

Tips for successful trademark licensing

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Key licensing issues for senior executives

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Tips for successful trademark licensing

A trademark licence is, in the final analysis, a business arrangement. The key to ensuring a successful outcome is to put in place a licence that is fair and beneficial to both licensor and licensee

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In the last 20 years, trademark licensing has grown to a multibillion-dollar business. No longer restricted to trademarks of fashion designers, sports teams and entertainment properties, trademark licensing is now big business involving corporate trademarks across a wide range of industries, including food and beverages, automobiles, consumer electronics, financial services, furniture and sporting goods. A well-designed licensing programme can be an important tool to build the value of a brand, enhance sales of branded products and generate a significant income stream from royalties.

The synergies that a licensing programme creates can greatly increase the exposure, and consequent public recognition, of a licensed trademark. Advertising and sales by licensees expose consumers to the core brand in new geographic markets or in new product categories. Not only can this lead to increased sales of the core product, but the greater public recognition of the licensed trademark can also significantly increase its value. This article discusses the key issues raised by a trademark licence and offers some suggestions of how these issues may be resolved.

Know your licensee

Before entering into any licensing negotiation, it is crucial to understand the business and capabilities of the prospective licensee. Does the prospective licensee have the manufacturing and distribution capabilities in the relevant markets to exploit the licence successfully? Does the prospective licensee

have relationships with any competitors that might create a conflict of interest? Is the prospective licensee financially stable? Is the prospective licensee litigious? Does the prospective licensee have a good reputation, not only for manufacturing and selling quality products, but also as a member of the business community? Because a licence requires an ongoing relationship between the parties, it is important in selecting a licensee that the parties be able to cooperate and work together harmoniously.

Know the scope of your trademark rights

A licensor should be aware of the scope of its rights before embarking on a trademark licensing programme. Trademark rights are territorial. Consequently, a mark that is registered in one country may not be available in another. Likewise, trademark rights are linked to specific products or services, and a mark that is registered for one product may not be available for use on different products. It is imperative, therefore, that any mark be searched before a licence is granted if the mark is not already used or registered in the territory or for the goods or services for which it is to be licensed.

Grant of rights

The scope of rights being granted is the core of any licence agreement. A trademark licence enables a trademark owner to extend the range of products or services being sold or offered under the licensed mark, or to extend the geographic reach of the mark, or both. In deciding whether to license a mark, it is important that the licensed products be consistent with the image of the brand. For example, a trademark used on a line of trendy products aimed at a young audience may be

difficult to license successfully for use on a line of products directed to an older, more conservative market. Because a trademark represents a specific image, the most successful licences are for products that are consistent with the image of the licensed brand.

In addition to considering the nature of the products or services being licensed, it is important to consider the territory the licence will cover. While it is possible to grant a worldwide licence, many licences are more narrowly tailored to the licensee's strengths in a particular market. A licensor should be reluctant to grant rights that the licensee may not be capable of exploiting fully. It is therefore important to know in advance of signing an agreement the licensee's manufacturing and distribution capabilities in the market to be covered by the licence. A licensor should know in advance that the licensee has the manufacturing capacity to meet the demand in the licensed territory. Likewise, the licensor should look into the licensee's distribution capabilities to ensure that the licensee will be able to distribute the licensed product efficiently and to the appropriate trade channels. An understanding of the licensee's manufacturing and distribution capabilities may keep the licensor from granting a broader licence than the licensee is capable of exploiting.

A licence may be either exclusive or non-exclusive. Frequently, a licensee will not be willing to make a substantial investment to manufacture a new product line and create a market for products for which it has only non-exclusive rights. On the other hand, by granting exclusive rights the licensor has limited options if the licensee underperforms. One way in which a licensor may protect itself against having the licensee become overextended so that it does not fully exploit the rights granted in the licence is by narrowly tailoring the granted rights to the licensee's strengths. It is helpful, therefore, to have the licensed products and services defined with specificity. Or, if the licensee has expertise in a particular market segment, the licensed rights might be tailored to correspond to the licensee's expertise.

A licensor may also protect itself against an underperforming licensee by keeping the term of the licence short. On the other hand, a licensee may be reluctant to invest in a licence that will not last long enough for the licensee to reap the benefits of its investment. A common solution to this problem is to structure the licence with a short term, but with multiple renewal periods that vest upon the licensee achieving certain

milestones, usually expressed in terms of sales targets or royalty thresholds. This type of arrangement provides an incentive to the licensee to diligently exploit the licence, while at the same time protecting the licensor against being locked into a long-term relationship with a licensee who is not meeting the licensor's expectations.

Quality of licensed products and use of licensed trademark

A trademark licensing programme should strive to have all licensed products and services meet consistent quality standards, display the licensed mark uniformly and be marketed in a consistent manner. Doing so will reinforce consumers' expectations across the line of licensed products and build goodwill in the mark.

Because the function of a trademark is to represent a consistent quality level to consumers, a licensor has an obligation to monitor the quality of any products or services that are offered or sold under a licensed mark. A licensor who fails to control the quality of its licensees' products and services runs a serious risk that a court will find that the licensed trademark has been abandoned.

In addition to avoiding the risk of losing the licensed mark, a properly run quality control programme serves important functions for both the licensor and licensee. By maintaining a consistent level of quality among all products sold under the licensed mark, the parties ensure that consumers receive goods of consistent quality under the mark. Meeting consumers' expectations benefits both the licensor and licensee. A consumer who is disappointed after having an experience with one product bearing the licensed mark is less likely to purchase another product sold under the same mark, regardless of whether the product is made by the trademark owner or a licensee. For this reason, allowing a licensee to sell inferior, or even different quality, products under a licensed mark can harm not only the licensor but also other licensees. Accordingly, a licensee would be well advised to insist that the licensor be required to ensure that all other licensees and the licensor itself will be held to the same quality standard.

