METHODS AND APPLICATIONS, 326, (2011).

[11]Stout, *Financing Alternatives for Companies Using Intellectual Property as Collateral*, September 01, 2014, available at https://www.stout.com/en/insights/article/financing-alternatives-companies-using-intellectual-property-collateral/

perfect example of the structure mentioned would be the example of the well-known American store chain, Sears, which in 2007, created USD 1.8 billion worth of bonds based on the brand names Kenmore, Craftsman and Diehard (KCD), considered to be Sears 'crown jewels and transferred the said brands to a wholly owned SPV known as KCD IP. KCD charges Sears royalty fees as license to use those brands and in turn uses the royalties to finance the repayment of the principal and interest of the bonds[12].

An oft cited, popular instance of IP- based securitization is that of the famous singer David Bowie, who in 1997 was able to secure USD 55 million from the United States insurance giant Prudential Finance in a landmark deal, and raised asset-backed bonds through a 10 year term. The bonds were issued on the basis of 'future' royalties (receivables from music tapes) on his hit music rights and publishing rights from master recordings of 25 pre-recorded albums. Bowie got a fixed annual return of 7.9% p.a. from these bonds, which were popularly termed as Celebrity bonds[13]. Likewise, Paramount Pictures in 2004 raised USD 210 million from projected royalties for films to be made 'in future'. This is an outstanding example of the confidence the finance market reposed in the 'brand', which in effect was also the IP leveraged along with the royalties; as otherwise, agreeing to securitise royalties of films in the pipeline or yet to be produced, could well be a risky and scary proposition[14].

Other examples of securitisation can be seen in the instances of the famous animation studio DreamWorks (Animation LLC), founded by Steven Spielberg, David Geffen and Jeffrey Katzenberg, which raised USD 1-billion from the securitisation of copyrights in a film portfolio in 2002 to refinance outstanding credit facilities[15]; Lehman Brothers Inc., acting as lead underwriter and sole structuring agent closed a USD 1.7-billion securitization of all revenue-generating assets of Dunkin' Brands Inc. in 2006[16]; while in another such instance, Kodak's patent portfolio was used as collateral to secure USD 965 million line of credit that helped to keep its door open during its bankruptcy proceedings[17].

3. Sale-and-Leaseback transactions: are those in which an IP owner sells its IP to a specialized investor or a lender in exchange for immediate funding. The original IP owner is then granted a license to use the IP, whereby it is required to make specified royalty

[12] BONNIE G. BUCHANAN, SECURITIZATION AND THE GLOBAL ECONOMY: HISTORY AND PROSPECTS FOR THE FUTURE, 97 (2017).

[13] BONNIE G. BUCHANAN, SECURITIZATION AND THE GLOBAL ECONOMY: HISTORY AND PROSPECTS FOR THE FUTURE, 94 (2017).

[14] Anuradha Maheshwari, *Leveraging IP- Recent Trends*, LEGALERA (Mumbai) December 2012, 48.

[15] Reuters, *DreamWorks completes deal with Reliance ADA*, September 23, 2008, available at https://www.reuters.com/article/industry-us-dreamworks/dreamworks-completes-deal-with-reliance-ada-idUSTRE48M2T720080923

[16] Moodys Research, *Moody's Rates Dunkin Brands Franchise Royalty Fee Securitization*, May 30, 2006, available at https://www.moodys.com/research/MOODYS-RATES-DUNKIN-BRANDS-FRANCHISE-ROYALTY-FEE-SECURITISATION-Aaa--PR_114174

[17] Stout, *Financing Alternatives for Companies Using Intellectual Property as Collateral*, September 01, 2014, available at https://www.stout.com/en/insights/article/financing-alternatives-companies-using-intellectual-property-collateral/

payments to the buyer for a period of time. At the end of a specified term, the IP owner normally retains the option to buy back the IP asset(s) at a predefined price. The advantage of this model is that the IP owner can increase its liquidity for short-term operations while maintaining the use of its IP. An IP sale and leaseback transaction happened between Motorola and GE Commercial Finance, when Motorola sold a portfolio of non- core patents to GE for an upfront fee of USD 50 million and an undisclosed percentage of royalties collected by GE over the years following the sale[18].

