TRADEMARK CLEARANCE AND INVESTIGATION CONSIDERATIONS BEFORE EXPANSION THROUGH A NEW OR EXISTING CONCEPT

Christopher P. Bussert
Kilpatrick Townsend & Stockton LLP
Atlanta, Georgia

and

Jason S. Adler
Cellairis Franchise, Inc.
Alpharetta, Georgia

October 16-18, 2019
Denver, Colorado

©2019 American Bar Association
Table of Contents

I. INTRODUCTION .................................................................................................................. 1

II. THE EMERGING CONCEPT’S TRADEMARK PORTFOLIO ............................................. 2
   A. Are the Trademarks Federally Registered and, If So, on What Register? ......................... 3
   B. Verification of Registration Status ................................................................................. 4
   C. Confirming Ownership of the Acquired Registrations ................................................. 8
   D. State Registrations ........................................................................................................ 9
   E. Goods and Services Covered by the Filings ............................................................... 10
   F. Word Mark Registrations Versus Combination Registrations ...................................... 11
   G. Accuracy of Marks and Logos .................................................................................. 11
   H. Registrations With Disclaimers .................................................................................. 12

III. OTHER ISSUES EFFECTING THE STRENGTH AND PROTECTABILITY OF THE TRADEMARK .......................................................... 13
   A. Implied Performance Claims ...................................................................................... 13
   B. Descriptiveness and Trademark Function .................................................................. 15
   C. Legality of Operations .............................................................................................. 17
   D. Responses to Information Requests .......................................................................... 19
   E. Licenses, Litigation, and Warranties ........................................................................ 19

IV. AVAILABILITY OF THE TRADEMARK FOR NATIONWIDE USE .................................. 20
   A. Searching and Other Third-Party Due Diligence ...................................................... 21
B. Determining Priority and Risk of Third-Party Users of Identical or Confusingly Similar Marks – What Steps Should be Taken Next? ................................................................. 22

C. Junior Users and Ripeness Issues ........................................ 22

D. Senior Users and Related Issues ....................................... 24

E. Fraudulent Filings .................................................................. 25

V. TRANSACTIONAL PROTECTION ........................................................ 26

A. Representations and Warranties ........................................ 27

B. Indemnification .................................................................... 31

   1. Unsecured Reliance on the Emerging Concept ...... 32

   2. Secured Indemnification Protection ......................... 33

C. Recording Responsibilities ................................................. 38

VI. CONCLUSION ...................................................................................... 38

Biographies
TRADEMARK CLEARANCE AND INVESTIGATION CONSIDERATIONS BEFORE EXPANSION THROUGH A NEW OR EXISTING CONCEPT

I. INTRODUCTION

Much has been written in recent years about the rise of multi-brand franchise concepts as a preferred means for expansion. In that regard, both franchisors and franchisees have discovered they can adapt their existing systems and procedures to add emerging concepts with complimentary brands to their portfolios and that this may be the best strategy for achieving growth.

One commentator, who addressed this subject from the perspective of potential franchisee expansion in the food industry, recently noted:

For multi-unit franchisees with well-established concepts, hard-earned success can often lead to growth challenges – including any lack of available territories, expansion roadblocks and fewer operational opportunities to develop new food offerings that excite customers. When savvy multi-unit operators reach a plateau, they should consider it a call to action to diversify their portfolios, grow their companies and re-energize their operations by adding new brands.

While on the surface, an emerging concept may have more risk than a well-known brand, experienced entrepreneurial-minded, multi-unit franchisees are at a distinct advantage to adopt an early-stage brand. They can not only apply their business acumen, market knowledge and creative energy to an emerging concept – they often have a chance to work collaboratively with a brand’s leadership or franchise development team to make recommendations that help shape process and best practices. These factors combined can contribute to a ground-floor prospect, developing a brand with a strong growth trajectory and unlimited potential.

This commentator then noted, quite appropriately, the following factors that a franchisee should consider when evaluating the potential of adding an emerging concept:

- Is this the right brand, at the right time?
- Are there real estate and pairing opportunities?
- Is there a strong ROI?
- Does it help diversify my business portfolio?

1 The genesis of this program is an earlier work by one of the authors, see Christopher P. Bussert & Lauren S. Ralls, Caveat Emptor: Trademark Clearance and Investigation Before Acquisition of a New Concept 32 Franchise L.J. 212 (Spring 2013). This paper, however, represents a substantial expansion of, as well as a different approach to, a number of the topics addressed in that earlier work.

2 Dan Markel, Multi-Unit to Multi-Brand, Franchising World 19-20 (March 2019). See also Ruth Atwell, Tips for Launching Your Own Brand, Franchising World 14-16 (July 2019) (in which the author discusses six steps a business should consider in preparing to franchise).
• Does the brand have “crave-able” staying power?3

These factors are equally applicable to franchisors who desire to expand the reach of their holdings into new, arguably complimentary goods and services fields. In assessing a franchisor’s or franchisee’s desire to move forward with the acquisition of an emerging concept, the due diligence conducted oftentimes focuses on a review of documents and information that will inform on the factors outlined above, including balance sheets, profit and loss statements, real estate leases and title reports, EPA phase 1 and phase 2 reports, key vendor contracts, franchise agreements, and compliance and marketing studies. However, the authors submit that one of the most important, if not the most important, due diligence consideration often goes ignored completely or is only given cursory attention, that being the emerging company’s trademark portfolio. And in many cases where the issue of the emerging company’s trademark portfolio is identified as one to be reviewed by outside counsel as part of due diligence, in the authors’ experience it is also accompanied by the request: “We are closing a major deal tomorrow. Can you spend no more than a couple of hours looking at the IP issues and give us your blessing?” This request either assumes you are a miracle worker or that the transfer of intellectual property is a purely ministerial activity, which is rarely true except for the most basic of transactions. More often, multiple issues and sub-issues are identified during the due diligence process where the answer to one question may lead to many new inquiries that need to be chased down. And the problem of obtaining access to all relevant information from the emerging concept is often exacerbated by the lack of organization of the emerging concept’s record-keeping system.

Both franchisors and franchisees who are considering expansion through acquisition of an emerging concept have been known to make a number of alarming assumptions about the emerging concept’s principal or “house” trademark, i.e., the name and trademark under which the emerging concept operates and has presumably developed at least common law rights. Perhaps the most potentially disastrous assumption is that the trademark is available for use nationwide solely on the basis of the emerging company’s use of that mark in connection with all of its current goods and services without challenge in a limited geographic area. Such assumptions can prove to be dangerous and costly, especially where, as in a vast majority of cases, the principal goal of the acquisition is to expand the emerging concept’s operations under its principal trademark into new geographic areas, if not nationwide. In the experience of the authors, to the extent any due diligence is conducted on the emerging concept’s trademarks, it is often limited to whether the emerging concept claims to own its principal mark or perhaps whether it owns a federal registration of that mark. However, ownership of a federal registration is alone insufficient to verify whether the emerging concept’s principal mark (or any of its other marks) are available for use beyond its current area of operation.

This paper identifies and reviews the risks of failing to conduct thorough due diligence in the brand aspects of acquiring emerging concepts, and it provides recommendations for protections the acquiring company can seek to help maximize the return on investment the acquiring company expects in the transaction.

II. THE EMERGING CONCEPT’S TRADEMARK PORTFOLIO

During the course of most acquisitions, the emerging concept “target” of the acquisition usually provides a list of trademarks. Sometimes the list will include marks bearing the ® symbol suggesting that the subject marks have been registered. In other cases, the list may include

3 Id.
application or registration numbers, the latter of which may designate either federal or state registrations. All registrations, however, are not created equal so a more detailed review of the emerging concept’s trademark portfolio is strongly recommended.

A. Are the Trademarks Federally Registered and, If So, on What Register?

Once the emerging concept provides a list of trademarks, a good place to start is to ascertain (or verify in the event the emerging concept’s list of trademarks include marks bearing the ® symbol or numerical information), whether the marks are subject to a federal registration or application or a state registration. To the extent any numerical information is provided, in most cases (assuming the information provided is accurately stated), it is relatively easy to determine whether the information denotes a federal registration or application or a state registration. A U.S. federal registration is typically identified by a seven-digit registration number (e.g., 2,345,678) although very old federal registrations may be identified by fewer digits. Federal registration applications are typically identified by an eight-digit serial number (e.g., 87/765,432). State registrations often include a combination of one or more letters followed by numbers (e.g., S-234,567).

Whether the mark or marks at issue are covered by a federal registration or a federal registration application is a critical distinction. And perhaps of equal importance, not all federal registrations are created equal as marks can be registered on the Principal or Supplemental Register. Marks that are registered on the Principal Register provide a number of benefits to their owners, including:

- the registrant is entitled to the application filing date as its nationwide “constructive use” date;
- the registration constitutes prima facie evidence of the validity of the registered mark, the registrant’s ownership of and exclusive right to use the mark, and that the subject mark is not confusingly similar to other registered marks;
- the registration is constructive notice of a claim of ownership, which eliminates any defense of good-faith adoption and use made after the date of registration; and
- the registration may become incontestable as conclusive evidence of the registrant’s right to use the mark subject to certain statutory defenses.

Marks that are registered on the Supplemental Register provide none of these key benefits. Such marks are, in most cases, housed there because they have been deemed by the United States Patent and Trademark Office (USPTO) to be too descriptive to be registered on the Principal Register. The principal benefits available to the owner of a Supplemental Register registration are that the owner may use the ® symbol with its mark and file a claim for infringement

4 If international territories or expansion are also of interest, the acquiring company should similarly investigate whether there is adequate coverage in those areas for both the emerging company’s principal mark and any other important marks used in connection with the emerging concept’s goods or services, especially as most foreign jurisdictions only provide rights to registered trademarks. International expansion of use of a trademark can be a complicated and expensive proposition, and the acquiring company should consult with knowledgeable trademark counsel regarding the procedure for the same.

Because the ® symbol can be used with both Principal Register and Supplemental Register registrations, it is important for an acquiring company to confirm the register on which the emerging concept’s federal registrations is housed.

Rights associated with federal registration applications are even more limited. Among other things, these applications are often subject to further review by the Examining Division of the USPTO to determine their eligibility for registration, and even assuming they survive the Examining Division, they may be subject to third-party opposition proceedings. All of the foregoing may result in the subject applications failing to proceed to registration or with significant limitations.

B. Verification of Registration Status

Whether one or more of the emerging concept’s marks have been federally registered, and on what register, can be verified at the USPTO’s website accessible at www.uspto.gov. The home page of that website includes a link to “Trademarks.”

Clicking on the “Trademarks” link provides access to several internal links that allow users, among other things, to check the status of pending trademark registrations and applications, to perform a search of the USPTO’s trademark database (Trademark Electronic Search System or TESS), and to access manuals and guides explaining trademark procedures.
Searches on the TESS database can be conducted by individual mark or by owner, and the results will include active and cancelled/expired registrations as well as active or abandoned applications. Even assuming a search of the TESS database reveals the emerging concept owns one or more
Principal Register registrations, this does not end the inquiry. Indeed, the acquiring company should continue to explore further the details of any of the subject registrations to confirm there are no other potential issues with:

- ownership and current status;
- the goods and services covered by the registration;
- whether the registrations cover the word or design form of a mark; and
- any limitations in the registrations including any elements that have been disclaimed.

Most of these inquiries can be answered by reviewing the information available on the TESS database and specifically through the TSDR (Trademark Status and Document Retrieval) System.

Through the TSDR link, information can be viewed on the status of the mark as filed with the USPTO as well as all communications between the Examining Division and the applicant with respect to an application or registration.
BULK DATA: The TSDR Application Programming Interface (API) will be unavailable starting May 7 at 12 a.m. ET for at least two weeks. Bulk data customers who rely on the TSDR API can use alternative methods to receive bulk data from TSDR. If you are a bulk data customer who has questions or needs additional information, please email us at INTERMITTENT SYSTEM ISSUES.
Due to high-volume workloads, you may experience intermittent issues on the Trademark Status and Document Retrieval (TSDR) system between 6 – 8 a.m. ET. Refreshing your web browser should resolve the issue. If you still need assistance accessing a document, email task@uspto.gov and include your serial number, the document you are looking for, and a screenshot of any error messages you have received. ENHANCEMENT TO PROTECT YOUR PRIVACY: When applicants and registrants are not represented by an attorney, the USPTO now marks the correspondence email address in the status tab and the Application Programming Interface (API). We made this change to reduce the likelihood that customers will be subjected to scams and unwanted solicitations.

