

WIPO/TM/BEY/03/6

ORIGINAL:English

DATE:March2003



REPUBLIC OF LEBANON

WORLD INTELLECTUAL  
PROPERTY ORGANIZATION

## WIPO NATIONAL SEMINAR ON THE PROTECTION OF TRADEMARKS AND GEOGRAPHICAL INDICATIONS

organized by  
the World Intellectual Property Organization (WIPO)

in cooperation with  
the Government of the Republic of Lebanon

**Beirut, March 17 to 19, 2003**

LICENSING AND FRANCHISING: MAKING THEM MOST OF A MARK

*© March 2003 Dr. Gerd F. Kunze, Intellectual Property Consultant of Counsel,  
Walder Wyss & Partners Zurich, Switzerland  
Adjunct Professor, Franklin Pierce Law Center, Concord NH, USA*

## **Trademark Licensing and Franchising: Making the Most of a Mark**

### Contents

	Page
1. Importance of Licensing	3
1.1 General considerations	3
1.2 Trademark license	3
1.3 Transfer of technology agreements	4
2. Trademark licensing in practice	5
2.1 Introductory provision	5
2.2 Preamble	5
2.3 Definitions	5
2.4. Manufacturing and Selling License	6
2.5 Technical Assistance	6
2.6 Trademark License	6
2.7 Other intellectual property rights	8
2.8 Remuneration	8
2.9 Term and termination	9
2.10 Miscellaneous	10
3. Trademark franchising	11
3.1. Economic considerations	11
3.2 Legal considerations	

## **Trademark Licensing and Franchising: Making the Most of a Mark**

### **1. Importance of Licensing**

#### **1.1 General considerations**

It is common practice for intellectual property right holders, to license the right to use their trademark or patent to third parties on the local level in the country where they exercise their own business. This is an alternative to marketing their products or services themselves or an additional marketing means. The principal importance of the possibilities offered through licensing lies, however, in its use for international business relations. Licensing is indeed the principal means of the use of intellectual property rights of foreign companies by local businesses.

Such license agreements are very common between partners from different developed countries and they do exist between partners both originating in developing countries or even between a licensor from a developing country and a licensee in a developed country.

However, they play a particularly important role in the relationship between licensors from developed countries and licensees in developing countries. In these situations such agreements are rarely simple trademark or patent licenses, but rather complex arrangements which may include the licensing of trademarks, patents and other intellectual property rights such as copyright and industrial designs, but also, and this is of particular importance, know how and technical assistance to be given to the licensee. Such arrangements are a key factor for the economic development of developing countries and are often characterized by a flow of transfer of technology, the creation of working places and the use of local raw materials. Such agreements are in many countries regulated by special provisions of national law, which provide for control and approval of the agreement, or even of the whole investment project, of which the agreement forms a part, by government authority.

#### **1.2 Trademark license**

To the extent that the agreement exists exclusively of, or at least includes, the licensing of trademarks, the requirements of the respective trademark laws must be met. Nearly all laws today do recognize the possibility of trademark licensing. This seems at first glance to be contradictory to the basic function of the trademark, which is to indicate the origin of the goods or services, since the goods offered under the licensed trademark on the market will be those of the licensee and will not come from the registered owner. To safeguard the origin function of the trademark it is therefore necessary and sufficient that the owner exercises control over the use of the mark by the licensee, particularly concerning the quality (compliance with quality standards set by the licensor) of the goods and the conditions under which they are marketed. If such control is effective, the registered owner of a trademark need not use it himself. Use of the trademark by the licensee can be deemed to be the owner's use for all purposes of trademark protection. This means more particularly that the trademark cannot be attacked because of alleged non-use and that the licensee cannot himself claim ownership on the mark.