4. Venture Debts: are those IP based financing models in which both debt and equity features are seen. In this kind of financing, the IP owner seeking the required funding gains access to capital in the form of a loan on which it agrees to pay interest. Simultaneously, the borrower issues warrants for equity in the company, which are acquired by the lender. IP represents a key asset to facilitate these deals, but it is to be noted that the loan is typically backed by a blanket lien, i.e. a claim on all the assets of the firm in case of default[19].

With reference to the above, it must also be pointed that the routes listed above, do not necessarily pave ways for perfect situations of financing with IP collaterals. At times, a particular vehicle of IP financing may meet with rough weather, as is borne out by the cases that have landed in protracted legal battles, mainly because the legal ramifications and nuances of such IP- backed transactions or the very nature of the assets were either not well understood or are not closely examined by the involved parties. However, it is not the purpose or intention of this paper to dwell on IP financing *per se*, but to use it as the backdrop and context against which the more pertinent subject of 'trademarks as assets for financing', will be explored and scrutinized as discussed below.

III. TRADEMARKS BASED FINANCING

A. TRADEMARKS AS ASSETS

Trademarks as intellectual properties are globally understood to be signs or combinations of signs or symbols that are used to distinguish the goods or services of one trader/enterprise from similar goods or services of another trader/enterprise trading in similar goods and services[20]. While that is the primary function and purpose of trademarks, it also creates an effective barricade against the unfair competition of traders and competitors seeking to free ride on the goodwill and reputation of a trademark

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[18]Stout, *Financing Alternatives for Companies Using Intellectual Property as Collateral*, September 01, 2014, available at https://www.stout.com/en/insights/article/financing-alternatives-companies-using-intellectual-property-collateral/

[19]THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT ('OECD'), *Enquiries into Intellectual Property's Economic Impact*, (2015).

[20]The Agreement on Trade-Related Aspects of Intellectual Property Rights, 1995, Article15. Definition of TMs- a trademark is any sign, or any combination of signs, capable of distinguishing the goods and services of one "undertaking" from those of other undertakings must be eligible for **trademark** protection. Section 2 (zb) of the Indian Trade Marks Act, 1999 defines trademarks to be: " *a mark capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of others and may include shape of goods, their packaging and combination of colors*.").

owner. The legal system provides the owner of a trademark the exclusive right to use it in the marketplace to identify the owner's certain goods or services, as well as to authorize (or license) others to use it in return for payment or other benefits. The IP and the strength of a trademark or its property value, hence, lies in its distinctiveness and uniqueness as a mark and a good trademark over time also becomes the trader's market identity.

For example, the moment the word apple is mentioned, for many it conjures up an image of "Apple" as in computers and I-phones produced by Apple Inc rather than the common fruit from which the famous company derives its name. Such is the impact of the iconic mark, that in the human subconscious, Apple for many has become synonymous with electronic devices of daily use. Distinctiveness thus, is the hallmark of a trademark and the first step to building brands and asset creation. The devil lies in the detail and in this case in the choice of the trademark/s that the company /enterprise adopts, so that it can be suitably leveraged to raise capital or borrow against it or be sold or auctioned in dire financial situations like insolvencies. Today Apple is one of the world's top brands along with Amazon and Google and is pegged at 2020: $140,524m (2019: $153,634m – *Brand Finance, Global 500*)

Of the gamut of intellectual assets known, whether statutorily or otherwise, Trademarks have always been a preferred option as collateral security in IP financing, mainly because it is the more visible of the intangible assets of a company/entity and hence is perceived to be easier to deal with. Besides, as a moveable, intangible property; trademarks are not as complex to navigate as opposed to a patent or a copyright of literary or cinematographic film or music composition. The attraction of trademarks emanates from two factors; its longevity and its inherent nature.

The life of registered trademark can be measured in centuries as a mark can theoretically survive for ever with periodic renewals, which is every ten years post its registration. In the case on un-registered trademarks, factors of renewals do not arise and the trademarks goes on as long as goods and/or services under the trademarks can go on as long as goods and/or services under the trademarks continue to be supplied to the market. The life of a trademarks helps in creating valuable licensing deals and generating almost endless streams of revenues from those licenses and franchises. The longevity of trademarks helps in creating valuable licensing and franchising deals and if carefully exploited, can generate almost endless streams of revenues from such deals.

