

Sublicensing Terms Must Be Clear, Complete

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Trademark sublicensing must include provisions clearly setting out protections for licensee.

Granting license to use patent and trademark rights is an accepted way of life in the international business community. It enables good economic sense to obtain additional revenue by having another party manufacture, distribute, or sell a product on behalf of the owner. In fact, the figures suggest that licensing more than makes good sense; licensing is fast becoming a preferred way of doing business.

Some industries generate at least half of their revenue through licensing of various products.¹ A catchy corporate trademark can more than enhance sales of the company's products. The artwork can create a business unto itself. Licensing of corporate logos and trademarks has quadrupled in the last five years.² A recent study revealed that the total amount of retail sales of consumer licensed goods was estimated at more than \$8 billion, and that report only covered the United States.³ Some consumer industry prognosticators predict that this growth will continue, and that by 1990 annual retail sales of licensed properties in the United States will top \$10 billion.⁴

As a result of this incredible surge of growth in licensed properties, licensors have been concentrating, with increasing frequency, on granting secondary licenses, known as "sublicenses," by the original licensee to promote greater productivity and market penetration. This article, focusing primarily on United States legal and business practices, will discuss some of the issues that affect the content and practice of sublicensing.

A sublicense is a grant by the original licensee of rights to a subli-

ciary party. This arrangement is in contrast to a grant by the owner to the original licensee, or if you will, a "parent license." With respect to both trademarks and patents, a licensee may authorize the licensee of sublicensees provided he is authorized to do so by the terms of the original license from the property owner.⁵ As in the case of a parent license, an authorized sublicensee may either be written or oral and the rights granted will be determined by the terms and conditions of the sublicense agreement.⁶

While courts have in the past recognized oral license and sublicense agreements, it is important to understand the dangers inherent in reliance upon oral contracts. For example, many oral license or sublicense agreements may be deemed unenforceable under the statute of frauds.⁷ The law of the state of law in reviewing this issue. As an example, New York's statute of frauds provides, in part, as follows:

"Every agreement, promise or undertaking in real estate or in some other or some other interest, to be written, and authorized by the party to be charged thereunto, or by his lawful agent, in such agreement, promise or undertaking.

1. It is void in part to be performed within one year from the making thereof in the performance of which it is necessary to compel before the end of a lifetime."⁸

New York courts have held that the length of one party's contractual liability to another is the deciding factor as to whether an oral agreement falls within the stated prohibitions.⁹ Therefore, the case law suggests, in part, that an oral license in order not to be subject to New York's statute of frauds should be

for a relatively short term, and in no case exceed the one-year statutory period. Accordingly, as a general rule, before parties to an license or sublicense agreement rely on the enforceability of same, diligence must be made to the statutory and case law of the appropriate state forum.

The sublicense agreement need not expressly utilize the word "sublicense" to be construed as one.¹⁰ A licensor may simply grant a license to one party who in turn grants a license to a second party. While not a well settled issue of law, some courts have held a sublicense may exist where the license agreement was silent as to sublicensing. For example, in *Restigouche Electric and Manufacturing Company v. Tri-City Radio Electric Supply Company, the Eighth Circuit Court of Appeals granted a matter in which a licensee granted a limited right to a licensee to sell a mechanical part of a radio involving not "only of licensee's manufacture."¹¹ The court interpreted this provision to mean that "the manufacture was to be in such a manner as to obtain the benefit of the skill and personality and integrity of the licensee."¹² The language in the opinion suggests that supervision by the licensee over the sublicensee is sufficient to ensure that the product is "of licensee's manufacture."¹³ On this basis the court held that a sublicensing arrangement did in fact exist under the circumstances. As a result, the court awarded the licensor's profits from the sublicensing activities to the licensee even though the licensee was neither aware of nor approved the sublicensing arrangement.*

While it should be obvious to all

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In order to avoid ambiguity and unnecessary litigation, the parties must carefully draft the terms and conditions in the agreement. Two often-tigered-in cautions drafting results in a judicial context. The relationship between licensee and licensor, licensee and sublicensee and licensee and sublicensee should always be clear. In many instances a licensee may prefer the licensee to be responsible for supervision of the quality of goods or services as well as collection of royalties. A licensee may properly provide for a licensee to retain a percentage of the royalties paid by his sublicensee, since the retained percentage is considered a commission.²⁰ In this case, the licensee is acting as an agent for the licensor and the courts will enforce this relationship.²¹ The licensee may act as a licensor's agent or representative in the maintenance of quality control over the production of goods bearing the trademark or the performance of services associated with the service mark. Thus, the issue of quality control may be resolved a provision in a sublicense agreement as to it is a licensee agreement. If exercised properly, quality control means that a consumer will receive the same value in the product or service as provided by the licensee. This is the legal basis whereby the public is assured that the goods or services originate from the same source.