General principles of trademark law do not require any formalities for a trademark license to be valid. The only important aspect, which is imminent to the system, is that the owner exercises effective control over the use of the trademark by the licensee. This principle is generally recognized, even if a few laws only provide expressly for quality control (for example Sri Lanka, USA; the 9<sup>th</sup> Circuit in 2002 confirmed that a “naked” license results in trademark abandonment). But many countries do require in their trademark law formalities such as the recording of the license agreement in a register as condition for the agreement to be enforceable against third parties, or for the use of the trademark by the licensee to be deemed to be use of the registered owner for all purposes of the law (so-called registered user agreements). However, the GATT-TRIPS agreement expressly provides in Art. 19 that for the use of another person than its owner to be recognized as use of the trademark for the purpose of maintaining the registration only one condition may be imposed: That the use of the third person be subject to the control of the trademark owner. No formality, such as a registered user agreement, can be requested for that purpose.

### 1.3 Transfer of technology agreements

As said before, sole trademark license agreements are barely concluded, even if they are of course possible (for the contents of such sole trademark license agreement the considerations in 4.2.6 also apply). In general the right to use a trademark or several trademarks is given in the framework of a general license agreement which a foreign trademark owner concludes with a local company with the intention to have certain products manufactured and sold under his trademarks in the market. For this purpose the licensor has also to license his manufacturing know-how and to give the necessary technical assistance. To the extent that the processes to be used or the products to be manufactured are protected by patents, the use of the patented processes respectively products will also be licensed. Furthermore the licensor may agree to render all kinds of management services. Such agreement may be the essential part of the business transaction, it may also be a part of a more far-reaching transaction such as the set-up of a new company, which may be a joint-venture company or a 100% foreign owned company, with all its necessary elements, including the construction of a factory, the organization of the management of the company, provisions on the financing, etc. Clearly, additionally to the requirements set by trademark laws, many other legal requirements imposed by other national laws may have to be met. In a number of countries, such as Indonesia, Korea, Malaysia, Sri Lanka and Vietnam, every new investment project, whether in the form of a joint-venture or a license to an existing local company has to be submitted to the government for approval, and the need for approval includes of course the license agreement, which is part of the investment project. The reasons for these special requirements are that the respective countries want to exercise control over the type of the intended investment as well as over the conditions negotiated between the parties. Other countries such as Singapore and Thailand do not ask for any approval.

In view of the importance of the legal framework, which will govern the future relationship between the parties, a clear understanding of the scope, contents and legal effect of a transfer of technology agreement is indispensable both for the licensor and the licensee and also for the government officials often involved in the negotiations or in the approval procedure. It is in the time available not possible to deal with all possible problems to be taken into account, which may be very different depending on the nature of the business transaction and also on the differing legal situations in different countries. I will in the following concentrate on a discussion of some typical topics often to be considered when negotiating a transfer of technology agreement taking into account the interests of the negotiating parties, how ever,

also the problems caused to them and more specifically to the licensor by the control exercised by the authorities and by other legal requirements to be met.

## 2. Trademark licensing in practice

### 2.1 Introductory provision

The agreement will normally have a title such as "License Agreement" followed by an identification of the parties to the agreement, in general the Licensor and the Licensee. Sometimes this provision also mentions the time and place of the conclusion of the agreement. Alternatively this information may be given at the end of the agreement. Sometimes in the introductory provision or somewhere else in the agreement the date is fixed at which the agreement is deemed to become effective, whilst at the end of the agreement the date(s) is (are) noted at which the agreement was signed by the parties. This may be useful if government approval is needed. Mentioning the place of conclusion may be a factor in determining the applicable law, absent specific rules in the agreement or in the national legislation of the country of the licensee.

### 2.2 Preamble

The introductory provision is normally followed by a preamble, consisting of the so-called WHEREAS Clauses. These clauses indicate the reasons, which caused the parties to conclude the agreement. Furthermore they may describe the business background of the parties, contain references to the ownership of industrial property rights or the possession of know-how, and may express the desire of the parties to conclude the agreement and to agree to its terms and conditions. The recitals may also refer to any prior or concurrent agreement and explain the relationship between the respective agreements.

WHEREAS Clauses are normally helpful for the understanding and interpretation of the agreement. They may, however, also be in contradiction to later provisions of the agreement. In such cases the language of the latter usually prevails.

