

NSFW: Naked Licensing And Uncontrolled Trademark Use

By Luke S. Curran

The nucleus of trademark owners' post-registration operations centers on protecting and enforcing those rights against unauthorized use by third parties. Conversely, much less attention is afforded to addressing the potential for inadvertent loss of rights when employed by authorized third parties.

Businesses are continually under pressure to generate new revenue streams from existing intellectual property assets. In turn, licensing agreements offer brand owners the ability to expand or even exploit new markets with lower financial barriers to entry. When confronting the daunting task of generating mark recognition, companies often welcome the opportunity to pay considerable royalty rates for the ability to offer their goods or services in connection with a renowned brand. Likewise, the licensee's marketing campaign ultimately benefits the licensor's goodwill. This proposition, on its face, appears to be a win-win as these agreements are the essence of any merchandising program.

However, a trademark licensing agreement, absent adequate quality control provisions, offers no guarantee precluding the risk of abandonment. Here, the operative word is "control." In the context of trademark licensing, avoid getting caught streaking with your business partner. Naked licensing occurs when the licensor fails to exercise adequate quality control over the licensee.¹

This careless practice may result in the mark no longer representing the quality of a product or service that consumers expect.² The safest road to abandonment is the gradual one. Moreover, the necessary amount of authority exercised over the licensee cannot be answered in general terms.³

Accordingly, it is critical for mark owners to develop and implement a strategic plan to map licensing agree-

ments, usage guidelines, approval mechanisms, and compliance monitoring efforts. Your trademark may be your company's most valuable asset. You should ensure that it is treated that way. The following catalogues several non-exhaustive considerations when entering into such arrangements with third parties.

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Roadmap to Avoid Indecent Exposure: Level of Quality Control

The Lanham Act provides no guidance regarding the adequate level of quality control necessary to avoid a naked license.⁴ So how much control is enough? A sufficient level of control has been found when the licensee's goods or services satisfy the "expectations created by the presence of the mark."⁵ Thus, there is no bright line rule as "[i]t is difficult, if not impossible to define in the abstract exactly how much control and inspection is needed to satisfy the requirement of quality control" over licensees in the modern marketplace.⁶

In order to avoid a judicial declaration of trademark abandonment for naked licensing, courts commonly consider:

- 1) Whether a mark owner retained contractual rights over quality of the use of the mark;
- 2) Whether a mark owner actually controlled quality of the mark's use by licensee; and

1. See *FreecycleSunnyvale v. Freecycle Network*, 626 F.3d 509, 515–16 (9th Cir. 2010) (emphasizing that naked licensing is "inherently deceptive" and constitutes abandonment of "any rights to the trademark by the licensor.").

2. See *J. Thomas McCarthy, McCarthy on Trademarks and Unfair Competition* § 18:48, at 18–79 (4th ed. 2001).

3. *Eva's Bridal, Ltd. v. Halanick Enters.*, 639 F.3d 788, 790–91 (7th Cir. 2011) (emphasizing that the level of authority exercised over the licensee "can't be answered generally" and the "licensor's self-interest largely determines the answer" when examining the nature of the business and customers' expectations).

4. 15 U.S.C. § 1127 (stating that "[a] mark shall be deemed to be abandoned. . . [w]hen any course of conduct of the owner, including acts of omission as well as commission, causes the mark to become the generic name for the goods or services on or in connection with which it is used or otherwise to lose its significance as a mark.").

5. *Eva's Bridal*, 639 F.3d at 790.

6. *Fuel Clothing Co. v. Nike, Inc.*, 7 F. Supp. 3d 594, 606 (D.S.C. 2014) (quoting *Barcamerica Int'l USA Trust v. Tyfield Importers, Inc.*, 289 F.3d 589, 595–96) (9th Cir. 2002)) (emphasizing that "the standard of quality control and the degree of necessary inspection and policing by the licensor will vary with the wide range of licensing situations in use in the modern marketplace").

