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Licensing of Products Poses New Challenges

The courts are redrawing the lines defining rights.

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THE CURRENT explosion in domestic and international licensing programs for trademarks, franchises and other intellectual property assets is a natural next stage in the evolution of trademark law and a wholly predictable byproduct of a service economy in the information age. The manifestations of this movement are everywhere.

Perhaps the most dramatic measure of the licensing boom is the proliferation of "brand extension programs." Brand extension hits home when a popular candy bar's trade dress and name appear in the ice cream case as a "new" frozen confection. The outdoor kerosene lamp brand is attached to various types of camping gear. The name of a restaurant chain appears in the grocery store on a frozen entree. It is a fact of life today that familiar brand names no longer are confined to familiar products.

At the same time, image licensing is expanding at an even faster rate. To anyone with small children, it is no news that everything from diapers to baby bottles has sprouted likenesses of familiar puppets, cartoon mice or androgynous blue humanoids.

Statistics confirm what most people have seen in the marketplace. Industry observers have estimated that trademark licensing of all kinds, including corporate promotion, brand extension programs, character licensing and entertainment and sports licensing, represented approximately $50 billion in 1985. This number will more than *triple* by the end of this decade.

It also has been observed that trademark licensing is moving from the fringe areas of business into the mainstream. There are a number of reasons for this expansion. For one thing, companies believe they can overcome many of the marketplace barriers to entry for the introduction of a new branded product by licensing their marks and trade dress to a manufacturer that is familiar with the market, can provide the capital for product introduction and has in place the distribution system for the new product.

An established manufacturer is usually far better-positioned to bring a new product to market quickly. This makes it possible to avoid much of the product development research that otherwise would have to be undertaken by the trademark owner.

Finally, corporate managers are discovering that trademark royalty incomes compare favorably to the financial returns of new branded products that might be generated by the trademark owner, and at less risk.

Rise of Franchising

Franchising, a species of trademark licensing, has seen record growth during the past few years. It has been estimated by the IFA, or International Franchise Association, an organization based in Washington, D.C., that if one includes the petroleum and automobile industries, franchising accounts for approximately one-third of all retail dollars spent in the U.S.

Business-format franchising, which includes such famous names as McDonald's, Pizza Hut and Holiday Inns, is believed to account for 12 percent of retail sales. The IFA estimates that in 1990 there were approximately 521,000 franchised units in the United States, excluding auto and gasoline franchises, and that the numbers for 1991 increased to 542,496. Total sales at these businesses during 1991 were estimated at $232.2 billion.

While the business markets in licensing are expanding, the courts are redrawing the lines defining intellectual property rights. The right to publicity, the definition of protectable trade dress and the interpretation of franchising statutes all have undergone dramatic changes in recent years. Regarding the right to publicity, the case law has followed an early, clear trend toward upholding the right of a well-known individual to control the use of his or her likeness or commercial identity, and the right to publicity has become recognized in the common law and by a number of state statutes.

One example is the classic 1983 case *Carson v. Here's Johnny Portable Toilets Inc.*,[1] involving a claim, upheld by the 6th U.S. Circuit Court of Appeals, that the defendant's use of the phrase "Here's Johnny" to identify portable toilets — coupled with the phrase "The World's Foremost Commodian" — violated the Michigan common-law right of publicity of "Tonight Show" host Johnny Carson, notwithstanding the fact that neither his name nor likeness was used.

Similar results were reached in the 1988 9th Circuit case *Midler v. Ford Motor Co.*,[2] in which a "sound-alike" sang a song made famous by Bette Midler in a television commercial for Ford Motor Co. automobiles.

And last summer, in *Waits v. Frito-Lay Inc.*,[3] a sound-alike crooning in the raspy singing voice of Tom Waits offered a "hip" (quotation marks supplied by the 9th Circuit) endorsement of SalsaRio Doritos — "It's buffo, boffo, bravo, gung-ho, tally-ho, but never mellow . . . try 'em, buy 'em, get 'em, got 'em." The advertisement led the court to uphold the principles of *Midler* as well as a lower court's award of damages to Mr. Waits for mental distress and economic loss, and punitive damages of $2.3 million plus attorney fees.

