Product Liability in EC Licensing

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Trademark license carries liability burden under German, EC law; minimizing explosure necessary

APPLICABLE LEGAL PROVISION

The Council of Ministers of the EEC issued the Council Directive of July 25, 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products (Product Liability Directive) with the aim of harmonizing the different product liability rules in the Member States of the EEC.

According to information from the Commission, the Directive has by now been implemented by all the member countries of the European Community except France and Spain, which have by now also prepared draft bills, which will probably be passed in the near future.

In Germany, the Directive was transformed by the Product Liability Act of December 15, 1989. Although there are additional sources of law that may be applicable in Germany in special cases, for example the Food Act, the Act on Safety of Appliances and the Pharmaceuticals Act, the general provisions on product liability are to be found in the Product Liability Act.

This paper is concerned with "Product Liability and Trademark Licensing Under EC and German Law." As a starting-point, an attempt shall be made to define the problem.

Paragraph 4, subparagraph 1, first sentence of the German Product Liability Act, reads:

> "Producer within the meaning of this Act is [any person] who has manufactured the finished product, any raw material or a component part."

In the case of a trademark license, the trademark owner and licensor grants another company, the licensee, a license for production and sale of a product under the licensor's trademark. Since the licensee is the person who "manufactures the finished product," it could be concluded that, if the product is defective and causes damage, the licensee will be liable in accordance with paragraph 4, subparagraph 1, first sentence of the Product Liability Act.

This would be a rather straightforward matter and might be the end of the topic, if the cited paragraph did not continue with the 2nd sentence as follows:

> "Furthermore, any person is considered to be the producer who, by putting his name, trademark or other distinguishing feature on the product presents himself as its producer."

This implies that the licensor, who is the trademark owner, might be liable, although he has not himself manufactured the product. Unlike in the case of the "normal" producer, where the manufacturer and trademark owner are identical and there is therefore no uncertainty as to who is liable, in a trademark license the manufacturer of the product (the licensee) and the owner of the trademark (the licensor) are not identical. Accordingly, there are two persons who are potentially liable — the licensee as the manufacturer of the product and the licensor as the owner of the trademark used on the products.

◄ Other Situations ►

The trademark license is not the only situation in which the manufacturer and the trademark owner are not identical. There is another possibility that the trademark owner buys a product manufacturer and the trademark owner are not identical.

Although this is not a case of trademark licensing, because the trademark owners is keeping all the rights in his trademark and is distributing the product under his own mark, the basic question of who is liable is the same. It seems worthwhile dealing with this case as well within the context of this presentation.

In both cases — the trademark license and the sale of goods manufactured by a different producer — there are the following possibilities:

- The manufacturer is liable.
- The trademark owner is liable.
- Both are liable.

LIABILITY IN THE CASE OF THE TRADEMARK OWNER WHO APPLIES HIS OWN MARK TO A PRODUCT MANUFACTURED BY SOMEONE ELSE

In practice, there are two main cases where this type of constellation will be found:

Manufacturer's Marks

One possibility is that a manufacturer has certain products manufactured by a different producer and then markets them under his own trademark. There may be various reasons for this kind of marketing strategy.

In some cases, it may be cheaper for the manufacturer not to produce certain products himself but to have them produced by a different company. An example is a company situated in a low-cost manufacturing country like Korea.

In some cases, the manufacturer may wish to market certain products, which he is not able to pro-

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duce himself under his own trademark. For example, a fashion designer or manufacturer of exclusive cigars has perfume manufactured by a different producer and markets it under his own trademark (FENDI, DAVIDOFF).

The owner of a famous mark wishes to exploit the mark for P.R. products, which are not related to the product for which the mark is famous (PORSCHE sunglasses, CAMEL boots/bags/lighters).

Dealer's Marks

The second possibility is the case of a dealer, e.g., a chain of department stores or a mail-order firm, that sells products that do not indicate the manufacturer's name but instead bear the housemark of the store.

For example, the NECKERMANN company sells video recorders manufactured in Korea under the NECKERMANN mark.

Liability of the Actual Manufacturer

In both cases, the liability of the actual manufacturer follows clearly from Paragraph 4, subparagraph 1, first sentence of the Product Liability Act.