Trademark Status & Document Retrieval (TSDR)

Trademark Documents

- Document Description

- Document Type

- Created/Issued Date

XML

Jun. 01, 2017

TEAS Withdrawal of Attorney

XML

Jun. 01, 2017

Change of Address

XML

Mar. 28, 2017

Change of Address

XML

Apr. 05, 2016

TEAS Rev, App and/or COA of Atty/Dom Rep

XML

Jul. 28, 2015

Registration Certificate

JPEG

May 12, 2015

OG Publication Confirmation

XML

Apr. 22, 2015

Notice of Publication

XML

Apr. 22, 2015

Notification Of Notice of Publication

XML

Apr. 04, 2015

Publication & Issue Review Complete

MULTI

Mar. 13, 2015

TRAM Snapshot of App at Pub for Opponent

MULTI

Mar. 12, 2015

Amendment and Mail Process Complete

MULTI

Mar. 11, 2015

Examiners Amendment

XML

Mar. 05, 2015

Amendment and Mail Process Complete

MULTI

Mar. 04, 2015

Examiners Amendment

MULTI

Mar. 04, 2015

Notification to File

XML

Jan. 28, 2015

Office Action Outgoing

MULTI

Jan. 28, 2015

Notification to File

XML

Jan. 22, 2015

XSearch Search Summary

XML

Oct. 10, 2014

Design Search Code Corr Project

XML

Oct. 02, 2014

Application

MULTI

Oct. 02, 2014

Drawing

JPEG

Oct. 02, 2014

Specimen

JPEG
This record of communications is often referred to as the “File or Prosecution History” and it often provides a wealth of information regarding the subject mark including statements made by the applicant in responding to substantive Office Actions. In some cases, these statements may significantly limit the scope of rights in and to the subject mark including the meaning of one or more of the terms that comprise the mark\(^6\) or whether the subject mark is confusingly similar to or can coexist peacefully with other similar registered marks cited by the Examining Division in an Office Action.\(^7\) Any such statements will likely be viewed as admissions and will be binding on the acquiring company.

C. Confirming Ownership of the Acquired Registrations

Prior to moving forward with the acquisition, the acquiring company should confirm any mark registrations and applications being acquired from the emerging concept are in the name of the emerging concept. In that regard, it is not unusual for an emerging concept’s initial registrations to be obtained in the name of one or more of the founding individuals or a predecessor entity. In some cases, the emerging concept can remedy any discrepancies in ownership prior to any acquisition by filing appropriate documentation with the Assignment Division of the USPTO to establish a proper chain of title to and current ownership by the emerging concept. Whether and to what extent any documents relating to ownership have been filed with the USPTO can be viewed by accessing the “ASSIGN Status” internal link for each individual mark while conducting a search of the TESS database.

---

\(^6\) See, e.g., U.S. Registration No. 3,912,221 for the SNACK SUPER CANTINERO mark, in which the applicant admitted that the term “Cantinero” literally means “Barman” but also in the context of the product the term can be understood as “The Snack of a Mexican Bar.”

\(^7\) See, e.g., U.S. Registration No. 3,807,666 for the mark CANTINA DIABLOS, which was preliminarily refused registration based on an earlier filed application for the EL DIABLO mark. In responding to that refusal, the applicant argued:

Applicant’s mark “CANTINA DIABLOS” create a different commercial impression than the mark “EL DIABLO” in spite of the fact that both marks use the term “DIABLO.” The fact that both marks include the common term “DIABLO” is not controlling when the overall commercial impression of the marks is substantially different . . . .

A search of the Google database identified hundreds of restaurants and/or bars that use the term “DIABLO” in their restaurant or bar name. The name is common in restaurants or bars having a Mexican or Hispanic theme. Because of this, customers have come to recognize that simply using the term “DIABLO,” without more, does not indicate that two restaurants or bars are affiliated in any way.

See Response to Office Action, p. 1. What effect will these statements have on future efforts by the owner of the CANTINA DIABLOS mark to enforce rights in that mark against third parties?
Notably, the documents accessible through the ASSIGN Status link also will include any recorded encumbrances including security interests.

In some cases, discrepancies in ownership of a mark may be complicated as a result of the failure to document or record appropriately the ownership interest of multiple prior owners or to secure the removal of old encumbrances such as security interests. In such cases, establishing a clear chain of title may require significant effort and expense, including securing proper assignments from prior owners and undertakings from financial institutions to remove security interests previously recorded on the subject filings. An even greater challenge is presented when one or more of the earlier owners is no longer in existence, which may make obtaining and filing of appropriate assignment documents to establish a clear chain of title to the current alleged owner impossible. In that event, the USPTO may accept as an alternative to the filing of one or more assignment documents a declaration containing sufficient facts to support a transfer of title.8

Even if no discrepancies are identified from a review of the portfolio utilizing the TESS, TSDR and ASSIGN Status databases, the acquiring company should request representations and warranties to confirm that the emerging concept is the owner of the identified registrations and applications and, at a minimum, knows of no conflicts or encumbrances.9

D. State Registrations

State registrations provide few of the benefits offered by federal registrations. In particular, state registration does not authorize use of the ® symbol as use of that symbol is limited exclusively to federal registrations. Indeed, misuse of the ® symbol can result in the owner of the mark being vulnerable to a false advertising or unfair competition claim.10

8 See Trademark Manual of Examining Practice (TMEP) § 1604.07(b) (Oct. 2018). One of the authors relied on the predecessor to this section in submitting a declaration supporting the maintenance of U.S. Registration No. 1,004,132 for the OTTAWA ROUGH RIDERS mark where multiple prior entities, who arguably owned an interest in the registrations, had long ago been dissolved.

9 See infra Section V. A.

In most states, obtaining a state trademark registration has little legal significance beyond establishing the registrant’s claim that it was using a particular mark as of a particular date. In a minority of states (namely Florida, Texas, California and Michigan) state registration of a trademark creates prima facie evidence of ownership and validity of the mark, which presumption may be rebutted by a challenger.\(^{11}\) The geographic area of protection provided by state registration in a majority of states is coextensive with the area in which the mark owner operates or in which it can show it has established customer recognition.\(^{12}\) In a minority of states (namely Ohio, Washington, Virginia), however, state registration statutes provide protection through the entire state even if the registrant is operating only in a limited area of the state.\(^{13}\) Accordingly, having a firm command on where the emerging concept has used its mark and the state or states in which it has obtained registrations of its mark is another important element in assessing the emerging company’s trademark portfolio.

E. Goods and Services Covered by the Filings

Another important consideration in examining the trademark portfolio of an emerging concept is to review the description of the goods and services covered by the existing registrations against the goods and services actually provided by the emerging concept. In that regard, it is not unusual for the goods and services covered by an emerging concept’s initial federal registrations to be quite limited (i.e., drain cleaning services); whereas, the concept may now be providing many more complimentary goods and services (i.e., a full range of plumbing services and drain cleaning products). In some cases, the goods and services of the emerging concept may have expanded into entirely new areas (electrical, HVAC, etc.). Although these deficiencies potentially can be addressed, they also raise the possibility of significant conflicts down the road. As to the emerging concept’s existing federal trademark registrations, it is not permissible to “amend” these registrations to add new goods or services. Rather, new registration applications for any expanded goods and services will need to be filed, which will result in a new and later priority date as to those goods and services. Perhaps more importantly, without further investigation, there is no assurance the mark utilized by the emerging concept may even be available for the expanded goods and services on a nationwide basis let alone on a local or regional basis. Accordingly, as part of its due diligence, the acquiring entity should conduct a search to (1) confirm the emerging concept’s trademarks are available for use or registration for all of the goods and services the emerging concept is currently providing, and (2) determine if one or more third parties have prior rights in an identical or confusingly similar mark for the same or related goods and services, particularly in the geographic areas of interest to the acquiring company. A commercial trademark search that includes searches of federal, state, common law, business name, and domain name databases is often a key starting point in that investigation as well as a follow-up investigation of any potentially problematic names and marks disclosed by the commercial search.\(^{14}\)

---

\(^{11}\) See, e.g., FLA. STAT. § 495.061; V.T.C.A., BUS & C. § 16.060, MICH. COMP. LAWS § 429.34(3); Levi Strauss & Co. v. Blue Bell, Inc., 778 F.2d 1352 (9th Cir. 1985).


\(^{13}\) See Id.

\(^{14}\) See infra Section IV. A.
F. Word Mark Registrations Versus Combination Registrations

The scope of an emerging company’s rights in its individual trademark registrations also depends on whether the particular registration is for a word mark or a mark combined with a design element or in a particular color. A registration covering a word mark in block letters (also known as a standard character mark) provides the broadest scope of protection to the registrant.

**TWO MEN AND A TRUCK**

Registrations that cover a mark consisting of a word or words in combination with a design element or in a particular color offer less protection as the combination of the word, design and/or color in its totality must be assessed in evaluating whether there is infringement by a third party.\(^{15}\)

\[\text{TWO MEN AND A TRUCK}\]

A word mark registration, on the other hand, covers use of a word mark alone as well as in a stylized format or together with a design element or in a particular color. Unfortunately, the trademark lists provided during due diligence rarely provide information beyond the word elements of marks. This magnifies the importance of the acquiring entity’s independently reviewing the emerging company’s federal filings on the TESS database as doing so will clearly indicate whether the subject marks have been registered in word and/or design form.

G. Accuracy of Marks and Logos

Acquiring companies as part of their due diligence should confirm that any federal registrations consisting of or including design elements accurately reflect the form of the trademark currently in use by the emerging concept. It is not unusual for emerging concepts to “tweak” the design elements of their trademarks or change them entirely from time to time without regard for the impact such changes may have on their existing federal filings.\(^{16}\)

\(^{15}\) See 4 MCCARTHY, supra note 12, at § 23:47 (“Conflicting marks consisting of both words and pictorial symbols must be compared in their entireties to determine likelihood of confusion.”); see also King of the Mountain Sports, Inc. v. Chrysler Corp., 185 F.3d 1084, 1091 (10th Cir. 1999) (finding no infringement between two logos that contained an identical phrase because “the sight and sense of meaning invoked by defendants’ logo and plaintiff’s stylized mark differ drastically”); Omaha Nat’l Bank v. Citibank (S.D.), N.A., 633 F. Supp. 231, 234 (D. Neb. 1986) (“Defendant’s designations are mere words while plaintiff’s composite mark is a combination of words and design.”).

\(^{16}\) See TMEP § 1604.13 explaining how the USPTO analyzes marks at the time of maintenance of registrations where the current form of the mark differs from the mark as shown in the registration. See also 3 MCCARTHY, supra note 12, at § 17.26 (citing Joseph & Feiss Co. v. Tempco Quilters, Inc., 171 U.S.P.Q. 378, 379 (T.T.A.B. 1971) (“[I]t is
In the event the emerging company’s current design mark is different from that covered by its federal registration(s), what are the options? Of course, one approach would be to file a new trademark application for the new design form of the mark, although doing so has the downside of resulting in a later filing and registration date, which could impact the ability to enforce rights in that mark against third parties. Another option is to seek amendment of the existing registration to reflect the current version of the design mark.\(^{17}\) The advantage of this approach is that it retains the priority filing date and other benefits of the existing registration.\(^{18}\) However, this approach is only available in the event the new design is deemed not to be a “material alteration” from the existing version.\(^{19}\) In the case of certain well-known marks, existing design mark registrations have been amended many times over the years expressly for the purpose of retaining the earliest possible priority filing date and other benefits of the existing registration, for example, BETTY CROCKER, the MORTON SALT girl and RONALD MCDONALD. One example shown below reflects the historic amendments made to the QUAKER OATS man registration.