The case law appears to be well settled should adequate quality control not be properly exercised.²² In a case in which an exclusive sublicensee was successful in a counterclaim for trademark infringement and unfair competition, the United States District Court of California held that the same damages present in a pure licensing arrangement exist in a sublicensing arrangement.²³

Trademark licensing without quality control is not licensing as it is on the public market licensing is on level with the licensed trademark, and constitutes unfair trade.²⁴

The Lanham Act

Section 43 of the Lanham Act suggests that, if a licensee adequately controls the nature and quality of the licensee's goods or services, the licensee is deemed a "related company" whose use of

the trademark or the service mark will be deemed use by the proprietor/licensor.²⁵ Specific quality-control requirements for a trademark licensee in a sublicense are not clearly established in the Act. For example, there is no definition of adequate "control" in the Lanham Act. However, case law indicates that a trademark proprietor must exercise actual control over the licensee and a mere contractual or passive right to control will be deemed a "risky" license, which will result in the trademark ceasing to function as a symbol of quality and controlled source, which will lead to the abandonment of the mark.²⁶

Delegation of Supervision

Auditory rules supporting the principle that a licensee can delegate the responsibility for quality control over the goods manufactured or services performed by a licensee to a party other than himself. The responsibility can be passed to an authorized agent,²⁷ third party²⁸ or licensee.²⁹ The theory behind these decisions appears to be that the purpose of the control requirement is to avoid the danger that the public be deceived as to the quality of a product sold or service performed under a recognized mark, and that this requirement can be met by relying on the integrity of someone other than the licensee to monitor the level of quality.³⁰ Taken one step further, it can be argued that delegation by the owner of the duty to supervise quality control creates "primary of control" between the owner and the end user of the intellectual property right through the concept of agency.

However, most cases that have come before the courts involve direct licensing arrangements. It is submitted that these principles should also apply in the sublicensing context, as long as actual quality control is maintained, albeit indirectly, by the licensee/proprietor.³¹ Such circumstances effectively preserves the source identification and quality of the products or services in the marketplace.

Cases and Commentary

There are cases that involve sublicensing arrangements; however,

they raise as many unanswered questions as they address. For example, in *Turner v. WMY Publishing Company, Inc.*,³² the United States Court of Appeals for the Fifth Circuit rejected a claim by Ethel L. Turner and On-The-Tour, Inc., doing business as Atlanta's Playboy Club, that WMY Publishing had abandoned its trademarks since it had failed to show valid use of the marks by relying on use made by third-party sublicensees who had operated clubs under the service mark pursuant to a license agreement. The court, in reaching its decision, noted the quality control of the goods used in connection with the service marks were exercised by executives of the licensee as well as independent third parties who regularly visited the clubs and reported on the maintenance of the standards of goods and services provided. The court stated:

Months before trademark application to show that WMY (a) actively controlled and directed the nature and quality of the goods and services used in connection with the trade and service marks by the service licensee, (b) a licensee in genuine business, it is required to meet standards established by the trademark proprietor which have not been stated by WMY. These standards include design, quality and quality of trade, literature, and entertainment with clubs. Such standards contained in the trademark already constitutive existing sublicensing agreements with licensees (a) made expressly subject to the terms of the trademark license with WMY (b) non-transferable and cannot be processed or otherwise and the right of supervision is a continuing program.³³

Unfortunately, it is unclear from the opinion whether the court would have found the exercise of quality control to be sufficient without the policing by executives of the licensee.

The United States District Court of Alabama in *Horvath v. Frito-Lt. v. A-1 Horvath Frito Co.* decided a case in which plaintiff alleged defendant infringed the trademark FURROSE and the Blowing Man Logo without permission from the trademark owner.³⁴ Defendant, A-1 Horvath Frito Company, in answer to the complaint, alleged that the plaintiff had abandoned its trademark rights to the name FURRO-

SCANE and Blowing Man Logo, that the plaintiff is estopped by laches from bringing this suit at this time—due to plaintiff's failure to object to defendant's usage of the mark over the last eight years, and that plaintiff had apparently or impliedly acquiesced in defendant's usage of the mark.

