

"THE TRADE MARK LICENSING AGREEMENT" (TLA)

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A trade mark licensing agreement (TLA) is a complex matter. Many economical, commercial, marketing and legal issues have to be taken into account in discussing and finalizing such an Agreement (A).

The following issues will be concentrated on in this lecture:

- Granting of a License
- Questions of Use
- Quality Control
- Legal Disputes
- Restrictions under European Law

In negotiating a license agreement (LA) many controversial issues have to be agreed upon between the licensor (LO) and the licensee (LEE).

A typical example is the license fee or royalty. Naturally, the LO is interested in a high royalty, whereas the LEE strives to pay as little as possible.

Each and every clause of the A can be formulated either in favour of the LO or more in favour of the LEE.

However, an A that is supposed to work for many years must take care of the needs of both parties. For each clause a solution must be found, which not only covers the basic interests of both parties, but also works in practice.

Both parties must be content with the A. In the end both parties must be happy.

A TLA will only be filled with life if it is for the benefit of both parties.

After these general considerations, let's go on to discuss the important issues involved in a license agreement, starting with the granting of a license.

1. In granting a license, it is essential that the terms are well defined and that the important issues are discussed, agreed upon and fixed in the A.

It is important to define the trade marks (TMs) and goods, which are covered by the license and to also define the territory to which the license extends.

Whether an exclusive or non-exclusive license is of eminent interest to the parties and whether the LEE can grant sublicenses should be stated clearly in the A. Finally, the regulations concerning royalties should be established and laid down in the text.

For the sake of argument, let us consider a simplified situation. A short A merely states the following:

“Tommy Hilfiger US grants a license to company Z in Europe.”

Obviously, a simplified A such as this one will not work and will immediately cause dispute, because there is a clear lack of definition of terms.

It is completely open whether Tommy Hilfiger grants a license on all their TMs, including for instance, Tommy Hilfiger’s old TMs, which are no longer in use by Tommy Hilfiger US today. Likewise, it is unclear, whether the license is for sportswear only or whether it also extends to perfume and sun glasses.

Therefore, the A should include a list of all the TMs with their respective registration number and country. By including the registration number the licensed right is clearly defined. Furthermore, the list should explicitly name each of the countries intended for licensing, because in many instances not all of the TMs are registered in all of the countries of interest.

For international registrations a list of countries is also necessary, because the number of countries to which the registration extends can vary.

Not every TM will have been registered for the same goods and services and therefore, in order to ascertain the extent of the license, a list of goods and services for each TM should be an annex to the A. The easiest way to do this is to have copies of the registration certificates attached to the A.

The NBA and Major League Baseball registered the TMs of their various teams comparatively late in Europe. In countries with a large number of TMs on the register,

such as Germany, severe problems were encountered, because many of the team names including e.g. “Angels”, “Pirates” or “Bulls” were already registered for sports wear. Some of these conflicts could only be overcome by signing a coexistence A with the other European TM owners, in which the list of goods was limited or a specific use for the contended TMs agreed to.

Naturally, limitations deriving from a coexistence A that was signed by the LO are also binding for the LEE, and consequently, have to be brought to the knowledge of the LEE and be part of the A.

Furthermore, it is important to clearly define the territory to which the LA extends, i.e. the countries which are covered by the A.

The designation “Europe” is not a good definition. It is unclear whether Turkey is part of Europe. Moreover, what about Belarus, the Ukraine, Russia, Greenland or even the French colonies?

In this respect the term “European Union” is a better definition. But did the parties consider that Switzerland and Norway are not part of the European Union, although they are economically fully integrated? What about countries that might join the European Union in the future? Is the license to be extended automatically to Bulgaria when it joins the European Union?

It might be reasonable to allow different activities of the LEE in certain countries only. The license could grant the exclusive right to produce in a certain country, but allow selling and marketing in many more countries.

Furthermore, the A should clarify which rights remain with the LO in the countries, which are covered by the A.

The famous Campari Decision stands for a specific problem in the European Union. Although there is but one Common Market, there are still a multitude of national TM rights. In the Campari Decision the European Court of Justice ruled that TM rights cannot be used to block the free flow of goods in the European Market. The consequence of this is exemplified by the following situation:

A LO can grant a license to company A for the French market and to company B for the German market. It is possible to restrict the active selling and marketing of A and B to their respective territories. However, if A sells in France to a French distributor C and the distributor C resells in Germany, then the German LEE B cannot enforce the German TM against the import from France. It is important to take this into consideration when dealing with a TM license that covers the European Union.

Every TLA should clearly express whether the license is exclusive or non-exclusive. There are considerable differences between these two types of license. In an exclusive license, only the LEE is entitled to use the TMs. All rights are with the LEE. Even the LO is excluded from these rights. He is not entitled to use the TMs.