Vanna White Case

The California-based 9th Circuit, federal appeals court to the stars, has wrestled mightily with the appropriate balance of interests between entertainment figures and those of the public who would parody, copy, imitate or pirate their "identities." Earlier this year, the court refused to rehear a 1992 decision in which game-show hostess Vanna White successfully sued Samsung Electronics over a magazine advertisement depicting a robot dressed in a blond wig, gown and jewelry gesturing gracefully before the familiar "Wheel of Fortune" letter board.

The court found that although the robot was not Ms. White's "likeness" — a term narrowly construed under the California Civil Code Sec. 3344 to mean a visual image — the common-law right to publicity reaches further to protect commercial interest in one's "identity." On this basis, over a sting-

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ing dissent by Judge Arthur L. Alarcon, the court concluded that the advertisement may have violated Ms. White's right to publicity.

The court also found that Ms. White's claim under Sec. 43(a) of the Lanham Act, proscribing false descriptions or representations of origin or sponsorship, should have survived summary judgment. There was a genuine issue of material fact regarding the likelihood of confusion over Ms. White's endorsement of Samsung electronic products.

The decision not to rehear the Vanna White case was itself subject to a three-judge dissent, in which Judge Alex Kozinski expressed the view that the ruling created a broad, new property right under California law and struck an unsettling balance of interests substantially more favorable to the celebrity. "Instead of having an exclusive right in her name, likeness, signature or voice," wrote Judge Kozinski, "every famous person now has the exclusive right to *anything that reminds the viewer of her*."[4]

California and New York, the homes of the entertainment industry, have led the development of statutory protection for rights to publicity. The New York Civil Rights Law[5] and the California Right of Publicity Statute[6] both create a private right of action for damages resulting from advertising using, without permission, another person's "name, portrait or picture" (New York) or another's "name, voice, signature, photograph, or likeness" (California).

Trade-Dress Cases

The protection of trade dress, the non-functional elements of a product or service that make up its look and feel, has made significant strides in the past few years.

The courts have found enforceable examples of trade-dress infringement not only in product design and packaging but also in the look, feel and environment of a restaurant. For instance, in the 1987 case *Fuddrucker's Inc. v. Doc's B.R. Others Inc.*,[7] the 9th Circuit found that the overall image of the Fuddrucker's restaurant was non-functional, protectable trade dress, even though some of its individual elements may have been functional.

The big news in trade dress was delivered last year, in a decision that will make it easier to establish a trade-dress infringement case under federal law in the future. In June 1992, the U.S. Supreme Court unanimously affirmed a multimillion-dollar award for trade-dress infringement under Sec. 43(a) of the Lanham Act in *Two Pesos Inc. v. Taco Cabana Inc.*[8]

The *Taco Cabana* case involved two Mexican-food restaurant chains. Taco Cabana had built six restaurants by 1985, the year Two Pesos opened its first unit and caused a likelihood of confusion through the "brazen copying" — in the Supreme Court's words — of the Taco Cabana restaurant design and its interior and exterior decoration.

The trial court jury found specifically that the Taco Cabana trade dress was inherently distinctive but had not acquired "secondary meaning," that magical process by which the public comes to associate a trade dress with a single source.

The question of whether secondary meaning was a necessary element was answered in the negative by the Supreme Court, which found the notion at odds with the principles generally applicable to trademark infringement cases. The elements of trade dress protection under Sec. 43(a), according to the Supreme Court, are distinctiveness, likelihood of confusion and lack of functionality.

As a poignant postscript to the *Taco Cabana* dispute and its crippling award of damages, the parties have announced that all the restaurants in the Two Pesos chain will be sold to Taco Cabana.

Franchising Concepts

Franchising is trademark licensing in overdrive. Franchisors typically grant to franchisees the right to employ an entire retail business concept, identified by the franchisor's marks and specified in the system operating manuals.

Every aspect of the franchised business may be detailed by the franchisor, from the number of seconds the french fries should cook to the uniforms worn by employees. These continuing commercial relationships may last as long as 20 years and may allow for a renewable term upon expiration.

The classic business-format franchise features a substantial initial fee and continuing royalties, the grant of territorial rights, an initial training program and continuing service and support from the franchisor. Mature franchise systems offer powerful national advertising, administered through systemwide or regional franchisee committees and funded by franchisee contributions based on a percentage of gross sales.

