

# Trademark Licensing In A Corporate Transaction

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## I. Introduction

Trademark rights pose special problems in a corporate transaction. Because trademark rights involves legal issues that are not attendant to other forms of property, intellectual or real, unique problems can arise. Two key areas of concern are the requirement of quality control and the potential for the loss of rights if the transaction results in the splitting of trademark rights. Each of these concerns is discussed in more detail below, followed by a discussion of the key considerations in the terms of a trademark license and sample clauses.

## II. The Quality Control Requirement

### A. Licensing and Identification of Source

By definition, a trademark is any device that serves as an indication of source. When a trademark is licensed, how does it continue to serve as an indication of source? Well, it does so, the theory goes, if the licensor controls the nature and quality of the goods. Then, the licensee is merely an arm of the licensor and the source-indicating function of the trademark is preserved. Licensing without such control is called licensing in gross or naked licensing, and may cause the mark to lose its source-indicating function. In such circumstances, enforceable rights in the trademark may be lost. This basic principle is often overlooked by the business person or counsel, who are inclined to treat trademarks as ordinary property rights such as patents, which they are not.

### B. Historical Roots

Originally at common law, the licensing of a trademark resulted in an abandonment of rights because the mark was no longer associated with a single source.<sup>2</sup> Over time, however, the common law caught up with the commercial realities of the marketplace, and licensing of trademarks was allowed if the licensor controlled the nature and quality of the goods or services involved.<sup>3</sup> This principle continues to be stretched to the limit by the demands of the market, raising the question of how the manufacturer of motorcycles can exercise meaningful control over the nature and quality of HARLEY-DAVIDSON cigarettes, the maker of soft drinks over COCA-COLA clothing, and the producer of a movie over STAR WARS toys, trading cards and cereal. Indeed, how can the Chicago Cubs, who can't control a baseball game, control the nature and quality of hats, T-shirts and jackets. The answer lies in the definition of a trademark as a source-indicating device. As long as the licensee acts as an arm

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<sup>2</sup> See *Macmahon Pharmacal Co. v. Denver Chem. Mfg. Co.*, 113 F. 468 (8th Cir. 1901).

<sup>3</sup> See *Dawn Donut Co. v. Hart's Food Stores, Inc.*, 267 F.2d 358 (1959).

of the licensor the goods continue to have a single source.

### **C. Abandonment Based on Lack of Quality Control**

Does a lack of quality control necessarily result in an abandonment of rights or is it merely evidence of an abandonment of rights? While the black letter principle is well-established, it is rarely enforced to produce the draconian consequence of a total loss of rights in a mark. The Court's seek to avoid a forfeiture of rights when a defendant raises the issue to defend a claim of infringement, and the issue rarely arises in other circumstances. Typically, in such cases, the courts will accept the slimmest evidence of quality control as sufficient.<sup>4</sup> Although many question its continuing merit in our modern marketing world, the quality control requirement continues to have force: the failure to exercise meaningful quality control over licensees can still result in the loss of trademark rights.<sup>5</sup>

### **D. Statutory Basis for the Requirement**

Although the requirement of quality control is black letter trademark law, what is the statutory authority for the requirement? Why does a lack of quality control result in a loss of trademark rights? The Lanham Act contains no specific provision that requires quality control as a condition of valid licensing. Instead, the requirement is the result of a combination of provisions.

15 USC 1127 defines a trademark as any "device" used "to identify and distinguish his or her goods, including a unique product, from those manufactured or sold by others and to indicate the source of the goods . . ."

15 USC 1127 also states that rights in a mark may be deemed abandoned, and therefore unenforceable, "when any course of conduct of the owner, including acts of omission as well as commission, causes the mark . . . to lose its significance as a mark. . . " Thus, if a mark is no longer used to indicate a particular source, the result may be an abandonment of rights. How does licensing avoid this risk?

15 USC 1055 provides that use by a related company "shall inure to the benefit of the registrant [or owner of the mark] and "shall not affect the validity of such mark or registration, provided such mark is not used in such a manner as to deceive the public."

15 USC 1127 defines a related company as any person who "is controlled by the registrant . . . in respect to the nature and quality of the goods or services in connection with which the mark is used."