<table>
<thead>
<tr>
<th>Older Versions of Mark</th>
<th>Updated Mark</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="Image1" alt="Older Version" /></td>
<td><img src="Image2" alt="Updated Mark" /></td>
</tr>
</tbody>
</table>

**H. Registrations With Disclaimers**

Rights in a federally registered trademark on the Principal Register may be even more limited if the registration discloses a disclaimer of one or more terms as a condition to obtaining registration. The USPTO routinely requires disclaimers of terms considered alone to be too descriptive or generic to protect.\(^{20}\) The disclaimer essentially operates as an admission that the

---

\(^{17}\) See \textit{In re Umax Data Sys., Inc.}, 40 U.S.P.Q.2d 1539, 1540-41 (Comm’r Pat. 1996) (finding that an amendment was not a “material alteration” when “[t]he nature of the proposed change is such that the commercial impression of the modified mark is essentially the same as that of the original mark”);

\(^{18}\) See \textit{Sands, Taylor & Wood Co. v. Quaker Oats Co.}, 978 F.2d 947, 955 (7th Cir. 1992) (“So long as the owner continues use of the ‘key element’ of the registered mark, courts generally will not find abandonment.”).

\(^{19}\) See 3 \textit{McCARTHY}, supra note 12, at § 17.26.

\(^{20}\) See \textit{In re Petersen & Pegau Baking Co.}, 100 U.S.P.Q. (BNA) 20, 21 (Comm’r Pat. 1953) (finding no material alteration when the only change was to the design, which was “mere background and not in any sense an integral part of the trade mark”).

---
disclaimed terms are available for anyone to adopt and use. Whether or not the terms have been disclaimed and under what circumstances can be ascertained from a review of the TESS database, in particular the file history of the registration accessible through the TSDR link as well as the registration certificate itself. In some cases, the negative effect of a registration in which all or most of the words are disclaimed can be reversed by filing a new application seeking to register the mark including the words previously disclaimed without disclaimer. In such cases, it is very important that the new application be filed as soon as possible to cut off the rights of subsequent adopters of identical or confusingly similar trademarks.

III. OTHER ISSUES EFFECTING THE STRENGTH AND PROTECTABILITY OF THE TRADEMARK

A. Implied Performance Claims

Acquiring companies need to be on the lookout for implied performance claims suggested by a trademark that are likely to be perceived as a guarantee. There are several examples of this issue arising in the franchising field. One historic example is a challenge that was brought by Hardee’s against McDonald’s based on McDonald’s federally registered QUARTER POUNDER mark. Hardee’s filed a Complaint alleging that the QUARTER POUNDER mark falsely advertised the actual weight of McDonald’s QUARTER POUNDER burgers actually served to customers. McDonald’s moved to strike this allegation from Hardee’s Complaint under Rule 12(f), but the court denied that motion and instead held the allegation at issue involved questions of fact to be resolved at trial. Although the parties later settled, it is notable McDonald’s advertisements post-settlement included a disclaimer that its QUARTER POUNDER burgers weigh 4 ounces, or one quarter of a pound before cooking.

Similarly, Subway has for some time used and extensively promoted the $5 FOOTLONG mark and filed federal registration applications for the FOOTLONG mark separately for

---

21 See 3 MCCARTHY, supra note 12, at § 19:65; In re DNI Holdings Ltd., 77 U.S.P.Q.2d 1435, 1442 (T.T.A.B. 2005) (“[I]t has long been held that the disclaimer of a term constitutes an admission of the merely descriptive nature of that term, as applied to the goods or services in connection with which it is registered, and an acknowledgement of the lack of an exclusive right therein at the time of the disclaimer.”).

22 See, e.g., U.S. Registration No. 4,622,844 for the mark $5 FOOTLONGS and design, which disclaims exclusive rights in the elements “$5” and “FOOTLONGS”.

23 Compare U.S. Registration No. 3,909,922 (which disclaimed “5 Day Kitchens”) with U.S. Registration Nos. 4,670,559 and 4,780,650 (“5 Day Kitchens” not disclaimed).

24 And, as discussed below, it may also be prudent for the acquiring company to conduct a clearance search prior to filing the new application to ascertain whether any third party has, in the interim period since the disclaimer was made in connection with the earlier registration, filed an application for registration or obtained a federal registration claiming trademark rights in the disclaimed terms for related goods or services. See Section IV. A., infra.


27 See supra note 22.
sandwiches and restaurant services. However, those applications were opposed by a number of Subway’s competitors who claimed that “FOOTLONG” is a generic measurement in the restaurant industry, as well as allegations that the term misleads consumers. And to make matters worse, a series of class actions were filed against Subway, purportedly on behalf of consumers, alleging that Subway deceptively advertised sandwiches as “FOOTLONGS”, when the sandwiches were allegedly less than 12 inches in length. In those actions, the consumers averred that Subway had not followed the example of McDonald’s and its “QUARTER POUNDER” disclaimer. In response to those lawsuits, Subway released an official statement reaffirming its “commitment . . . to ensure that every Subway Footlong sandwich is 12 inches at each location worldwide.”

As to its FOOTLONG mark application, the Trademark Trial and Appeal Board, in one of the oppositions filed by a Subway competitor, eventually ruled the term FOOTLONG was not registrable because it was generic in the context of sandwiches.

More recently, Smashburger has experienced similar difficulties involving its “Triple Double Burger”, which Smashburger initially marketed under various “Double the Beef” slogans including “Triple the Cheese, Double the Beef”, “Triple the Cheese, Double the Beef in Every Bite”, and “Classic Smash Beef Filled with Triple the Cheese & Double the Beef in Every Bite.” In-N-Out Burgers, a competitor, filed a Complaint alleging trademark infringement and unfair competition against Smashburger, and later amended the Complaint to add false

---

28 Subway’s FOOTLONG trademark application (App. No. 77324328) was opposed by competitors Sheetz of Delaware, Inc. (Opp. No. 91192657); Domino’s IP Holder LLC (Opp. No. 91193982, dismissed with prejudice); Firehouse Restaurant Group, Inc. (Opp. No. 91193183, dismissed with prejudice); KBI Holdings, L.L.C., owner of the BLIMPIE mark (Opp. No. 91193167, dismissed without prejudice); Long John Silver’s Inc. (Opp. No. 91193165, dismissed with prejudice); Taco Bell Corp. (Opp. No. 91193164, dismissed with prejudice); Pizza Hut, Inc. (Opp. No. 91193163, dismissed with prejudice); A&W Restaurants, Inc. (Opp. No. 91193162, dismissed with prejudice); and KFC Corporation (Opp. No. 91193157, dismissed with prejudice). See also note 33 infra.


31 Id. at 8-9 (“Subway is aware that one of Subway’s competitors, McDonald’s, posts warnings and disclaimers that its ‘Quarter Pounder’ represents the pre-cooked weight of that product and that the completed sandwich may not in fact be a quarter pound when served to consumers. Despite this example, Subway provides no similar warning to consumers stating that the ‘Footlong’ is less than a foot in length.”).


advertising counts based on the foregoing “Double the Beef” claims. As to the false advertising claims, Smashburger was eventually undone by its recipe cards, which provided that its Classic Smashburger was comprised of a single 5.0 ounce beef patty; whereas, each version of the Triple Double Burger had two 2.5 ounce beef paddies for a total of 5.0 ounces of beef. Relying on the recipe cards, the court held the claim that the Triple Double Burger contains “double the beef” compared to the Classic Smashburger was “literally false on its face.” And to compound Smashburger’s problems, it is now facing a class action lawsuit purportedly brought on behalf of consumers claiming that the foregoing representations regarding the Triple Double Burger are false, misleading, and reasonably likely to deceive the consuming public as consumers are not actually receiving “double the beef.”

B. Descriptiveness and Trademark Function

As noted above, it is not unusual for an emerging concept’s trademark portfolio to include recently filed federal applications the USPTO has yet to examine. In that case, the acquiring company needs to be cognizant of possible significant challenges in seeking to register and enforce rights in the subject marks resulting from descriptiveness issues and, as explained below, it may also want to address this subject further in the transactional documentation. Section 2(e) of the Lanham Act, the federal statute governing trademark law, provides that trademarks may be refused registration if the terms comprising the trademarks are “merely descriptive” of the goods or services for which registration is sought including their nature or characteristics. The concept of descriptiveness includes terms that are laudatory (e.g., BEST), primarily geographically descriptive (e.g., GEORGIA PECANS) for pecans from Georgia, or merely a surname (e.g., SMITH). In the absence of a showing by the trademark owner that the term or terms at issue identify the source of goods and services, as opposed to their nature or characteristics, such terms are freely available for use by others and cannot be protected.

To better assess any descriptiveness issue associated with the emerging company’s trademarks, the acquiring company should conduct a search of the term or terms at issue on the USPTO database to determine how the USPTO has treated those terms in the past. Does the term at issue typically proceed through the USPTO process without a disclaimer, or is it uniformly disclaimed, or are the results mixed? Similarly, how have courts reacted to protectability of the identical or closely similar terms? 

38 See discussion in Section V., infra.
40 See, e.g., In re Yarnell Ice Cream, LLC, 2019 U.S.P.Q.2d 265039 (T.T.A.B. 2019) (multiple third-party registrations of marks in which the term “Scoop” was disclaimed are probative of the descriptive meaning of that term); See also Real Foods Pty Ltd. v. Frito-Lay N. Am., Inc., 906 F.3d 965 (Fed. Cir. 2018) (CORN THINS and RICE THINS for snacks were found to be merely descriptive); In re Nett Designs, Inc., 236 F.3d 1339 (Fed. Cir. 2001) (THE ULTIMATE BIKE
It is also not unusual for emerging concepts to attempt to take advantage of current or cutting edge trends and vernacular in making brand decisions and, in some cases, they attempt to obtain trademark protection for current catchy terms or phrases used in the media or terms preceded by a hashtag (#) design element. The danger presented here is that such designations may be difficult to register and protect because they are deemed as not functioning as trademarks. One recent example followed President Trump’s infamous use of “Covfefe” in one of his Twitter messages. A number of entrepreneurs immediately tried to register this term in connection with a variety of goods or services. These efforts to date have been unsuccessful because the Examining Division at the USPTO has uniformly taken the position that the term “Covfefe” does not function as a trademark. Rather, the Examining Division has noted this term is a commonly used message originally written by the President of the United States, and any use of that term in connection with goods or services is likely to be perceived by consumers not as a trademark but as a message in support or disapproval of the President.

Marks consisting of a term preceded by a hashtag present a similar issue of whether the designation functions as a trademark. Indeed, since the advent and growth of Twitter, the Examining Division at the USPTO routinely takes the position that a term preceded by a hashtag is normally perceived as an online social media term with no source-indicating function. Rather, the designation is viewed as merely facilitating categorization and searching within online social media. Accordingly, to the extent the emerging concept’s “trademarks” consist of commonly

RACK found to be merely descriptive and therefore subject to disclaimer); In re Bos. Beer Co. Ltd. P’ship, 198 F.3d 1370, 53 U.S.P.Q.2d 1056 (Fed. Cir. 1999) (THE BEST BEER IN AMERICA so highly laudatory and descriptive as applied to beer and ale that it is incapable of acquiring distinctiveness); In re Best Software, Inc., 58 U.S.P.Q.2d 1314 (T.T.A.B. 2001) (the words BEST and PREMIER in mark BEST! SUPPORTPLUS PREMIER held merely descriptive of computer consultation and support services and thus subject to disclaimer); In re Consol. Cigar Co., 35 U.S.P.Q.2d 1290 (T.T.A.B. 1995) (SUPER BUY held merely descriptive of tobacco products); compare U.S. Registration No. 4283931 for the mark SUPERFREEZE for various cooling devices, requiring no disclaimer.


