IP Based Financing Scoping Hypothecation Of Trademarks

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

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

Keywords**:** *Intellectual Property, Financing, IP Based Lending in India, Hypothecation of Trademarks,*

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I. Introduction

A. Property Rights – A Legal Construct

Recognised since primeval times and expounded well in the Middle Ages by great philosophers like John Locke and Thomas Hobbes, 'property' was considered to be one of the basic and fundamental[1] rights of man. However, a lesser known fact is that property as a legal concept is one of man's most brilliant invention, an ingenious bit of social engineering, which along with the legal constructs of ownership, entitlement and possession, satisfy more human wants and interests than any other single phenomenon on earth.

As is known, the expression 'property' grew in dimensions through the ages to encompass different things in different epochs and was gradually classified into the realms of moveable and immoveable and a hitherto unknown territory of 'intangible property', distinct and different from the physical, corporeal kind. Property has evolved today to become the centre of economic organisation in civil society, and it is this entitlement of property, which forms the basis of the discussions following herein.

B. Ownership In Intellectual Property ('IP')

As the value in intellectual creations and labours of the mind were gradually perceived and appreciated, the notion of property along with their proprietorship and commodification, was applied and extended to such intellectual labours, through State developed protection mechanisms, policies and regulations of the market place. Thus, the primary purpose of the award of a patent, copyright, trademark or other proprietary rights through various territorial IP statutes, is to enable creators legally fence what one creates, fend off predators and to publicly proclaim what one owns as a *jus in rem*. Its secondary and more compelling objective is to commercially exploit the legally owned property and reap financial rewards from the same, through standard trading and leveraging methods that typically follow the licensing, franchising, merchandising routes or even outright sales of the property.

[1] Tuckness, Alex, 'Locke's Political Philosophy', *The Stanford Encyclopedia of Philosophy* (Edward N Zalta, ed 2020 Edition), , available at <https://plato.stanford.edu/archives/spr2020/entries/locke-political/>

Natural Rights of a man was a theory expounded by John Locke (1632–1704), who is among the most influential political philosophers of the modern period, in his book, the Two Treatises of Government. He defended the claim that men are by nature free and equal against claims that God had made all people naturally subject to a monarch. He argued that people have rights, such as 'the right to life, liberty, and property,' that have a foundation independent of the laws of any particular society; revised Jan 2016.

II. IP Commercialisation

The obvious benefits of IP monetisation or commodification are to cover risks and costs of IP development, access and penetration of new markets and generation of steady revenue streams through long-term royalty incomes. The greater advantage however, lies in the fact that a single IP could be exploited in multiple ways to generate multiple streams of returns and revenues. A patent, copyright, trademark, design, or any other IP could be licensed or leveraged to different parties across different countries for different purposes, and could thus create separate and disparate royalty streams and income. The phenomenal growth of companies such as Apple, Google, and Facebook attests to the case in point and reflects the importance of building IP and IP assets in today's economy.

IP backed financing as an IP leveraging strategy, specifically refers to the usage of IP assets to gain access to market credit and funding. For example, a patent apart from being licensed could also be mortgaged with a bank for raising a loan, or a company could borrow money against their growing brand. Another recent development to have successfully captured the imagination of the market place is raising essential funds by auctioning of one's intellectual assets through specialist IP auction houses.[2] For instance, in June 2011, Nortel's 6000 patents were auctioned, and in February 2013, Kodak's 1,100 digital imaging patents were auctioned.[3] Empirical research has shown that investments in knowledge-based capital, i.e. intangible assets, have become key drivers of economic growth across countries.

A. Asset Based Financing/Lending

As a concept and a financial market system, 'asset-based lending' is perhaps age old and money markets have been very familiar with the many financial tools and vehicles involved in such financing. Essentially, it means that in exchange of the monies borrowed, the borrower grants to the lender a 'security interest' in his or her assets as collateral against the loan. Traditionally, immovable property such as plants and moveable property such as machinery, vehicles, are used as collateral[4] for asset-based loans. The worthiness and reliability of any asset as security in lending, depends on its rates of appreciation or depreciation (for the term of

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[2] Lucinda Longcroft, 'Intellectual Property Financing – An Introduction', *WIPO Magazine,* September,2008, available at < https://www.wipo.int/wipo_magazine/en/2008/05/article_0001.html> Last seen on 5th November, 2020.

[3] ABF Journal, 'IP Asset Value as Collateral: The increasing Use of Patents as Collateral in Asset based Lending', January 8, 2016, available at <https://www.abfjournal.com/articles/ip-asset-value-as-collateral-the-increasing-use-of-patents-as-collateral-in-asset-based-lending/>.

