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COMMENTS

The Naked Licensing Doctrine Exposed: How Courts Interpret the Lanham Act to Require Licensors to Police Their Licensees & Why This Requirement Conflicts With Modern Licensing Realities & the Goals of Trademark Law

I. INTRODUCTION

In trademark licensing, a trademark owner (licensor) grants another individual or entity (licensee) permission to sell goods or services under the owner's mark, often for royalty payments.¹ A license is necessary when the licensee's use would otherwise constitute trademark infringement.² Licensing allows licensors to retain ownership interests in their trademarks.³ Additional benefits of licensing to licensors include the following: (1) licensors may grant licensees permission to sell in any size territory, any good or service the licensor offers, for any time period;⁴ (2) licensors may expand to new markets while transferring the risk of business failure to a third party;⁵ and (3) licensors may purchase expertise in areas where they lack it, such as in distribution or manufacturing.⁶

Trademark law benefits consumers through reducing search costs and through encouraging the production and delivery of high-quality goods and services.⁷ Licensing spreads a trademark's information-

1. See ROGER E. SCHECHTER & JOHN R. THOMAS, *INTELLECTUAL PROPERTY: THE LAW OF COPYRIGHTS, PATENTS AND TRADEMARKS* § 32.2 (2003).

2. *See id.*

3. *See id.*

4. *See id.*

5. See Elizabeth Cutter Bannon, *Revisiting "The Rational Basis of Trademark Protection": Control of Quality and Dilution – Estranged Bedfellows?*, 24 J. MARSHALL L. REV. 65, 89 (1990); Sidney A. Diamond, *Requirements of a Trademark Licensing Program*, 17 BUS. LAW. 295, 300 (1962).

6. See Bannon, *supra* note 5, at 89; W.J. Keating, *Promotional Trademark Licensing: A Concept Whose Time Has Come*, 89 DICK. L. REV. 363, 372 (1985) (both discussing promotional licensing or merchandising).

7. See 1 J. THOMAS MCCARTHY, *MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION* [hereinafter MCCARTHY] § 2:3 (4th ed. 1996) (citing William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J. L. & ECON. 265 (1987)).

economizing benefits across the larger market. However, protection for licensed trademarks may also threaten trademark law's ability to encourage the production and delivery of high-quality goods and services because a licensee can free ride on the licensor's success while failing to live up to the licensor's quality standards.⁸ This issue has been addressed by the courts through the naked licensing doctrine. Most federal courts that have considered the issue have required licensors to police their licensees or suffer abandonment of their trademark rights. In this Comment, I examine whether this policing requirement furthers the goals of trademark law, and, if it does not, what standards courts should apply instead.

In Part II of this Comment, I introduce the naked licensing doctrine, including how it is used by litigants and how courts discovered it within the Lanham Act. I also discuss and critique varying judicial standards of licensee control. In Part III, I discuss judicial reluctance to use the naked licensing doctrine, and how courts have treated loss of rights through naked licensing differently than loss of rights through genericide. In Part IV, I discuss modern licensing arrangements, such as merchandising and franchising, and argue that the growth of these licensing arrangements obviates the need for the policing requirement. In Part V, I argue that neither consumer deception nor loss of distinctiveness is a suitable alternative standard, and that courts should instead weigh both. Finally, in Part VI, I conclude that courts would further the goals of the Lanham Act in using such a balancing test.

II. NAKED LICENSING BASICS

Before evaluating the naked licensing doctrine, one should understand its characteristics. First, one must understand that litigants use this doctrine as a defense to trademark infringement. Second, one must understand what the naked licensing doctrine means; that courts interpret the Lanham Act to require licensors to control their licensees. Finally, one must understand that most courts have required licensors to police their licensees in order to satisfy this control requirement.

8. See 1 MCCARTHY, *supra* note 7, § 2:4 (“If your mistakes and blunders are untraceable, there is little incentive to do a quality job.”).

A. Naked Licensing Is Commonly Used as a Trademark Infringement Defense or in a Petition for Trademark Cancellation

The naked licensing doctrine is most often used as a defense against trademark infringement, either as an alternative defense,⁹ or as a counterclaim for trademark cancellation.¹⁰ Though the goal of the naked licensing doctrine is to prevent consumer deception,¹¹ litigants are almost exclusively businesses pursuing their commercial interests. In fact, most courts that have considered the issue have held that deceived consumers have no standing under the Lanham Act.¹²