43 See, e.g., Office Action issued with respect to U.S. Serial No 88/013,166 for the COVFEFE mark at p. 3.

44 Id. See also Carma Hassan, Cardi B wanted to trademark “Okurr”. The patent office said “uh uh”, CNN (July 1, 2019, 2:42 PM) https://www.cnn.com/2019/07/01/entertainment/cardi-b-okurr-trademark-trnd/index.html (reporting on the USPTO’s refusal to permit registration of the purported mark OKURRR on the grounds that the term is “commonly used in the drag community and by celebrities as an alternative way of saying ‘okay’ or ‘something that is said to affirm when someone is being put in their place’.”)

45 See In re Deporter, 129 U.S.P.Q.2d 1298 (T.T.A.B. 2019) (registration refused to purported #MAGICNUMBER108 mark for various clothing items on the grounds that it fails to function as a trademark); In re i.am.symbolic, llc, 127 U.S.P.Q.2d 1627, 1633 (T.T.A.B. 2018) (registration refused to purported #willpower mark in part because “the
used terms or include a hashtag prefix and the acquisition of these trademarks is important to the transaction, additional care must be taken to determine whether they are even eligible for protection in the first instance.

C. Legality of Operations

Acquiring companies should routinely verify as part of the due diligence process that the emerging concept is in compliance with all applicable laws, regulations, ordinances, and licensing requirements imposed by federal, state, or local authorities, particularly those that directly impact the goods and services provided under the emerging concept’s trademarks. In addition, the acquiring company should confirm whether the emerging company’s business may be subject to additional laws and higher levels of regulation in new geographic areas as the concept is expanded post-acquisition. Certain types of businesses are particularly prone to regulation by such agencies as federal or state health departments or public service commissions. Because the USPTO requires that trademarks used in commerce be lawful, an emerging company’s failure to provide goods and services in compliance with applicable laws or regulations may put its trademarks at risk. For example, at least one court has refused to allow enforcement of the trademark owner’s mark because the product with which the mark was used did not comply with federal food labeling requirements.46

In the event a state or federal agency believes a trademark owner’s marks are or have been used in connection with an unlawful enterprise or activities, the trademark owner may be forced to defend against claims by these agencies that the trademark owner’s rights in its trademarks should be deemed forfeited. United States v. Church was a criminal proceeding involving the Atlanta-based franchise system JILLY’S THE PLACE FOR RIBS in which the principals of Jilly’s were accused of using the franchise system in aid of numerous criminal ventures including money laundering.47 The United States sought and obtained an order of forfeiture in which it acquired the JILLY’S service mark and became both the franchisor of the Jilly’s franchise system and the franchisee of several Jilly’s restaurants.48 Surprisingly, several years after operating the Jilly’s franchise system the United States agreed to transfer the JILLY’S service mark and franchise system to several of the former principals of Jilly’s.49

More recently, in United States v. Mongol Nation, the U.S. Attorney's Office tried (but eventually failed) to strip a biker gang’s ownership of its trademark, consisting of the word “Mongols” and a drawn image of “a Genghis Khan-type character with sunglasses and a ponytail, riding a motorcycle with the letters ‘M.C.’ appearing below the motorcycle,” as a result of the biker

---

46 CreAgri, Inc. v. USANA Health Sci., Inc., 474 F.3d 626 (9th Cir. 2007); see also Gray v. Daffy Dan’s Bargaintown, 823 F.2d 522, 3 U.S.P.Q.2d 1306, 1308 (Fed. Cir. 1987) (“lawful use of a mark is a prerequisite to federal registration”).


gang’s involvement in unlawful activities.50 The court denied the trademark forfeiture request in part because the mark at issue was used as the biker gang’s collective membership mark to denote membership in the gang, rather than as a mark for specified goods or services.51 Similarly, in \textit{State of Georgia v. Hankerson},52 which involved certain GLADYS KNIGHT CHICKEN AND WAFFLES restaurants operated under license, the licensee was accused by the State of Georgia of theft and tax evasion as a result of failing to pay over $650,000 of sales and withholding taxes owed to the State and instead using the funds for personal use. In an effort to secure payment of the amounts owed, the State of Georgia instituted an action under the Georgia Uniform Civil Forfeiture Procedure Act seeking forfeiture of “all property of every kind used or intended for use [by the licensee] in personam in the course of, derived from, or realized through [a] pattern of racketeering activity,” arguably including the GLADYS KNIGHT CHICKEN AND WAFFLES name and mark.53 Although the State’s attempt to secure rights in that name and mark was eventually unsuccessful, substantial resources were expended defending that claim. Thus, the acquiring company should be aware that the emerging company’s noncompliance with laws and regulations could result in serious consequences including inability to enforce the emerging company’s trademark or being forced to defend a claim for loss of trademark rights, in addition to other legal and regulatory consequences.54

The issue of legality of operations is currently front and center in an emerging area of franchising, namely cannabis dispensaries. Among other challenges, federal registrations cannot currently be obtained through the USPTO for marks that “touch the plant,” that is, goods and/or services that do not comply with the Controlled Substances Act.55 Although state trademark registrations and acquisition of common trademark rights are arguably available in those states that have legalized cannabis sales, the picture is far from clear regarding how robust those rights will be in enforcement actions where courts are forced to evaluate competing federal and state


51 \textit{Id.} at 51.


53 \textit{Id.} at ¶ 46.

54 Although its policy has varied over the years, the Trademark Trial and Appeal Board in inter partes proceedings currently “adopts a case-by-case policy of rejecting a use as ‘unlawful’ only in cases of clear, serious, and material violations.” 3 \textbf{MCCARTHY}, supra note 12, at § 19:1234. However, on occasion, the inclusion of certain goods or services in the identification may result in the Examining Division posing additional inquiries to verify that the applicant’s operations are lawful. See, \textit{e.g.}, \textbf{TMEP} § 1401.14(f) (identification including “ivory”, “bone”, “waterbone”, “horn”, or “tusks” may result in an inquiry whether the applicant’s business violates the Endangered Species Act).

interests. Under the current paradigm, it is possible a cannabis business trademark owner’s mark could be subject to an attack by a competitor that it is unenforceable, even in a state which has legalized cannabis, on the grounds that the trademark owner is involved in the sale of products that violate federal law.

D. Responses to Information Requests

It is not unusual for the Examining Division of the USPTO to pose an inquiry to a trademark applicant whether all or portions of the applied-for mark have any meaning in a foreign language or in a particular field or industry. To the extent the emerging concept has fielded any such inquiries in connection with its federally registered trademarks, it is essential to ensure that any such inquiries have been responded to accurately as a failure to do so could result in the subject registration being vulnerable to a challenge on the grounds of fraud.

E. Licenses, Litigation, and Warranties

The acquiring company should also request the following: (1) license agreements and license files, including quality control files; (2) litigation files including past infringements, disputes, demands, or language in court orders that may impact future litigation; and (3) settlement agreements and administrative or judicial decisions affecting ownership or validity of the marks or that may restrict expansion of the marks geographically or to other goods or services. As discussed in further detail below, it is also advisable to secure representations and warranties regarding the same, as well as confirmation all relevant registrations have been maintained and are currently in force. This may include vouching for the validity, incontestability, and absence of abandonment of the trademarks subject to any registrations.

Specifically, the acquiring company should insist on reviewing any applicable licenses or agreements with third parties involving the subject trademarks and closely review those documents to determine whether they impose any limitation on the acquiring company’s ability to: (1) use variations of the trademark; (2) expand its use of the trademark into different goods and services; or (3) expand a concept into different geographic areas. For example, one of the authors has been involved in separate transactions involving agreements where the target company: (1) was permitted to use only a single specified design form of its mark (with no mention of using any alternative or updated designs or, more importantly, the word form of the mark); (2) was not permitted to expand beyond a limited geographic area; and (3) agreed not to expand into certain specified areas of goods or services and, in some cases, into any areas of goods or services beyond those currently provided by the target at the time the agreement was entered into. In such cases, the acquiring company potentially faces liability in the event it expands use of the

56 See TMEP § 809.01(a).

57 This is particularly true where the applicant falsely states that a term is a valid mark when substantial evidence exists demonstrating descriptive or generic use in the applicant's industry or field. See MCCARTHY, supra note 12 at § 31.69. See also Caymus Vineyards v. Caymus Med., Inc., 107 U.S.P.Q.2d 1519 (T.T.A.B. 2013) (a claim of fraud was stated by allegations that in response to examiner's question if the term CAYMUS for wine had a geographical significance, the applicant's attorney misled the examiner in a telephone conversation).

58 See infra discussion in Section V. A.

59 The latter category of agreements, often referred to as “Field of Use” agreements, are often entered into to stave off a possible opposition by a third party.
acquired mark beyond that specified in the agreements entered into by the emerging concept. Such limitations not only present a serious liability concern, they may essentially negate the benefits of the proposed acquisition to the extent the principal objective behind the acquisition is expansion.

In addition, the acquiring company should carefully evaluate any assignment and license documents provided during the due diligence to determine whether any purported assignment is deemed to be “in-gross” (i.e., without transfer of the attendant goodwill associated with the mark) or the emerging concept has engaged in “uncontrolled” or “naked” licensing, either of which can result in a loss of trademark rights. Trademarks and service marks are not property rights that may be sold apart from the goodwill with which they have been developed and associated. Trademarks that are sold, licensed, or assigned without the accompanying goodwill may be deemed abandoned and available for use by others without risk of infringement. This is because assignments-in-gross or naked licenses generally constitute use of a trademark in connection with a business other than one symbolized by the mark, and thus a fraud on the public. The ultimate inquiry is whether any prior licensees or assignees have produced a product or performed a service of substantially similar kind and quality to that of the licensor or assignor so that consumers would not have been deceived or harmed by the license or assignment of a mark they have come to rely on as an indication of quality.

Finally, although trademarks are generally conveyed by a simple assignment, some caution must be exercised when the mark at issue is subject to an intent-to-use registration application. Such applications may be transferred prior to the filing of a Statement of Use only to a successor of the applicant’s business or portion of the business to which the mark subject to the application pertains, if that business is ongoing and existing.

IV. AVAILABILITY OF THE TRADEMARK FOR NATIONWIDE USE

Even if the emerging concept owns a federal registration for its trademark, it is essential for the acquiring company to recognize that federal registration does not guarantee availability of the emerging concept’s principal mark for use nationwide and that third-party issues may exist.

60 See, e.g., Int’l Cosmetics Exchange, Inc. v. Gapardis Health & Beauty, Inc., 303 F.3d 1242, 1246 (11th Cir. 2002) (“[I]t is well-settled law that ‘the transfer of a trademark or trade name without the attendant good-will of the business which it represents is, in general, an invalid, ‘in gross’ transfer of rights’” (citation omitted)); C.P. Interests, Inc. v. Cal. Pools, Inc., 238 F.3d 690, 701 (5th Cir. 2001) (“It is true that assignment of a trademark without the goodwill it represents is invalid.”).


63 In addition, a motivating factor behind some transactions is the acquiring company’s desire to achieve priority in a dispute with a third party. Although at first blush this may seem to be “underhanded,” courts have routinely held that a purchaser’s motivation for acquiring a trademark or a service mark is irrelevant to the validity of the transfer. See, e.g., Lone Star Steakhouse & Saloon, Inc. v. Alpha of Va., Inc., 43 F.3d 922 (4th Cir. 1995); Dial-A-Mattress Operating Corp. v. Mattress Madness, Inc., 841 F. Supp. 1339 (E.D.N.Y. 1994).

A. Searching and Other Third-Party Due Diligence

As noted above, expansion of an emerging concept’s business is often a principal goal of an acquisition. Accordingly, it is essential to ascertain the existence and impact of confusingly similar trademarks. This is particularly important if any federal registrations have not yet achieved incontestability and are subject to challenge on descriptiveness, prior use, or other grounds.

It is important to note that even if the emerging concept has used its principal trademark in its current area of operations without incident, this does not necessarily mean the acquiring company can expand into a new geographic area without encountering a conflict. There may be: (1) individuals or companies that have used or registered an identical or confusingly similar trademark before the emerging concept initiated use of its mark anywhere (senior users); or (2) individuals or companies that have used or registered an identical or confusingly similar trademark after the emerging company initiated use of its trademark anywhere (junior users). The effects of senior and junior users on an acquiring company’s rights to the principal trademark of the emerging concept depend on many factors discussed in further detail below. In any situation, however, the more information the acquiring company gathers before initiating expansion into a new geographic area or purchasing a concept, the more flexibility it will have in addressing potential issues, including avoiding encroachment on a senior user’s superior trademark rights and protecting its franchisees from disruptive, expensive, and potentially embarrassing litigation.