[4] Joan F Garrett, *Banks and their Customers* (1995) 99. 'Collateral is a borrower's promise of specific property if a loan is not repaid'; Investopedia defines collateral as 'an asset that a lender accepts as security for a loan, so that the lender can seize it if the firm becomes insolvent or otherwise defaults on the loan and resell the same to recoup the losses'.

the loan), using market determined systems of projections, that provide the lender necessary insights into the value of the asset and which in turn becomes the benchmark to determine the size of the loan to be sanctioned or the funds to be deployed, under the terms of the engagement. The Hollywood film 'The Big Short' produced by Paramount Pictures in 2015 was shot in the backdrop of the sub-prime crisis in the US and best illustrates the dynamics of financial engineering and the manoeuvres of the banking system involved in leveraging of assets for borrowing.

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

> "*One well-known instance of using IP as collateral to secure financing occurred when Thomas Edison used his patent on the incandescent electric bulb as collateral to secure financing to start his company, the General Electric Company.*" [5]

B. IP- Based Financing/Lending

By the late 20th century, IP financing had caught on and today, IP owners seeking financing typically do so on the strength of their valuable patents, copyrights, trademarks, designs, trade secrets, goodwill or brand. Though the system as a whole has been more predominant in developed economies, the past few decades have witnessed an upsurge in IP based funding and lending in India too, particularly those involving trademarks and brands as collaterals for securing the funds or loans. The reason why such financing has gained traction globally, is because the legally protected IP rights of a company, whether single or in a portfolio, not only contribute to its economic strength through present and future revenue pipelines, but also provide scope for further exploitation. Besides, intangibles and knowledge based assets of a company reveal a lot about the company, and its business, technologies, management and approach, without having to dig for them.

[5] Andre J Millard, *Edison and The Business of Innovation* (1990) 43–46.

Based on the nature and worth of the IP and the need of the borrower seeking alternative sources of capital, strategies in IP based financing range from the traditional form of lending to mezzanine debts with equity conversion clauses, and with lenders and investors devising many novel and bespoke forms of IP asset-based financing, constructed on the borrower's specific capital needs and quite similar to their tangible counterparts. The Organisation for Economic Cooperation and Development ('OECD')[6] has observed that the main debt financing models connected to the exploitation of IP are broadly as follows:

1. Mainstream IP-backed lending**:** where IP is pledged directly as collateral in loans. When using IP as collateral, the borrower in effect promises to give up his rights in the IP if he does not repay the loan. The entire purpose of obtaining a security interest in lending is to be able to liquidate the asset for repayment of the loan in the event of the borrower's failure to repay. Even the rights to IP-generated income accruing in the future, such as royalties, can also be transferred against an upfront loan.

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

> "*This way, lending institutions can eliminate the risk of holding IP assets while the IP owner can obtain more favourable funding conditions. This is because the securities issued by the SPV are in theory, separated from the firm's risk and therefore the firm can receive more favourable credit ratings.*"[7]

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

Further, as the original owner is no longer the legal owner of the sold assets, the burden of repayment is shifted away from the original owner to the SPV.[8] The main purpose for creation of an SPV is to ensure that the obligations of the new entity remain secure and that its assets actually achieve bankruptcy remoteness, meaning that the SPV is not impacted even if the parent company

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[6] The Organisation for Economic Co-operation and Development ('OECD'), Enquiries into Intellectual Property's Economic Impact (2015).

[7] Federico Munari & Raffaele Oriani, 'Patent Securitization' in *The Economic Valuation of Patents: Methods and Applications* (2011) 326.

[8] Stout, 'Financing Alternatives for Companies: Using Intellectual Property as Collateral', September 1, 2014, available at <https://www.stout.com/en/insights/article/financing-alternatives-companies-using-intellectual-property-collateral/>.

goes bankrupt. As a system, securitisation has been quite prevalent in the developed economies and is increasingly gaining ground in India. A perfect example of the structure mentioned would be the example of the well-known American store chain, Sears, which in 2007, created USD 1.8 billion worth of bonds based on the brand names Kenmore, Craftsman and Diehard ('KCD'), considered to be Sears 'crown jewels' and transferred the said brands to a wholly owned SPV known as KCD IP. KCD charges Sears royalty fees as license to use those brands and in turn uses the royalties to finance the repayment of the principal and interest of the bonds.[9]

An often cited, popular instance of IP-based securitisation is that of the famous singer David Bowie, who in 1997 was able to secure USD 55 million from the United States insurance giant Prudential Finance in a landmark deal, and raised asset-backed bonds through a 10 year term. The bonds were issued on the basis of 'future' royalties (receivables from music tapes) on his hit music rights and the publishing rights from master recordings of 25 pre-recorded albums. Bowie got a fixed annual return of 7.9% per annum from these bonds, which were popularly termed as 'Celebrity bonds'.[10] Likewise, Paramount Pictures in 2004 raised USD 210 million from projected royalties for films to be made 'in future'. This is an outstanding example of the confidence the finance market reposed in the 'brand', which in effect was also the IP leveraged along with the royalties; as otherwise, agreeing to securitise royalties of films in the pipeline or yet to be produced, could well be a risky and scary proposition.[11]

Other examples of securitisation have been seen in the instances of the famous animation studio DreamWorks, founded by Steven Spielberg, David Geffen and Jeffrey Katzenberg, which raised USD 1 billion from the securitisation of copyrights in a film portfolio in 2002 to refinance outstanding credit facilities.[12] Lehman Brothers Inc., acting as lead underwriter and sole structuring agent closed a USD 1.7 billion securitisation of all revenue-generating assets of Dunkin' Brands Inc. in 2006.[13] While in another such instance, Kodak's patent portfolio

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[9] Bonnie G Buchanan, *Securitization and the Global Economy: History and Prospects for the Future* (2017) 97.