B. Courts Have Interpreted the Lanham Act to Require Licensee Control

The Lanham Act does not unambiguously prohibit naked licensing; courts have interpreted the Lanham Act to prohibit naked licensing through various provisions. The Lanham Act sections dealing with abandonment provide the most logical avenue because “abandonment,” which is an incontestability defense,¹³ is defined as: “[w]hen any course of conduct of the owner, including acts of omission as well as commission, causes the mark to . . . lose its significance as a mark.”¹⁴ However, few courts use the abandonment provisions without also referencing the related company provisions.¹⁵ The operative related company provision says:

Where a registered mark or a mark sought to be registered is or may be used legitimately by related companies, such use shall inure to the benefit of the registrant or applicant for registration,

9. See, e.g., *Stanfield v. Osborne Indus., Inc.*, 52 F.3d 867 (10th Cir. 1995); *Kentucky Fried Chicken Corp. v. Diversified Packaging Corp.*, 549 F.2d 368 (5th Cir. 1977).

10. See, e.g., *Dawn Donut Co. v. Hart's Food Stores, Inc.*, 267 F.2d 358 (2d Cir. 1959). See also *Land O'Lakes Creameries, Inc. v. Oconomowoc Canning Co.*, 221 F. Supp. 576 (D. Wis. 1963), *aff'd*, 330 F.2d 667 (7th Cir. 1964) (petition for trademark cancellation paired with unfair competition cause of action).

11. See, e.g., *Taco Cabana Int'l, Inc. v. Two Pesos, Inc.*, 932 F.2d 1113, 1121 (5th Cir. 1991), *aff'd*, 505 U.S. 763 (1992); *United States Jaycees v. Philadelphia Jaycees*, 639 F.2d 134, 140 (3d Cir. 1981); *Robinson Co. v. Plastics Research & Dev. Corp.*, 264 F. Supp. 852, 863 (D.C. Ark. 1967).

12. See *Colligan v. Activities Club of N.Y.*, 442 F.2d 686, 689 (2d Cir. 1971). The plaintiffs received substandard service and based their suit on § 43(a), which prohibits trademark owners from using their trademarks to misrepresent their products or services. *But see Thorn v. Reliance Van Co.*, 736 F.2d 929, 932 (3d Cir. 1984).

13. 15 U.S.C. § 1115(b)(2) (2004).

14. 15 U.S.C. § 1127.

15. See, e.g., *Dawn Donut*, 267 F.2d at 366-67.

and such use shall not affect the validity of such mark or of its registration, provided such mark is not used in such manner as to deceive the public.¹⁶

Section 45 further provides: “[t]he term ‘related company’ means any person whose use of a mark is controlled by the owner of the mark with respect to the nature and quality of the goods or services on or in connection with which the mark is used.”¹⁷ Most courts read the abandonment provisions and related company provisions together; they define loss of distinctiveness in terms of control, thus stripping the abandonment provisions of their meaning in their usual context.¹⁸ It is no coincidence that the related company provisions seem out of place in a naked licensing analysis; courts primarily use the related company provisions to determine whether a mark owner has satisfied the Lanham Act’s use in commerce requirement through its licensees.¹⁹ Arguably, courts should closely scrutinize whether a trademark owner controls its licensees when the trademark owner is seeking trademark protection, but should focus on loss of significance when determining whether the trademark owner has abandoned its trademark through naked licensing. However, courts have not recognized this distinction and have instead focused on control when evaluating a naked licensing defense.²⁰

16. 15 U.S.C. § 1055.

17. 15 U.S.C. § 1127.

18. For example, as I will discuss in Part III. B., the loss of distinctiveness standard is used by courts to evaluate genericness defenses. Courts do not need to find an absence of control by the trademark owner in order to hold that a trademark has become generic; in fact, courts have held that such evidence is irrelevant in certain contexts.

19. See, e.g., *Secular Orgs. For Sobriety, Inc. v. Ullrich*, 213 F.3d 1125, 1131 (9th Cir. 2000). The decision in *Ex parte United States Steel Co.*, 23 U.S.P.Q. (BNA) 145 (Comm’r Pat. & Trademark 1934) “was instrumental in spurring the drive for [the related company provisions].” *Trademark Licensing: The Problem of Adequate Control*, 59 TRADEMARK REP. 820, 830-31 (1969). In *United States Steel Co.*, a holding company’s application for trademark registration was rejected because only its subsidiaries used the trademark in commerce. See *id.*

20. Granted, at least two Courts of Appeals have recently used the loss of distinctiveness standard to evaluate whether a trademark has been abandoned through naked licensing. See *Exxon Corp. v. Oxxford Clothes*, 109 F.3d 1070, 1080 (5th Cir. 1997); *Tumblebus, Inc. v. Cramner*, 399 F.3d 754, 766 (6th Cir. 2005). However, these decisions ultimately fail as authority for the proposition that loss of distinctiveness is the correct standard to use when evaluating a naked licensing defense because controversy exists in each case as to whether the “licenses” were really licenses or mere consent agreements. See *Exxon*, 109 F.3d at 1076-77; *Tumblebus*, 399 F.3d at 765. This distinction is important because when a trademark owner enters into a consent agreement regarding the use of its mark, the trademark owner is not required to exercise quality control over the consentee because the nature of the agreement presumes no likelihood of confusion. See *Tumblebus*, 399 F.3d at 765 (quoting 2 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 2:3 (4th ed.