Liability of the Manufacturer or Dealer Who Applies His Own Mark to a Product Manufactured by Someone Else

The wording of the second sentence of this provision, "any person . . . who, by putting *his trademark . . .* on the product, *presents himself as its producer*" is clearly applicable to the trademark owners who applies his own mark to a product manufactured by someone else. There is no dispute in the literature on this point. The Product Liability Act does not distinguish between "manufacturers' marks" and "dealers' marks."

From the point of view of product liability, any person, by using his mark on a product, is presenting himself as its producer. The wording that he is *considered to be* the producer makes it clear that this is an irrefutable legal assumption. The consequences cannot be avoided, even if the consumer knows positively or can at least assume that the trademark owner is not or cannot be the actual producer.

The consequences can also not be avoided by subsequently naming the real producer. The trademark owners is precluded from referring to Paragraph 4, subparagraph 3, first sentence, Product Liability Act, which reads:

> "Where the producer of the product cannot be identified, each supplier of the product is considered to be its producer, unless he informs the injured person of the identity of the producer or of the person who supplied him with the product."

This clause is intended for anonymous products sold without a trademark or any other distinguishing feature, and is therefore not applicable in our case.

The result is therefore that both the actual manufacturer and the trademark owner are basically liable. This is a very favorable situation for the consumer who, in case of damage, can chose which of the two parties he prefers to sue.

In many cases this will be the trademark owner. Often, the consumer will not even know that the product has not been manufactured by the trademark owner, and even if he does know, he will not know who the actual producer is. In these cases, the consumer need not conduct any further investigation as to the identity of the actual manufacturer. He can sue the trademark owner directly.

It may be noted in this connection that the introductory articles of the EEC Directive, in the light of which the national product liability laws have to be interpreted, in several places mention the protection of the consumer as being an important factor. It is obviously in the consumer's favor if he can rely on the trademark and sue the trademark owner, without having to try and find out who the actual producer is.

Possibilities of Evading Liability

It should now be considered whether there are any possibilities for the trademark owner to evade liability. What would be the consequence, for example, if he has, in addition to his trademark, the following inscription put on the product: "Manufactured by . . .," followed by the name of the actual producer.

It should be considered, in this connection, that Paragraph 4, subparagraph 1, second sentence of the Product Liability Act, is a liability provision based on the *objective impression* created by using the trademark.

It is furthermore a provision that was introduced to protect the consumer, who should be able to rely on the trademark if he has no other way of identifying the producer.

It is clearly not the intention of the law that the trademark owner should be primarily liable. On the contrary, it is the actual producer who is primarily liable, and the trademark owners is only liable as a consequence of the objective impression created, if there is no other way of identifying the producer. Thus, if the actual manufacturer is clearly indicated on the product, the impression that might be created by the trademark is destroyed with the consequence that the trademark owner is *not liable*.

◄ Intention ►

However, it must be remembered that in most cases where a manufacturer or dealer applies his own mark to a product manufactured by someone else, it would be contrary to his intentions (i.e., to the image he wants to create), if he indicated the real manufacturer's name.

The intention is to give the product the image of his own mark. NECKERMANN, for example, might not particularly want it to be known that the video recorder was manufactured in Korea, and a company like YVES SAINT LAURENT would certainly not want it to be know that the perfume was produced by a small perfume factory in the small town of Grasse in the South of France.

A point that should be made in this connection is that an indication like: "Made in Taiwan" or "Made in Korea" alone, without indication of the manufacturer's name, if not sufficient for the trademark owner to evade liability.

Therefore, it may only remain for the trademark owner to arrange,

internally with the manufacturer, that he shall be reimbursed in case he is held liable for damage caused by the defectiveness of the product.

LIABILITY IN THE CASE OF A TRADEMARK LICENSE

For example, U.S. cosmetics manufacturer of the name UNIVERSAL grants a German company a license to produce a cosmetic (e.g. a skin cream) and to market it under the trademark "Universal." The cream is manufactured and packed in Germany by the German licensee.

Liability of the Actual Manufacturer

Here, again, the actual manufacturer's liability follows clearly from Paragraph 4, subparagraph 1, first sentence of the Product Liability Act.