[10] Bonnie G Buchanan, *Securitization and the Global Economy: History and Prospects for the Future* (2017) 97.

[11] Anuradha Maheshwari, 'Leveraging IP- Recent Trends', *Legal Era (Mumbai)*, 26 May, 2014, available at < https://www.legaleraonline.com/articles/leveraging-ip-recent-trends > Last seen on 5th November, 2020.

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

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

was used as collateral to secure a USD 965 million line of credit that helped to keep its door open during its bankruptcy proceedings.[14]

1. Sale-and-Leaseback transactions: are those in which an IP owner sells its IP to a specialised investor or a lender in exchange for immediate funding. The original IP owner is then granted a license to use the IP, whereby it is required to make specified royalty payments to the buyer for a period of time. At the end of a specified term, the IP owner normally retains the option to buy back the IP assets at a predefined price. The advantage of this model is that the IP owner can increase his or her liquidity for short-term operations while maintaining the use of its IP.

2. Venture Debts: are those IP based financing models in which both debt and equity features are seen. In this kind of financing, the IP owner seeking the required funding gains access to capital in the form of a loan on which it agrees to pay interest. Simultaneously, the borrower issues warrants for equity in the company, which are acquired by the lender. It is to be noted that the loans are typically backed by blanket liens, i.e. a claim on all the assets of the firm in case of default.[15]

With reference to the financing models discussed above, it must also be pointed that they, do not necessarily pave ways for perfect situations of financing with IP collaterals. At times, a particular model of IP financing may not be ideal, as is borne out by the number of cases that have landed in protracted legal battles, mainly because the legal ramifications and nuances of such IP-backed transactions or the very nature of the assets were either not well-understood or were not closely examined by the involved parties. However, an introduction to IP financing has been provided herein to set the context for examining the more pertinent subject of 'trademarks as assets for financing', as discussed below.

III. Trademarks Based Financing

A. Trademarks As Assets

Trademarks as intellectual properties are globally understood to be signs or combinations of signs or symbols that are used to distinguish the goods or services of one trader or enterprise from similar goods or services of another trader or enterprise trading in similar goods and services.[16] While that is the primary

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[14] Stout, 'Financing Alternatives for Companies Using Intellectual Property as Collateral', September 1, 2014, available at <https://www.stout.com/en/insights/article/financing-alternatives-companies-using-intellectual-property-collateral/>.

[15] The Organisation for Economic Co-operation and Development ('OECD'), Enquiries into Intellectual Property's Economic Impact (2015).

[16] The Agreement on Trade-Related Aspects of Intellectual Property Rights 1995, art 15. Definition of TMs - a trade mark is any sign, or any combination of signs, capable of distinguishing the

function and purpose of trademarks, they also create an effective barricade against the unfair competition of traders and competitors seeking to free ride on the goodwill and reputation of a trademark owner. The legal system surrounding trademarks, provides the proprietor of a trademark with the exclusive rights to use its mark in association with its goods or services in the market place, to help identify them as well as to authorise or license others to use its marks in return for payments or other benefits. The IP value and strength of a trademark, hence, lies in its distinctiveness and uniqueness as a mark, and a good trademark over time becomes the trader's market identity and brand.

For example, the moment the word apple is mentioned, it conjures up for many, an image of 'Apple' as in computers and I-Phones produced by Apple Inc. rather than the common fruit from which the famous company derives its name. Such is the impact of the iconic mark in the human subconscious, that Apple for many today has become synonymous with electronic devices of daily use, underlining therefore, that distinctiveness is the hallmark of a trademark and the first step to building brands and asset creation. The choice in the adoption of the trademark when exercised diligently, displays the obvious merits in the mark, which can then be suitably leveraged to raise capital or borrow against it or be sold or auctioned in dire financial situations like insolvencies. Today Apple is one of the world's top brands along with Amazon and Google and is pegged at USD 140,524 million in 2020 and in 2019: $153,634m.[17]

Of the gamut of intellectual assets known, whether statutorily or otherwise, trademarks of reasonable strength, proffer an effective option as collateral security in IP financing, primarily because all trading entities definitely own a trademark, whether registered or not and forming an intangible yet visible asset of that entity. As opposed to other intangibles of the IP category, like a patent or copyrights of literary or cinematographic film or music composition, trademarks are not as complex to navigate and are thus perceived to be easier to deal with. From a lender's perspective, preference for trademarks as securities emanates from two principal factors, i.e. their longevity and their inherent nature.

