International

Naked licensing

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The concept of 'naked licensing' can have an major impact on proprietary rights in a licensed trademark and the consequences can include the abandonment or relinquishment of rights and ineffective enforcement. Comparing views across the United States, the United Kingdom and India, this chapter highlights the steps that licensors and owners can take to avoid their trademarks being subjected to scrutiny and (mis)appropriation by licensees or third parties.

Introduction

A 'naked licence' is a licence under which a licensor allows use of its trademarks by a licensee without incorporating quality control provisions in the licence agreement and/or enforcing such provisions. Broadly speaking, this leads to undesirable consequences for consumers who, without their knowledge, are deprived of the implicit assurance that products emanating from the licensee are of the same quality as those emanating from the licensor. It does not end here. Additional consequences may unravel for the licensor and licensee, as their ability to enforce rights against third-party misuse of trademarks could be seriously compromised. Ultimately, the licensor stands potentially to forfeit or abandon its rights to the trademarks in question, as these no longer function as trademarks as they do not consistently indicate origin of goods and the assured quality of the products or services thereunder.

Traditionally, trademark licensing has been frowned on. It was simply impossible to digest that goods sold under a trademark could have more than one origin, and any activity which led to confusion as to origin of goods was considered unlawful. The only exceptions were cases where, notwithstanding the involvement of multiple hands, all signs led eventually and unequivocally to the licensor. This view persisted into the 20th century until changes in commerce led to the recognition of the quality assurance function of a trademark as an independent indicator of a trademark's identity. Thus, consumers were prepared to accept multiple origins of a product provided that the product's quality was guaranteed.

An influential role in this regard was played by Frank Schechter, whose pivotal article "The Rational Basis of Trademark Protection" (*Harvard Law Review*, 1927) put forward the idea that trademarks were no longer merely indicators of origin but (in his own words) an anonymous and impersonal guarantee of satisfaction.

United States

In the United States, legislation and the courts have recognised that in certain circumstances a trademark may be deemed abandoned by the owner. Courts have consistently held that the presence of quality control provisions and/or enforcement thereof would determine whether a case for abandonment has been made out in instances involving licensing of trademarks.

In the 1948 decision in *EI Du Pont De Nemours & Co v Celanese Corporation of America* the majority opinion, considering the Trademark Act 1905, held that the licence agreement contained clear quality control provisions, including provisions for enforcement thereof. Further, there were provisions where the licensee acknowledged the validity of the licensor's rights and that it would not do anything to infringe such rights, and that even though the licensee had theoretically violated the terms of the agreement by not stating the licensor's name in a few instances of advertising of the licensed product, these instances in no way indicated that the licensor had potentially abandoned its rights in the licensed trademark. In short, drawing support from some prior and analogous cases and an overall examination of the circumstances governing the licence, it was held that no case for abandonment had been made out. It is noteworthy that no allegations were based on non-compliance with other provisions of the licence agreement (eg, quality control). Thus, it may be inferred that in arriving at a decision, emphasis was placed on a cumulative reading of facts and circumstances rather than the letter of the licence agreement in question.

In the 1959 decision in *Dawn Donut Co v Hart's Food Stores Inc* the US Court of Appeals for the Second Circuit stated that the only effective way to protect the public where a trademark is used by licensees is to impose on the licensor an affirmative duty of policing in a reasonable manner the activities of its licensees. The court elaborated that the public is hardly in a position to uncover deceptive uses of a trademark before they occur and will, at best, be slow to detect them after they happen. Thus, unless the licensor exercises supervision and control over the operations of its licensees, the risk that the public will be unwittingly deceived will be increased. Interestingly, even in the dissenting opinion, it was held that absence of express provisions to inspect and supervise a licensee's operations is not material and that it is actual inspection/control/supervision that is important.