On the other hand, in a non-exclusive license or “simple” license the LO is entitled to use the TMs in the same territory to which the license extends. Furthermore, the LO can grant additional licenses to an unlimited number of further LEEs. So the LO maintains a strong legal position.

Therefore, legally and also factually there is a significant difference between an exclusive and a non-exclusive license.

A sublicense is a grant of a license by the original LEE to a third party in the framework of his own license. Whether the LEE is permitted to grant sublicenses should be clearly regulated.

An exclusive license automatically entitles the LEE to grant sublicenses.

The LEE might be interested in a sublicense, for instance, to have the licensed product produced by somebody else if his own capacity is limited. Alternatively the LEE might grant a sublicense for selling in certain regional areas, for instance in South East Europe, where the European LEE might have little marketing knowledge.

The risk for the LO is that he has no influence on the selection of the sublicensee - unless this is specifically regulated in the A. This entails the risk of quality problems in production and marketing by the sublicensee, which could impair the reputation of the TM.

As far as royalties of the sublicense are concerned, these are not automatically royalties to be paid in full to the LO. So it is important to address this issue in the A.

Naturally, the royalties are an important part of the A and royalty payment has to be regulated in detail.

Royalties can be based on the number of products sold. This is a comparatively simple method, which is easy to control. For example, the parties agree on a royalty fee of 50 cents for every baseball cap and \$ 1.20 for every T-shirt sold.

However, basing the royalties on numbers does not always work out. If the price of a T-shirt varies between \$ 5.00 and \$ 50.00 then it is more appropriate to base the royalties on the turnover. In this case, a further specification is necessary, e.g. whether the whole sale or the retail price is to be used for calculating the turnover, if taxes are deducted, if reductions given to the customers by the LEE or the costs for shipping and so on are to be deducted from the turnover.

In specific situations, a fixed overall royalty to be paid in one lump sum or on a yearly basis might be the best solution. In this case both parties know the predetermined price, and no further checking or auditing is required.

Minimum royalties are regularly found in TLAs. This encourages the LEE to sell the products under the license and guarantees the LO a certain minimum sum independent of the commercial success of the LEE.

Also, an upfront payment is quite usual. This type of payment in advance is frequently encountered when the A is being signed, thereby affirming that the LEE is indeed interested in the license.

The royalty payment procedure must be laid down clearly in the A, e.g. whether the royalties are to be paid on a monthly or annual basis, within which time period after the sales, and what happens when the royalties are not paid in time.

Furthermore, the auditing rights of the LO should be fixed, thus permitting the LO to check the accuracy of the royalty payments.

What is an adequate royalty? There is no number answer to this question. In one situation a royalty of 0.3 % might be considered appropriate, in another 25 %. The percentage depends on various factors.

Firstly, it depends on the type of the product. A perfume will sell with a high profit. The margin in selling steel sheets could be very small.

The reputation of a TM also strongly influences the royalty. The TM “TIMBERLAND” for shoes will permit a higher royalty for the LO than a TM that is hardly known to the consumer.

The kind of license is also of importance. If the LEE has to compete with many other LEEs who hold non-exclusive licenses he will not be willing to pay high royalties.

Of course, the general market situation influences the profits, which can be made in a certain market.

Finally, the license might include specific know-how thereby increasing the chargeable royalties. For instance the license may encompass the production of the license product (LP), e.g. the recipe for making coke.

2. The second major issue of concern after “Granting a License” is questions of use. In most countries use requirements exist. If the TM is not properly used, it may be susceptible to cancellation. The use of the TM by the LEE is always attributed to the LO, because he remains the TM owner.

Furthermore, the TM must be put to use in the registered form. Any other form of use will not uphold the TM rights. There are, however, varying provisions to this question in different jurisdictions.

Also for other reasons, the LO will have a vested interest in seeing that the TMs are used in the proper form. So for instance, TOMMY HILFIGER will make sure that the colors of their red-white-blue logo are produced in the right color shades. It is therefore appropriate to annex copies of the TMs to the A in order to define the color and/or to define the colors by color codes.

It might also be adequate to inform the consumer about the existing LA. This information can be provided on the package of the product or in sales brochures. Consumers might be reassured when seeing that the LP is under the control of a well-

known LO. So, for example, it might be beneficial to indicate that this toner for printers is under the license of HP.

Finally, clauses regulating the control of marketing activities by the LO should be considered. A LEE might advertise the products in a less attractive way or sell them at unattractive places, which could be detrimental to the reputation of the TM.

3. Coming to the third major topic, the value of a TM is highly dependent on the quality of the products sold under the TM. Therefore, quality control is essential and important to maintain the reputation of the TM.

If a NORTH FACE hiking boot falls apart the fifth time it is worn, then the consumer will not likely purchase another pair of NORTH FACE boots and will probably spread the news to his friends on how disappointed he was when finishing the trip with wet feet. Quality control is essential for NORTH FACE.