It is not unusual for the emerging concept’s rights in its principal mark to consist of common law rights limited to the immediate geographic area in which it has done business. However, it is important for the acquiring company to request that the emerging concept provide any comments, demand letters, agreements, lawsuits, or other information relating to third parties. For example, the emerging concept should advise as to whether it is aware of any comments from customers referencing unrelated businesses with similar trademarks.

Whether the trademark is registered or not, the acquiring company should ask the emerging concept whether it has conducted any searches regarding the availability of the trademark, including commercial searches, checking online directories, and conducting internet searches for businesses with similar names. If so, this information may disclose potential issues in the current market, as well as issues with possible expansion that may need to be considered, if not addressed, before purchase. If there is a prior user of the identical or confusingly similar trademark with superior rights, the ability to use or register the trademark may be severely limited, if not completely barred.

If no recent commercial search has been conducted by the emerging company, the acquiring company should begin with a commercial trademark search obtained through a reliable legal advisor or commercial search vendor, and supplement it with searches using web-based searching engines, as well as telephone directory searches. Conducting such a search may also be advisable even if the emerging concept has conducted an earlier search if a significant period of time has elapsed since that search was conducted, as the new search could potentially disclose one or more third parties who have begun operating in an area remote to the emerging

---

65 Reliable commercial search companies include Thomson Compumark and Corsearch, which can provide searches of federal and state trademark records, as well as business name records, domain name registrations, websites, and other databases, for arguably similar marks. See http://compumark.thomson.com and https://www.ctcorsearch.com.
concept’s operations since the initial search. The cost of commercial searches is relatively low, especially in comparison to the cost of potential litigation.

A typical commercial search includes the following sections: a federal section, a state trademark registration section, a common law section (containing information from a variety of published sources including trade directories, new production publications, advertising journals, and websites), trade name listings, and domain name registrations. Here, the acquiring company would be well advised to have a seasoned trademark attorney review the commercial search to better assess the availability of the trademark and any associated risks.

A cautionary note with respect to searching. Emerging companies in some cases retain advertising agencies or branding companies to assist in the creation of word and design versions of their marks. In doing so, they often have the impression that any marks created for them by these agencies or companies have been searched or otherwise vetted for nationwide availability. This is almost never the case as these agencies and companies rarely have the experience or resources to provide reliable clearance searching. And in many cases the written agreements executed by the emerging concept with these agencies and companies do not clearly address ownership of the marks or other work product created.

B. Determining Priority and Risk of Third-Party Users of Identical or Confusingly Similar Marks – What Steps Should be Taken Next?

A key consideration in the acquisition of an emerging concept is whether the acquiring company (who would step into the shoes of the emerging concept) has superior rights that will enable it to expand freely under the emerging concept’s trademarks into new geographic areas. Assuming the emerging concept has obtained a federal registration for its principal mark(s), that registration only protects against subsequent adopters of a confusingly similar trademark after the emerging concept’s nationwide priority date.

In order to assess priority, the acquiring company should first conduct an investigation to determine: (1) when and where the trademark was first used by any third parties disclosed in the commercial search; (2) the goods and/or services with which the trademark is used by the third parties; and (3) the extent of use by the third parties, including the number of locations, geographic scope of use, and promotion of the trademark. Helpful tools to uncover this information, which can be used to determine the appropriate action, are online search engines such as Google, online Secretary of State records, Dun & Bradstreet searches, and telephone directories. If additional information is needed, the acquiring company should consider retaining a professional investigative organization to make, at a minimum, anonymous inquiries and purchase the goods or services of the subject third party. A trademark attorney can take this information, paired with the review of any relevant trademark filings, and better assess which entity has superior rights.

C. Junior Users and Ripeness Issues

If one or more of the third-party users of confusingly similar marks disclosed in a commercial search initiated operations after the emerging company’s nationwide priority date for

its principal trademark, then the emerging company has superior rights. That said, this does not necessarily mean that the emerging company (or the acquiring company) should immediately take action including sending a cease and desist letter to the third-party junior user. Although the emerging concept technically has superior rights as a result of its federal registration, its ability to challenge the junior user’s use successfully will depend on several factors.

First, although a federal registration does give the emerging company nationwide priority, it does not relieve the emerging company or any successor of its burden to establish in litigation that consumers in the geographic area in which the third-party user is operating are likely to believe, mistakenly, that the junior user’s operations are affiliated or associated with or licensed or endorsed by the emerging concept. In order to make that showing, the emerging concept or any successor must demonstrate either: (1) that its reputation extends to the geographic area in which the third party is operating; or (2) that the emerging concept has definite concrete plans to expand there. Unless the emerging concept or its successor can satisfy either or both of these requirements, a court will likely conclude that there is no likelihood of consumer confusion and the litigation will be unsuccessful. However, once the emerging concept or successor expands to the disputed territory, it should be entitled to an immediate injunction. This principle is known as the “Ripeness Doctrine” or “Dawn Donut Rule,” named after the Second Circuit’s landmark decision in Dawn Donut Co. v. Hart’s Food Stores, Inc.\(^{67}\) The Dawn Donut Rule has been applied in trademark disputes involving franchise systems. For example, in Comidas Exquisitos, Inc. v. Carlos McGee’s Mexican Cafe, Inc., the court held that an Atlanta-based restaurant chain and owner of a federal trademark registration for CARLOS MCGEE’S did not have the right to prevent use of the CARLOS MCGEE’S name for a restaurant in Iowa because the Atlanta-based restaurant chain was unable to show that its reputation extended to Iowa or that it had a present concrete intent to expand to the Iowa market and, therefore, was unable to establish a likelihood of confusion.\(^{68}\)

A number of geographic expansion cases turn on whether the senior federal registrant can show sufficiently concrete plans to expand into the new area in which the junior user operates.\(^{69}\) Although there is no firm standard, evidence of one or more of the following is likely sufficient: (1) a recently signed franchise agreement for the geographic area in which the junior user operates; (2) a bona fide franchise prospect for that area that balks at signing a franchise agreement because of the junior user’s conflicting use; (3) a planned opening date for a new corporate or franchise location operating under the emerging concept’s principal trademark in the geographic area at issue; and/or (4) the new area franchisee’s attendance at a franchisor sponsored pre-opening training event. On the other hand, a mere operational goal or aspiration to expand a franchise concept nationwide without specific details generally will not be sufficient.\(^{70}\)

---

\(^{67}\) 267 F.2d 358 (2d Cir. 1959).
\(^{68}\) 602 F. Supp. 191 (S.D. Iowa), aff’d, 775 F.2d 260 (8th Cir. 1985). Both the district court and Eighth Circuit relied on Dawn Donut in reaching their conclusion of no infringement.
\(^{70}\) For example, courts have rejected naked assertions that a trademark owner/federal registrant is willing to sell a franchise or initiate operations itself, or is ready to begin selling product into the junior user’s territory, for failing to establish sufficient concreteness. See, e.g., Palteria La Michoacana, 188 F. Supp. 3d at 119 (finding both that these alleged facts were insufficient and unsupported by the record). In another case, a trademark owner/federal registrant’s
One concern trademark owners frequently grapple with is whether their delay in addressing infringement issues in remote geographic areas will expose them to claims that the delay constitutes laches or acquiescence. In that regard, because there is arguably no infringement during the period of time the parties’ activities are geographically distinct, courts have routinely held that a trademark owner’s failure to take immediate action or, for that matter, any action prior to its expansion into the disputed territory, does not result in laches or acquiescence.\footnote{\citelowref{71}}

\section*{D. Senior Users and Related Issues}

If one or more of the third-party users of confusingly similar marks disclosed in a commercial search initiated operations before the emerging concept’s nationwide priority date for its principal trademark, then this third party or parties are the senior user. Addressing such senior user third parties must be done with extreme care as a failure to do so can result in protracted legal proceedings that will most likely result in a limiting of the rights in the emerging concept or the acquiring company in the principal trademark.

A mistake trademark owners sometimes make in moving forward with expansion is to send cease and desist letters to third-party users of confusingly similar marks without verifying first that the trademark owner has priority vis-à-vis the third party. This course of action can result in disaster as oftentimes the third-party’s counsel turns the tables on the trademark owner by pointing out that its client is the senior user and because the trademark owner has admitted in the cease and desist letter that the marks of the parties are confusingly similar, it is the trademark owner that must cease use of its mark. And if the trademark owner’s federal registration for its principal mark has not yet achieved incontestability, a cease and desist letter might also provoke the third party to file a petition to cancel the trademark owner’s federal registration on the grounds of prior use. If the emerging concept’s federal registration for its principal trademark has reached incontestability by the time the cease and desist letter is sent, the federal registration will no longer be subject to cancellation based on prior use. However, if the emerging concept had sufficient knowledge of the third party’s use of the confusingly similar mark prior to its filing a federal registration application for its principal mark, the resulting registration may be vulnerable to a claim of fraud. Moreover, even assuming the federal registration for the emerging concept’s principal trademark is not subject to challenge on prior use or fraud grounds, the senior user third party will still likely be successful in preventing the acquiring company or any of its franchisees from expanding into the geographic area in which the third party senior user can demonstrate it has historically operated.

There are several strategies the acquiring company may employ in addressing third-party senior users of similar marks. One is to seek to acquire the third party’s rights in and to its mark ideally anonymously through a third-party source.\footnote{\citelowref{72}} Another option for the acquiring company to consider is filing a new registration application for the principal trademark based on concurrent assertions that it had traveled to the junior user’s territory, consulted with real estate agents, organized investor meetings, and attempted to establish local relationships was held insufficient to demonstrate a sufficiently concrete likelihood of entry. See Russell Rd. & Beverage, 2013 WL 321666, at *3-4.


\footnote{72 See supra note 66 for companies that provide this service.}
use, in which the acquiring company seeks registration for the entire United States excluding the geographic area in which the senior user third party is known to operate. However, as noted further below, it is not possible for the acquiring company unilaterally to amend a geographically unrestricted existing federal registration that has not reached incontestability to one based on concurrent use unless the senior third-party user agrees.

E. Fraudulent Filings

An unwelcome surprise in conducting thorough due diligence is discovering information that might jeopardize one or more of the emerging concept’s federal filings. An action between a large restaurant franchisor, Firehouse Restaurant Group (FRG), and a single operator with a similar name, Calli Baker’s Firehouse Bar & Grill (Calli Baker), provides an example of the importance of and potential pitfalls associated with a similar scenario.

In June 2008, after learning of the presence of the Calli Baker restaurant, FRG’s counsel sent a cease and desist letter in which it relied on FRG’s federal registration for the FIREHOUSE mark, which had a nationwide priority date before Calli Baker’s first use of its mark. In response to that letter, Calli Baker filed a declaratory judgment action of noninfringement and FRG filed a separate lawsuit alleging infringement of its federally registered mark. As the senior user with vastly greater financial resources, this would seem to be an easy win for FRG. Instead, Calli Baker was the aggressor and moved to have FRG’s FIREHOUSE mark registration invalidated on the grounds that Firehouse had perpetrated fraud on the USPTO at the time it filed its registration application. FRG, like all applicants for trademark registration, submitted an oath with the application that to the best of its knowledge “no other person, firm, corporation, association or other legal entity has the right to use the mark in commerce” in a manner that was likely to cause confusion. However, Calli Baker presented evidence that Firehouse knew of the existence of Firehouse Grill & Pub, a Tampa restaurant whose use of the FIREHOUSE mark predated FRG’s use. That evidence included several communications between FRG’s upper management and the Tampa-area franchisee acknowledging Firehouse Grill & Pub’s senior use, the potential problem that posed to FRG’s brand management and mark integrity, and even actual confusion between the restaurants. FRG’s president had even personally visited the Firehouse Grill & Pub restaurant shortly before FRG’s filing of its application for registration and had sent a proposed coexistence agreement with a $5,000 check to Firehouse Grill & Pub’s owner only a few weeks later.