Twenty-five years on, in *Engineered Mech Servs v Applied Mech Tech* the US District Court for the Middle District of Louisiana found that even if a licensor did not exercise quality control when it was contractually obligated to do so, since the licence had adequate quality controls and the licensor had ultimate authority to terminate (the licence) if the quality was inadequate, it certainly maintained the effectiveness of the trademark. Courts do not and ought not supervise the terms and provisions of every licensing agreement as to quality control. Retention of a trademark requires only minimal quality control and, in this context, courts do not sit to assess the quality of products sold on the open market.

In an instance involving a finding of naked licensing, the US Court of Appeals for the Ninth Circuit in *Barcamerica International USA Trust v Tyfield Importers Inc* (2002) held that where the licensor sporadically tasted wine produced and bottled by the licensee which was using the licensor's trademark, in the absence of quality control provisions in two successive licence agreements and any other evidence that quality control was exercised, the licensor had engaged in naked licensing. There was no effort to ensure that quality of the licensee's wine was at least sufficient to be labelled with the licensor's trademark. Rejecting the licensor's argument that the licensee produced good quality wine and that the public would not be deceived by the licensee's use of the licensor's trademark, the court ruled that it was irrelevant whether the product in question was of a high quality. What was essential was that the licensor played no meaningful role in holding the wine to a particular standard of quality.

In *Tumblebus Inc v Cranmer* (2005) the US Court of Appeals for the Sixth Circuit examined a claim of abandonment of a trademark through naked licensing as a defence to a claim of infringement where admittedly, the licensor maintained records in an informal manner and did not maintain contacts with all licensees. In fact, although there were few or no quality control provisions as traditionally understood, the court, after examining the evidence and taking note of decisions where abandonment of trademarks was examined with reference to specific geographical areas, opined that there was no basis to conclude that the licensor had abandoned its mark in the geographical zone where infringement was alleged.

Even though the court was unclear whether the agreement between the plaintiff (rights holder) and 'licensees' was actually not a licence and instead a consent-to-use agreement (with the latter not requiring quality control provisions), this can be viewed more as a question of semantics. In other words, nomenclature is irrelevant if, in substance, abandonment resulted as a consequence of the rights holder not exercising a reasonable degree of supervision on the trademark user.

The substance of the opinion in *Tumblebus* was reiterated by the US Court of Appeals for the Second Circuit in the 2011 decision in *Anthony Banas v Patsy's Italian Restaurant Inc.*

In *Freecycle Sunnyvale v Freecycle Network* (2010) the factual matrix broadly included:

- a lack of written licences;
- a lack of actual control over the licensees;
- a lack of a close working relationship with the licensees; and
- an inability to terminate licences if licensees used the mark contrary to guidelines and policies published online by the licensor.

The US Court of Appeals for the Ninth Circuit held that in such a situation, naked licences had been granted.

The situation in the United States does not tilt one way or the other in regard parameters to define what naked licences. Courts have consistently looked at the letter and the spirit of licence agreements in close conjunction with the working of such agreements in arriving at their decisions.

United Kingdom

In the United Kingdom, cases have largely emphasised the acceptance of licensing subject to the presence of adequate quality control mechanisms.

The House of Lords went a step further. In *Scandecor Development AB v Scandecor Marketing AB* the House of Lords had occasion to opine on the concept of bare (naked) licensing. It was stated that from the perspective of the public, the presence of a legal requirement (of quality control) did not necessarily indicate that the proprietor retained and exercised control over the licensee's activities. Further, the fact that a licence was categorised as a bare licence did not necessarily mean that the licensed trademark:

- had been abandoned by the licensor;
- was liable to mislead the public;
- or had become deceptive or lacked distinctiveness.

The House of Lords implied that the fact that licensees were chosen carried with it an assumption that all parties have an interest in maintaining brand value and that terms dedicated to maintaining brand integrity would have been imposed. While questions emanating from this case were referred to the European Court of Justice (ECJ), the matter was settled between the parties before the ECJ could opine in the matter.