A possible clause in the A is therefore that the LEE is required to provide samples of all products he is producing and selling on a regular basis.

Furthermore, the LO could have the right to inspect the production site of the LEE.

This type of quality control should be performed on a continuous basis during the whole term of the A. Quality control is not something, which is merely put to pen and paper in the contract, but rather an essential action that must be effected at regular intervals in order to ensure that the TMs rights are not impaired.

The consequences for the LEE in the case of insufficient quality of the products should also find their place in the A. This includes the measures and sanctions that are to be taken in the event that the quality is insufficient. Furthermore, what happens to those goods for which the quality is inadequate? Will they have to be destroyed, or can they be sold elsewhere? Ultimately, insufficient quality should allow the LO to terminate the A.

4. Our fourth issue is legal disputes.

On the one hand, legal disputes arise out of the necessity to defend TMs against infringement by third parties. It is the LEE who is operating on a market, where the LO might not be present at all. Therefore, LAs often state that the LEE has the duty to inform the LO about infringements.

The next question is, who, the LO, the LEE, or both together, can or must, take what action.

If not specifically regulated, this question depends on the type of the license. In the case of a non-exclusive license the LO has to take action. According to European Community TM Law, the LEE may only bring an action with the consent of the proprietor.

In the case of an exclusive license, the LEE has to take the action.

Irrespective of the license type, these aspects should be discussed by the parties and agreed upon in advance.

For instance, the parties might agree to a contract stating that at first the LO has to take action, but if he refrains, then the LEE is automatically entitled, but not obliged, to take action in his own name.

Legal disputes are expensive, and therefore it is frequently wise to regulate the division of the costs of possible disputes in the A.

On the other hand, legal disputes often arise out of an attack by third parties on the TMs addressed in the A. This attack could be to cancellation or opposition proceedings.

Also court actions might be brought by a third party, who claims that the use of the licensed TM is infringing the third party's rights. In this case, it is usually the LEE who will have to bear the consequences of the attack, because he is actually using the TM. In discussing the A, the LEE might therefore request a warranty by the LO in the TLA stating that the use of the licensed TM is not infringing any third party rights.

5. In the fifth and last part of my talk I would like to shed some light on the restrictions on what can be agreed upon under European Law.

Especially in Europe careful notice should be taken of what can be arranged in a LA . These restrictions do not arise from the fact that European law is highly formalistic or that Europe is attempting to defend its own interests, but rather because of the specific situation as explained earlier between the national intellectual property rights and the idea of a Common European Market, and the prohibition using these rights to split up the said Market.

These restrictions must be scrutinized carefully for two reasons: Firstly, an A which contains an unallowable restriction is automatically void, and secondly, very severe fines can be imposed on the parties by the European authorities. The fines can amount to one billion dollars or even up to 10 % of the worldwide turnover of the company.

The main provision to be considered is Art. 81 of the Treaty establishing the European Community. The decisive passage is:

“The following shall be prohibited as incompatible with the Common Market: all agreements between undertakings..... which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the Common Market....”

Some restrictions are expressis verbis mentioned in the following of Art. 81:

- directly or indirectly fixing purchase or selling prices or any other trading conditions
- applying dissimilar conditions to equivalent transactions with other trading parties, hereby placing them at a competitive disadvantage.

To understand the practical impact of Art. 81 let us look at three provisions, which might be part of a TLA. The question is, whether these restrictions are allowed under Art. 81.

First example:

The LEE may produce and sell the licensed products, e.g. sports shoes, with an upper limit of 10.000 pairs per year only.

Is this allowable? The answer is “no”! This is a clear restriction of the competition within the Common Market, because it limits the quantity of goods and thus the marketing potential of the LEE.

The second example is a provision:

The LEE may not sell the licensed products to discount markets.

Allowable or not? The answer is again “no”! This is a clear restriction with regard to the customers of the LEE. A certain class of potential customers may not be excluded.

The third example is:

The LEE may not sell to customers from which it can be assumed that they export the licensed products outside the licensed territory.

The answer here is again “no”! This restriction covers the scenario that, for instance, when the licensed territory is Austria and the customers intend to export to other countries of the European Union, then the restriction is in full breach of Art. 81, because it influences the free flow of goods within the European Market.

However, if the objectionable clause was confined to non-European issues, so that the LEE may for example not sell to customers, who intend to export to USA, then this provision would be allowable, because it has no restricting effect on the trade in Europe.

The matter is comparatively complex, but important and interesting.

Together with my former partner Jennifer Clayton-Chen I have written a book on precisely this topic. The book was published by INTA and has the title “Trade Mark Licensing & Selective Distribution – Strategies for Valid Agreements under European Law”.