The jury found that FRG had materially misrepresented the exclusivity of its use of the FIREHOUSE mark to the USPTO and that, consequently, its registration should be canceled.

73 Unless the parties are able to resolve the territorial issue by agreement, an inter parties concurrent use proceeding will be declared in which the Trademark Trial and Appeal Board will rule on whether the acquiring company is entitled to a concurrent use registration and the scope of the geographic area to be excluded from that registration.

74 See U.S. Registration No. 2,262,489 for the JITTERBEAN’S SANDWICH & COFFEE CO trademark which was restricted by agreement of the parties to a geographic area comprising the United States except for the states of Kentucky, Tennessee, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Florida, Arkansas east of Little Rock; and Livingston County New York.


76 37 C.F.R. § 2.33(e)(4).
Although FRG filed an appeal, the parties’ settlement shortly thereafter included a joint motion to vacate the verdict of fraud, which was granted.\textsuperscript{77} Despite the verdict being vacated, the underlying factual basis for the fraud claim arguably remains, which conceivably could be a basis for future court challenges against other FRG “FIREHOUSE” registrations and hamper FRG’s efforts in enforcing those registrations.\textsuperscript{78}

The *Firehouse* case demonstrates that the failure to address the known existence of a senior user of a confusingly similar trademark at the time of filing a federal application, without requesting a geographically restricted (i.e., concurrent use) limitation of that application, can potentially result in a later invalidation of the resulting registration. This problem could be especially acute with franchisors, as the FTC Franchise Rule requires that a franchisor disclose to its franchisees whether it knows of superior rights or infringing uses in a state where such a franchisee locates. Accordingly, the acquiring company should be aware that the misrepresentations to the USPTO could not only open the door for fraud suits from third-party users, they could also generate litigation from franchisees in states where the franchise had not disclosed the presence of known prior users.

V. TRANSACTIONAL PROTECTION

Benjamin Franklin is credited with saying “An ounce of prevention is worth a pound of cure.” The authors are sure Mr. Franklin was not thinking of performing due diligence on an emerging concept’s intellectual property portfolio at the time he made this famous statement.\textsuperscript{79} As discussed in detail above, performing due diligence on the front end of the transaction is an extremely worthwhile and critical step. However, conducting due diligence alone is not enough, because even the most thorough due diligence may still leave the emerging concept’s principal mark vulnerable to issues the acquiring company did not or could not have anticipated. Thus, the transactional documents will play a key role in ensuring the acquiring company is protected. In fact, even if the acquiring company does not take the due diligence steps detailed within this paper, the transactional protections discussed below can help prevent catastrophic issues from arising. It is important to keep in mind that if there is a failure of any representation or warranty a possible claim for indemnification exists; however, any such indemnification is only as good as the entity that is providing the indemnity.

\textsuperscript{77} See *supra* note 75.

\textsuperscript{78} At a minimum, FRG appears to have encountered some resistance in seeking to enforce rights in its FIREHOUSE portfolio of marks. After the conclusion of the litigation with Calli Baker, FRG has pursued at least one trademark opposition against a third-party applicant who sought to register the mark COLUMBIA FIREHOUSE. See Opposition No. 91/221,728. Although that opposition was resolved based in part on the applicant’s agreement to abandon its COLUMBIA FIREHOUSE trademark application, a third party, William H. Rogers, Jr., sought to intervene in the opposition and to introduce portions of the record from the Calli Baker litigation. Mr. Rogers has also been publicly critical of FRG’s enforcement efforts calling it “trademark bullying.” William H. Rogers, 2016 *Firehouse Subs Franchise Trademark Lawsuit Update: Firehouse Subs Pays to Put Out Old Flames*, BLUE MAUMAU (April 19, 2016), https://www.bluemaumau.org/blog/2016/08/19/2016-firehouse-sub-franchise-tradmark-lawsuit-update-firehouse-sub-subs-pays-put-out. More recent decisions invalidating federal trademark registrations on the grounds of fraudulent statements made by the applicant as to its purported rights in the subject mark include *Covertech Fabricating, Inc. v. TVM Building Products, Inc.*, 855 F.3d 163 (3rd Cir. 2017) and *Anello Fence, LLC v. VCA Sons, Inc.*, Civil Action No. 13-3074, 2019 WL 351899 (D.N.J. Jan. 28, 2019).

\textsuperscript{79} The authors could not find any connection between Mr. Franklin and a review of an IP portfolio, but that does not make the quote any less perfect for this paper and presentation!
A. Representations and Warranties

Representations and warranties are often hotly negotiated between the parties whereby the seller agrees to indemnify the buyer for breaches of the representations and warranties that are provided by the emerging concept.\(^{80}\) As discussed below, these representations and warranties are ideally backed by an escrow agreement provided by the emerging concept reserving a certain percentage of the overall purchase price and over a certain period of time. There is a growing trend, however, for parties to purchase representation and warranty insurance as an alternative method of protection.\(^{81}\)

There are numerous representations and warranties the acquiring company should consider requesting within the acquisition agreement relating to intellectual property.\(^{82}\) Some examples of these representations and warranties include:

1. “No Infringement. Use of the Intellectual Property does not infringe upon the rights of any third parties; and no third party has infringed upon or misappropriated any Intellectual Property right.”\(^{83}\) This first representation and warranty is considered a classic, as most agreements address this concept in some form. However, this representation and warranty contains two concepts within its short one sentence. The non-infringement of intellectual property as to the rights of third parties is the part that often receives the most attention, but it is the second part of this representation and warranty that is much more difficult to investigate. There is no comprehensive repository of information or easy search that can be performed on Google (or other available search engine) that will disclose if the intellectual property owned by an emerging concept is being infringed upon by any other third party. Thus, this particular representation and warranty requires some creative searching of competitors and others that may be providing competitive goods or services in order to determine if the intellectual property or colorable imitations thereof are being used.

2. “Inventorship/Authorship/Ownership. [Seller] owns the entire right, title and interest in the Intellectual Property, and no claims have been asserted challenging [Seller’s] inventorship, ownership or right to use the Intellectual Property.”\(^{84}\) If there have been any material challenges to inventorship or ownership of the intellectual property, this is an area where,

---


\(^{81}\) One study revealed that the typical escrow is between 10% and 15% of the overall purchase price which lasts between one to two years. \textit{Id.}

\(^{82}\) This paper is not addressing other representations and warranties that are typically found in asset purchase agreements or stock/membership unit purchase agreements. Additionally, it should be noted that many of the representations and warranties discussed could be applied to numerous concepts within a larger transaction; however, the items discussed in this paper are focused on the trademark portfolio.


\(^{84}\) \textit{Id.}
depending on the challenge and how important the element of intellectual property being challenged is to the overall transaction, the acquiring company should consider walking away from the deal in its entirety. The acquiring company should be very careful about proceeding with the transaction if a material challenge to the emerging concept’s principal marks is disclosed, or if a particular product or service of the emerging concept offered under another well-known mark is being challenged by a third party.\footnote{Id. As discussed below in Section V. B. 2. ii. infra, this could be a time that a holdback would be of great value, both from a legal as well as an economic perspective.}

3. “Valid and Enforceable. The Intellectual Property is valid and enforceable and there are no pending or threatened claims or legal actions asserting that such Intellectual Property is invalid or unenforceable.”\footnote{Id.} As discussed in the preceding example, the importance of the element of intellectual property to the overall transaction must be kept in mind. Although in today’s digital age it is not difficult to search for filed actions, threats of legal actions are significantly harder to search because they are rarely public and are likely known by a very small group of people, some of whom may no longer be employed by the emerging concept. Thus, this particular representation and warranty is crucial for any transaction to protect the acquiring company from any possible claims that “happened to be on someone’s desk or more likely email inbox” but were not disclosed or discovered.

4. “No Disputes or Litigation. The Intellectual Property is not and has not been the subject matter of any dispute or potential dispute.”\footnote{Id.} As discussed in item 2 above, the existence of potential disputes is the area where a substantial amount of time needs to be spent, as the due diligence team needs to make sure to speak with enough people who would be in the position to receive claims from third parties so that any possible claims can be researched to determine viability.\footnote{Id.}

5. “Right to Transfer. [Seller] has the right to sell, license or otherwise transfer the Intellectual Property, and has obtained the assignment of all interests and all rights to the Intellectual Property from any and all third parties (including employees).”\footnote{Id.} This representation and warranty is important because many entities rely on their employees for numerous creative endeavors, ranging from devising names of products to making adjustments to recipes or formulas or new product or service offerings. Although the “work for hire” doctrine is one that conveys copyright ownership to the employer, it does not necessarily apply to all creative undertakings of employees such as if the work performed occurred substantially outside of working hours or if the work itself does not relate to the kind of work that the employee was hired to perform. Thus, it is important that the acquiring company ascertain who is the owner of the

\footnote{Id. Another concern to be considered by the seller would be any competitors or third parties who learn about a possible sale and as a result file an action claiming an intellectual property violation vis-à-vis the third party’s intellectual property rights with the sole goal of a quick settlement because of the perceived claim being a due diligence issue for the buyer. Troy Ungerman, "IP Representations and Warranties in Tech M&A," NORTON ROSE FULBRIGHT (Sept. 28, 2017), https://www.deallawwire.com/2017/09/28/ip-representations-and-warranties-in-tech-ma/.

\footnote{Galvez, et al., supra note 83.}
intellectual property and whether any assignments need to be obtained prior to the consummation
of the acquisition.

6. “No Conflicting Rights. [Seller] has not granted any right, license or interest in or
to the Intellectual Property that is in conflict with the rights or licenses granted under this
agreement, nor has [Seller] encumbered any Intellectual Property.”\textsuperscript{90} Although this may seem
like an obvious representation, the acquiring company needs to ensure that the valuable
intellectual property assets being purchased can actually be used by it or its franchisees.
A situation can arise where the selling Company A could have entered into a transaction years
earlier where it purchased a competitor, Company B, but gave that Company certain rights to
various elements of that company’s intellectual property (which would now belong to Company A).
Fast forward a number of years and now, your client is purchasing Company A, and is under the
impression that it has unrestricted rights to various intellectual property that in fact, it does not
have the ability to use because of the original deal between Company A and Company B.

7. “All Intellectual Property Needed for Business. [Seller] owns or has valid licenses
to use, free and clear of all liens, including, without limitation, any claim of ownership or other right
all Intellectual Property that is necessary to conduct the business as currently operated or as
expected to be operated in the future.”\textsuperscript{91} This representation and warranty is similar to item 6;
however, this item is broader as it seeks to cover not only the intellectual property being sold to
the acquiring company, but also any intellectual property the acquiring company “needs” to
operate the current business. Basically, this representation and warranty provides that everything
the acquiring company needs will be transferred to it, and nothing will be retained by the emerging
concept.\textsuperscript{92}

8. “Registration. [Seller] possesses all necessary rights and privileges to cause the
Intellectual Property to be duly and appropriately registered in, filed in or issued by the United
States Patent and Trademark Office, United States Copyright Office or the corresponding offices
of other jurisdictions and countries, and there is no fact or circumstance which would prevent such
registration, filing and/or issuance.”\textsuperscript{93} As discussed in Section II above regarding Examining the
Existing Portfolio, it is crucial to be aware of any federal registrations that have been obtained by
the emerging concept, and more importantly what is not covered by these registrations. In terms
of research, this may be the easiest item on which to perform due diligence, because both
trademark and copyright registrations are easy to obtain and review! This is another area where
purchasing a company that has been active in its acquisition of intellectual property rights can
cause some attorneys angst. The analogy would be the purchase of a piece of real estate and
doing a title search to make sure the owner who is selling you the land was the actual owner, and
going back far enough to give you comfort that the owner actually owns the property you are
purchasing. Here, the acquiring company needs to make sure any assignment issues have been

\textsuperscript{90} Id.

\textsuperscript{91} Id.