C. Courts Have Generally Required Licensors To Police Their Licensees In Order To Satisfy The Control Requirement

Courts have developed a general standard of licensee control and exceptions to this general rule. The general rule is that licensors have an affirmative duty to police their licensees.²¹ Courts have created an exception to this policing requirement through holding that licensors may rely on a licensee's control efforts if the licensing relationship is close and there is no evidence of deficient quality or consumer complaints.²² Also, some courts have arguably rejected this policing requirement through allowing the market regulate quality control efforts.²³

1. *Dawn Donut* – The General Rule

*Dawn Donut Co. v. Hart's Food Stores, Inc.*²⁴ is the seminal naked licensing case. In *Dawn Donut*, Plaintiff Dawn Donut sold donut mix to food stores and licensed these food stores to sell donuts under its name.²⁵ Hart's Food Stores sold donuts under Dawn's name without a license.²⁶ Dawn Donut sued Hart's Food Stores for trademark infringement, and Hart's Food Stores counterclaimed that Dawn Donut had abandoned its trademark through naked licensing.²⁷ Utilizing the abandonment and related company provisions of the Lanham Act,²⁸ the *Dawn Donut* court unanimously agreed that the Lanham Act binds a trademark licensor with an affirmative duty to "take reasonable measures to detect and prevent misleading uses of his mark by his licensees or suffer cancellation of his federal registration."²⁹ In holding that licensors have an affirmative duty to police their licensees, the *Dawn Donut* court assumed that consumers were necessarily deceived when a licensor failed to exercise such control:

If the licensor is not compelled to take some reasonable steps to prevent misuses of his trademark in the hands of others the public will be deprived of its most effective protection against

2004).

21. See discussion *infra* Part II.C.1.

22. See discussion *infra* Part II.C.2.

23. See discussion *infra* Part II.C.3.

24. 267 F.2d 358.

25. See *id.* at 361.

26. See *id.*

27. See *id.*

28. See *id.* at 366-67.

29. *Dawn Donut*, 267 F.2d at 366.

misleading uses of a trademark. The public is hardly in a position to uncover deceptive uses of a trademark before they occur and will be at best slow to detect them after they happen. Thus, unless the licensor exercises supervision and control over the operations of its licensees the risk that the public will be unwittingly deceived will be increased and this is precisely what the Act is in part designed to prevent.³⁰

The court elaborated on its requirement:

Clearly the only effective way to protect the public where a trademark is used by licensees is to place on the licensor the affirmative duty of policing in a reasonable manner the activities of his licensees. The critical question . . . is whether the plaintiff sufficiently policed and inspected its licensees' operations to guarantee the quality of the products they sold under its trademarks to the public.³¹

While the majority found that Dawn Donut had achieved this standard, Circuit Judge Lumbard dissented from the dismissal of Hart's counterclaim:

I do not believe that we can fairly determine on this record whether plaintiff subjected its licensees to periodic and thorough inspections by trained personnel or whether its policing consisted only of chance, cursory examinations of licensees' operations by technically untrained salesmen. The latter system of inspection hardly constitutes a sufficient program of supervision to satisfy the requirements of the Act.³²

Dawn Donut therefore stands for the proposition that licensors have an affirmative duty to police their licensees.

Judge Lumbard needed a policy basis for his court's holding because his statutory basis does not withstand close scrutiny. Even if one grants that the related company provisions have any relevance to abandonment through naked licensing,³³ nothing in those provisions require licensee policing.³⁴ The operative provision *presumes* that use of

30. *Id.* at 367 (citing S. REP. NO. 1333, 79th Cong., 2d Sess. (1946)).

31. *Id.* at 367.

32. *Id.* at 369. Note that this is not designated as a dissenting opinion. Chief Judge Lumbard also wrote the majority opinion.