In its decision, the court focused on the fact that the quality of the license manufactured by the sublicensee was not adequately monitored by the licensee or the licensor. "The most crucial issue going to the abandonment question is the lack of supervision over the defendant's use of the mark by the plaintiff."¹⁴ While the court rejected a claim of abandonment apparently on the basis that the register weighed in favor of the plaintiff, the court clearly emphasized the importance of the exercise of quality control in a sublicensing arrangement, citing a case decided by the United States Court of Appeals for the Fifth Circuit:

The owner of a trademark has not only a right to have the use of his trademark monitored, but also a concurrent duty to exercise control and supervision over the licensor's control of use. Failure to exercise such control and supervision for a significant period of time may cause the trademark owner to be deemed to have abandoned the mark and business which the license has developed during the period of unmonitored use. This principle is analogous to the obligation against a trademark owner who knowingly or negligently fails to diligently use his trademark over a significant period of time.¹⁵

Although the Fifth Circuit made this ruling in a pure licensing arrangement, the United States District Court held that this duty should apply to a sublicensing agreement as well. Unfortunately, while the courts appear to have established a duty to exercise control, they have not clearly addressed how this duty may be met. For example, in a sublicensing situation, must actual quality control be exercised by the licensor/proprietor over the sublicensee or may this requirement be met by delegating this duty to an authorized agent, third party or licensee as permitted by the courts in a pure licensing situation? In addition, whenever exercising the duty, the question remains as to how often they must do so. Can

an adequate level of quality control be achieved by infrequent inspection and review of samples or must the supervisors take place on a regular or frequent basis?

Parties to sublicensing arrangements should be aware that the courts will focus on their activities in addition to the rights and obligations set forth in license or sublicense agreements when deciding issues arising out of a contractual relationship. In *Yamashita & Co. America, Inc. v. Hideo United, Inc.*, the court reviewed a case in which defendant, an exclusive sublicensee of the trademark owner, brought a counterclaim against a plaintiff who alleged defendant interfered with his contractual and business relationships with an exclusive licensee.¹⁶ The court concluded that a prior license agreement between the plaintiff and the exclusive licensee was terminated by acquiescence by their actions in failing, and refusing to tender royalty payments for use of the trademark, plaintiff implicitly agreed to termination of any contractual rights and associated mark rights.¹⁷ Accordingly, it appears that the court is reaching its conclusions solely on the activities of the parties and not upon the provisions contained in the license agreement.

Influences of General Contract Law

Since there have been few cases arising out of sublicensing arrangements involving patent and trademark rights, it appears that the drafting of sublicense agreements should be engineered with delivery to case law involving pure licensing arrangements and general contract principles.¹⁸ For example, in *Innovative Enterprises, Inc. v. Adap et al.*, plaintiff brought an action against Marvin Lee Adap, licensee professionally as "Ment Loaf," contending that as the exclusive licensee of the trademark MENT LOAF, it had standing under the Lanham Act to bring actions for trademark infringement and unfair competition.¹⁹ The court concluded that plaintiff was not attempting to enforce the register's proprietary rights; instead, the licensee was attempting to enforce its own rights under the license agreement. Ac-

cordingly, the court correctly held that the present matter was a contract dispute and should be brought under contract theory. Therefore, apparently, many courts will resolve issues that arise out of sublicensing intellectual property rights based on contract rather than trademark or patent principles of law.

While it appears no reported sublicensing case has yet discussed the issue, the nature of a trademark right may be jeopardized and a court of law may refuse to enforce a sublicense agreement that lacks sufficient "privity of contract" between parties. For example, A, a licensee, enters into an agreement with B, a licensee, to use a trademark and sublicense another, C, without the requirement for prior approval by A. Thereafter, B enters into an agreement with C without obtaining the consent or approval of A. Accordingly, C is now using A's trademark or patent without an express grant or the consent of A. Furthermore, A may not even be aware that C exists. It is possible that a court may interpret the sublicense agreement as appointing B as A's agent to bind A to C. However, the absence of a written understanding, signed by A and C, may become an issue in the event A wishes to bring an action against C for indemnification. A, who received an indemnification from B, may be unable to recover any damages from C paid by A to a third party for a negligent act by C. Accordingly, failure to consummate a written agreement may lead to ambiguities which might arise with respect to the obligations and coverings of A, B and C.

If it is true that licensing evolved as an exception to trademark privity,²⁰ it is certainly true that a trademark right will be further jeopardized by making the source of the product even further remote from the trademark proprietor. Therefore, it logically follows that a product trademark owner should be contractually bound to the end user of the right being sublicensed.²¹

Conclusion

Until the state of the law on sublicensing becomes more certain,