\textsuperscript{92} Id. For those of you that are parents to young children or have memories of that, this is the representation and
warranty that provides that batteries are included with the toy you are trying to assemble.

\textsuperscript{93} Id.
dealt with and that it is able to use what it is buying, and perhaps more importantly that it is buying, something that can in fact be sold by the emerging concept.

9. “Status. The Intellectual Property rights have been properly maintained and all applicable maintenance fees and renewal fees have been paid.”94 One would think this would be the second easiest item on which to perform due diligence, as all the acquiring company needs to do is ensure that all fees are paid and files are up to date; however, timing with renewals and ensuring the proper documentation has been filed must be checked. If a deadline passes and a renewal was not done, that could create significant issues for the brand.

10. “Safety and Efficacy. . . . [Seller] has not intentionally concealed the existence of any data or information concerning the Intellectual Property that suggests that there may exist quality, toxicity, safety and/or efficacy concerns that could materially impair the utility and/or safety of the product, or anticipated components thereof.”95 No one wants to spend money on buying an asset and then not be able to use that asset because of a safety issue or class action litigation possibilities.96 The due diligence involved in protecting the acquiring company from an issue relating to this representation and warranty could get expensive and be time consuming, as one would have to test each product offered by the emerging concept using an independent testing facility to make sure it is “safe” for consumer use. This is often not practical from both the cost and timing of the closing of the deal.

11. “Full Disclosure. [Seller] has not withheld any material information in its possession relating to the Intellectual Property, and the information related to the Intellectual Property that [Seller] has provided is up-to-date and accurate in all material respects.”97 This representation and warranty can easily be tied to all of the above examples that have been provided, and this acts as a catchall to protect the acquiring company. As an example, it would be material if the emerging concept actually owns the trademark that it is purporting to sell versus the trademark being owned by an employee or unrelated third party. Knowledge that a third party could have the ability to make a claim against the acquiring company challenging ownership or that a third party already did make a claim but has yet to file an action would be “material information.” Another issue that may be pertinent to a transaction is the emerging concept’s knowledge of use of its principal mark in other fields or non-competitive markets, which could lead to all sorts of possible issues within the marketplace. For example, if the emerging concept owns a federally registered trademark covering wireless device accessories but the same mark is also used by a number of different unrelated companies for noncompetitive goods and services (lunch boxes, snack items), this can still cause numerous issues, particularly if the fields of the acquiring company’s products and services and those of the unrelated third parties are likely to converge

---

94 Id.
95 Id.
96 Actually, to be more accurate, no one wants to tell the client or CEO that they cannot use the product they just spent all that money to buy.
97 Galvez, et al., supra note 83.
in the future. At a minimum, the existence of multiple identical marks by unrelated third parties suggests rights in the principal mark may be diluted.98

A common tension with respect to representations and warranties is the differing objectives of the acquiring company and emerging concept. On the one hand, the acquiring company's objective is for representations and warranties to be as broad as possible. On the other hand, the emerging concept's objective is to limit the scope of such representations and warranties. One way an emerging concept may seek to do so is by including the phrase “to the best of Seller's knowledge, information, and belief . . .” or language to that effect, as this would clearly limit the possible liability to what the emerging company actually knew.99 For example, the use of this “knowledge qualifier” language might be used if the acquiring company requested a representation and warranty that there are no companies currently infringing on the trademarks being purchased, because it would be nearly impossible for an emerging concept to provide this broad representation and warranty comfortably without extensive investigation is very difficult.

A possible compromise would be to use the following qualifying phrase, which would require more from the emerging concept than simply relying on its existing knowledge: “After Seller’s reasonable inquiry and research, Seller represents and warrants the following.”100 Utilizing the same example as above, the emerging concept would have to perform a reasonable amount of investigation when providing the representation and warranty regarding infringement, e.g., at a minimum searching internet and online trademark databases. The emerging concept would not be able to use the ostrich theory of putting its head in the sand and simply claiming it had no knowledge.

B. Indemnification

In the event the emerging concept breaches a representation or warranty, what happens? Ideally, the acquiring company would turn to the indemnification provision within the transaction documents to determine whether and to what extent the emerging concept is responsible for the breach. The goal of the indemnification provision is to shift any loss suffered by the acquiring company as a result of the breach to the emerging concept. A typical indemnification provision to the benefit of the acquiring company will read as follows:

Each of Seller and the Stockholders agree to, jointly and severally, indemnify and hold Purchaser, its Affiliates and each of their respective directors, officers, employees, Affiliates, stockholders, agents, representatives, successors and assigns (collectively, the “Purchaser Indemnified Parties”) harmless from and against any and all Losses that any of Purchaser Indemnified Parties may sustain (whether or not instituted by a third party), or to which any

---

98 If anyone is not sure about this, spend a few minutes with your client’s or your brand’s marketing department and ask them what they would do if the trademark they have spent time, money, and effort promoting was not only promoting your client or brand, but also something else that is not competitive but still out there in the marketplace.

99 Although not the focus of this paper, it is worth mentioning that another often negotiated point is the timing for the buyer to bring claims against the seller for a breach of any representation or warranty. See Ungerman, supra note 89.

100 Another possible approach would be to qualify certain representations and warranties “to the knowledge of Seller’s legal department, there are no claims of infringement of any intellectual property.” This would provide a limited representation and warranty; however, it would arguably be coming from the part of the company most likely to be aware of any claims relating to the intellectual property.
of Purchaser Indemnified Parties may be subjected, arising out of or in connection with:

(i) any inaccuracy or misrepresentation in or breach of the representations or warranties made in any Seller Document by Seller or either Stockholder;

(ii) any breach of any covenant or agreement set forth in any Seller Document by Seller or any Stockholder;

(iii) any and all Taxes (or the nonpayment thereof) of Seller; and

(iv) any Liabilities related to the pre-Closing operation of the Business or ownership of the Assets, or Liabilities that are not directly related to the Business.

In the event there is a breach of a representation and warranty and there is an indemnification provision, both the emerging concept and the acquiring company have an interest in ensuring that the indemnification obligations are supported financially. For example, assume that after the transaction is consummated a third party asserts an ownership right to the trademark that was just purchased by the acquiring company. In many cases, the transactional documents provide that the acquiring company is required to defend that claim. And in turn, the acquiring company would seek to be indemnified by the emerging concept for any costs including reasonable attorneys’ fees incurred and any damages suffered as a result of that claim. In seeking that indemnification, the acquiring company also wants to ensure that the emerging company can satisfy the financial obligation of the indemnification. There are several means available to address the financial viability of indemnification, some of which offer greater protection than others. As discussed below, there are both “unsecured” and “secured” options that can be implemented. The unsecured option relies on the financial condition of the emerging company to cover the indemnification obligation. The secured options either rely on a representation and warranty insurance policy or the establishment of an escrow or holdback reserve.¹⁰¹

1. Unsecured Reliance on the Emerging Concept

A common unsecured method of indemnification protection is to rely on the emerging concept being in a sufficient financial position to cover any such indemnification obligation extended to the acquiring company. There are inherent risks in utilizing this option, mainly that the emerging concept has the financial wherewithal to cover any indemnification obligation. The reason this option is considered to be unsecured is that if there are no or limited financial resources behind the emerging company, then the acquiring company’s right to be indemnified is limited or worthless. In the event the emerging concept is sold in its entirety or all of its assets are transferred, the major concern would be that transferring entity will shut down or disappear and the owners of such entity move to a location that starts serving fancy drinks at noon.¹⁰²

¹⁰¹ This list is not intended to be exhaustive, but merely provide examples of possible indemnification funding options.

¹⁰² In the event the shareholders or members of the emerging concept are personally signing the transaction documents thereby providing a guarantee, the acquiring company would be able to seek monetary reimbursement or coverage
2. **Secured Indemnification Protection**

As noted above, a “naked” indemnification provision has its obvious risks; however, there are options whereby the obligations can be at least partially secured by taking additional steps. Such methods include the purchase of representation and warranty insurance and the creation of an escrow account or holdback reserve.

i. **Representation and Warranty Insurance**

Any representations and warranties provided by the emerging concept in connection with any transaction are only as good as the party providing them and as good as the conditions of their provision. One way to help either an acquiring company feel more comfortable in relying on the representations and warranties provided or the emerging concept feel more comfortable in providing such representations and warranties is to purchase insurance.103 “By shifting the risk of such losses from the seller to an insurer, the buyer and seller can limit or even eliminate the seller’s liability for certain rep breaches, all without materially diminishing the buyer’s coverage.”¹⁰⁴

One issue presented by representation and warranty insurance is that it may only partially secure the emerging concept’s indemnification obligations because the indemnification claims received are for a combined amount that exceeds policy limits. If the policy limits are exceeded, the fallback position would be the same “unsecured” remedy discussed above whereby the emerging concept would have to satisfy any additional financial liability, and the acquiring concept would be wholly dependent on the emerging concept’s financial condition.

For the emerging concept, having a representation and warranty insurance policy may result in it being less concerned about “knowledge” qualifiers (or their absence) as the emerging concept would have additional financial protection by obtaining such a policy. Representation and warranty insurance can also allow the emerging concept to retain more of the sales proceeds and avoid monies being tied up in an escrow as discussed below,¹⁰⁵ as well as having its

---

103 A second way to help ensure comfort is a holdback or reserve, which is discussed in Section V. B. 2. ii., *infra*.


105 “It can provide a cleaner exit for the Seller, with fewer contingent liabilities. It may also be purchased to protect a passive or minority investor that was not in direct control.” *Representation and Warranty Ins.*, PERKINSCOIE https://www.perkinscoie.com/en/insurance-recovery-resource-library-1/representation-and-warranty-insurance.html (last visited May 10, 2019). See also Harroch, *supra* note 80.
indemnification obligations reduced or eliminated.\footnote{106} Furthermore, “[i]t can provide for a cleaner exit to the [s]eller, with fewer contingent liabilities” associated with the sale of the company.\footnote{107}

For the acquiring company, the purchase of such a policy helps ensure that there is coverage for any breach of a representation or warranty, and by obtaining the policy itself, the acquiring company is in a better position to control policy exclusions, deductible amounts (including a reduction in the deductible as time passes), selection of counsel, and other terms and conditions that are often negotiated when purchasing insurance. At the outset, having a plan for obtaining representation and warranty insurance can make an initial bid to the emerging concept more appealing because there can be “no (or limited) escrow or holdback required, since the buyer will rely on the insurance for indemnification protection.”\footnote{108} Although the focus of this paper is performing due diligence to ensure that the acquiring company is fully knowledgeable about any trademark issues or challenges, the ability to obtain representation and warranty insurance is an extra layer of protection because the insurance “can extend the time for duration of the representations and warranties, giving the buyer additional time to discover problems.”\footnote{109} Another benefit of the acquiring company obtaining representation and warranty insurance is the ability, in some cases, to extend the period of time of an indemnification obligation. For example, it is possible that an emerging concept may agree to provide an indemnification for a specific period of time, say twelve months from the date of the transaction, but at the end of that period what happens? To the extent it is feasible that third-party claims could be made beyond that period related to the subject of the indemnification, one benefit of having an insurance policy is that the acquiring company may be able to extend this indemnification obligation beyond the period of time to which the emerging concept commits.

Another benefit to the acquiring company in obtaining representation and warranty insurance is to help eliminate the impact of the limitations imposed by the emerging concept’s use of any qualifiers on the representations and warranties provided. Having this insurance in place could avoid a “litigation within litigation” scenario. If the acquiring company was ever sued by a third party and the acquiring company sought to be indemnified by the emerging concept, then the use of “knowledge” qualifiers by the emerging concept could create a complicated situation. At the same time the acquiring company is litigating with the third party plaintiff, the acquiring company and the emerging concept might be litigating in a separate action over whether the emerging concept knew about the underlying issue or conducted a reasonable investigation into its possible existence. The emerging concept would likely argue there was no breach of the underlying representation and warranty, and thus there is no indemnification rights afforded to the acquiring company, because the emerging concept had no “knowledge” of such situation or that it conducted a reasonable investigation as contemplated by the representation and warranty and failed to identify the situation. Therefore, by obtaining representation and warranty insurance, it is possible that the emerging concept may agree to broader representations and warranties and not insist on the use of any qualifiers.