Liability of the Licensor and Trademark Owner

Paragraph 4, subparagraph 1, second sentence provides that "any person is considered to be the producer who, by putting *his* trademark . . . on the product presents himself as its producer." In the case of the trademark license, the person who is putting the mark on the product is not the trademark owner but the licensee, and the trademark owner is not the one who is (himself) putting the mark on the product. According to one opinion, in order for the provision to be applicable, the person who presents himself as the producer must put his own trademark and not somebody else's on the product, i.e., the person to whom the trademark *refers* and the person who *applies* the trademark must be identical. According to this opinion, a trademark licensor is not liable. Upon closer inspection, this narrow interpretation of the text is not plausible.

Although it is true that it is not the licensor who, applies the trademark, the trademark is applied with his permission and on the basis of a license agreement, by the licensee. The application of the second sentence of subparagraph 1 should not depend on who actually applied the mark (a purely factual question). It should depend on whether the mark was applied with or without the trademark owner's consent (a legal issue).

A closer inspection of the case discussed earlier (i.e., the case where a trademark owner applies his own mark to a product manufactured by someone else) shows that, in that case, too, the trademark owner does not usually apply the trademark himself, but has it applied according to his instructions by the actual manufacturer.

For example, the NECKERMANN mark will be applied to the video recorder during manufacturing in Korea, and not by NECKERMANN in Germany. In that case, too, the trademark owner's liability does not depend on whether he actually applied the mark himself or whether he permitted someone else to apply the mark. Those authors who accept the trademark owner's liability in the NECKERMANN case but deny it in the case of the trademark license fail to see that, if both trademark owners have permitted others to put their trademark on a product, they should both be liable.

According to another opinion, the licensor, even if according to Paragraph 4, subparagraph 1, second sentence of the Product Liability Act he is liable, cannot be held liable if, in accordance with Paragraph 1, subparagraph 1, Number 1 he proves that he did not put the product into circulation. Paragraph 1, subparagraph 2, Number 1 reads:

> "The liability of the producer is excluded if he did not put the product into circulation."

This opinion seems to be based on the idea that it is not the licensor but the licensee who puts the product into circulation. This argument, again, does not seem plausible because, as can be seen from the examples mentioned in the commentaries, Paragraph 1, subparagraph 2, Number 1 only intends to exclude liability if the product is put into circulation without the producer's cooperation and consent, i.e., in cases of theft, loss, product or trademark piracy, or in cases where the product was not intended for sale (prototypes, garbage).

In the case of the trademark license, however, the trademark owner/license did consent in putting the product on the market by granting a license. Therefore this clause is not applicable.

There can, therefore, not be any real doubt that the licensor and trademark owner is liable, with the consequence that he and the actual manufacturer are both liable, and that the consumer can chose who to sue.

One of the reasons there seems to be some resistance in the German legal literature to accept this consequence is that — before the EEC Directive was issued — German law and jurisprudence, like most national jurisdictions in the European Community, did not recognize liability on the basis of the mere use of a trademark.

Possibilities of Evading Liability

The last question to be asked in connection with the trademark license is whether the licensor has the possibility of evading liability by putting an inscription on the product identifying the real producer. In this case the inscription would read, for example, "UNIVERSAL cream, manufactured under license from the Universal Company, Ohio, by XYZ Company, Germany."

As in the case discussed earlier, the identification of the actual producer destroys the impression created by the trademark, so there is no reason or necessity for the licensor to be held liable. In these cases therefore the licensee alone is liable.

PRODUCT LIABILITY AND QUALITY CONTROL PROVISIONS IN LICENSE AGREEMENTS

Since we have come to the conclusion that, unless the actual manufacturer is clearly indicated on the product, the trademark licensor will be liable for damages caused by a defective product, the licensor will be well advised — besides including indemnification clauses in the license agreement — to include quality standard and quality control provisions in the license agreement,

in order to reduce the *factual* risk of being held liable.

Such clauses in trademark licensing agreements are permissible, according to German and EEC competition law. The leading decision on the European level is the *Campari* decision of December 23, 1977. According to case it is permissible to impose on the licensee the obligations:

1. To observe minimum-quality specifications with regard to the goods or services that are the subject of the trademark license.

2. To procure goods or services from the licensor, insofar as such quality specifications or goods or services are necessary for ensuring that the licensee's production conforms to the quality standards that are respected by the licensor and other licensees.

3. To allow the licensor to carry out related checks.

In Germany and most European countries, it is not obligatory but it is permissible and generally considered advisable in the licensor's — and to some extent also in the public's — interest to include quality supervision clauses in trademark licensing agreements. This holds all the more in the light of the trademark licensor's liability for defective products.