The second element of attraction in our estimation stems from the 'visibility' and 'portability' factor of a trademark, as opposed to the other intellectual properties. The appeal of the trademark, it's worth and its brand value is clearly visible to a party transacting with the proprietor of the mark, and therefore it becomes easier to negotiate any financing/lending. Portability factor implies that documentations relating to trademarks and the marks themselves are relatively far from voluminous, in comparison to other IPs and are thus far easier to transfer to buyers or lenders.

B. TRADEMARKS & BRANDS

Often 'brand' and trademarks are used interchangeably to mean the same thing. However, as most experts in the subject point out, 'brand' refer to the reputation of the enterprise earned on account of and through its business; while trademarks represent both – the enterprise and its brand. In essence, strong and distinctive trademarks evolve into strong brands and are eventually the face of the brand. Globally, instances abound of companies seeking finance on the merit and strength of their trademarks, like Calvin Klein, which leveraged its brand for USD 58-million securitisation in 1993, which was linked to future sales and royalties of its perfume brands arising from the exclusive right to use the Calvin Klein trademarks[21].Similarly, the world-famous brand Guess raised USD 75-million in 2003 from securitisation of its domestic and international trademark royalties generating licences[22]. Athlete's Foot, a sports footwear retailer, raised around USD 40-million from securitising its franchise resources[23].

Likewise, Burn Stewart Distillers raised £ 31-million from the Belgium-based bank KBC against its whisky brands in 2008[24]. In India, New Delhi-based LT Foods (earlier LT Overseas) used its Daawat brand of packaged rice as collateral to raise debt for its USD 50 million acquisition of US-based rice firm Kusha Inc. and even United Spirits (India), collateralised some of its leading whisky brands like Bagpiper and a few Whyte & Mackay brands to raise over Rs 6,000 crore from institutions such as ICICI Bank[25]. And as is well known, even the beleaguered Kingfisher Airlines, was able to obtain an Rs 2000 crores sanction from the State Bank of India, leveraging its brand/registered trademarks as a collateral or security. This was the first instance of a public sector bank granting credit against an intangible asset that being the borrower's brand.

C. HYPOTHECATION OF TRADEMARKS

When raising the necessary finance through trademarks it is important to note that the security offered to the lender is in fact the asset value in the trademark/s, which in effect translates to the commercial worth of the trademarks, with or without the title to them. It becomes vital then to implement a legal mechanism of transfer of that security in the mark/s to the lender, which is usually accomplished by way of a mortgage, pledge or hypothecation or any other prevalent legal modes of securing property. Typically, in a mortgage, the legal title to the IP is transferred to the lender, by way of an assignment of

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[21]ET Bureau, *Mallya to raise Rs 2,000 crore from conservative SBI*, July 23, 2009, available at https://economictimes.indiatimes.com/industry/banking/finance/mallya-to-raise-rs-2000-crore-from-conservative;
sbi/articleshow/4809470.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

[22]Businesswire, *Guess? , Inc. Announces $ 75,000,000 Securitization Transaction*, April 29, 2003, available at https://www.businesswire.com/news/home/20030429005510/en/Guess-Announces-Completion-75000000-Securitization-Transaction

[23]ET Bureau, *Mallya to raise Rs 2,000 crore from conservative SBI*, July 23, 2009, available at https://economictimes.indiatimes.com/industry/banking/finance/mallya-to-raise-rs-2000-crore-from-conservative;
sbi/articleshow/4809470.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

[24]Ian Ellis, *Maximizing Intellectual Property and Intangible Assets: Case Studies in Intangible Asset Finance* 11 (Athena Alliance Working Paper No. 07, 2009), available at https://core.ac.uk/download/pdf/71342793.pdf

[25]Institute of international Trade, *Collaterisation of Brands*, available at http://www.iitrade.ac.in/kmarticle.php?topic=Collateralization%20of%20Brands

the security, on the condition that the IP will be reassigned to the debtor when the security obligations are discharged in full[26]. Legal mortgage is probably the safest form of security transaction, but it also requires that the IP be assigned to the lender with a license being granted back to the debtor[27]. In India, mortgages are generally associated with transfer of interest in specific immovable properties for the purpose of securing the payment of money advanced by way of loan.

Hypothecation on the other hand is the preferred option for securing properties in trademarks with lenders, as it merely creates a charge over the trademarks as a security for a debt or demand, without parting with the possession (and ownership) of the property. According to the Black's Law Dictionary, 'hypothecation' means to pledge a thing as security without delivery of title or possession to the pledgee, while H.L.

