Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=6cd5e56b-42ff-4bde-aada-f635db14ee05

Trade mark licensing made easy: part two

In the last issue of MIP, **Oliver Herzfeld** and **Richard Bergovoy** reviewed some of the most important provisions of trade mark licences and explained why understanding what each party wants is crucial to the deal. Here the authors complete their guide to negotiating successful licence agreements

Trade mark registration and maintenance

Licence agreements allocate the parties' respective responsibilities for registration, recordation with local Customs authorities, and policing infringement of licensed trade marks.

Licensees will usually expect their licensors to assume responsibility for seeking and maintaining registration of the licensed mark in appropriate categories for the licensed products in all territories covered by the licence agreement, at the licensors' expense. Licensors may attempt to shift some of the expense to licensees, particularly if a licensee adopts new variations of the mark unique to its specific products. At a minimum, licensees should be obliged to assist licensors in obtaining and maintaining registrations of trade marks for the licensed products by providing evidence of use or other necessary assistance.

Licensors may want to control the trade mark recordation process in foreign jurisdictions, or prefer to obligate their licensees, who may be more locally situated, to carry out the recordation. In any event, licensees should be required to record any sublicenses.

AT-A-GLANCE

Licence agreements should provide for execution of a short form licence suitable for trade mark recordation in local jurisdictions rather than recordation of the original agreement in its entirety. Licensors will want to ensure that the terms of the principal agreement include a conflicts provision that explicitly overrides the short form agreement where the short form contains abbreviated or altered terms necessary for compliance with local licensing formalities.

Protection of trade mark rights

Licensors will usually insist on retaining the sole right to take action to enforce their trade mark rights. Allowing a licensee to enforce a licensed trade mark may lead to litigation the licensor would rather avoid (such as a lawsuit against an important customer of the licensor, or a suit in which the trade mark may be held invalid or unenforceable). The licensor, however, may want to delegate the obligation (and related expenses) to police the mark to the licensee, particularly in the case of an exclusive licensee. But even where the licensee is authorized to enforce the licensed trade mark, the licensor would be well advised to retain the right to approve of and control any dispute.

Licensees sometimes negotiate the explicit right to take enforcement action against infringers to protect their interest in the licensed trade mark, particularly if the licensor declines to do so. In such event, the licensor:

1) may request a right of first refusal to take action itself. Any such provision should contain a specific time frame in which the licensor must notify the licensee of its action to enable prompt preliminary relief;
2) should be obligated to participate in the action if the licensee will otherwise not have standing to sue; and
3) should be required to provide evidence and testimony regarding ownership and use of the mark.

AT-A-GLANCE

In the US, the Lanham Act limits the right to bring an action for infringement of a federally registered trade mark to the registrant. Courts have found, however, that an exclusive licensee may also bring such a claim, especially if the exclusivity provision prohibits even the licensor from using the mark. And any licensee may bring an unfair competition claim against an infringer.

If the licensor retains the right to enforce the trade mark, the licensee should require the licensor to keep it informed of the action and any potential settlement that might be adverse to the licensee's rights. It should also seek an obligation for the licensor to reimburse the licensee's expenses in assisting in the action.

If the parties have joint enforcement rights, then the licence agreement should clearly delineate the division of any monetary damage award between the parties.

Licensee-created IP

When a licensee creates its own materials in connection with the licensed product (such as artwork, advertising, promotional materials), ownership of the copyright, trade marks and other IP relating to all such creations are usually transferred to the licensor by way of either work made for hire or outright assignment. Where ownership is transferred to the licensor, a frequent point of contention is the scope of the IP transferred. Licensors argue that they should obtain full ownership of all licensee IP, even product designs, on the grounds that anything associated with the licensor's trade mark should never be used or associated with other products of the licensee or any third party. Licensees counter that only marks or other graphic elements that directly incorporate the licensed mark should be transferred, on the grounds that requiring the licensee to transfer its own IP that does not directly incorporate the licensed mark is overreaching on the licensor's part

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=6cd5e56b-42ff-4bde-aada-f635db14ee05

and exceeds the quintessential *quid pro quo* of the licence agreement. Licensees also try to include a carve-out for prior-created IP since such property was created, owned and likely used by the licensee before the inception of the licence agreement. Licensors will usually resist such a carve-out based on the same rationale described above. However, licensors will sometimes counteroffer certain narrow carve-outs for pre-existing underlying product designs (such as apparel designs) or inventions (such as mark-bearing consumer electronics invented by the licensee).