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<sup>4</sup> See *Transgo, Inc. v. Ajac Transmission Parts Corp.*, 768 F. 2d 1001 (9th Cir. 1985)(reliance on licensee to maintain quality was adequate control due to ten year association between licensor and licensee).

<sup>5</sup> For example of recent cases where the principle resulted in a loss of rights, see *First Interstate Bancorp v. Stenquist*, 16 U.S.P.Q.2d 1704 (N.D. Cal. 1990); *Kortez v. Heffernan*, 1993 U.S. Dist. LEXIS 1846 (N.D. Ill 1993); *Stanfield v. Osborne Industries, Inc.*, 1993 U.S. Dist. LEXIS 18612 (D. Kan. 1993)

These provisions lead us to question whether a lack of quality control necessarily results in abandonment or does it merely create the conditions that may result in an abandonment? Does it still remain open to question whether as a matter of fact there has the mark has lost its significance as an indication of source? I favor the latter view, but court dicta often suggests that the lack of quality control alone is sufficient. The latter view is also supported by recent decisions where the lack of quality control did not result in a loss of rights because, for example, "the particular circumstances of the licensing arrangement indicate the public will not be deceived."<sup>6</sup>

#### **E. What is Adequate Quality Control?**

The level of control required to meet the quality control requirement in trademark licensing has progressively declined, to the point where many courts have accepted only minimal controls as sufficient. It remains clear, however, that the exercise of quality control, not merely the right to exercise quality control, is important. The licensor may conduct its own inspections or delegate the authority to a third party. Where there is a sufficiently close relationship between the licensor and licensee (same officers, family relationship, etc.) sufficient quality control may result from the relationship alone. In a limited number of cases, quality control by the licensee has been deemed sufficient, but this is a dangerous approach for the licensor since it puts the continued validity of the mark out of the licensor's control.

#### **F. The Adverse Effects of Quality Control**

Can too much quality control be a bad thing? Strong control may also increase a licensor's liability for the acts of a licensee.<sup>7</sup>

### **III. Splitting Trademark Rights**

#### **A. The Risk of Mishandled Marks**

In corporate transactions, the risks of mishandling trademarks are high. The consequences range from weakened rights to total abandonment of valuable trademarks with long term licensing and litigation problems in between. These problems can arise when the transaction involves part of a business operated under a house mark. Assuming, for example, that the goal of the transaction is to sell certain subsidiaries as they are currently operated while continueing in business with the other subsidiaries, what happens to the house mark? Several principles apply.

#### **1. Loss of Rights**

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<sup>6</sup> *Taco Cabana Int'l, Inc. v. Two Pesos, Inc.*, 932 F.2d 1113, 1121 (5th Cir. 1991), aff'd on other grounds, 112 S.Ct. 2753 (1992).

<sup>7</sup> See Hawes, *Trademark Licensing Can Lead To Product Liability*, 34 Practical Lawyer 23 (1988); *Crinkley v. Holiday Inns, Inc.*, 844 F.2d 156 (4th Cir. 1988).

First, a transaction which results in the ownership of the same mark by unrelated companies for similar goods may destroy the mark. As defined in 15 USC 1127, a mark may be deemed abandoned when any acts or omissions of the other cause the mark to lose its significance as a mark, that is, lose the ability to distinguish one company's goods or services from another. If two unrelated companies both use the same name for similar goods, the name may cease to function as a trademark for either.

A good example of this problem is *Heaton Enterprises of Nevada v. Lang*.<sup>8</sup> Heaton, the original trademark owner, started a pizza parlor in Iowa under the name MINSKY'S. It sold the pizza parlor with the right to use the name, but reserved the right to use the name itself in another business. It opened up another pizza parlor, also called MINSKY'S, then sold that one with the right to use the name. This process continued. In the end there were many unrelated owners using the MINSKY name for pizza parlors. Lang, a trustee of the Minsky estate, also sought to use the MINSKY'S name, for pizza parlors, and Heaton opposed. The Board ruled against Heaton. By selling the businesses and allowing unrelated companies to be using the same name, the opposer had lost all rights in the mark.