Since the early 1970s, franchising as a method of distribution — it is definitely not an "industry" and has the business diversity to prove it — has spawned its own, somewhat arcane, body of law. The Federal Trade Commission, since 1979, has required franchisors to provide a prescribed offering document, roughly modeled on securities-law disclosures, to prospective franchisees at least 10 business days before they purchase a franchise.[9]

Fifteen states have additional statutory requirements for the sale of a franchise. Most of these states require that the franchisor submit its proposed offering documents for review by state officials, who extend a one-year registration and authorize franchise sales only when the review process has been completed.

State law in 17 jurisdictions also imposes standards under which a franchisor may terminate or fail to renew a franchise relationship. This body of relationship law has generated more than its fair share of franchisor-franchisee litigation and is the legal battleground whenever a franchise relationship crumbles.

Trademark attorneys frequently are admonished not to allow their trademark license drafting to wander inadvertently into the franchise arena. Classic trademark licensing programs often cut close to the legal definition of a franchise.

The elements of a franchise generally are defined as:

- The licensing of the franchisor's trademark, to identify either goods to be sold or the franchised business itself.
- The prescription of a "marketing plan," the existence of a "community of interest" or, under the FTC definition, the provision of "significant control or assistance."
- The payment, directly or indirectly, of a franchise fee.

Key Franchising Case

A slowly growing body of case law now offers interpretations of these impenetrable terms. Most notably, the Supreme Court of New Jersey recently tackled the full range of issues presented by one of the oldest state franchise-relationship laws, the venerable — circa 1971 — New Jersey Franchise Practices Act.

In 1992, in *Instructional Systems Inc. v. Computer Curriculum Corp.*,[10] the New Jersey Supreme Court reversed lower-court rulings and found that a reseller agreement for computer hardware constituted a franchise under the Franchise Practices Act. The case is instructive not only for the computer industry but for all counsel representing traditional product distributors.

The court offered a useful analysis of the two key elements of a franchise under the statute, the license of a trademark and the presence of a "community of interest." It found the trademark-license element had been satisfied even though the licensee did not operate under the licensor's mark or display it on stationery, business cards or business signs.

The court looked beyond the language of the reseller agreement and the absence of the mark on stationery, business cards and signs to find that the relationship between the two parties created "a reasonable belief on the part of the consuming public that there is a connection between the trade name licensor and licensee by which the licensor vouches, as it were, for the activity of the licensee in respect to the subject of the trade name."

As to the community-of-interest element, the *Instructional Systems* court found that there were sufficient levels of franchise-specific investment and interdependence to create the "close symbiotic relationship" that characterizes a franchise.

In drafting trademark-license agreements in New Jersey, counsel will do well to avoid public perceptions of vouching and, by all means, symbiosis.

Franchising is receiving all the right attention in all the wrong places these days. As impressive as its growth statistics may be, the U.S. Congress and the legislatures of a number of states are examining critical issues involving fundamental fairness, abusive practices, encroachment and source of supply. They are also looking at termination and renewal issues in the relationship between franchisee and their franchisors.

Last year, over the strenuous objections of franchisors, Iowa enacted the most stringent relationship law in the country. Rep. John J. LaFalce, D-N.Y., has proposed legislation in the 103d Congress that would set a national standard regarding franchise termination, non-renewal and other franchise practices and would require additional pre-sale disclosure. The law would be enforceable by a private cause of action for disclosure violations that is not now available under the national FTC disclosure rule.

At the frontiers of trademark licensing, the courts are struggling with questions involving what may and may not constitute protectable intellectual property and examining the relationships to be protected by sweeping definitions of franchise law. What they may be doing, in fact, is taking the judicial steps necessary to usher in the decade of the intellectual property license.

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(1) 698 F.2d 831 (9th Cir. 1983).
(2) 849 F.2d 460 (9th Cir. 1988).
(3) 23 U.S.P.Q.2d 1721 (9th Cir. 1992).
(4) White v. Samsung Electronics Amer. Inc., 23 U.S.P.Q.2d 1583 (9th Cir. 1992), rehearing denied, 90-55840 (9th Cir. March 18, 1993) (emphasis in original).
(5) Secs. 50-51 (McKinney 1992).
(6) Cal. Civil Code Sec. 3344.
(7) 826 F.2d 837 (9th Cir. 1987).
(8) 112 S. Ct. 2753, reh'g denied, 113 S. Ct. (1992).
(9) See 16 C.F.R. Part 436.
(10) 614 A.2d 124 (N.J. 1992).