If the ownership transfer of the licensee's IP is not allowed under the law in a particular territory, the licensee will usually grant the licensor a worldwide, non-exclusive, royalty-free licence to use such IP in perpetuity without restriction. The licensee will retain a non-exclusive, royalty-free licence to use its creations during the term of the licence agreement solely for the exploitation of the licensed rights in accordance with the terms and conditions of the agreement.

Audit rights

In the usual trade mark licence, the licensee calculates and pays royalties based on sales information that the licensor is not privy to. In effect, the licensee is invoicing itself, on the honour system. It is therefore critical for the licensor to have the right to audit the licensee's records to verify the accuracy of the licensee's royalty payments. From the licensee's point of view, it is equally critical that audits do not interfere with the licensee's normal business operations.

A basic audit provision should address:

1) What kinds of records the licensee is required to maintain for the licensor's inspection. The starting point is financial and accounting records related to sales of the licensed goods and calculation of royalties thereon, and may also include inventory, manufacturing and quality control records.
2) How long the licensee must maintain the records. Licensors usually insist that records be maintained for at least a year after expiration or termination of the agreement.
3) When and how often the licensor or its agents may gain access to the licensee's records, and on what kind of notice. For example, a typical audit provision might provide that the licensor may gain access to the licensee's records only at the licensee's headquarters, only during normal business hours, upon a minimum of three business days notice, and no more than twice a year. The licensor usually wants less notice and fewer restrictions, to ensure the integrity of the information, while the licensee wants the opposite, to minimize disruptions to its business operations.
4) Whether the licensor can shift its audit expenses to the licensee if the audit reveals a royalty discrepancy exceeding a defined maximum. Licensors argue that such a provision provides incentive for the licensee to get it right the first time, especially since professional royalty auditors can be very expensive.

The financial audit provision may be combined with or separately supplemented by an audit provision relating to worker safety and worker treatment by the licensee and/or its manufacturers.

Warranties

In a trade mark licence agreement, the parties will usually seek representations and warranties from each other that guarantee the validity and binding nature of the agreement.

In addition to these generic representations and warranties, each party will seek representations and warranties that address its business concerns specific to the licence transaction.

The licensee will want the licensor to provide representations and warranties that ensure the licensee is getting the trade marks and other licensed IP free of claims and conflicts. In particular, that:

1) the licensor owns or has the right to license the IP;
2) there are no claims against or encumbrances on the licensed IP; and
3) the licensed IP does not infringe the proprietary rights of any third party.

The third warranty is likely to be the focus of contention during negotiations. The licensee will seek an unqualified warranty from the licensor, covering use of the IP in all licensed territories, on the grounds that the validity of the licensed IP is the very basis of its bargain. The licensor will seek to avoid this warranty, or limit it with so-called best of knowledge qualifiers, or limit it to only the licensor's home territory, excluding foreign licensed territories on the grounds that it is impossible to discover and therefore guarantee against all potentially conflicting iterations of the IP, especially outside of the licensor's home territory.

The licensor will want the licensee to provide representations and warranties that protect the licensor against liability caused by the licensed goods, their manufacture, or by IP that the licensee contributes to the licensed goods. In particular, that:

1) the licensed goods do not have defects, will not cause injury, and will not be the subject of a recall;
2) the licensed goods are manufactured in accordance with samples submitted to the licensor for approval;
3) the licensed goods are manufactured in compliance with law, especially labour and product safety laws; and
4) any IP contributed to the licensed goods by the licensee (such as package design or graphics) will not infringe the proprietary rights of any third party.

As important as the warranties themselves (but often overlooked during negotiations), are the remedies for a breach of those warranties. If a warranty is breached, the licence agreement may allow the warranty beneficiary to terminate the agreement and sue for full damages, or it may limit the beneficiary's remedy to the warrantor's good faith attempt to cure the problem.

Indemnities

Indemnities are risk allocation provisions, specifically, those that allocate the risk of legal liabilities and their associated legal defence costs. In effect, they are miniature insurance policies, given by one contract party to protect the other. Even in the case of an unfounded legal claim, defence costs alone can be considerable, so the indemnities are often one of the most vigorously negotiated provisions in any kind of contract.

Just as there are both generic and licence-specific representation and warranty provisions, so too there are both generic indemnities and indemnities specifically addressing the risks each party seeks to limit.