> Hart defines it as: "Where property is charged with the amount of a debt, but neither ownership nor possession is passed to the creditor, it is said to be hypothecated[28]. Thus, in contrast to a pledge that requires actual or constructive delivery of the underlying goods to the pledgee, in 'hypothecation' both the possession and ownership remain with the owner, as it is contracted without delivery of the thing hypothecated[29]. Essentially, it is a security for a debt and nothing more and cannot survive the debt and as express by the well-known jurist, Salmond, "It is merely the shadow, so to speak, cast by the debt upon the property of the debtor"[30] and the hypothecatee can only sue on the debt and proceed in execution against the hypothecated goods, if they are available.

The obvious advantage of hypothecation over other methods of transfer lie in the absence of actual transfer of interest or property in the goods by the hypothecator to the hypothecate and the absence of any rights in favour of the hypothecatee to possess the property or to sell it. In relation to hypothecation of trademarks, it is observed that the kinds of legal issues that parties get embroiled in are whether trademarks can be sold by the creditor on non-payment of loans or whether trademarks as security can be provided after the disbursement of a loan as collateral for non-payment of the same or must it be securitised before the loan? The same has been elaborated upon at length below, with the support of relevant case laws.

1. DCHL Case: Whether trademarks can be sold by the creditor on non-payment of loans?

As an example of the above instance, DCHL (Deccan Chronicles Holdings Limited) which published the Deccan Chronicle newspaper from Hyderabad and having a

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[26]Mondaq, *Taking Security Over IP*, March 23, 2015, available at https://www.mondaq.com/uk/Intellectual-Property/383230/Taking-Security-Over-IP

[27]Lucinda Longcroft, Intellectual Property Financing–An Introduction, WIPO MAGAZINE, 2008.

[28]H.L. HART, THE LAW OF BANKING, Vol.2, 906 (4th ed., 1931).

[29]BOUVIER'S LAW DICTIONARY, Vol.2, 1480 (8th ed., 1914).

[30]P. J. FITZGERALD, SALMOND ON JURISPRUDENCE 469 (12th ed., 2016).

wide readership in the south, was found to have defrauded public sector banks to the extent of Rs 1,161.93 crores, being Canara Bank (Rs. 357.77 Cr.), Andhra Bank, Indian Overseas Bank, Central Bank of India, Corporation Bank and IDBI Bank. It had executed deeds of hypothecation for its trademarks in favour of IDBI Bank, which stated that since the borrower (DCHL) was not in a position to create charge on its fixed assets, the borrower agreed to create a charge on its trademarks of `Deccan Chronicle', `The Asian Age', 'Andhra Bhoomi' and `Financial Chronicle' as security for the loan together with all interest(including goodwill), charges and expenses payable to IDBI in terms of the loan agreement (of INR 250 crores). The Deed further stated that in the event of any breach or defaults by DCHL, IDBI Bank within a period of 15 days of default, would have the option of selling the trademarks in all the classes that they are registered in or advertising the availability of the goods manufactured under the trademark, among other things[31].

In June of 2016, IDBI Bank was again[32] set to auction the trademarks of 'wilful defaulter' Deccan Chronicle Holdings Ltd (DCHL), to recover part of its outstanding dues of about Rs 444 crore. The bank had invited bids till June 23 for the four title trademarks — Deccan Chronicle, Andhra Bhoomi (Telugu daily), The Asian Age and Financial Chronicle. Interestingly, the reserved prices for the trademarks were set at Rs 120 crore, Rs 3.5 crore, Rs 18 crore and Rs 3 crore, respectively, indicating thereby that a careful valuation of the trademark assets were also undertaken by the bank for the recovery of its dues[33].

Similar attempts by a State Bank of India-led consortium was made in March and April to auction the brand, logos and the corporate office of another 'wilful defaulter', Kingfisher Airline, but did not find any takers for the same. IDBI Bank too, did not receive any bids for its auction of the trademarks of the four Deccan Chronicle Holdings newspapers following a court intervention, as the DCHL promoters who are also part owners of the trademarks, moved the Calcutta High Court seeking an injunction against the sale just days prior to the auction. They pleaded that if the trademarks are sold off, then the business would be in jeopardy and would derail the promoters' efforts of repaying the bank's dues[34].