## 2. Distinct and Separable Businesses

The second principle is a corollary of the first. In general, rights in a mark may be split between "distinct and separable" businesses. As always, the test should focus on the public perception, whether or not the relevant public would likely assume that the goods coming from the assigned portion were controlled by the retained business or not.

For example, in *Gentry Canning Company v. Blue Ribbon Growers, Inc.*<sup>9</sup> a company called the Oakford Company assigned its rights in the BLUE RIBBON trademark for tea to a company that was not involved in the later litigation. Later, Oakford assigned its rights in the BLUE RIBBON mark for canned fruits and vegetables to the predecessor of Blue Ribbon Growers, Inc., one of the parties in the litigation. Then Gentry Canning Company used BLUE RIBBON for canned vegetables, sought registration and was denied. It petitioned to cancel Blue Ribbon Growers' registration on the grounds that the BLUE RIBBON mark for tea on one hand, and canned fruits and vegetables on the other, resulted in an abandonment of the mark.

The Board dismissed the petition, stating: "[w]hat we have here is a party who owned a number of registrations covering the mark BLUE RIBBON and design for a large number of grocery products, and assigned one registration for one distinct phase of its business to one party, and a number of registrations concerned with another distinct phase of its operations, particularly of interest to a canner or a packer, to another party." Thus, rights in a mark may be split when different but arguably related products are involved.

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<sup>8</sup> *Heaton Enterprises of Nevada v. Lang*, 7 U.S.P.Q. 2d 1842 (T.T.A.B. 1988).

<sup>9</sup> *Gentry Canning Company v. Blue Ribbon Growers, Inc.*, 138 U.S.P.Q. 536 (T.T.A.B. 1963).

These cases illustrate two very different results: splitting ownership of a mark between identical pizza parlor services results in abandonment, but splitting ownership between tea and canned vegetables does not. How close can the line be drawn? The following cases are instructive.

In *Gould Engineering Co. v. Goebel*,<sup>10</sup> the GOULD name was split between oil and oil burners. The issue was whether that split resulted in an abandonment of the mark. The court held that it had not.

In *Texaco, Inc. v. Kane County Oil, Inc.*,<sup>11</sup> Texaco purchased the oil business of a company called MCCORMACK OIL. McCormack reserved the right to use the MCCORMACK name on its tire dealership. Later, there was a dispute as to whether splitting the MCCORMACK mark between the oil company and the tire dealership had resulted in an abandonment. The court held that there was no abandonment because the McCormack oil business and the McCormack tire dealership were distinct and separable businesses.

### **3. Weakened Rights**

The third principle qualifies the second. Even if the assignment is valid, splitting ownership rights in a mark between unrelated parties may weaken the value and enforceability of the mark.

The classic case in this area is *California Fruit Growers Exchange v. Sunkist Baking Co.*<sup>12</sup> The California Fruit Growers Exchange used the mark SUNKIST for fruit and soft drinks. The California Packing Corporation, an unrelated entity, used SUNKIST for canned and dried fruits and vegetables. By contract, the two agreed to co-exist.

Together they sued Sunkist Baking Company for using SUNKIST on bread. The Court of Appeals held that if the Exchange and the Baking Company could agree to co-exist without confusion, then they could not be heard to complain about the use of the same mark for bread.

Similarly, in *Campbell Soup Co. v. Armour & Co.*<sup>13</sup> Carnation, which had a white and red label for milk, and Campbell, which had a red and white label for soup, agreed to coexist in their respective product lines. Carnation and Campbell sued Armour for using a red and white label. The district court focused on the agreement to co-exist, stating: "The essence of a trademark is that it shall be a true badge of origin in indicating that the contents to which it is affixed is the product of the trademark proprietor and no others . . . It is vital to the existence of a trademark that it should be used by one and by only one concern. A trademark cannot serve two masters; it cannot identify two sources at the same time and remain a trademark."

### **B. Strategic Options**

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<sup>10</sup>*Gould Engineering Co. v. Goebel*, 68 N.E.2d 702 (Mass. S. Ct. 1946).