Firstly, on the issue of longevity, it is to be noted that the life of registered trademark can be measured in centuries, as a mark can theoretically survive for ever or at least as long as the trade using the mark survives, but with periodic renewals, which is every ten years post its registration. In the case on unregistered

goods and services of one 'undertaking' from those of other undertakings must be eligible for **trade mark** protection. S 2(*zb*) of the Indian Trade Marks Act 1999 defines trade marks to be: '*a mark capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of others and may include shape of goods, their packaging and combination of color*'.

[17] Brand Finance, 'Global 500 (2019) The Annual Report on the World's most valuable and strongest brands', January, 2019, available at <https://brandfinance.com/images/upload/global_500_2019_free.pdf> (Last visited on September 7, 2020).

trademarks, the factor of renewals does not arise and the trademarks can go on as long as the trade in goods or services under the marks continue. Many a times, a strong trademark may outlive the original enterprise or the goods or services for which it was adopted. The longevity of trademarks thus, help in creating valuable licensing and franchising deals and if carefully exploited, can generate almost endless streams of revenues from such deals.

Secondly, trademarks as opposed to other intellectual properties appear more appealing as financing assets also because of the mark's 'visibility' and 'portability' factors. The likeability, worthiness and brand value of a trademark is evidently visible to any party transacting with the proprietor of a mark, making it easier in the negotiations of the financing or lending transactions. Portability factor on the other hand, implies that the documentations relating to trademarks and the marks themselves are less onerous in comparison to other IPs and thus, far easier to transfer to buyers or lenders.

B. Trademarks & Brands

The terms 'brand' and trademarks are often used interchangeably to mean the same thing. Though most experts opine that 'brand' refers to the reputation of the enterprise earned on account of and through its business, while trademarks represent both – the enterprise and its brand. In essence, strong and distinctive trademarks evolve into strong brands and eventually become the face of the brand. Globally, instances abound of companies seeking finance on the merit and strength of their trademarks, like Calvin Klein, which leveraged its brand for USD 58 million securitisation in 1993, which was linked to future sales and royalties of its perfume brands arising from the exclusive right to use the Calvin Klein trademarks.[18] Similarly, the world-famous brand Guess raised USD 75 million in 2003 from securitisation of its domestic and international trademark royalties generating licences.[19] Athlete's Foot, a Swiss sports footwear retailer, raised around USD 40 million from securitising its franchise resources.[20]

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

19 'Guess?, Inc. Announces Completion of $75,000,000 Securitization Transaction', *Business Wire* (April 29, 2003), available at <https://www.businesswire.com/news/home/20030429005510/en/Guess-Announces-Completion-75000000-Securitization-Transaction>.

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

Likewise, Burn Stewart Distillers raised Euros 31 million from the Belgium-based bank KBC against its whisky brands in 2008.[21] In India, New Delhi-based LT Foods used its Daawat brand of packaged rice as collateral to raise debt for its USD 50 million acquisition of US-based rice firm Kusha Inc. Even United Spirits, India, collateralised some of its leading whisky brands like Bagpiper and a few Whyte & Mackay brands to raise over Rs 6000 crores from institutions such as ICICI Bank.[22] Besides, as is commonly known, even the beleaguered Kingfisher Airlines, was able to obtain Rs 2000 crores sanction from the State Bank of India, leveraging its brand and registered trademarks as a collateral or security. This was the first instance of a public sector bank granting credit against an intangible asset, which was the borrower's brand.

C. Hypothecation Of Trademarks

As mentioned earlier, when raising finance through trademarks, the security offered to the lender is the asset value of the trademarks, which essentially translates into the commercial worth of the trademarks, with or without the titles to them. There are many legal mechanisms and practices by which a security interest in the marks is transferred to the lender, and a transfer is usually accomplished by a mortgage, pledge, hypothecation or other prevalent legal modes of borrowing on property.

Generally speaking, legal mortgages in many countries are seen as the safest form of security transactions, as the legal title to the IP is transferred to the lender by way of an assignment of the security, on the condition that the IP will be reassigned to the debtor when the security obligations are discharged in full.[23] However, mortgages for the purpose of securing the payment of money advanced by way of loans, are typically associated with transfer of interest in specific immovable properties and real estate, especially in India.

Considering the inherent nature of trademarks and their longevity, hypothecation on the other hand serves as the preferred option for securing properties in trademarks with lenders, as it merely creates a 'charge' over the trademarks as a

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

[22] Institute of International Trade, 'Collateralization of Brands', available at <http://www.iitrade.ac.in/kmarticle.php?topic=Collateralization%20of%20Brands>; 'Mallya to raise Rs 2,000 crore from conservative SBI',*ET Bureau*, July 23, 2009, available at <https://economictimes.indiatimes.com/industry/banking/finance/mallya-to-raise-rs-2000-crore-from-conservative;sbi/articleshow/4809470.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst>.