India

In India, the Trademarks Act 1999 (which came into force on September 15 2003) recognises use of a trademark by a registered user and a permitted user (not being a registered user) which has entered into a written agreement with the licensor. Permitted use – not being use by a registered user – was not statutorily recognised previously. Insofar as recordal of registered users is concerned, the act clearly prescribes that the registered user agreement (and supporting affidavit) should contain details of the degree of control of the rights holder over the permitted use. Thus, mandatory prescription of quality control or similar provisions in a registered-user agreement under Indian law may readily be inferred. Although there is no description of what a written agreement covering a permitted (non-registered) user) may contain, an inference may be drawn that such description would not deviate much from what is prescribed for a registered user.

Even before the Trademarks Act, the Indian courts have passed orders allowing use by a common law licensee (who was not a registered user) to accrue to the benefit of the registered proprietor. The rationale behind these decisions was that the licence agreement ought to be examined in substance to determine if there was a real and proximate connection between the licensor, licensee and permitted use of the licensed trademark.

In a detailed 1990 judgment in *KR Jadayappa Mudaliar v KB Venkatachalam* the Madras High Court considered cancellation proceedings against a registered trademark alleged to have been abandoned by the rights holder and licensor by licensing its use to 22 different entities, which allegedly eroded the licensor's claim of exclusive ownership of the licensed mark. After examining the rival parties' contentions, the court concluded that:

- each 'licensee' was in effect manufacturing the licensor's products and applying the

licensor's trademark thereon for the sole purpose of supplying the products to the licensor, which retained exclusive rights to sell the products;
- each licensee acknowledged absolute proprietorship of the licensor over the licensed trademark; and
- no licensee indulged in any actual sales of the licensor's product in the open market.

The court held that the licensor had neither abandoned the mark nor indulged in trafficking, nor was any case of loss of distinctiveness of the licensed trademark made out. The court held that the mere fact that the licensee's name appeared in small print on the label (to comply with excise regulations) and the licensor's name did not was inadequate to conclude that use of the mark was likely to deceive the public. The court held that consumers go by the pictorial representation of the label and not by the source of manufacture in their decision to purchase the product. It was further held that the name of the licensee did not constitute a disappearance of the right of the licensor to its trademark.

In an interesting and instructive 2011 judgment in *UTO Nederland BV v Tilaknagar Industries Ltd*, while examining whether the words 'cede' and 'revert' used in a contractual document referred to licensing or a complete transfer of trademark rights, the Bombay High Court had occasion to discuss the concepts of bare licensing and quality control.

The court held that it is reasonable to presume that parties which seek and obtain a licence to use a trademark acknowledge the reputation and goodwill attached thereto. In other words, without such acknowledgement, a licence under onerous terms and conditions would not be negotiated. Thus, on these facts and after examining the (onerous) conditions of the licence agreement, the court rejected the defendant's contention that the licence was in fact, a bare licence. It would, thus, appear that an assertion of a bare licence requires stringent supporting evidence.

The court eventually found that the plaintiff had in fact abandoned its rights after examining all attendant facts and circumstances and subsequent agreements in the case, including the absence of quality control.

Conclusion

These cases from different jurisdictions highlight the need for due diligence, actual control (over quality and otherwise) and effective remedial steps on the part of the licensor (rights holder). Basically, a hawk's eye and an ant's diligence seem the right prescription for a licensor notwithstanding the *avant-garde* opinions expressed in some of the decisions noted above, including the decision where even though the licensor did not exercise quality control, no case for naked licensing was established.

With multiple, ever-increasing business obligations and constant churning of human resources, it is easy for a licensor to lose track of its obligations in a licence agreement. Indeed, these obligations would easily get overshadowed by focusing on the licensee's obligations. Intellectual property – particularly trademarks – potentially offers less onerous avenues for pilferage as opposed to patents, for example. Courts have pressed the warning button in several cases by finding licensors wanting in their obligations, with some paying the ultimate price by relinquishing their rights in the trademark. Licensors should take heed and invest a little time, effort and expenditure towards the maintenance of that invaluable, perpetual and time-honoured symbol of business – the trademark. iam

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