### 2.3 Definitions

Sometimes the initial part of a license agreement contains also a paragraph defining certain terms used in the agreement. Another approach sometimes used is to define certain terms when they first appear in the agreement. No doubt it is important to define basic expressions used in the agreement in order to avoid any misinterpretation, and in the case of more complicated and relatively long agreements it will facilitate the understanding if the respective definitions can be found in the introductory part of the agreement. Important terms to be defined for the purpose of the agreement are usually terms such as "Patents", "trademarks", "know-how", "products", "technical assistance", "territory", "net selling price" and other terms important for a proper calculation of the royalties to be paid.

### 2.4. Manufacturing and Selling License

The principal purpose of a transfer of technology agreement is normally not to allow the licensee the exploitation of a given patent or several patents held by the licensor but to grant the licensee the right to manufacture a given product or certain products, for which the licensor possesses the know-how and in relation to which he may be the owner of a patent or

certain patents or of other intellectual property rights, such as utility models or industrial designs. In most cases, this agreement provides also that the products manufactured are to be sold under the trademarks of the licensor. Most transfer of technology agreements therefore include a trademark license agreement or clauses regulating the use of the trademarks of the licensor. In certain cases, such as a license and distributor agreement relating to the bottling and selling of a soft drink, the emphasis may be on certain ingredients to be bought by the licensee from the licensor and on the disclosure of the know-how necessary for the preparation of the licensed product (soft drink) from the ingredients, and such agreement will generally also comprise the right to sell the soft drink under the licensed trademark. More generally the licensor may in certain cases wish to oblige the licensee to acquire certain items from him or from a specified origin, such as product-components, spare parts or raw materials. This kind of tied-clauses, linking the licensee to such supply, may be justified on objective grounds. However, they should not lead to unjustified remuneration to be paid by the licensee. The licensor may therefore give the licensee a guarantee, that he will charge competitive prices.

## 2.5 Technical Assistance

Technical assistance may and often will play an important role in the framework of a license agreement.

Clearly the licensor will undertake to provide to the licensee all technical information and assistance and more general all kind of management services required for the satisfactory manufacture of the contract products. This will of course include the rendering of product specifications and the description of the quality standards set by the licensor. This information and assistance will generally go beyond any disclosure by the description of an invention as may be found in a patent, if any.

## 2.6 Trademark License

A transfer of technology agreement does not necessarily include the licensing of the use of trademarks owned by the licensor to the licensee. No doubt license agreements are concluded where the emphasis is on the disposal of technology protected by patents or other intellectual property rights. However, no doubt many license agreements are concluded including or even emphasizing the right of the licensee to use certain trademarks owned by the licensor. This right is often even essential for the successful marketing of the products manufactured by the licensee under the license agreement. This is specifically true for the consumer goods industry, including the food industry. In such situations the license agreement will contain a chapter on the right to use the licensed trademarks for the marketing of the licensed products. The licensed trademarks should be listed in the agreement or in an annex thereto together with the registration or application numbers as the case may be. Furthermore, the goods licensed to be marketed under the trademarks should clearly be defined. These goods should of course be within the scope of goods for which the licensed trademarks are registered or applied. However, the list of the licensed goods may be narrower than the list of goods for which the trademarks are registered in the country. This is indeed happening in practice, but in order to avoid problems with the protection of the registered marks under the point of view of possible user-obligation provisions in the respective trademark law, it is recommended to provide for the arrangement of the sales necessary to safeguard adequate trademark protection (an alternative may in such situations be to arrange for imports of products manufactured by the licensor).