[23] 'Taking Security Over IP', *Mondaq* (March 23, 2015), available at <https://www.mondaq.com/uk/Intellectual-Property/383230/Taking-Security-Over-IP>; Lucinda Longcroft, 'Intellectual property Financing – An Introduction', *WIPO Magazine*, 2008,September,2008, available at < https://www.wipo.int/wipo_magazine/en/2008/05/article_0001.html> Last seen on 5th November, 2020.

security for a debt or demand, without actually parting with the possession and ownership of the property. According to the Black's Law Dictionary, 'hypothecation' originating from the Latin word *hypothecare*, which means to pledge a thing as a security without delivery of title or possession to the pledgee. H.L. Hart defines it as "where property is charged with the amount of a debt, but neither ownership nor possession is passed to the creditor, it is said to be hypothecated."[24]

Thus, in contrast to a pledge that requires actual or constructive delivery of the underlying goods to the pledgee, in hypothecation both the possession and ownership of the property remains with the owner, till the discharge of the contract either by performance or by the assertion of the hypothecate or creditor's rights over the property on the owner's failure to perform. Hence, hypothecation is contracted without delivery of the thing (tangible or intangible) hypothecated[25]. In the case, *Simla Banking and Industrial Co. Ltd. v Pritams*,[26] the Punjab High Court held:

> "*Hypothecation has been defined as a right which a creditor has over a thing belonging to another and which consists in the power to cause it to be sold in order to be paid his claims out of the proceeds. It is an act of pledging a thing as security for a debt or demand without parting with the possession. It follows as a consequence that although the property remains in the possession of the debtor, it cannot be transferred to a third party without the express consent or permission of the creditor.*"[27]

The foregoing implies that the hypothecator can remain in possession of the goods hypothecated and enjoy the same without causing any damage to the rights of the hypothecatee. Essentially, it is a security for a debt and nothing more and cannot survive the debt. As expressed by the well-known jurist, Salmond, "it is merely the shadow, so to speak, cast by the debt upon the property of the debtor",[28] and the hypothecatee can only sue on the debt, to execute against the hypothecated goods, if they are available.

The obvious advantage of hypothecation over other methods of transfer lie in the absence of actual transfer of interest or property in the goods by the hypothecator to the hypothecatee and the absence of any rights in favour of the creditor to possess the property or to sell it. Although it must be said that there is an implied right in favour of the creditor to possess and sell the property in case of hypothecator's inability to satisfy the debt. In relation to hypothecation of trademarks, typically it is observed that the legal issue to surface often is whether

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[24] HL Hart, *The Law of Banking* (vol 2, 4th edn, 1931), 906.

[25] *Bouvier's Law Dictionary* (8th edn, 1914) vol 2, 1480.

[26] *Simla Banking and Industrial Co Ltd v Pritams* 1959 SCC OnLine P&H 54.

[27] *Simla Banking and Industrial Co Ltd v Pritams* 1959 SCC OnLine P&H 54.

[28] PJ Fitzgerald, *Salmond on Jurisprudence* (12th edn, 2016) 469.

the trademarks as security can be sold by the creditor on the debtor defaulting on repayment of loans. The same along with other issues that emerge are discussed with respect to the following case below.

Deccan Chronicles Holdings Limited ('DCHL') which published the Deccan Chronicle newspaper from Hyderabad and has a wide readership in the south, was found to have defrauded public sector banks such as Canara Bank, Andhra Bank, Indian Overseas Bank, Central Bank of India, Corporation Bank, and IDBI Bank to the extent of Rs. 1,161.93 crores. It had executed deeds of hypothecation for its trademarks in favour of IDBI Bank, which stated that since the borrower DCHL was not in a position to create charge on its fixed assets, the borrower agreed to create a charge on its trademarks of 'Deccan Chronicle', 'The Asian Age', 'Andhra Bhoomi', and 'Financial Chronicle' as security for the loan together with all interest, including goodwill, charges and expenses payable to IDBI in terms of the loan agreement of Rs. 250 crores. The Deed further stated that in the event of any breach or defaults by DCHL, IDBI Bank would have the option of selling the trademarks in all the classes that they are registered in or advertising the availability of the goods manufactured under the trademark, among other things.[29]

In June 2016, IDBI Bank was again[30] set to auction the trademarks of 'wilful defaulter' DCHL, to recover part of its outstanding dues of about Rs. 444 crore. The bank had invited bids till June 23 for the four title trademarks — Deccan Chronicle, Andhra Bhoomi (Telugu daily), The Asian Age, and Financial Chronicle. Interestingly, the reserved prices for the trademarks were set at Rs. 120 crores, Rs. 3.5 crores, Rs. 18 crores, and Rs. 3 crores, respectively, indicating thereby that a careful valuation of the trademark assets were also undertaken by the bank for the recovery of its dues.[31]