2. Canara Bank vs N.G. Subbaraya Setty: Whether trademarks as security can be provided after loan disbursement?

[31]Hindustan Times, *IDBI to auction trademarks of Deccan Chronicle Holdings,* June 10, 2016, *available at* https://www.hindustantimes.com/business/idbi-to-auction-trademarks-of-deccan-chronicle-holdings/story-7h9HYEVN7RKuEnecEPSUmI.html

[32]This was the second attempt by IDBI Bank to sell these DCHL trademarks as the first one in Aug of 2013, was put on hold by the Debt Recovery Tribunal.

[33]Hindustan Times, *IDBI to auction trademarks of Deccan Chronicle Holdings,* June 10, 2016, available at https://www.hindustantimes.com/business/idbi-to-auction-trademarks-of-deccan-chronicle-holdings/story-7h9HYEVN7RKuEnecEPSUmI.html

[34]DNA, *IDBI gets no bidders for Deccan Chronicle trademarks*, July 01, 2016, available at https://www.dnaindia.com/business/report-idbi-gets-no-bidders-for-deccan-chronicle-trademarks-2229861

In response to the above query, it would be relevant to discuss the very interesting case of Canara Bank *vs* NG Subbaraya Setty[35], wherein, the Supreme Court articulated a different set of views in relation to securing of the trademarks with the lender. The facts of the case reveal that the cause of action arose in 2001, when respondent No.1 availed a credit facility from the petitioner bank. As respondent No.1 defaulted in the repayment of a sum of over 53 lakhs, the petitioner bank understandably filed a suit against the Respondents before the Debt Recovery Tribunal, Bangalore, in 2002. Respondent No.1, in order to repay the dues of the bank, signed an assignment deed dated October 8, 2003 with the Chief Manager, Basavanagudi Branch, Bangalore for assignment of the trademark "EENADU" in respect of agarbattis (incense sticks) on certain terms and conditions as set out in Clauses 1 to 7 of the said deed.

However, by a letter dated 27.1.2004, the Chief Manager wrote to respondent No.1 stating that they were cancelling the above mentioned deed as they learnt that the bank could not be a 'patent rights holder'. In April, 2004, respondent No.1 filed a suit against the bank challenging the cancellation of the said assignment, whereupon the petitioner bank filed a counter suit for a declaration that the assignment deed was vitiated by mistake, undue influence and fraud and that, therefore, the said deed was unenforceable in the eyes of the law.The apex court ruled that

> "We are of the view that the trademark cannot be said to be property which has come into the possession of the bank in satisfaction or part satisfaction of any of the claims of the bank. We are further of the view that the trademarks are not part of any security for loans or advances that have been made to the first respondent, or connected with the same."[36]

D. ASSIGNMENT UNDER TRADE MARKS ACT

Section 45 of the Trademarks Act, 1999 and the Trademarks Rules, 2002[37], was extensively relied upon in the judgement to articulate a critical aspect of the case that unless the trademarks were assigned to the lender, meaning unless they were registered with the trademarks Registry the assignment if any and hence the hypothecation of the EENADU trademarks could not be said to have been completed and would be void in the eyes of the law. In other words, for the hypothecation of the marks to be considered valid, it should have been followed by the assignment of the marks, which did not transpire for reasons mentioned below. Section 45 permits the assignment and transmission of trademarks pursuant to a valid transaction and for consideration, with or without the good will of the business and in respect of all or some of the goods or services in respect of which the trademarks are registered.

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[35]Canara Bank v. N.G. Subbaraya Setty (2018), SCC 4233.

[36]Canara Bank v. N.G. Subbaraya Setty (2018), SCC 4233.

[37]The Trade Marks Act, 1999, § 45(1). Registration of assignments and transmissions: *Where a person becomes entitled by assignment or transmission to a registered trade mark, he shall apply in the prescribed manner to the Registrar to register his title, and the Registrar shall, on receipt of the application and on proof of title to his satisfaction, register him as the proprietor of the trade mark in respect of the goods or services in respect of which the assignment or transmission has effect, and shall cause particulars of the assignment or transmission to be entered on the register: Provided that where the validity of an assignment or transmission is in dispute between the parties, the Registrar may refuse to register the assignment or transmission until the rights of the parties have been determined by a competent court.*

The court reiterated the observations of a 2013 ruling in the matter that though the bank had filed for an 'assignment' in the Registry with a fee of Rs. 5000/- the fee was in deficit and was not accompanied by the borrower's affidavit attesting to the hypothecation of the trademarks. Hence the registration of the assignment was refused till the necessary formalities were completed. As, the Court pointed out that, that an unregistered assignment obviously cannot be admitted in evidence by any Court, in proof of title to the trademark by assignment.[38] On the same point of assignment, the US judgement in *Re Cleanser*[39] is being highlighted, where the court reasoned that a grant of a security interest in the IP asset is not an assignment and the US Trademark Act, 1946 (Lanham Act) specifies a place for filing of such assignment.