33. The related company provisions apply to both registered and "sought to be registered" marks. 15 U.S.C. § 1055.

34. Though other commentators have agreed with this position in passing, none have justified their positions through this textual analysis. See Keating, *supra* note 6, at 378; Kevin Parks, "Naked" Is Not A Four-Letter Word: Debunking The Myth Of The "Quality Control Requirement" In Trademark Licensing, 82 TRADEMARK REP. 531, 531 (1992); William R. Woodward, *Some Observations on Legitimate Control of the Nature and Quality of the Goods*,

a trademark by a related company does not affect its validity, on the condition that the trademark is not used to deceive the public.³⁵ The only mention of control is in the definition section, within the definition of "related company."³⁶ However, the *Dawn Donut* court treated control as the *raison d'être* of the Lanham Act and consumer deception as something that is assumed if control is absent.³⁷ Even if one believes that control formalities are more important than consumer deception, control does not necessarily mean licensee policing. In fact, licensee policing *alone* does not equal control. If a licensor has sampled and inspected its licensee's substandard merchandise but has not terminated its licensee for this breach of contract, the licensor does not control the licensee.

2. The Largely Insignificant Close Relationship Exception

*Land O'Lakes Creameries, Inc. v. Oconomowoc Canning Co.*³⁸ was the case that first elucidated the close relationship exception to *Dawn Donut's* policing requirement. In *Land O'Lakes Creameries*, Land O'Lakes Creameries petitioned for the cancellation of Oconomowoc Canning's mark, alleging that Oconomowoc Canning engaged in naked licensing.³⁹ While it agreed that a licensor has an affirmative duty to police its licensees,⁴⁰ the court found that Oconomowoc Canning had justifiably relied upon its licensee for quality control because it found no evidence of deficient quality or consumer complaints during the forty-year licensing relationship.⁴¹ Therefore, *Dawn Donut's* policing requirement does not apply if a court finds a close licensing relationship and no evidence of consumer deception. The Fifth Circuit Court of Appeals captured the essence of this exception in *Taco Cabana International, Inc. v. Two Pesos, Inc.* when it stated:

The purpose of the quality-control requirement is to prevent the public deception that would ensue from variant quality standards under the same mark or dress. Where the particular circumstances of the licensing arrangement persuade us that the public will not be deceived, we need not elevate form over

49 TRADEMARK REP. 609, 609-10 (1959).

35. See 15 U.S.C. § 1055 and *supra* text accompanying note 16.

36. See 15 U.S.C. § 1127 and *supra* text accompanying note 17.

37. See *Dawn Donut*, 267 F.2d at 367.

38. 221 F. Supp. 576.

39. See *id.* at 579.

40. See *id.* at 581.

41. See *id.*

substance and require the same policing rigor appropriate to more formal licensing and franchising transactions. Where the license parties have engaged in a close working relationship, and may justifiably rely on each parties' [sic] intimacy with standards and procedures to ensure consistent quality, and no actual decline in quality standards is demonstrated, we would depart from the purpose of the law to find an abandonment simply for want of all the inspection and control formalities.⁴²

The close relationship exception's focus on consumer deception shows more fidelity to the text than the policing requirement;⁴³ furthermore, a focus on consumer deception furthers the purposes of the Lanham Act more than a focus on policing formalities.

However, the close relationship exception is limited to close licensing relationships, and courts have struggled to answer the question of how close a relationship must be to fit within this exception. *Taco Cabana's* facts do not provide a meaningful guideline because the case involved a cross-license between brothers.⁴⁴ The court in *First Interstate Bancorp v. Stenquist*⁴⁵ set limits to this exception through refusing to apply it in a case where the licensor of a trademark for real estate services had known the licensee socially for at least six years and had conducted business with him at least ten times.⁴⁶ In contrast, the court in *Transgo, Inc. v. Ajac Transmission Parts Corp.*⁴⁷ applied this exception to a licensing relationship in which the parties had worked together for ten years and the licensee manufactured the licensed product from components that were almost exclusively supplied by the licensor.⁴⁸ The disparity between the *Stenquist* and *Transgo* holdings may indicate a reluctance to apply the close relationship exception when services are involved.⁴⁹

Therefore, it is highly questionable whether this exception has any utility within the context of modern licensing relationships. While these modern licensing relationships will be discussed in detail later, it suffices

42. *Taco Cabana*, 932 F.2d at 1121.

43. *See Dawn Donut*, 267 F.2d at 367, 369 and text accompanying notes 32-33

44. *See Taco Cabana*, 932 F.2d at 1121-22.

45. 16 U.S.P.Q. (BNA) 1704 (N.D. Cal. 1990).

46. *See id.* at 1706.

47. *Transgo, Inc. v. Ajac Transmission Parts Corp.*, 768 F.2d 1001 (9th Cir. 1985).

48. *See id.* at 1017-18.