Similar attempts by a State Bank of India-led consortium was made in March and April to auction the brand, logos and the corporate office of another 'wilful defaulter', Kingfisher Airline, but did not find any takers for the same. IDBI Bank too, did not receive any bids for its auction of the trademarks of the four DCHL's newspapers following a court intervention, as the DCHL promoters who are also 'part owners' of the trademarks, moved the Calcutta High Court seeking an injunction against the sale just days prior to the auction. They pleaded

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

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

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

that if the trademarks are sold off, then the business would be in jeopardy and would derail the promoters' efforts of repaying the bank's dues.[32]

Purely on the issue whether trademarks hypothecated to the lender can be sold or not by the unpaid lender, the Mysore High Court ruled:[33]

> "*In the case of hypothecation or pledge of moveable goods, there is no doubt about the creditor's right to take possession, to retain possession and to sell goods directly without the intervention of Court for the purpose of recovering his dues. Hypothecation is only an extended idea of pledge, the creditor permitting the debtor to retain possession either on behalf or in trust for himself (the creditor). Hence, so far as the movables actually covered by the hypothecation deeds are concerned, there can be no doubt that the bank is entitled to retain possession and also to exercise the right of private sale.*"

Thus, the hypothecatee's right to take possession of the hypothecated property on its own, or through the court, as per the terms of the hypothecation, as well as to sell it for the realisation of the debt secured by such hypothecation, is now thus, a settled issue in law. However, in the DCHL case, one wonders whether the owners of the DCHL trademarks could have been able to stop the sale, had the marks been assigned to the lenders following the hypothecation. As mentioned earlier in the paragraphs, while the grant of a security interest in a trademark collateral through hypothecation is merely 'a device to secure an indebtedness', a trademark assignment on the other hand, is an absolute or partial, limited transfer of the owner's right, title and interest in and to the trademark. As such, the grant of such a security interest to a lender is not equivalent to an assignment, where an assignor transfers to an assignee its property rights in the mark. Nonetheless, a hypothecation of trademark is also an implied agreement to assign the trademark in the event of a default by the debtor, where the debtor is executing against the hypothecated assets and which would be strengthened with such assignment. Assignments of trademarks have been discussed in greater detail in the following section.

D. Assignment Under Trademarks Act

Assignments of trademarks as a subject was debated at length in the very interesting case of *Canara Bank v N.G. Subbaraya Setty*,[34] in the Supreme Court.

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[32] 'IDBI gets no bidders for Deccan Chronicle trademarks', *DNA* (July 1, 2016), available at <https://www.dnaindia.com/business/report-idbi-gets-no-bidders-for-deccan-chronicle-trademarks-2229861>.

[33] *Sree Yellamma Cotton, Woollen and Silk Mills Co Ltd, In re* 1968 SCC OnLine Kar 133: AIR 1969 Mys 280.

[34] *Canara Bank v NG Subbaraya Setty* (2018) 16 SCC 228.

The cause of action in the case arose, when respondent No.1 availed a credit facility from the petitioner bank in 2001, and upon his default in the repayment of loan amount, the petitioner bank filed a suit against the respondents before the Debt Recovery Tribunal, Bangalore, in 2002. In order to repay the dues of the bank, Respondent No.1 signed an assignment deed dated October 8 2003, assigning to the petitioners, the trademark "EENADU" in respect of *agarbattis* (incense sticks) on certain terms and conditions as set out in Clauses 1 to 7 of the said deed.

However, by a letter dated January 27 2004, to respondent No.1, the petitioner cancelled the above mentioned deed, on learning that the bank could not be a 'patent rights holder'. In April 2004, respondent No.1 filed a suit against the bank challenging the said cancellation of the assignment, whereupon the petitioner filed a counter suit for a declaration that the assignment deed was vitiated by mistake, undue influence and fraud and that, therefore, the said deed was unenforceable in the eyes of the law. The apex court opined that a trademark cannot be assigned to the creditor by a borrower who has defaulted on a loan and ruled in their wisdom that:

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

The above judgment relied extensively upon §45 of the Trade Marks Act, 1999, ('the Act') and the Trade Marks Rules, 2002,[35] to articulate a critical aspect of the above case, that unless the trademarks were assigned to the lender, meaning thereby that unless they were registered with the trademarks Registry in the name of the lender, the assignment if any, of the EENADU trademarks could not be said to have been completed and would hence, be void in the eyes of the law. §45 of the Act permits the assignment and transmission of trademarks pursuant to a valid transaction and for consideration, with or without the good will of the business and in respect of all or some of the goods or services in respect of which the trademarks are registered.

