First Circuit Affirms Trademark Owner's Ability to Stop Former Franchisee's "Holdover" Use Despite Disclaimer

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by Phillip Barengolts

The owner of a trademark generally has unfettered control over the manner in which its mark may be used in connection with goods and services offered in commerce. Thus, one who does not own a trademark but wants to offer products using the mark must seek a license from the mark's owner. After such a license has been terminated, the former licensee has no right to continue using the mark. *See*, *e.g.*, *Burger King Corp. v. Mason*, 710 F.2d 1480, 1493 (11th Cir. 1983) ("[M]any courts have held that continued trademark use by one whose trademark license has been cancelled satisfies the likelihood of confusion test and constitutes trademark infringement."); *Church of Scientology Int'l v. Elmira Mission of Church of Scientology*, 794 F.2d 38 (2nd Cir. 1986).

This relationship between a trademark owner and its licensee forms the basis of most franchise systems. Thus, franchisors have long been able to obtain relief against franchisees' use of trademarks, trade dress, logos, and color schemes after the termination of the franchise, generally referred to as "holdover" use. The First Circuit recently confirmed this fundamental concept in *Shell Co. Ltd. v. Los Frailes Serv. Station, Inc.*, 605 F.3d 10 (1st Cir. 2010).

Here, the court addressed the interplay between The Petroleum Marketing Practices Act ("PMPA")[1] and the Lanham Act, among other claims,[2] in a dispute between the franchisor and the franchisee of a SHELL service station. Specifically, the franchisee, Los Frailes, experienced cash-flow problems, which resulted in missed payments for gas delivered by Shell to the station, eventually resulting in Shell's refusal to deliver SHELL gasoline to Los Frailes. The lack of supply prompted Los

[1] The PMPA was enacted to address the "allegedly unfair franchise terminations and nonrenewals in the petroleum industry by establishing minimum federal standards governing the termination and nonrenewal of petroleum franchises." *Mac's Shell Serv., Inc. v. Shell Oil Prods. Col. LLC*, 130 S. Ct. 1251, 1255 (2010).

[2] The additional claims included breaches of the various lease agreements for the property upon which the station was located, and an antitrust claim brought by Los Frailes. The discussion of these claims is unnecessary here and played only a minor role in the First Circuit's review of the district court's decision.

Frailes to send a letter to Shell cancelling the entire commercial arrangement between the parties, including the purported termination of Shell's lease of the property from Los Frailes, which owned the land upon which the station was located, because Shell purportedly had failed to pay rent to Los Frailes. Shell, in turn, sent a responsive letter terminating the franchise agreement – but not the lease – and denying the validity of the termination of its lease for the property because Los Frailes failed to comply with the lease termination provisions, namely, a provision allowing Shell to cure any alleged breach of the lease agreement within 60 days of receiving notice of the alleged breach. Los Frailes proceeded to procure gasoline from other distributors, attempted to cover up the Shell trademarks and trade dress at the station, and posted a disclaimer on the gasoline pumps at the station that stated "We Do Not Sell Shell Gasoline."

The parties then filed various claims against each other in the United States District Court for the District of Puerto Rico, including Shell's PMPA and Lanham Act claims. The district court ruled for Shell and granted it a preliminary and, ultimately, permanent injunction. The First Circuit upheld the district court's findings that: 1) Shell's termination of the franchise under the PMPA was valid; 2) Los Frailes's termination of Shell's lease of the property was invalid; and 3) Shell was entitled to a permanent injunction under the Lanham Act ordering Los Frailes to "refrain from further use of any Shell trademarks, trade dress or color patterns." It also affirmed the district court's order requiring Los Frailes to comply with its post-termination contractual obligations, namely, turning over Shell's properties to Shell so that Shell could find another franchisee to operate the station.

In upholding the district court's injunction for Los Frailes's violation of Shell's trademark and trade dress rights under the Lanham Act, the First Circuit listed three predominant facts that "amply" supported the district court's finding of a likelihood of confusion among reasonably prudent consumers. In particular, Los Frailes:

- operated a Shell service station for ten years at the property;
- continued to use Shell's trade dress at the station after termination; and
- covered up some but not all of Shell's trademarks displayed at the station while selling non-Shell branded fuel to the same customer-base.

The First Circuit further noted that Los Frailes's display of a disclaimer stating "We Do Not Sell Shell Gasoline" at the station's gas pumps did not dispel the likelihood of consumer confusion.

The First Circuit's ruling fell squarely within well-established trademark principles; however, the court veered somewhat off course when it highlighted that Los Frailes sold inferior quality fuel at the station. Many juries, and even judges, find the sale of inferior quality goods as bolstering the likelihood that consumers will be confused by the use of a similar trademark, but the quality of the goods generally is not relevant to a proper analysis of the likelihood of consumer confusion. Under trademark law, the mere fact that Shell did not control the quality of the fuel sold at the station would be sufficient to support a showing of a likelihood of consumer confusion over the source of the fuel sold at the station. That is, Shell should be the only entity in control of the products sold under its brand because consumers will assume that products sold under the SHELL brand (including other pertinent trademarks and trade dress) are authorized by Shell, regardless of their quality. Of course, an analysis of product quality may be proper in the context of a claim of dilution by tarnishment, which does not appear to have been asserted here.

The PMPA provides gasoline service station franchisees some protection from termination, but it does not protect franchisees from termination and liability for trademark violations. Such violations are explicitly recognized under the statute as appropriate grounds for termination of a franchise. *See* 15 U.S.C. § 2802(c)(10). Notably, the First Circuit has held that termination is conclusively presumed to be reasonable as a matter of law if one of the events listed in 15 U.S.C. § 2802(c) occurs. Thus, the First Circuit upheld the district court's finding that Shell's termination of the franchise was objectively reasonable under the PMPA. Los Frailes also failed to make timely payments under its franchise agreement and temporarily closed the station, which also supported the district court's ruling.

Trademark law provides franchisors with a fast and effective way to address holdover franchisees' continued use of franchisors' trademarks and trade dress, permitting franchisors to quickly regain control over their valuable intellectual property. Even in the context of gas stations, where federal law grants franchisees added protections, trademark owners can assert their rights in meaningful ways to prevent harmful consumer confusion from holdover uses of their marks.

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Phillip Barengolts is a partner with Pattishall, McAuliffe, Newbury, Hilliard & Geraldson LLP, a leading intellectual property law firm based in Chicago, Illinois. Pattishall McAuliffe represents both plaintiffs and defendants in trademark, copyright, and unfair competition trials and appeals, and advises its clients on a broad range of domestic and international intellectual property matters, including brand protection, Internet, and e-commerce issues. Mr. Barengolts' practice focuses on litigation, transactions, and counseling in domestic and international trademark, trade dress, Internet, and copyright law.