<sup>11</sup>*Texaco, Inc. v. Kane County Oil, Inc.*, 238 N.E.2d 622 (Ill. App. 1968).

<sup>12</sup>*California Fruit Growers Exchange v. Sunkist Baking Co.*, 166 F.2d 971 (7<sup>th</sup> Cir. 1947).

<sup>13</sup>*Campbell Soup Co. v. Armour & Co.*, 175 F.2d 795 (3d Cir. 1949).

For these reasons there are clear risks in the assignment of rights without more. Fortunately, there are other options.

One possibility is to use a concurrent use agreement. The Federal Circuit in several cases has said that the opinion of businessmen on an issue of confusion as reflected in such agreements should be given great weight. Thus, a concurrent use agreement might avoid the problem of splitting rights in a mark. Unfortunately, concurrent use agreements are not always accepted. They may not be given weight if they constitute a naked consent or if a finding of likelihood of confusion is unavoidable. Finally, they do not avoid a weakening of rights under the Sunkist Doctrine.

Licenses are another way to address this problem. With proper control, the use by the licensee will inure to the benefit of the licensor. Thus, licenses, can avoid the problems that arise from splitting marks. Licenses pose other issues however. For example, there is the risk to the licensee that the license may be lost if the licensor goes bankrupt.

Another approach is joint ownership as shown in *In re Diamond Walnut Growers Inc.*<sup>14</sup> That case allowed two parties to claim joint ownership of a mark that was then used by a joint venture.

Finally, the issues has sometimes been addressed by assigning the mark to a holding company which then licenses the mark to the respective businesses. For example, in *The Ritz Hotel v. Charles of the Ritz*<sup>15</sup> separate parties claimed rights in the RITZ mark. The problem was resolved by placing the mark in a holding company co-owned by both parties.

The proper handling of trademarks in corporate transactions is an important and difficult issue. Trademark counsel should be involved in the entire process to insure that valuable rights are preserved.

#### **IV. Key Licensing Considerations**

There are various circumstances in which trademarks can be licensed. Each presents particular considerations that may differ from transaction to transaction. However, common concerns arise in most trademark licensing situations. The essential provisions of a trademark license agreements and the key interests of the licensor are outlined below.

##### **A. Use of Trademarks**

A trademark owner controls the manner in which its trademarks are used to insure a consistent marketing identity and to maintain the validity of the marks. To maximize its protection, the licensor should clearly set forth guidelines regulating uses of its trademarks.

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<sup>14</sup>*In re Diamond Walnut Growers Inc.*, 204 U.S.P.Q. 507 (T.T.A.B. 1979)

<sup>15</sup>*The Ritz Hotel v. Charles of the Ritz*, 12 IRP 417 (1989).

The Licensor's Goals:

- Set forth the manner in which others may use the licensor's trademarks in as detailed a manner as possible.
- Prevent use of the licensor trademarks as part of the other party's trademark, domain name or trade name.
- Prohibit any sale, transfer, assignment, or sub-license of trademark rights.

## **B. Rights in Trademarks**

A trademark owner wants to protect its ownership rights in the marks and avoid conflicts over the validity of its marks. Without provisions acknowledging the trademark owner's rights, the other party may have more latitude to challenge the ownership or validity of the trademarks.

The Licensor's Goals:

- Require the other party to recognize the licensor's ownership of the marks and the validity of and the licensor trademark registrations.
- Obtain an agreement not to dispute the licensor's ownership of the marks or their validity.
- Prevent the other party from applying for registration of the licensor's marks.
- Receive commitment to cooperate with the licensor in maintaining The licensor's ownership of the marks.

## **C. Quality Control/Quality Assurance**

Trademark licensors have an affirmative duty to ensure the licensee's use of the trademarks comply with the licensor's quality standards. *Lack of quality control can result in the licensor's loss of rights in its trademarks.* Agreement alone is probably not sufficient to satisfy the obligations of a licensor of trademarks. An ongoing program of actual quality control is necessary. Therefore, it is essential that the licensor set forth quality standards in the license agreements and then follow through by actively enforcing those standards.