3) Whether a mark owner reasonably relied on the licensee to maintain the quality.⁷

Fortunately, a party seeking to prove abandonment is confronted by a rather stringent burden of proof.⁸ Absent a clear showing of failure to exercise control, courts are simply averse to stripping a mark owner of its valuable rights on the grounds of naked licensing.⁹ Alternatively, when the licensor fails to adequately exercise control over the licensee, the mark owner may be estopped from asserting rights in the mark; for instance, for trademark infringement and related claims.¹⁰ Such abandonment is an “involuntary forfeiture” of rights and does not require a “subjective intent” to abandon the mark.¹¹

Trademark law requires the mark owner to exercise “decision-making authority over quality.”¹² It has been found that where no authority is exercised over the appearance, nature of the business operations, customers’ expectations, and even inventory of the licensee—this is the extreme paradigm of a naked license.¹³ Accordingly, examine the course of conduct between the parties to determine whether adequate quality control exists. The absence of both an express provision in the agreement and exercising actual control over the licensee’s operations exposes the licensor.¹⁴

I. Usage Guidelines For Licensees: Nature & Quality of Goods and Services

From a business perspective, the balance between inadequate control and excessively interfering with the licensee’s operations is delicate. The licensor has

the affirmative duty to confirm that the products and services offered in connection with its brand are of equal or greater quality. As a result, comprehensive and express quality control provisions establish the relationship in effective licensing arrangements—this is the first part of the court’s analysis.¹⁵ These provisions must safeguard the value of the mark while affording the licensee with freedom to operate.

Recognizing the importance of a mark’s source identifying function and related goodwill, the licensor must incorporate strict guidelines outlining any use of its marks. These standards should employ unambiguous language defining exactly how the mark will appear, where the mark will be used, and when.

Quality is key. Provide the licensee with electronic versions of all the licensed marks—especially when a design is involved—in order to avoid reproductions and dissection. Include in the agreement that only the marks provided by the licensor can be used in connection with the licensee’s goods and services. This preserves the marks’ integrity. Foreclose the opportunity for the licensee to create modifications and memorialize these terms in the agreement. The mark should never be modified (without prior approval) and include clear quality specifications so the graphical representations are of high resolution.

The arrangement should also include express provisions detailing the manner in which the mark will be used. For instance, it is advisable to include provisions emphasizing that the mark cannot be used with other trademarks without express approval. Moreover, include instructions in the agreement requiring the licensee to use appropriate registration notice symbols. Finally, the license should clearly outline how the goods will appear—the packaging, advertising, promotional materials, and service environment if a service mark is at play.

II. Approval By Licensor: Exercise Actual Control

Exercising actual control over the quality of the mark is the second part of the court’s analysis.¹⁶ The agreement should also incorporate a clear pre-approval program for all trademark use. Either give approved use as attachment to the license or develop a procedure for approval, or both. A sophisticated licensor commonly requires the licensee to submit a specific number of production samples of proposed uses of the marks. These are then subject to written approval before use.

7. *FreecycleSunnyvale*, 626 F.3d at 511 n.1 (citing *Barcamerica*, 289 F.3d at 596–98) (noting that by failing to enforce the terms of the mark’s use, the licensor may forfeit its rights to enforce the exclusive nature of the mark).

8. *Exxon Corp. v. Oxford Clothes, Inc.*, 109 F.3d 1070, 1075–76 (5th Cir. 1997) (citing *Moore Business Forms, Inc. v. Ryu*, 960 F.2d 486, 489 (5th Cir.1992)).

9. *FreecycleSunnyvale*, 626 F.3d at 514 (stressing that the person who asserts insufficient control of a trademark must meet a high burden of proof).

10. *Barcamerica International USA Trust v. Tyfield Importers Inc.*, 289 F.3d 589, 596 (9th Cir. 2002).

11. *Id.* (finding no express contractual right to inspect and supervise the use of the marks in addition to licensor’s infrequent wine tastings and unconfirmed reliance on the winemaker’s expertise as inadequate evidence of control to survive summary judgment).