Because the licensor must control the quality of the licensed products, it is in the interest of both the licensor and the licensee for the licensor to be involved from the earliest stages in the development of the licensed products. This will help the licensor ensure that the quality of the licensed products is appropriate and at the same time

Who pays for trademark protection and enforcement?

Protecting and enforcing a licensed trademark and complying with the requirements for recording trademark licences that exist in many countries can be expensive, particularly if the licence covers multiple jurisdictions. As a result, the provisions of a licence that require a party to register and maintain registrations of the licensed mark, and provisions pertaining to the recordation of the licence in those countries where it is necessary or beneficial to do so, can be hotly contested. In situations where the licence will cover many countries, it is important to be aware of these costs while the licence is being negotiated and to understand whether and how these costs will be apportioned.

Similarly, there is often a dispute about how the licensed trademark will be enforced against infringers. Typically, both the licensor and licensee seek to control the enforcement efforts, and both typically seek to shift the cost to the other. There are advantages and disadvantages to either party controlling trademark enforcement. As the trademark owner, the licensor has a strong interest in controlling how and when its mark is enforced. There may be business reasons why it might not want to take action against a particular infringer that has been especially bothersome to the licensee, or the licensor might have concerns about the merits of a particular action and may not wish to risk an adverse court decision. Conversely, the licensee may be the only party being directly affected by an infringer and in certain circumstances may have a more direct interest than the licensor in taking action. Coupled with all of this is the cost of bringing a lawsuit and how any recovery should be apportioned.

There is no right or wrong way to resolve this issue. In situations in which the licensor has a number of licensees, however, the licensor usually controls how the licensed mark will be enforced. This arrangement should provide some consistency in how the mark is enforced and how trademark disputes are resolved. It also allows the licensor – which, after all, is the trademark owner – to determine what risks it is willing to take in asserting its mark.

protect the licensee against learning that its products do not meet the licensor's quality standards after the products have been manufactured and are ready for sale. The licensor should seek to review and have approval rights for specifications, drawings, prototypes and production samples. The licensor should also review all packaging, labels and the like to ensure that the trademark appears in the appropriate manner. The graphics, logos, colours and designs on the licensee's packaging should be consistent with those of the licensor and other licensees. The goal is for the licensing programme to be transparent to consumers.

Often, the most efficient way to ensure consistency among multiple licensees is for the licensor to develop a style guide setting forth the font, colour, graphics and other requirements pertaining to the appearance of the licensed mark, packaging, advertisements and the like, and to require all licensees to adhere to the same guidelines. Frequently, such a requirement is coupled with a provision entitling the licensor to review all packaging and advertising for any licensed products to ensure that the appearance of these materials conforms to the licensor's standards and that these materials are appropriate for the image of the licensed brand.

Royalties

The vast majority of licences are royalty bearing. There are no hard and fast rules for structuring a royalty, although the most common arrangement is a royalty that is a percentage of the licensee's sales. Where the royalty is based on sales, rather than a flat fee, the licence agreement should require the licensee to keep adequate books and records to enable the licensor or its auditors to ensure that the royalty payments are correct. It is helpful to involve the auditors in the negotiation and drafting of the royalty provisions to ensure that the records that are kept are those that will be needed to audit the licensee's payments. Different marks and product categories typically command different royalty rates. These factors, including the notoriety of the licensed mark, should be considered by the parties in negotiating the terms of any licence.

Many licences contain minimum and guaranteed royalties. A minimum is a level of royalties the licensee must meet for some event to occur, most commonly the triggering of a right to renewal. A guaranteed royalty, on the other hand, is an amount the parties agree is the lowest amount the licensee will pay. If the percentage royalty is less than the

guarantee, the licensee typically is required to make up the difference.

Termination provisions

Probably the most important provision of a licence agreement is the termination provision. When there is a dispute or litigation between the licensor and licensee, the termination clause is frequently at issue.

While licensees generally seek termination provisions with generous cure periods, a licensor would be well advised to insist upon the right to terminate promptly in appropriate circumstances so that it can end its relationship with a troublesome or non-performing licensee. Licences commonly allow the licensor to terminate the licence if the licensee does not comply with the licensor's quality standards, if the licensee infringes the licensed mark or takes other actions that are inimical to the licensor's ownership rights, or if the licensee is repeatedly late in making royalty payments or fails to make required payments. Often, termination provisions relating to these types of events allow for a cure period. In situations in which there may be no way to cure the default, such as a breach of a licence that requires a licensee to introduce products by a deadline that is tied to a particular event such as the Superbowl or the release of a movie, the licensee's failure to meet a deadline may be sufficient cause for termination. If there are situations that warrant immediate termination, they should be clearly spelled out in the licence.

Because there are no specific requirements regarding the provisions of a trademark licence, each licence can be closely tailored to fit the specific situation for which it is intended. Ultimately, a trademark licence is a business arrangement and the key to a successful licence is to ensure that the arrangement is fair and beneficial to both the licensor and licensee alike.



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In addition to significant licensing and transactional matters, Mr Palladino has handled numerous trademark and copyright cases including: National Basketball Association v Motorola Inc; Société Des Produits Nestlé v Casa Helvetia; Home Box Office v Showtime/The Movie Channel; PostX Corporation v The docSpace Company Inc; and SC Johnson & Son Inc v Lever Brothers Co.



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