The generic indemnities generally require the indemnitor to indemnify, defend, and hold harmless the indemnitee against any claims, costs (including reasonable attorney's fees), damages, or liabilities arising out of or related to:

1) a breach of the indemnitor's warranties in the licence; and
2) the indemnitor's breach of, or conduct under, the licence agreement.

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=6cd5e56b-42ff-4bde-aada-f635db14ee05

Understanding what the other side wants

Provision	Licensors want:	Licensees want:
Trade mark registration and maintenance	Licensee pays prosecution expense for registrations covering licensed goods. Alternatively, licensee assists in licensor's prosecution at its own expense	Licensor pays for all prosecution expenses. Alternatively, licensor covers licensee's expenses related to prosecution
Protection of rights	For an exclusive license, the licensor may want to delegate the obligation and expenses to police the mark to the licensee. Even where the licensee is authorized to enforce licensed trade mark, the licensor may wish to retain the right to control the dispute	The licensee may obtain an explicit right to protect its interest in trade mark. However, the licensor may retain a right of first refusal to take action itself. The licensor should be obliged to participate in action if the licensee will not have standing. The licensor should be required to provide evidence and testimony regarding ownership and use of mark
Licensee-created IP	Licensor to obtain ownership of all licensee after-created IP in any way related to the licensed products or the licensed brand	Licensee to surrender ownership only of after-created IP that becomes directly associated or identified with the licensor's trade mark
	No carve-out for licensee prior-created IP, or only narrow carve-outs for pre-existing underlying product designs (such as apparel designs) or inventions (such as mark-bearing consumer electronics invented by the licensee)	A full carve-out for prior created IP
Audit rights	Licensee required to maintain a broad variety of records, such as financial, accounting, inventory, manufacturing, safety and worker treatment, and quality control	Licensee only required to maintain financial records related to calculation of royalties on the licensed goods
	Licensee required to maintain all records throughout the licence term, and for at least a year after termination or expiration	Licensee required to maintain records only on a rolling basis, for example, two years after the date of creation, and not after expiration or termination
	Licensor or its agents entitled to full access to licensee's records and licensee's offices on little or no notice	Licensor or its agents entitled to access only upon notice (typically three business days or more) and during normal business hours, for a limited number of inspections per year. Licensee may also insist that the audit team consists only of independent professional auditors or accountants, not licensor's employees
	Licensor may shift all of its audit expenses to licensee if the royalty discrepancy exceeds a defined cap, typically 3% to 5% of royalties actually paid	Either no expense-shifting provision, or if included, only (i) for discrepancies in excess of 10% of royalties paid (ii) limited to reasonable and necessary expenses of auditors and (iii) not to exceed a dollar cap
Warranties	Licensee to warrant that it is authorized to enter into the licence, and that the licence is a legal, valid and binding obligation	Same warranties as at left, from licensor
	Licensee to warrant that the licensed goods do not have defects, will not cause injury, are manufactured in compliance with law, and any licensee IP is non-infringing	No warranties to licensor regarding licensed goods, or limited by "best of knowledge"
	No warranties to licensee regarding licensed IP, or warranties limited by "best of knowledge," or limited only to the licensor's home territory	Licensor to warrant that licensed IP is non-infringing in all licensed territories
Indemnities	Licensee to indemnify against breaches of warranty and claims arising from licensee's actions or omissions	Same indemnities as at left, from licensor
	Licensee to indemnify against claims that licensed goods cause injury or property damage, were not manufactured in compliance with law or contractual specifications, or contain infringing licensee-created IP	Licensee gives no indemnity regarding licensed goods, or only indemnities against breaches of warranty, on an "after final judgment" basis
	Licensor provides no indemnity, or only indemnifies against trade mark (or other IP) infringement claims of third parties in its home territory on an "after final judgment" basis	Licensor to indemnify against trade mark (or other IP) infringement claims of third parties in all licensed territories
Third party manufacturers	No third party manufacturers permitted, or alternatively, permitted only if reviewed and approved by the licensor	If licensor has approval right over manufacturers, then not to be unreasonably withheld. Alternatively, licensee has blanket approval to use manufacturers, with notice only to the licensor
	Licensee to obtain from manufacturer unrestricted permission for licensor to inspect the manufacturer's factories	Licensee to make reasonable efforts only to obtain manufacturer's consent to inspection, but not responsible for manufacturer's failure to respond
	Licensee must obtain manufacturer's written agreement to comply with all terms and conditions of the licence agreement, as well as fair treatment for its employees, preferably with licensor as an intended third party beneficiary	Licensee to make reasonable efforts only to ensure manufacturer compliance with the terms of the licence. Alternatively, if the manufacturer is required to sign a manufacturer's agreement, licensee to make reasonable efforts only to obtain a signed agreement, but not responsible for the manufacturer's failure to respond
	Both licensee and manufacturer are fully liable to licensor for, and licensee must indemnify against, manufacturer's compliance with the licence, and acts or omissions resulting in liability to licensor	Licensee has no or extremely limited liability to licensor for manufacturer's acts or omissions, only responsible to terminate manufacturer, upon request of licensor
Modification of a licensed trade mark	Prohibit the licensee from any unauthorized changes or modifications to the licensed mark and retain sole discretion in the approval of any modifications	Prohibit the licensor from requiring modifications of the licensed mark. Where permitted or required, reserve the right to cost effectively transition to new a mark and sell-off any remaining inventory