Continuing the rationale, it can be said that the security interest in a trademark is deemed perfected only when the necessary registration of the assignment is followed through in the required format with the Registrar of Trademarks. If the relevant IP is registered, then the assignment will certainly need to be recorded in the appropriate register. Only when the acquired title of the lender is recorded in the Register of Trademarks, can the property in the trademark be effectively said to be transferred to the lender. A failure to record an assignment exposes the lender to the possibility that a later assignee of the IP may take a valid assignment of the IP free on the lender's security interest in such IP (assuming the assignee registers its interest).

E. SARFAESI

This paper has deliberately steered away from all the other observations of the judgement as it would not be germane to the central theme herein, being the hypothecation of trademarks. However, it would be remiss not to touch upon the relevant provisions of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI), which for some reason was not brought up in the matter discussed above. Under section 2(1)(t) of the Act property has been defined to include intangible property such as licenses, trademarks, copyrights, know how etc. Further, under section 2(1)(zf) "security interest" has been defined to mean the right, title or interest created on any property (tangible or intangible) in favor of a secured creditor, while the definition of a secured creditor includes any bank or financial institutions holding any right, title or interest over tangible or intangible property. Considering the cited provisions of the Act, many have argued that the bank accepting the assignment of trademark as security for an outstanding loan is a secured creditor and is entitled to sell the trademark or receive royalty in order to recover the loan amount. The trademark was

[38]The Trade Marks Act, 1999, § 45(2). *Except for the purpose of an application before the Registrar under sub-section (1) or an appeal from an order thereon, or an application under section 57 or an appeal from an order thereon, a document or instrument in respect of which no entry has been made in the register in accordance with sub-section (1), shall not be admitted in evidence by the Registrar or the Appellate Board or any court in proof of title to the trade mark by assignment or transmission unless the Registrar or the Appellate Board or the court, as the case may be, otherwise directs.*

[39]*In re Roman Cleanser Company, 802 F.2d 207 (6th Cir. 1986).*

offered as a security interest to restrain the bank from suing the borrower, which is deemed a valid consideration. M. Umarji[40], in an opinion piece has said

> "The object of making a clear provision facilitating creation of security rights over intangible properties is to facilitate availability of credit to intellectual property owners and other intellectual property rights holders, thereby enhancing the value of the intellectual property rights as security for credit."

It must be also mentioned here, that although hypothecation is a regularly used form of conveying security interests in IP in India, and though the term has not been defined in any statute, is accepted in mercantile law by long usage and practice and works very well as a system of creating security interests over trademarks assets for financing.

IV. VALUATION OF TRADEMARKS/IP ASSETS

As can be observed, the foregoing paras have been liberally peppered with instances of multi-million/billion dollars securitisations and lending transactions on IP backed assets. Anyone reading the figures would naturally be curious to know how the deal figures have been arrived at, especially considering that intellectual assets, unlike their tangible, physical counterparts, do not come with ready reckoners and available market information to determine their values easily. As mentioned at the beginning of our discussions herein, any financing transaction will finally be determined on the merit of the worth of the IP asset, which will ultimately rest with the price tag that is affixed on those intellectual creations. Justifiably then, a methodical, scientific and independent approach has to adopted while fixing the price of the IP, which in market parlance is called as 'valuation' of assets. Valuation thus is the key tool in the process of IP based financing and a complex, rigorous and tricky process that is undertaken to fix a fair price of the IP, especially as borrowers tend to magnify and extol the virtues and potential of their IP assets, while financiers attempt to downplay the same.