The Licensor's Goals:

- Insure that licensed products meet approved specifications.
- Insure that advertising by licensees and others is consistent with our image and specifications.
- Inspect samples of the licensee's products prior to their being used.
- Maintain the right to inspect products, packaging, advertising and other marketing materials.
- Require the other party to comply with the licensor's determination of a deficiency.

## **D. Enforcement**

A trademark owner must police and maintain its rights in its trademarks to prevent third parties from using the marks and weakening the owner's rights. When the licensor is granting nonexclusive permission or licenses, the enforcement provisions should require the other party to inform the licensor of any infringing activities, and allow the licensor, rather than the other party, to take action against infringers.

The Licensor's Goals:

- Require the other party to promptly inform the licensor of any unauthorized or infringing uses of the licensor's trademarks.
- Reserve the right to take action against any infringing or unauthorized users.
- Require the other party to cooperate and provide evidence in actions against infringing or unauthorized users.

## **E. Indemnification**

A trademark owner often includes an indemnification clause in trademark agreements to protect itself from claims that may arise from use authorized under the agreement. The indemnification typically will not include third party claims that the licensor's trademarks themselves infringe the rights of that third party. The licensor should include such a provision in its trademark agreements to insulate itself from liability that relates to the grantee's advertising, marketing, or promotion using the licensor's trademarks or the manufacture, sale or use of licensed products.

The Licensor's Goals:

- Require prompt notice of any claims relating to the licensor's trademarks.
- Ensure the other party indemnifies the licensor against claims arising from or relating to the licensee's activities.

## **F. Duration**

*The agreement should specify a term to ensure that it is not interpreted as a permanent assignment of rights.* The licensor should clearly set forth the end date of each agreement, while including a clause that enables the parties to extend the agreement if they so desire.

## **G. Termination**

The agreement should include a termination provision to set forth the conditions under which the agreement will end, as well as the parties' obligations following the termination. To maintain its rights to terminate, the licensor must specify the particular reasons when it may terminate the agreement, as well as the post-termination process. Although unenforceable by current federal statute, provisions calling

for termination in the event of bankruptcy are included to reflect the intent of the parties and the possibility of changes in the bankruptcy laws.

#### The Licensor's Goals:

- Ensure it has an unconditional right to terminate the agreements, subject to a notice provision.
- Reserve the right to terminate for any breach, particularly regarding the use and quality of the licensor's trademarks.
- Maintain the right to terminate if the other party seeks legal relief for financial difficulties to prevent creditors or any other third parties from claiming rights to the agreement.
- Require the other party to immediately cease using the licensor's trademarks upon termination of the agreements.

## V. Sample Agreement Clauses

These clauses are taken from existing licensing agreements and are intended as examples for consideration and modification. The differing interests of the parties to a given transaction are likely to require changes to these clauses to fit the situation and desired outcomes.

### Grant

Licensor hereby grants to Licensee, and Licensee hereby accepts, a non-transferable, non-exclusive right, license and privilege to use the Marks listed in Schedule A within the Territory, in connection with the manufacture, sale and provision of the Licensed Products and Services and in connection with the operation of Licensee's business.

### Expansion of Existing Business

Licensee shall be permitted to make line extensions, specification changes or trade dress changes with the consent of Licensor, such consent not to be unreasonably withheld or delayed. It will be reasonable to withhold consent if the proposed line extension is for a product which is not of high-quality or if the proposed line extension or change or trade dress would alter or denigrate the image of the Marks.

### Use Guidelines

1. LICENSEE shall use the trademarks only in the manner specified in the Use Guidelines.
2. LICENSEE shall use the Licensed Trademarks solely in connection with the Licensed Products and not for any other goods or services.
3. LICENSEE shall not incorporate the Licensed Trademarks as part of any other trademark or use the Licensed Trademarks as part of any trade name or corporate name.
4. LICENSEE shall not use the Licensed Trademarks in any matter which may disparage

the Licensed Trademarks or impair the validity, scope, title or goodwill of LICENSOR in the Licensed Trademarks.