49. The *Stenquist* court distinguished *Land O'Lakes Creameries* because Oconomowoc Canning's name appeared on the licensee's product label. *See Stenquist*, 16 U.S.P.Q. (BNA) at 1707. Given this reasoning, the court failed to clarify how any service provider could be exempted from the *Dawn Donut* rule.

to note at this point that these licensing relationships are rarely exclusive. Franchisors franchise their marks to thousands of franchisees;⁵⁰ promotional trademark licensors license their marks to hundreds of licensees.⁵¹ However, *Land O'Lakes Creameries* and its progeny contemplate licensing relationships where the licensor and licensee are each other's most important business contacts; this would clearly not include these national licensing relationships. Interestingly, those in close licensing relationships can easily exercise the policing required by *Dawn Donut*; parties to such relationships often work in the same metropolitan area. Therefore, the close relationship exception grants protection to those licensing relationships that do not need it and denies protection to those that do.

3. The Mythical Free Market Exception

Finally, some courts have arguably rejected the *Dawn Donut* test through allowing the market to determine the sufficiency of quality control. One such case was *Kentucky Fried Chicken Corp. v. Diversified Packaging Corp.*⁵² In *Kentucky Fried Chicken*, Diversified Packaging sold substandard packaging with Kentucky Fried Chicken's (KFC's) trademark on it to KFC franchisees without KFC's consent.⁵³ In response to KFC's trademark infringement claim, Diversified asserted a naked licensing defense.⁵⁴ The Fifth Circuit Court of Appeals rejected Diversified's defense and concluded that:

[r]etention of a trademark requires only minimal quality control, for in this context we do not sit to assess the quality of products sold on the open market. We must determine whether [KFC] has abandoned quality control; the consuming public must be the judge of whether the quality control efforts have been ineffectual.⁵⁵

The court in *Hurricane Fence Co. v. A-1 Hurricane Fence Co.*⁵⁶ arguably took a *laissez-faire* view towards trademark licensing as well.

50. Of McDonald's Corporation's approximately 30,000 stores, 70 % are franchised. See Hoover's Online, *McDonald's Corporation – Fact Sheet*, at <http://premium.hoovers.com/subscribe/co/factsheet.xhtml?ID=10974> (last visited Jan. 20, 2005).

51. The University of Wisconsin licenses its trademarks to around 450 companies. See University of Wisconsin-Madison, *Office of Trademark Licensing* at <http://www.wisc.edu/licensing/intro.html> (last visited Jan. 20, 2005).

52. 549 F.2d 368.

53. See *id.* at 372.

54. See *id.* at 387.

55. *Id.*

56. 468 F. Supp. 975 (S.D. Ala. 1979).

In *Hurricane Fence*, Hurricane acquiesced in A-1's trademark use for eight years after the licensing contract expired,⁵⁷ even acquiescing to A-1's trademark use on non-HURRICANE fences.⁵⁸ Nevertheless, the *Hurricane Fence* court rejected A-1's naked licensing defense and held it liable for trademark infringement:

The plaintiffs have numerous licensed dealers throughout the country and to impose upon the mark owner the duty of monitoring every sale of every dealer to regulate its use of the mark would be *unconscionable*. . . . The fencing business is unique and only minimal quality controls ought to be required.⁵⁹

However, it is debatable whether *Kentucky Fried Chicken* and *Hurricane Fence* represent an explicit rejection of *Dawn Donut*.⁶⁰ Each case uses language, which recognizes that trademark licensors have an affirmative duty to police their licensees.⁶¹ If anything, these courts are more honest, or less tactful, in admitting that they do not like to apply the naked licensing doctrine.⁶² As one commentator remarked even before the *Kentucky Fried Chicken* and *Hurricane Fence* decisions:

57. *See id.* at 979.

58. *See id.* at 989.

59. *Id.* (emphasis added).

60. *See* Lisa H. Johnston, *Drifting Towards Trademark Rights In Gross*, 85 TRADEMARK REP. 19, 28 (1995) ("Although reciting the rule that licensors have a duty to oversee the quality of the licensee's product, the Fifth Circuit in *Kentucky Fried Chicken Corp. v. Diversified Packaging Corp.* broke with the well-accepted principal [sic] that the franchisor must undertake reasonable measures to establish quality control standards . . ."). In my view, the *Kentucky Fried Chicken* opinion merely stands for the proposition that courts should evaluate control but not quality. Though I take issue with the notion that courts should evaluate control when evaluating a naked licensing defense, I also believe that it is unreasonable to expect courts to evaluate the quality of packaging.

61. *See Kentucky Fried Chicken Corp.*, 549 F.2d at 387; *Hurricane Fence*, 468 F. Supp. at 988 (quoting *Sheila's Shine Prods., Inc. v. Sheila Shine, Inc.*, 486 F.2d 114, 123-24 (5th Cir. 1973)).

