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Intellectual Property

Opening up new sources of capital for restaurant companies looking to grow

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STRONG BRANDING ALLOWS successful restaurants to rise above the fray, remain recognizable in a crowded field of competitors and resonate with loyal customers. The essential elements of a strong brand include not only a protectable trade name and logo, but also distinct signage, decor, food packaging and menu design. Intellectual property (IP) can also be an invaluable tool in gaining access to additional sources of financing vital to any restaurants' continued growth and success.

In addition to my thoughts on this subject, I've included insights from Joshua Mason, an attorney with the firm.

Protection

The first step toward the monetization of IP is protection. Since restaurants are an industry built on IP, no one should take their IP lightly. Various levels of trademark protection are available, including "common law" protection, state registration and federal registration. The right level of protection depends on the current and intended scope and geographic expanse of the business and sensitivity to cost. Common law trademarks can be acquired without any expense on the part of the trademark holder, but they provide limited protection of the mark in the area of actual use. State trademark registration allows limited protection within a single state but is generally a quicker and less expensive method than pursuing federal registration. Federal registration provides the highest level of protection and grants the trademark holder nationwide priority to the mark based on the filing date of the application. Federal registration also grants the right to use the registered trademark symbol and the right to file suit in federal court for trademark infringement.

Direct Sales

Once you establish protections, there are ways to leverage IP to gain additional financing. The most straightforward method is the IP's direct assignment or sale. While this may be a simple way to extract value from your intellectual property, it also requires relinquishing ownership of not only the IP but also derivative works, royalties and revenue streams or rights associated with the IP. For these reasons, a direct sale or assignment may not be the restaurant company's best option to maintain control of the brand.

Licensing

Licensing can be useful for monetizing IP, and when done properly can increase both the revenue and the reach of the brand without additional capital investment. A carefully negotiated license agreement is key to a successful program. Parties entering into a license agreement should consider the license's duration, whether it will be exclusive or not, the license's geographic scope, the IP ownership and the parties' responsibilities regarding maintenance of filings and enforcement activities against third parties. Depending on the parties' goals, monetary terms may be appropriate. Royalty payments can be structured as guaranteed minimums or tied to the business' sales on a percentage basis. Lastly, the license agreement should provide the licensor the ability to review and correct the IP's use by the licensee to ensure consistent brand quality and maintain the enforceability of IP rights.

IP Holding Companies

A more complex variant of the IP's direct sale or licensing that can be used to access third-party capital or as an estate and tax planning tool is the IP holding company (IPHC). This approach involves the sale or assignment of the restaurant IP into a special purpose subsidiary, parent or affiliate entity created to hold, maintain and collect IP royalties. The IPHC then licenses the use of the IP back to the original IP holder (and to third parties) and collects royalty payments. The IPHC structure's benefits include obtaining favorable tax treatment of the income from the royalty payments by formation of the IPHC in a jurisdiction that applies a lower tax rate to IP-related revenues, and to insulate the value of the IP from the litigation and general business risks faced by the operating company.

Royalty Trusts and Securitization

Another alternative to the IP's direct sale or assignment is a royalty trust. Under this structure, an IP holder sells its rights to all or part of an established revenue stream of royalty payments to an income trust established to hold the royalty interests. The income trust holders then collect IP royalty payments while the original IP holder maintains legal ownership. In order to protect the value of the rights contributed to the trust, the trust instruments can establish requirements and restrictions regarding the maintenance and assignment of the underlying IP.

IP As Collateral

IP can also be used to enhance credit availability from lenders. Future IP-related cash flows or the IP rights themselves can be pledged as collateral, similar to more traditional asset-back lending, with an interest in the IP serving as security for a loan. Borrowing against the IP's value allows IP holders to maintain ownership and control of it and can be more advantageous than the direct sale of IP from a tax perspective as the capital made available by IP-backed lending is debt rather than income.

Exit Strategy

Many times, a restaurant owner can use his or her IP as part of an exit strategy. For example, the former owners of Michigan-based restaurant and online retail giant, Zingerman's sold their operating business at an affordable price while retaining ownership of the underlying IP and licensing it back to the new operating company for a royalty. This strategy allowed flexibility in the operating business' sale and provided a continued revenue stream even after the sale. This can provide a transition, which also leaves open the possibility of a direct sale or assignment of the IP later on. We've also used an IPHC and license agreement structure to provide effective estate planning, which allowed second-generation family members who wanted to operate a restaurant to inherit or buy an ownership interest in the operating company while also providing for non-participating family members by way of a gift or sale of an interest in the IPHC or royalty trust.

Knowing how to leverage a brand can take a restaurant to the next level. Properly protected IP can be used to open up new financing and bring growth and opportunities within reach. In short, IP is the Golden Goose. To extract true value from their brands, restaurant owners need to protect, utilize, and take creative steps to capitalize on their IP. FSN

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