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

However, as rightly pointed out by the Supreme Court, the assignment in the EENADU trademarks did not take place, as the fees filed by the bank for an 'assignment' in the Registry was in deficit of the required amount and was not accompanied by the borrower's affidavit attesting to the hypothecation of the trademarks. Hence the registration of the Registrar of Trademarks had refused assignment till the necessary formalities were completed. The Court pointed out that an unregistered assignment cannot be admitted in evidence by any Court in proof of transfer of title to the trademark by assignment.[36] The Canara Bank ruling is also in conformity with the US judgment *Roman Cleanser Co., In re* [37] where the court reasoned that a mere grant of a security interest in the IP asset is not an assignment and the US Trademark Act, 1946, (Lanham Act) specifies a place for recording of such assignment, which is the USPTO. In continuation of the above rationale, it can be said that in order to perfect a security interest in collateral, the security interest must first attach to the collateral and the debtor has the rights or the power to transfer rights in the collateral to a secured party.

The transfer of a security interest in a trademark will be thus, deemed perfected only when the necessary recordal of the assignment is followed through in the required format with the Registrar of Trademarks. Only when the acquired title of the lender is recorded in the Register of Trademarks, in proof of the change of ownership of the trademark, can the property in the trademark be effectively transferred to the lender. It therefore means that for any hypothecation of trademarks to be considered as valid transfer of security, it ought to be followed by necessary assignment of the marks, in proof of the transfer of the proprietary rights in the marks. Going by the principles of the legal maxim *nemo dat quod non habet*, any sale by a hypothecatee creditor of a trademark, without due assignment would be a sale with defective titles and could be challenged. A failure to record an assignment also exposes the lender to the possibility that a later assignee of the IP may take a valid assignment of the IP free on the lender's security interest in such IP (assuming the assignee registers its interest).

E. Sarfaesi

However, the aspect of the judgment that "trademarks are not property or that they are not security for loans or advances" was criticised in view of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, ('SARFAESI') which was not considered. §2(1)(t)

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

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

under SARFAESI clearly defines property to include intangible property such as licenses, trademarks, copyrights, and know-how. Further, under §2(1)(zf), 'security interest' has been defined to mean the right, title or interest created on any property (tangible or intangible) in favor of a secured creditor, while the definition of a secured creditor includes any bank or financial institutions holding any right, title or interest over tangible or intangible property. Many have argued that the bank accepting the assignment of trademark as security for an outstanding loan is a secured creditor and is entitled to sell the trademark or receive royalty in order to recover the loan amount. The trademark was offered as a security interest to restrain the bank from suing the borrower, which is a deemed valid consideration. M. Umarji, in an opinion piece[38] has expressed:

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

It must be also mentioned here, that although hypothecation is a regularly used form of conveying security interests in IP in India and works particularly well for goods and trademarks assets in financing, it is not governed by any statute or law and finds acceptance in mercantile law through long usage and practice. That is why, in case of disputes relating to the same, the courts are guided in their decisions purely on the general conditions of the hypothecation contract between the lender and the borrower.[39]

F. Valuation Of Trademarks/IP Assets

As may be observed, the foregoing paragraphs have been peppered with instances of multi-million/billion dollars securitisations and lending transactions on IP backed assets. The deal figures would naturally raise some curiosity as to how they have been arrived at, especially considering that intellectual assets, unlike their tangible, physical counterparts, do not come with ready reckoners and available market information to determine their values easily. As mentioned at the beginning of our discussions herein, any financing transaction will finally be determined on the merit of the worth of the IP asset, which will ultimately rest with the price tag that is affixed on those intellectual creations. Hence, it would be germane to the deliberations herein to briefly describe the 'valuation' methods

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38 M Umarji, (Former Director, Reserve Bank of India) 'Why Intellectual Property Rights as security for loans is correct in legal terms', *The Economic Times* (June 20, 2018), available at <https://economictimes.indiatimes.com/news/economy/finance/why-intellectual-property-rights-as-security-for-loans-is-correct-in-legal-terms/articleshow/64657067.cms?from=mdr > Last seen on 5th November, 2020.

39 *SBI v SB Shah Ali* 1994 SCC OnLine AP 57: AIR 1995 AP 134: (1994) 3 ALT 332.¶ 18.

of fixing the price of the IP or the trademark assets or brands. Valuation is a key tool in the process of IP based financing and is a complex, rigorous, and tricky process that is undertaken to fix a fair value of the IP. Especially given the scenario that borrowers tend to magnify and extol the virtues and potential of their IP assets, while financiers attempt to downplay the same.

1. Undertaking due diligence: Being opaque in nature, it is imperative to first understand the IP asset thoroughly – its ownership, legal protections, class and life expectancy, the transacting company owning the IP, whether the IP is revenue generating or not, its potential for revenue pipelines and returns over investments, the market or sector in which the IP operates and whether the IP is encumbered or not. All these factors are critical in weighing how much the IP is worth and if worth financing at all. While it is true that most IP assets pledged as collateral generate royalty income from fruitful licenses, it is also equally true that IPs are prone to great risks and diminishing returns as they become victims of the vagaries of market upheavals, disasters, lack of market demand, infringements, unexpected litigations, revenue sources drying up, mergers and acquisitions (change of ownership), and insolvencies.