62. *See Kentucky Fried Chicken Corp.*, 549 F.2d at 387 n.23 ("That Container's deviousness succeeded for a time does not preclude *Kentucky Fried* from taking steps to protect its rights, now that its quality control program has located the culprit."); *Hurricane Fence*, 468 F. Supp. at 989:

However, this Court sits as a court of equity in determining trademark infringement questions, and the equities on this point clearly weigh in favor of the plaintiffs. . . . In this case the evidence is clear that the defendants intentionally expropriated the plaintiffs' mark with the intent of capitalizing on the mark for their own benefit, and they never communicated to the plaintiffs that they were or that they intended to be other than licensees of the plaintiffs.

“[j]udicial reluctance to consider the question of substantial actual control is a distinctive feature of cases decided since the Lanham Act.”⁶³

III. JUDICIAL RELUCTANCE AND INCONSISTENCY PERMEATES THE NAKED LICENSING DOCTRINE

Some commentators believe that the rule first stated in *Dawn Donut* has become illusory.⁶⁴ The policing requirement has always been illusory; the *Dawn Donut* court set the standard for judicial leniency in evaluating licensee policing.⁶⁵ Specifically, *Dawn Donut* allowed some licensees to sell donuts under its mark after their contracts expired, even donuts made with another company’s mix.⁶⁶ Nevertheless, only one judge out of three thought that Hart Food Store’s counterclaim should even survive dismissal.⁶⁷ This leniency would reach new heights two decades later in the *Hurricane Fence* case,⁶⁸ and it is therefore worth pondering why the *Dawn Donut* dog does not hunt. Some have suggested that courts recognize the expanding concept of goodwill inherent in trademarks; I believe that it is more likely that courts are pragmatic enough to realize that use of the naked licensing doctrine rewards infringers and hurts consumers. In addition to their reluctance to use the naked licensing doctrine, another curiosity involves courts’ inconsistent treatment of loss of rights through naked licensing and loss of rights through genericide. Specifically, trademark owners do not lose their rights through genericide unless the trademark has lost its significance. Since genericide and naked licensing both involve loss of trademark rights through a trademark owner’s act of omission, one must question why trademark owners are uniquely required to police their trademark use.

A. Why Courts Do Not Like To Apply The Naked Licensing Doctrine

Federal courts often refuse to use the naked licensing doctrine; an attitude that is a reversal of the judicial suspicion of trademark licensing that dominated the early part of the twentieth century.⁶⁹ Specifically,

63. *Trademark Licensing*, *supra* note 19, at 841.

64. See Alfred M. Marks, *Trademark Licensing – Towards A More Flexible Standard*, 78 TRADEMARK REP. 641, 645 (1988).

65. See Parks, *supra* note 34, at 543 (opining that *Dawn Donut* “set a high water mark for leniency . . .”).

66. See *Dawn Donut*, 267 F.2d at 369 n.6.

67. See *Dawn Donut*, 267 F.2d at 366 and *supra* text accompanying note 32.

68. See 468 F. Supp. 975 at 979, 989 and *supra* text accompanying notes 60-61.

69. See, e.g., *Everett O. Fisk & Co., Inc. v. Fisk Teachers Agency, Inc.*, 3 F.2d 7 (8th Cir.

before the Lanham Act, most courts viewed trademark licensing as a “philosophical impossibility.”⁷⁰ Courts held this view because they believed that trademarks solely communicated a product’s physical source;⁷¹ they treated a license as a trademark assignment without goodwill.⁷² However, trademark law eventually recognized an expanded concept of goodwill, thus creating the atmosphere for trademark licensing. One commentator describes goodwill in the following manner:

[Goodwill] exists in the minds of the buying public, where buyers trust the constancy of quality emanating from a particular producer. “Goodwill” thus becomes “a business value that reflects the basic human propensity to continue doing business with a seller whose goods and services . . . the customer likes and has found adequate to fulfill his needs.”⁷³

Franz Schechter introduced this expanded concept of goodwill to trademark law in his Harvard Law Review Article, *The Rational Basis of Trademark Protection*: “today the trademark is not merely the symbol of goodwill but often the most effective agent for the creation of good will, imprinting upon the public mind an anonymous and impersonal guaranty of satisfaction, creating a desire for further satisfactions.”⁷⁴ Since the idea that trademark owners cannot assign their marks without the underlying goodwill influenced the naked licensing doctrine, one may assume that courts are influenced by the expanding concept of goodwill when evaluating a naked licensing allegation. At least one commentator advances this view,⁷⁵ though he also argues that trademark

1924); *MacMahan Pharmacal Co. v. Denver Chem. Mfg. Co.*, 113 F. 468 (8th Cir. 1901).