Apart from the principal clause giving to the licensee the right to use the said trademarks for the manufacturing and sale of the licensed products within the territory this chapter usually contains a number of specific clauses, such as:

- the licensor to warrant his rights in and the validity of the registered trademarks
- obligation of the licensor to ensure proper protection of the licensed trademarks by the necessary registrations and renewals
- obligation of the licensee to use the trademarks only on products manufactured in accordance with the specifications and according to the standard of quality set by the licensor
- obligation of the licensee to submit from time to time samples of products sold under the trademarks for control
- obligation of licensee to submit to licensor for prior approval specimen of labels and packaging materials bearing the trademarks
- prohibition to make any change in the presentation of the trademarks without prior approval by the licensor
- obligation of licensee not to use any trademarks confusingly similar to the licensed trademarks.
- obligation of the licensee not to endanger the protection of the licensed trademarks by improper use or by non-use or by any other act.
- provisions whether the license is exclusive or non-exclusive
- provisions whether the licensee has the right to sub-license the use of the trademarks
- provisions on how to deal with trademark infringements by third parties
- provisions on who bears the expenses of proper trademark protection and who the costs incurring in relation to infringements
- provisions on the sale of products bearing the trademarks outside the territory (normally prior approval of licensor required)

The agreement may also provide, that on the labels and packaging of the licensed products the licensee has to indicate the licensor as a trademark owner and/or that the products are marketed under license. Furthermore it is common to confirm the internationally recognized rule that use of the licensed trademarks by the licensee shall inure to the benefit of the licensor.

## 2.7 Other intellectual property rights

The license agreement may additionally provide for the licensee's right to use any copyright, utility model or industrial design, which may be protected in the name of the licensor in relation to the licensed products or their packaging (such as trade dress), or to the respective

know-how. This can also include the license of any patents, if these are not already dealt with in the chapter on the manufacturing license, and of course the usual clauses contained in a patent license agreement. These clauses will be quite similar to some of the clauses mentioned in the context of the trademark license. Even more for patents than for trademarks it may be important that the licensor warrants the validity of the patent. Also licensors normally insist that the licensee undertakes not to contest the validity of the patent.

Furthermore the licensor may in certain cases wish or agree to allow the licensee to incorporate any of the licensed trademarks in its company name.

## 2.8 Remuneration

Provisions for remuneration can be made with respect to any of the rights granted to the licensee, such as for:

- the right to use the patents, trademarks or any other intellectual property rights
- the right to use the know-how
- the technical assistance rendered (documents etc.)
- special services and assistance given by personnel of the licensor

The agreement may provide for separate payment of the different activities or for a combined fee including all or several of the activities. Furthermore it may provide for a lump-sum arrangement or for the payment of royalties or for compensation of the actual services rendered or for any combination of these possibilities. There is no generally adopted practice. What is being agreed upon depends often even on what the government officials involved in the negotiations accept as proportionate to the acquired technology and as not constituting an unacceptable burden on the national economy or on what can reasonably be expected to be accepted by the fiscal authorities.

Even if no general solution exists, certain types of agreements may prevail. In the case of a transfer of technology agreement intended to have the products of the licensor manufactured and sold by the licensee in his territory it is very uncommon to base the remuneration on a sole lump-sum agreement. More likely a royalty fee will have to be paid, which is calculated as a percentage of the sales (and which may be combined with the provision for a minimum lump-sum to be paid). The royalty due for the use of the trademarks is sometimes fixed separately from the fee to be paid for the technical assistance rendered (including the necessary use of patents and know-how). Often it is, however, easier for the negotiating parties to agree upon a global royalty fee including the right to use the trademarks, other intellectual property rights as well as the know-how of the licensor and the technical assistance given. Also in these cases, it is, however, reasonable to provide for extra payments of the expenses occurring for special services rendered by employees of the licensor.

If the licensee is at the same time a majority or even 100% owned affiliate of the licensor, to whom he has to pay dividends, this normally does not influence the right of the licensor to ask for royalties for the use of his trademarks and the technical assistance given to the licensee. In such cases of the conclusion of a license agreement between a foreign company and its local subsidiary the governments will of course pay special attention to the conditions of the



proposed license agreement in order to assure that the interests of the licensee and those of the country are safeguarded.

The conditions of payment are normally quite detailed taking into account the problems arising from different currencies, changing currency exchange rates etc.