5. LICENSEE shall use the Licensed Trademarks in compliance with the legal requirements of the Territory.

6. LICENSEE shall not use any advertising and promotional materials bearing the Licensed Trademarks that have not been approved by LICENSOR. All such materials shall be submitted to LICENSOR for approval before use by LICENSEE. Such materials shall be deemed to be approved if LICENSOR does not provide written notice of any objection within fourteen (14) days of receipt.

### Quality Control

1. The Licensed Products sold by LICENSEE under the Licensed Trademarks shall conform to the Specifications.

2. LICENSOR or its duly authorized representatives or agents shall have the right to inspect the Licensed Products and LICENSEE's premises during LICENSEE's regular business hours upon prior written notice to LICENSEE.

3. At LICENSOR's request, LICENSEE will send samples of the Licensed Products to LICENSOR for testing and analysis. If any such sample, upon testing and analysis, does not substantially conform to the Specifications, LICENSOR shall promptly communicate the results of the testing and analysis to LICENSEE, and LICENSEE shall thereupon promptly take the necessary steps to ensure conformance with the Specifications.

### Enforcement

LICENSEE shall notify LICENSOR promptly of all infringing or unauthorized uses of the Licensed Trademarks of which LICENSEE may become aware. LICENSOR may take such action as it deems appropriate with respect to such infringements or unauthorized uses. LICENSEE shall cooperate in any such proceeding by furnishing documentary and oral evidence as may be reasonably requested by LICENSOR.

If LICENSOR elects that it will not take action, LICENSEE may take action on its own and LICENSOR shall cooperate in the action. LICENSEE shall not settle any such action without LICENSOR's prior written consent, which shall not be unreasonably withheld.

### Indemnification

1. LICENSEE shall defend, indemnify and hold harmless LICENSOR, its subsidiaries and affiliates, and their respective successors and assigns, for any liabilities, losses, expenses, or damages including reasonable attorneys' fees arising out of or resulting from any act or omission of LICENSEE relating to LICENSEE's activities under this Agreement

2. LICENSEE shall promptly advise LICENSOR of any claim asserted by any third party against LICENSEE arising out of LICENSEE's activities under this License Agreement.

3. LICENSOR shall have the right, but shall not be obligated to defend such claim. If LICENSOR elects to defend such claim, LICENSEE shall cooperate in the defense of the action at its own expense.

#### Insurance

LICENSEE shall obtain, at its own cost and expense, product liability insurance, the terms of which are reasonably acceptable to LICENSOR, with limits of ten million United States Dollars (\$10,000,000) protecting LICENSOR and LICENSEE and its sub-licensees against any claims or suits arising from any alleged defects in any Licensed Product manufactured, packaged or sold by LICENSEE under the Licensed Trademarks.

#### Attribution

Trademark Notice: Each time Licensee uses the Marks, the document, advertisement, sign, web site, or other place the marks appear must contain a trademark notice that states that the Marks used “are trademarks owned by American”

Example: “ACME® is a trademark owned by American.”

#### Trademark Registration and Maintenance

Licensor agrees to maintain all registrations and to pursue all pending applications for registration set forth in Exhibit A or that may become necessary throughout the Term of this Agreement.

#### Termination

1. LICENSOR may terminate this Agreement by providing LICENSEE with written notice of termination as follows:
  - (i) if LICENSEE shall default in the performance or observance of any of its obligations under this Agreement, and such default shall continue for thirty (30) days after notice specifying such default has been served upon LICENSEE by LICENSOR; or
  - (ii) (ii) if LICENSEE shall discontinue business or become bankrupt or insolvent, or apply for or consent to the appointment of a trustee, receiver, or liquidator of its assets, or seek relief under any law for the aid of debtors, or take or permit any action under the laws of the Territory similar to the foregoing;
2. Such right of termination shall not be exclusive, and LICENSOR's exercise thereof shall not preclude its exercise of any other right or remedy that it may have by law.
3. Upon the expiration or termination of this Agreement, the rights and licenses granted hereby to LICENSEE shall immediately terminate and LICENSEE shall cease to use the

Licensed Trademarks.

#### Phase Out of Retained Marks

Licensee shall not use the Licensor Retained Marks after June 30, 2003, or the exhaustion of Licensee's existing inventory of materials bearing those marks, whichever is earlier.