70. Johnston, *supra* note 60, at 23-24.

71. See *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 313 (1988) (Brennan, J., dissenting) (citing *MacMahan Pharm. Co.*, 113 F. at 475); Bannon, *supra* note 5, at 67-68.

72. See *Dawn Donut*, 267 F.2d at 366-67. Prior to the passage of the Lanham Act many courts took the position that the licensing of a trademark separately from the business in connection with which it had been used worked an abandonment. The theory of these cases was that:

“A trade-mark is intended to identify the goods of the owner and to safeguard his good will. The designation if employed by a person other than the one whose business it serves to identify would be misleading. Consequently, a right to the use of a trade-mark or a trade-name cannot be transferred in gross.”

Id. (quoting *Am. Broad. Co. v. Wahl Co.*, 121 F.2d 412, 413 (1941)).

73. Bannon, *supra* note 5, at 73-74 (quoting 1 MCCARTHY § 2.8(a)).

74. Franz I. Schechter, *The Rational Basis of Trademark Protection*, 40 HARV. L. REV. 813, 819 (1927), reprinted in 60 TRADEMARK REP. 334, 337-38 (1970).

75. See Parks, *supra* note 34, at 567-68.

law has misinterpreted Schechter's views from the beginning through taking his "guaranty" language literally.⁷⁶

Most likely, courts are reluctant to apply the naked licensing doctrine because they realize that it benefits infringers and creates confusion in the marketplace. First, as aforementioned, naked licensing is almost always alleged as a defense against trademark infringement.⁷⁷ Some courts do not hide their hostility towards assertion of this defense by an infringer with dirty hands.⁷⁸ Second, when a trademark infringer successfully asserts a naked licensing defense, the trademark owner is not enjoined from using its trademark. Instead, the trademark owner, the trademark infringer, and anyone else can use the trademark.⁷⁹ This hurts consumers through increasing their search costs; now they must deal with infinite deceptive users of a trademark instead of one.⁸⁰ Finally, in addition to these often unspoken barriers to the successful assertion of a naked licensing defense, courts have held that naked licensing works as a forfeiture and is subject to strict proof.⁸¹

76. *See id.* at 532.

77. *See* Stanfield v. Osborne Indus., Inc., 52 F.3d 867 (10th Cir. 1995); *Kentucky Fried Chicken*, 549 F.2d 368.

77. *See, e.g., Dawn Donut*, 267 F.2d 358. *See also Land O'Lakes Creameries*, 221 F. Supp. 576 (petition for trademark cancellation paired with unfair competition cause of action) and *supra* text accompanying note 9.

78. *See supra* note 62. *See also Parks, supra* note 34, at 541-44. *But see* James M. Treece, *Trademark Licensing and Vertical Restraints in Franchising Arrangements*, 116 U. PA. L. REV. 435, 459-64 (1968) (arguing that the unclean hands rationale conflicts with the public interest and advocating partial forfeiture to mitigate the harshness of the remedy).

79. *See Parks, supra* note 34, at 543 (citing Hanak); Elmer William Hanak, III, *The Quality Assurance Function of Trademarks*, 43 FORDHAM L. REV. 363, 367 (1974-75) (*reprinted in* 65 TRADEMARK REP. 318 (1975)).

80. *But see* Noah D. Genel, *Keep It Real: A Call For A Broader Quality Control Requirement In Trademark Law*, 8 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 269, 291 (1997); Johnston, *supra* note 60, at 26-27 (both arguing that naked licensing increases search costs). This is only true if consumers are actually deceived by a trademark owner's failure to control its licensees; furthermore, denial of trademark protection increases search costs more than naked licensing ever could. If some KRISPY KREME franchisees in Milwaukee use non-approved donut mix, such use may be motivated by temporary cost or supply concerns. Furthermore, assuming that Krispy Kreme Doughnuts, Inc. has the contractual right to inspect these licensees, these franchisees risk losing their license because of this practice. Therefore, one would expect temporary use of non-approved donut mix by KRISPY KREME franchisees. In contrast, if the KRISPY KREME trademark enters the public domain, one would expect stores to permanently sell KRISPY KREME donuts made with non-approved mix.

81. *See* Am. Foods, Inc. v. Golden Flake, Inc., 312 F.2d 619, 624-25 (5th Cir. 1963); *Edwin K. Williams & Co., Inc. v. Edwin K. Williams & Co.-East*, 542 F.2d 1053, 1059 (9th Cir. 1976).