## 2.9 Term and termination

License agreements may be concluded indefinitely or for a certain period of time. As concerns the negotiating parties there may not be an important difference, since also unlimited agreements can normally be terminated under certain conditions and the term of a limited agreement may be very long. I have indeed seen agreements concluded between important enterprises (on both sides) for 100 years. However, in many developing countries government authorities approve license agreements only for a certain period of time, which normally does not exceed 10 years. This means in practice, that after 10 years the agreement cannot simply be renewed, as this is usual practice between private parties, but must be re-negotiated with the government. The trend of governments in such situations is of course to request lower royalty rates, often with the argument that the technology transferred may have become less valuable by the time. The licensor has in such cases to prove that he has substantially improved his technology as licensed to the local licensee. Furthermore in these days the value of well known trademarks becomes more and more recognized, in contrast to former times, when many governments hesitated very much to accept the justification of substantial royalties for the use of trademarks and some even did not allow at all the payment of such remuneration.

Of course there are valid reasons that must enable either party to terminate the agreement, such as bankruptcy, or breach of important provisions of the agreement, change of ownership of the licensee including its nationalization. It is very important not only to clearly define these reasons for termination in the agreement, but also to regulate the effects of such termination. Typical clauses contained in license agreements in that context are obligations of the licensee to:

- deliver all materials and documents received together with the instructions for the manufacturing of the product;
- cease to use the know-how and any intellectual property rights related hereto;
- cease to use the licensed trademarks and to continue not to use any confusingly similar trademarks;
- to deliver or dispose of all materials used for the manufacturing of the products such as printing plates, molds, labels, packaging and other material bearing the trademarks.

Of course the licensee is normally allowed to sell out existing stocks of the products during a reasonable period of time.

## 2.10 Miscellaneous

License agreements contain usually a certain number of additional clauses which may be included in a separate chapter either before the chapter on termination or after it or which may be found on different places of the agreement depending on the context in which the parties may wish to put them. Such clauses are:

- Provisions on confidentiality with respect to all documentation and information supplied according to the agreement during the term of the agreement and normally also during a certain period of time after its termination.
- provisions on the effect of a partial invalidity or nullity of the agreement
- provisions on product liability claims
- provisions on the applicable law
- provision on arbitration.

### 3. Trademark franchising

#### 3.1. Economic considerations

From an economic point of view franchising may be described as a method of distributing goods and services through independently operated businesses that show a common identity to the public (example: MacDonald's).

A franchise agreement typically includes the following elements:

- the franchiser and the franchisee are independent entities
- the franchiser grants to the franchisee the right to use the franchiser's distinctive trade dress, which may and generally will include one or more trademarks (service marks) and advertising or other commercial symbols, and provides technical and commercial know-how and information
- the franchisee undertakes to use what has been granted by the franchiser under a uniform marketing plan or system prescribed in substantial part by the franchiser
- the franchisee is required to fulfill certain quality requirements
- the franchisee must pay royalties.

From an economic point of view a franchising agreement is quite different from a license agreement in general, and a trademark license agreement in particular. A franchise agreement is usually considered to be an agreement aiming at exploiting marketing plans or systems.

#### 3.2 Legal considerations

Legally, a franchise agreement may be considered to be a technology transfer agreement, as much as a manufacturing or bottling and distributing agreement may be a transfer of technology agreement (and governments, where transfer of technology agreements must be approved, will no doubt submit such franchising agreements to their approval procedures).

Since granting the right to use a trademark to a third person is typically a trademark license agreement, a franchise agreement will generally also *incorporate* a trademark license agreement. It is legally not essential, whether the franchise agreement is expressly supplemented by a trademark license or whether the grant to use the franchiser's trademarks and trade dress to the franchisee is described with other words. In all practical terms this grant is a trademark license and everything what has been said about trademark licensing, also applies to trademark franchising. This is particularly true as concerns the typical clauses mentioned in 4.2.6, which should and normally will be part of a trademark franchise agreement.

[End of document]