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=6cd5e56b-42ff-4bde-aada-f635db14ee05

However, it is not a foregone conclusion that the parties will give equivalent, mirror-image generic indemnities. Which party gives what indemnities often boils down to a matter of negotiating leverage.

In addition to generic indemnities, each party will seek licence-specific indemnities.

The licensee will want to be indemnified, defended, and held harmless against claims that the licensor's IP infringes the proprietary rights of any third party in any licensed territory.

Similarly, the licensor will want indemnities against claims:

1) that the licensed goods have caused injury, death, or property damage;
2) that the licensee or the licensed goods are in non-compliance with law or contractual specifications; and
3) that licensee-contributed IP infringes the proprietary rights of any third party in any licensed territory. (This assumes that the licensor is not already covered by equivalent warranties that feed into an indemnity against breaches of warranty.)

Frequently, a licensor will provide an indemnity against claims of trade mark infringement in its home territory, and a licensee will provide an indemnity against claims of death, injury, or property damage attributable to the licensed goods, or claims of trade mark infringement for IP it has contributed to the licensed goods. Also, the indemnitor will usually include a carve-out from its indemnity obligation to the extent that the claim can in some sense be attributed to the indemnitee's own actions. But as with generic indemnities, the final balance for licence-specific indemnities is determined to a large extent by which party has superior negotiating leverage.

A full treatment of indemnities is beyond the scope of this article, but two further points are worth mentioning. Similar to the situation with warranties, but to an even greater degree, procedural requirements and remedies accompanying the indemnity can be as important as the substantive indemnities themselves.

One limiting remedy often advocated by indemnitors is that there is no duty to indemnify until there is a final and non-appealable judgment by a court of competent jurisdiction that imposes liability on the indemnitee for a claim that falls within the scope of the indemnity. That way, the indemnitor will not need to pay legal defence or other costs of the indemnitee for claims that ultimately prove unsuccessful.

Finally, the indemnitee should ensure that the indemnity obligation survives termination or expiration of the licence agreement.

Third party manufacturers

Restrictions on subcontracting and assignment are a standard part of the boilerplate of every contract, and usually among the least controversial provisions. By contrast, the authorized manufacturer provisions in trade mark licence agreements are often among the most contested.

Licensees argue that the ability to utilize inexpensive foreign third party manufacturers for licensed goods is an economic necessity in today's global economy, and if they do not, their competitors will.

Licensors usually insist just as forcefully on reserving the right to restrict use of foreign third party manufacturers, arguing that news media stories of sweatshop labor conditions at, or unsafe products produced by, foreign factories can cause swift and irreversible damage to the value of their brand.

Licensors usually insist on reserving the right to restrict use of foreign third party manufacturers, arguing that news media stories of sweatshop labor conditions at, or unsafe products produced by, foreign factories can cause swift and irreversible damage to the value of their brand

The most commonly contested manufacturer issues are as follows:

1) Whether and under what conditions a licensee can use third party manufacturers to produce licensed goods. The licensor will usually allow the licensee to utilize third party manufacturers only on a prior notice and written approval basis, although the licensee sometimes succeeds in obtaining the right to use manufacturers solely upon prior notice to the licensor, with no veto right.
2) Whether the licensor has the right to inspect manufacturer factories for unsafe or illegal working conditions, pirating, etc.
3) Whether the manufacturer must comply with the terms of the trade mark licence agreement. The licensor usually insists that the licensee ensure that its manufacturers comply with all terms of the licence, as if they were the licensee, and licensees seldom resist. The licensor may also insist that the licensee obtain the manufacturer's direct signature on documentation in which the manufacturer promises the licensee to: (a) fully comply with the terms of the licence agreement, and (b) provide safe and fair working conditions for its employees, to prevent damaging sweatshop accusations against the licensor by association. Further, such documentation may also contain provisions explicitly making the licensor an intended third party beneficiary, so that the manufacturer is directly liable to the licensor. The licensee often objects on the basis that foreign manufacturers (particularly in China) may not read/understand, sign or return the forms.
4) Whether the licensee or manufacturer will be liable to the licensor for the manufacturer's bad acts. The licensor usually insists that it is not enough for the manufacturer to just promise compliance, but that both the licensee and the manufacturer must be liable to the licensor if the manufacturer breaches the licence, or otherwise creates liability for the licensor. Its rationale is that the manufacturer is in effect a subcontractor of the licensee, and traditionally general contractors are held legally responsible for the actions or omissions of their subcontractors. The licensee usually responds that it is unfair for it to be held responsible for the actions of a manufacturer half way around the world, but that it will, in appropriate cases, terminate the manufacturer relationship if requested. The licensor will also seek to be named an intended third party beneficiary of any manufacturer's agreement between the licensee and its manufacturer as described above.

Trade mark usage

Licensors will usually require licensees to only use the licensed trade mark in accordance with a published style guide that is

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=6cd5e56b-42ff-4bde-aada-f635db14ee05

attached to the licence agreement as an exhibit. Essentially, a style guide (sometimes referred to as a trade mark usage guide), is a set of rules and examples that direct the licensee regarding the proper way the licensor's trade mark must be used and displayed on licensed products, labelling, packaging, advertising and other marketing materials.

Licensors frequently seek to require licensees to include legal copy on all packaging and/or advertising identifying the licensor and indicating the trade mark is used under licence. Most licensees do not object to such a requirement since it benefits both the licensor and licensee in distinguishing officially licensed products from counterfeits. Nonetheless, some licensees resist, arguing that they do not wish to take any action that might dispel the illusion that the licensed products were actually manufactured by the licensor.

Whereas licensors usually retain the sole discretion to approve or reject any proposed modification to the licensed mark on the licensed products (usually as part of its overall quality control and approval rights), licensees sometimes negotiate a corresponding agreement provision that prohibits or limits the licensor's right to require the licensee to transition to and incorporate such a modification to the licensed mark. Of course, the rationale behind such a provision is to minimize the potentially high cost to the licensee in implementing such a change. If the licensor retains the right to require the incorporation of a modification to the licensed mark, the licensee should try to reserve the right to cost effectively transition to the new mark within a reasonable timeframe that affords the licensee a full and fair opportunity to sell-off any remaining inventory.

Co-branding and combined marks

Licensees sometimes seek to bolster the strength and recognition of their own trade mark through a direct association with the licensor's mark. In particular, licensees may negotiate a right to co-brand the licensed products or otherwise use the licensed trade mark in combination with, or in close proximity to, the licensee's own mark. Licensors are well advised that any type of co-branding may lead to the licensee potentially gaining some form of limited ownership or control over the licensor's trade mark. Consequently, before agreeing to such an arrangement, the licensor should carefully consider whether it makes sense to permit any co-branding. And if the licensor so agrees, it should precisely define what will be the parties' respective ownership and control rights in any combined marks. The parties should also address appropriate requirements regarding proportionality between the size of the licensed trade mark and any other marks, and the parties' respective obligations relating to the registration, recordation and policing of any combined marks.


Oliver Herzfeld


Richard R Bergovoy

© Oliver Herzfeld is SVP and chief legal officer of The Beanstalk Group, a brand licensing consultancy. Richard R Bergovoy is associate vice-president of legal affairs of The Beanstalk Group. All remarks and opinions are the authors' own, and should not be construed as those of The Beanstalk Group

Managing Intellectual Property™

The global magazine for IP owners

• News • In-depth features • Interviews • Case studies • Industry surveys • Regulatory overviews • Firm rankings

FIND OUT MORE TAKE A FREE TRIAL AT www.managingip.com or call +1 212 224 3570