A. REQUIREMENT OF DUE DILIGENCE

IPs being opaque in nature, it is imperative to first understand the IP asset thoroughly - its ownership, legal protections, class and life expectancy; the company owning the IP; whether the IP is revenue generating or not, its potential for returns over investments, the market/sector in which the IP operates and whether the IP is encumbered or not. All these factors are critical in weighing how much the IP is worth and if worth financing. While it is true that most IP assets pledged as collateral generate royalty income from fruitful licenses, it is also equally true that IPs are prone to great risks and diminishing returns as they become victims of the vagaries of the market upheavals, disasters, lack of market demand; infringements, unexpected litigations, revenue sources drying up, mergers and acquisitions (change of ownership), insolvencies etc. For example, the price of the Bowie Bonds declined in 2004, when the bonds were

[40]M. Umarji, (Former Director, Reserve Bank of India), "In the case of Canara Bank v. NG Subbaraya Setty, the SC held that assignment of a trademark as a security for a loan outstanding is against the Trademarks Act and the Banking Regulation Act", June 20, 2018.

downgraded in ratings to a notch above junk status[41]. Hence it becomes critical to engage in a thorough due diligence exercise to subject the asset to be financed, its owners, revenue pipelines etc. through carefully scrutiny, before the culmination of the financing transaction.

B. ESTABLISHED PRACTICES OF VALUATION

It is not the purpose of this paper to articulate on 'valuation' at length for that would mean stretching beyond the realm of law, but to inform briefly about the methods involved in valuations, merely to provide an insight into the subject. To begin with there are no fixed methods of valuations, though there is now a market demand for bring in standards like those followed by credit rating agencies, to bring a semblance of uniformity and organisation in the market. By and large, there are three accepted norms of valuation, and trademarks and brands as assets to be collateralised will be valued by anyone or all of the following methodologies which are best suited to the circumstances. They are (i) the **Costs** approach, which takes into account all the costs incurred by an entity in creation and development of their intellectual property; (ii) **Market** approach, where the price paid for a similar asset under similar circumstances is taken into consideration; and (iii) the **Income** approach, which takes into consideration the present and future cash flows for the purpose of servicing the loan repayment plan; meaning the economic benefit to the business over the IP's useful economic life. Another factor that is brought into consideration is the value that will be required to cover the investment in the event of default.

Though valuation is a domain of accounting expertise, subjective perceptions do creep into them, which may affect the assessments and hence the exercises are often criticised. That is why one often comes across different agencies rating the same brand differently, using perhaps different set of parameters, like in the instance of Apple and other top brands. There are of course accounting firms and specialised agencies offering services in valuations and once the valuation is done it is for the financiers to decide whether to accept the trademark/ brand as a security or not.

V. CONCLUSION

Two to three decades ago, to most people in India, a Calvin Klein, or a Hermes, or an Athlete's Foot or a Netflix or Amazon had little or no relevance. Today, living as we do in a digital, global market place and having global brands at our door step, we look out for the trademarks and brands to authenticate our purchases, whether physically or online and upon finding them as they ought to be, we heave sighs of relief. All such global products that reach us are not on account of foreign imports; infact the words 'imported products' have fallen off from our vocabularies simply because of large scale contract manufacturing, licenses and franchise operations or arrangements that now dominate the market place. Often a famous cosmetic brand will be found to have manufacturing operations say in Noida, (Delhi- NCR) or a famous leather accessories brand will be found to be sourced the item purchased from Chennai or a footwear brand

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[41]FT Alphaville, *A Short History of the Bowie Bond*, January 11, 2016, available at https://ftalphaville.ft.com/2016/01/11/2149761/a-short-history-of-the-bowie-bond/

from Kolkata. As most multinationals, companies and brands cast their nets far and wide, they would need more and more capital/debt to finance their operations, which is best done by increasing licenses and franchises, to leverage one’s trademarks and brand.

Till sometime back, a widely held misconception was that only patents yielded great returns and are the only IP worth commodifying. In fact as may be commonly observed, much of the discourse surrounding IP financing revolve arounds patents as the asset class of discussion. Likewise, it is commonly believed that trademarks are too small to be commodified or are best suited to draw boundaries in the market place and keep infringers/free riders at bay. The objective of this discourse was to thus highlight that contrary to common perceptions trademarks and brands make for excellent market commodities that can be leveraged more easily than other IPs, provided one understands the market practices while doing so and provided and more importantly, one has worked towards consistently maintaining strong marks, creating goodwill and building an impeccable brand by providing a consistent quality of goods and services. Thereafter, the vehicle for financing and conveying the mark/brand to the lender/ funder, of which hypothecation seems a sound way, is subject to the conclusive negotiations between the parties.