\footnote{106} Harroch, et al., supra note 80.

\footnote{107} Id.

\footnote{108} Id.

\footnote{109} Id.
Representation and warranty insurance is no different from other insurance policies when it comes to exclusions. Exclusions can be a double-edged sword, as the acquiring company will not be able to recover from the insurance company for any known liabilities that it discovered prior to the purchase of the policy, which makes sense from the insurance company’s financial perspective to ensure that it does not pay claims to an acquiring company for known issues. Therefore, more due diligence performed by the acquiring company may result in it being “fully aware of all of the [emerging concept’s] risks, but doing so will deprive the [acquiring company] of coverage under the policy for any liabilities that it uncovers.”\footnote{Chapman, et al., supra note 104.} However, without conducting due diligence, there may be many other issues that exist which would not be covered by any insurance or indemnification provision, so the “ostrich theory” to due diligence is not a recommended course of action.\footnote{There are other possible exclusions that could apply depending on the policy obtained, and some examples of those exclusions are as follows: (1) asbestos and polychlorinated biphenyls; (2) transfer taxes, (3) taxes disclosed to the buyer; (4) net-operating losses and other types of deferred tax assets; (5) underfunded benefit plan liabilities; (6) liabilities related to employee misclassification and compliance with wage-and-hour laws; (7) breaches of the seller’s covenants; (8) purchase price adjustments; (9) representations and warranties for future events, i.e. revenue projections; and (10) certain types of losses, i.e. consequential or multiple damages. Chapman, supra note 105; see also Harroch, supra note 81.} On top of having additional time to discover possible issues, obtaining representation and warranty insurance can also provide additional protection over and above what the emerging concept is willing to provide.\footnote{Harroch, et al., supra note 80.} Additionally, once the transaction has been consummated, representation and warranty insurance can be a useful transactional tool because it can act as a means of recovering damages when “pursuing the [s]eller is expected to be difficult (for example, if [s]ellers are numerous, in foreign jurisdictions, may be insolvent, or have stayed on in the target’s management).”\footnote{PERKINSKOIE, supra note 105.}

Once a representation and warranty insurance policy is in effect and there is a breach of a particular representation or warranty, then the acquiring company would seek coverage pursuant to the indemnification obligation.\footnote{It is worth mentioning, like any insurance policy, the purchase of representation and warranty insurance may seem like an attractive option; however, the cost of the policy, the deductible levels, and the exclusions together or separately may make this something that is not worth pursuing.} Having such a policy can in many cases greatly reduce the overall financial expense to the acquiring company both from an outlay of actual dollars and from a percentage of the overall deal and the relative exposure that exists. As an example to demonstrate the power of such a policy, if the overall transaction is for $500 million and the indemnification obligation is $50 million (10% of the overall purchase price) then the “cost” of a $50 million insurance policy would be the amount of the deductible. The deductible is commonly set at about 1% of the overall transaction\footnote{One study has found that the limits of coverage is “often set at 10% of enterprise value, with retentions typically 1-3% of enterprise value. Premiums generally range from 2%-4% of limits.” PERKINSKOIE, supra note 106.} thus for this example, the deductible would be $5 million, which reduces the percentage cost from 10%, if a party had to have $50 million set aside to 1%, based on the $5 million deductible. However, this amount could be reduced further, because as discussed above, having a representation and warranty insurance policy is advantageous for both the acquiring company and the emerging concept. In the event both

\footnotesize{110} Chapman, et al., supra note 104.
\footnotesize{111} Harroch, et al., supra note 80.
\footnotesize{112} PERKINSKOIE, supra note 105.
\footnotesize{113} It is worth mentioning, like any insurance policy, the purchase of representation and warranty insurance may seem like an attractive option; however, the cost of the policy, the deductible levels, and the exclusions together or separately may make this something that is not worth pursuing.
\footnotesize{114} One study has found that the limits of coverage is “often set at 10% of enterprise value, with retentions typically 1-3% of enterprise value. Premiums generally range from 2%-4% of limits.” PERKINSKOIE, supra note 106.
parties agree to split the amount of the deductible payment, the overall percentage cost would be 0.5%.  

In addition to the negotiation relating to the payment for the insurance policy and the division of the deductible, if any, a few other elements that are often negotiated between the parties are worth mentioning:117 (1) Do the representations and warranties being provided to the acquiring company expire at some point after the closing of the transaction?; (2) Despite having an insurance policy in place, does the emerging concept remain liable for the breach of certain representations or warranties?; (3) For certain types of losses that exceed the policy limits, does the emerging concept pay for such overages?; (4) What happens if there is a gap in coverage?; (5) What about coverage for items that are excluded from the representation and warranty policy?118

ii. Purchase Escrow Account/Hold Back Reserve

A second option that at least partially secures the indemnification obligations of the emerging concept is the implementation of an escrow account or holdback reserve as part of the transaction. "An indemnity holdback is a portion of the purchase price that is placed in a third party escrow account to serve as security for the buyer’s potential security indemnity claims against the seller."119 The ability to have an escrow or holdback is useful in the event representation and warranty insurance is not an option, or if it would be an option but there are certain liabilities that would be excluded from such policy or if the acquiring company is concerned about the limitations of such a policy.120 The acquiring company and emerging concept often negotiate over the number of escrow accounts to be established in connection with the transaction. The acquiring company will often attempt to negotiate the establishment of only one escrow account so that the maximum amount of funds will be available for any particular breach. The emerging concept, on the other hand, will often attempt to negotiate the establishment of a number of escrow accounts, one for each specific type of protection that the acquiring company seeks to cover, so that as time or events pass, the emerging concept would be able to recoup funds from the escrow account, thereby receiving more of the sale proceeds and limiting possible exposure.121

---

116 Chapman, et al., supra note 104.

117 The items that follow are by no means an exhaustive list, as this topic is not the main focus of this paper, but the authors wanted to provide some context as to other elements that are often discussed when a representation and warranty insurance policy is utilized in a transaction.

118 Harroch, et al., supra note 80.


120 There are numerous other ways to protect the acquiring company including, for example, reducing the purchase price thereby allowing the acquiring company to pay less based on the perceived amount of risk. However, that comes with some risks of its own because what happens if the eventual liability is more than the reduced price? The answer would appear that the acquiring company would be out of luck and would have to cover any such additional expense, unless there are other provisions within the agreement between the parties.

121 SCHWABE WILLIAMSON & WYATT, supra note 119.
This option may provide only partial security for the same reason articulated above as the representation and warranty insurance policy – e.g., the amount of the escrow or holdback is insufficient to cover the indemnified loss. And in that event the acquiring company again is in the position of relying on the emerging concept’s financial position to satisfy any under-funded reserve.

A benefit of an escrow account over obtaining representation and warranty insurance is that the escrow account can allow for much broader coverage to the acquiring company without limitations or exclusions inherent in some insurance policies.\(^{122}\) Insurance policies often contain numerous exceptions and limitations; however, an escrow account can be a much more “free” option for a transaction. The limitations and exclusions of any such account would be a negotiated point between the parties to the transaction rather than with a third party insurance company that is often not incentivized to make changes to the policy. Additionally, insurance policies have policy limits (as in the example detailed above, it was $50 million) and after policy limits are reached the paying party would then be financially responsible.\(^{123}\) Therefore, in the event an indemnification obligation is secured by an insurance policy there are two possible payment obligations that could be triggered: (i) the first payment obligation would be the payment of the deductible;\(^{124}\) and (ii) the second payment obligation would be the payment of any monies that exceeded the insurance policy limits, which amounts are uncapped and only limited by the paying party’s financial resources. With an escrow account the emerging concept could negotiate that the only monies the acquiring company can collect are from the escrow account, thereby providing the emerging concept with a sum certain of financial exposure.\(^{125}\) As discussed above, the double edge sword of performing diligence is something that can hurt the acquiring company when seeking to acquire representation and warranty insurance because known breaches by the emerging concept need to be disclosed to the insurance company, and those “known breaches” will often be excluded from coverage.\(^{126}\)

When representation and warranty insurance is not an option, having an escrow account and holdback can remove “concerns about the seller’s financial ability to cover post-closing indemnity claims if they should arise.”\(^{127}\) Furthermore, if the proceeds from the transaction are being distributed among numerous owners, then the ability to collect damages from these individuals could be significantly more difficult if there is not an holdback put into place. The

---

\(^{122}\) Id.

\(^{123}\) Harroch, et al., supra note 80.

\(^{124}\) The party paying the deductible, as discussed above, could be either (i) the emerging concept; (ii) the acquiring company; or (iii) it could be split as between the two parties.


\(^{126}\) “[I]f the Buyer, for example, has particular concerns about the way the Seller has been handling a tax issue, R&W Insurance coupled with a tax representation is not the solution.” PERKINSCHOIE, supra note 106.

\(^{127}\) SCHWABE WILLIAMSON & WYATT, supra note 119.
holdback allows the acquiring company to have greater assurance that there will be at least some funds available in the event there are post-closing issues.\textsuperscript{128}

Typically, a certain negotiated amount of the purchase price is held in an escrow account for a negotiated period of time. The escrow agreement should be very specific on how the acquiring company is able to access the funds from the escrow account in order to resolve certain issues. An escrow account can also be triggered upon the occurrence of a certain event, such as the issuance of a Principal Register trademark registration by the USPTO.\textsuperscript{129} Of course, in the event there are no claims made to the escrowed funds, then after the expiration of the agreed date the emerging concept would be able to obtain those funds.

C. Recording Responsibilities

An agreement should address which party will be responsible for preparation and recording of appropriate assignment documents to ensure that there are no gaps in the chain of title going forward. The fees required to record assignments and encumbrances of trademark rights can be fairly substantial, particularly where there are numerous federal filings. It is thus important that the agreement be clear as to who is required to pay for recording the foregoing documents involved in the transaction.

VI. CONCLUSION

Acquisition of an emerging concept is indeed a sound strategy for both franchisors and franchisees to achieve growth. However, if adequate effort is not spent on trademark due diligence and related transactional documentation, the perceived value underlying the transaction may erode significantly and the acquiring company may find that it has unwittingly assumed substantial liability. Conducting proper due diligence of the trademark assets of the emerging concept and addressing any gaps through the transactional protections identified above can go a long way towards ensuring that the acquiring company is able to maximize the value of the acquisition.

\textsuperscript{128} \textit{id.} It is entirely possible that upon the proceeds being distributed to the owners of the company, that the money gets spent or gifted to others, thereby making it very difficult, if not impossible, to successfully collect against in the event of future litigation. \textit{See also supra} note 103, which discusses a similar point relating to the purchase of representation and warranty insurance.

\textsuperscript{129} For example, if a Principal Register registration has not issued within ten months after the closing of the transaction, then one-third of the total escrowed monies would be paid to the acquiring company, and if the registration has not been issued within fifteen months, then the second one third would be paid to the acquiring company, and if the registration has not issued within twenty months, then the remaining one third of the escrowed funds would be paid to the acquiring company. This is just one example of a way to structure an escrow account holdback; however, it shows that the parties can build in certain triggering events so that each party is able to be protected. \textit{Purchase Price Holdback Sample Clauses}, LAW INSIDER, \url{https://www.lawinsider.com/clause/purchase-price-holdback}.  

38
CHRISTOPHER P. BUSsert is senior counsel in the Atlanta office of Kilpatrick Townsend & Stockton LLP. Over the past 30 years, Chris has represented clients in trademark, copyright, false advertising, and franchise litigation, and in licensing and trademark clearance and prosecution matters. He is a past editor-in-chief of The Franchise Law Journal and a past member of the Governing Committee of the American Bar Association Forum on Franchising.

JEREMY B. LIEBMAN is Senior Counsel for Krispy Kreme Doughnut Corporation in Winston-Salem, North Carolina. Jeremy focuses his practice on domestic and international franchising and distribution, intellectual property, and strategic expansion and development.