12. *Eva’s Bridal*, 639 F.3d at 791.

13. *Id.*

14. *Fuel Clothing*, 7 F. Supp. 3d at 606 (quoting *FreecycleSunnyvale*, 626 F.3d at 516) (considering “whether the license contained an express contractual right to inspect and supervise the licensee’s operations,” or, if such contractual rights are absent, whether the licensor has exercised sufficient quality control over license).

15. *FreecycleSunnyvale*, 626 F.3d at 516 (noting that “the absence of an agreement with provisions restricting or monitoring the quality of goods or services produced under a trademark supports a finding of naked licensing.”).

16. *Id.* at 511 n.1 (citing *Barcamerica*, 289 F.3d at 596–98).

Eliminate any uncertainties by establishing a reasonable timeframe for approval or rejection of the proposed trademark uses. And if approval is not provided, expressly require that the materials affixed with the licensor's mark be sent to the licensor, or in the alternative, destroyed.

III. Best Practices for Periodic Compliance Monitoring

Finally, periodically demonstrate control through inspection or supervision, which must be detailed in the agreement.¹⁷ While the court also examines whether the licensor reasonably relied on the licensee to maintain quality—the final factor of analysis—periodically monitoring compliance helps mitigate the risk of naked licensing.¹⁸ Sole reliance on a licensee's own quality efforts is simply not enough to overcome a finding of naked licensing without other indicia of control.¹⁹ Courts have even excused the lack of a contractual right to control quality in the event the licensor demonstrates actual control.²⁰

It is best practice to routinely conduct on-site inspections to ensure compliance with the license agreement, quality standards, and all applicable laws. Just ensure notice provisions are included and refrain from disrupting business operations. Likewise, monitor developments with the brand's reputation and review customer service comments and complaints, which

may prove useful when developing future versions of the goods based on customers' expectations.

Moreover, be cognizant that adding excessive quality control provisions into the license may make it appear as if it is a franchise agreement. Strike a balance. It is equally as important to note that the quality control requirement may mean that parties injured by the product may drag you into litigation under product liability theories where the operations of the licensee have resulted in harm. For this reason, ensure strong indemnification and insurance provisions are in place. Lastly, while some countries have no legal requirement for records of licenses (*e.g.*, U.S. and U.K.), it is best practice to record the agreement to place others on notice. In other countries, a license must be recorded to be effective.

Closing Remarks

Ultimately, when licensing a mark, 1) ensure that you retain contractual rights over quality of the use of the mark, 2) actually control the quality of the mark's use, and 3) periodically inspect and supervise. Quality control will always play a critical role because the brand represents the company's reputation and consumers rely on this reputation when confronted with purchasing decisions. ■

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17. *Id.* at 518 (finding inadequate quality controls when they were not enforced and were not effective in maintaining the consistency of the trademarks); *see, e.g., Barcamerica*, 289 F.3d at 596–97 (finding no contractual right to inspect and monitor the use of the marks coupled with licensor's infrequent inspections and unconfirmed reliance on licensee's expertise as inadequate evidence of quality controls to survive summary judgment); *Stanfield v. Osborne Indus., Inc.*, 52 F.3d 867 (10th Cir. 1995) (granting summary judgment to licensee where license agreement lacked a right to inspect operations, and alleged actual controls were that licensor examined a few products, occasionally reviewed promotional materials, and gave licensee sole discretion to design the mark).

18. *FreecycleSunnyvale*, 626 F.3d at 511 n.1 (citing *Barcamerica*, 289 F.3d at 596–98).

19. *Id.* at 519 (citing *Transgo, Inc. v. Ajac Transmission Parts Corp.*, 768 F.2d 1001, 1017–18 (9th Cir. 1985)) (noting that licensor did not rely solely on his confidence in the licensee, but exercised additional control by, *inter alia*, periodically inspecting goods and was consulted regarding any changes in product).

20. *Barcamerica*, 289 F.3d at 596 (holding that a licensor may overcome the lack of a formal agreement if it exercises actual control over its licensees).