2. For example, the price of the Bowie Bonds declined in 2004, when the bonds were downgraded in ratings to a notch above junk status.[40] The illustrations and cases cited above point out to things that could go wrong with secured lending or financing. Hence it is critical to first and before the culmination of the financing transaction, engage in a due diligence exercise and subject the asset to be financed, its owners, revenue pipelines to thorough and carefully scrutiny.

Practices in valuation: To begin with there are no fixed methods of valuations, though there is now a market demand for introducing approved standards, formalised by financial accounting bodies of countries, in order to bring a semblance of uniformity and organisation into the market. By and large, there are three accepted norms of valuation, and trademarks and brands as assets to be collateralised are generally valued by anyone or all of the following methodologies, which are best suited to the circumstances.

These are (i) the Costs approach, which takes into account all the costs incurred by an entity in creation and development of their intellectual property; (ii) Market approach, where the price paid for a similar asset under similar circumstances is taken into consideration; and (iii) the Income approach, which takes into consideration the present and future cash flows for the purpose of servicing the loan repayment plan, meaning the economic benefit to the business

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[40] Alphaville, 'A Short History of the Bowie Bond', *Financial Times* (January 11, 2016), available at <https://ftalphaville.ft.com/2016/01/11/2149761/a-short-history-of-the-bowie-bond/>.

over the IP's useful economic life. Another factor that ought to also be considered and computed is the value that will be required to cover the investment in the event of default.

Though valuation is a domain of accounting expertise, subjective perceptions do creep into them, which does affect the assessments of the worth of the IP, trademarks and often causes disputes. That is also the reason, why one often comes across different agencies rating the same trademark or brand differently, using perhaps different set of parameters. There are, of course, accounting firms and specialised agencies offering services in valuations and it is for the parties to the transaction to agree on the valuation agency, and post the valuation, it is for the financiers to decide whether to accept the trademark or brand as a collateral security or not.

IV. Conclusion

To reiterate, hypothecation is a charge created in or upon any movable property, by a borrower in favour of a secured creditor as security for financial assistance, but without delivering possession of the property to such creditor. It only creates a notional and an equitable charge in favour of the hypothecatee and the right of the hypothecatee, as already stated, is only to sue on the debt and proceed in execution against the hypothecated goods, if they are available. Hypothecation was developed as a market system to manage and control repayments of debts through the providing of the debtors assets as collaterals, but allowing the debtor to retain physical custody over them on the presumption that the debt will be honoured and that the borrower will part with the assets whenever called upon by the creditor to do so. It certainly does not contemplate depositing of goods or titles to the creditor at the beginning of the transaction. The charge of hypothecation is then converted into that of a pledge and the lender enjoys the rights of a pledgee at which point of time the assignment of trademarks can be brought in, subject to the contract between the parties.

It is pertinent to note that in case of hypothecation of moveable or intangible assets, the same has to be registered under §125 of the Indian Companies Act, 1956, whereas no such provision exists in case of charges by way of pledge. Additionally, the RBI from 2011 has been issuing directions to banks and financial institutions to register the transactions relating to securitisation and reconstruction of financial assets relating to immovable, movable and intangible assets and those relating to mortgage by deposit of title deeds with CERSAI. On January 22 2016, through a gazette notification, it further specified the types of security interests to be registered on the portal, which includes "security interest in intangible assets, being know-how, patent, copyright, trademark, licence, franchise or any other business or commercial right of similar nature". Again on December 27 2018, RBI reminded the banks to register relevant data with

CERSAI. In the absence of any statutory status given to a hypothecation transaction, the above legal safeguards work favourably in creating necessary controls over such lending transactions.

Till sometime back, a widely held misconception was that only patents yielded great returns and are the only intellectual properties worth commodifying. In fact as may be commonly observed, much of the discourse surrounding IP financing revolves around patents as the pertinent asset class. Likewise, it is commonly believed that trademarks are too small to be commodified or are best suited to draw boundaries in the market place and keep infringers and free riders at bay. The objective of this composition reflecting the author's thoughts is to point out that registered marks and brands make for competent IP contenders as more effective assets for financing. Though the vehicle for such activity must be carefully weighed, it is hypothecation of trademarks that works quite advantageously for this asset class in consummating financing deals. As most multinationals, companies and brands cast their nets far and wide, they would need more and more capital and debt to finance their operations, which is best done by increasing licenses and franchises, to leverage one's market presence through their trademarks and brand. Needless to assert that the rider that goes along with it is that, the devil lies in the detail and the hypothecation deeds have to capture the ultimate intent of the transacting parties, including all aspects of the assignment or transmission of the property, the kind of charges to be created over the trademarks, the debtor's restrictions, necessary endorsements of hypothecation, revenue sharing from licensing pipelines, renewals of trademarks, and the parties' rights and obligations.