Therefore, one might argue that courts only pay lip service to the policing requirement and that they actually require consumer deception or loss of distinctiveness before finding that a trademark owner has nakedly licensed. However, trademark licensors should not take this judicial leniency for granted,⁸² especially if they plan on filing trademark infringement actions in California. Recently, the Ninth Circuit Court of Appeals affirmed the District Court for the Eastern District of California's judgment of abandonment through naked licensing for the "Leonardo Da Vinci" mark for wine.⁸³ The *Barcamerica International USA Trust v. Tyfield Importers, Inc.*, court failed to consider whether consumers were deceived by the licensing relationship, and called the licensor's failure to exercise control over its licensee "*inherently deceptive*."⁸⁴ Therefore, at least in California, the policing requirement is here to stay. Granting that caveat, the fact remains that naked licensing defenses are largely unsuccessful.

B. The Policing Requirement Is Inconsistent With the Standards Courts Use to Evaluate Genericide

Courts that hold trademark licensors to a higher standard than the loss of significance standard found in the Lanham Act's abandonment provisions advance a position which conflicts with the standard for genericide. Like naked licensing, genericide is a way for a trademark owner to lose trademark rights based on its acts of omission. Since 1984, the Lanham Act has required courts to use the primary significance standard for determining whether a trademark has become generic.⁸⁵ Congress derived this test from Judge Learned Hand's test in *Bayer v. United Drug Co.*:⁸⁶ "What do the buyers understand by the word for whose use the parties are contending?"⁸⁷ A trademark fails the primary significance test if its principal significance to the relevant public is as an "indication of the nature or class of an article, rather than an indication of its origin."⁸⁸ For example, a district court from the same circuit that

82. See Marks, *supra* note 64, at 650.

83. See *Barcamerica Int'l USA Trust v. Tyfield Importers, Inc.*, 289 F.3d 589 (9th Cir. 2002).

84. *Id.* at 597-98 (emphasis in original). See also *Halo Mgmt., LLC v. Interland, Inc.*, 308 F. Supp. 2d 1019, 1028-31 (N.D. Cal. 2003).

85. 15 U.S.C. § 1064(3).

86. *Bayer v. United Drug Co.*, 272 F. 505 (S.D.N.Y. 1921).

87. *A.J. Canfield Co. v. Honickman*, 808 F.2d 291, 301 (3d Cir. 1986) (quoting *Bayer v. United Drug Co.*, 272 F. at 509).

88. *Genesee Brewing Co. v. Stroh Brewing Co.*, 124 F.3d 137, 144 (2d Cir. 1997)

created the policing requirement recently held that the primary significance of the PILATES mark is as a method of exercise; therefore, the PILATES mark had become generic as applied to the method of exercise and, consequently, as applied to collateral products and services bearing that mark.⁸⁹ Heightening the irony, the *Pilates, Inc. v. Current Concepts, Inc.* court cited a Second Circuit case for the proposition that a trademark owner's policing efforts are irrelevant to a determination of genericness when "the mark has 'entered the public domain beyond recall'"⁹⁰ Perhaps courts do not want to use the same standards to evaluate naked licensing defenses as they use to evaluate genericness defenses because of the work involved; in contrast to the short shrift they give naked licensing defenses, courts evaluate genericide defenses through fact-intensive, multi-factor tests.⁹¹

However, Congress arguably intended different standards for naked licensing and genericide. Specifically, the *Dawn Donut* court cited evidence that the New Deal-era Congress was not ready to give licensing the green light.⁹² Granted, if Congress wanted to require controlled licensing, it could have been more specific. Nevertheless, the rest of this Comment will proceed on the assumption that the *Dawn Donut* court interpreted the Lanham Act's text and Congress's intent correctly. Then, one must ask whether the dichotomy between loss of trademark rights through genericide and loss of rights through naked licensing is still justified. In other words, have changes in consumer behavior and licensing relationships during the past sixty years diminished the need for a policing requirement?

(quoting *King-Seeley Thermos Co. v. Aladdin Indus., Inc.*, 321 F.2d 577, 580 (2d Cir. 1963)).

89. See *Pilates, Inc. v. Current Concepts, Inc.*, 120 F. Supp. 2d 286, 304 (S.D.N.Y. 2000).

90. *Id.* at 300 (citing *Murphy Door Bed Co., Inc. v. Interior Sleep Sys., Inc.* 874 F.2d 95, 101 (2d Cir. 1989)).

91. See *Pilates*, 120 F. Supp. 2d at 297: "Types of evidence to be considered in determining whether a mark is generic include: (1) dictionary definitions; (2) generic use of the term by competitors and other persons in the trade; (3) plaintiff's own generic use; (4) generic use in the media; and (5) consumer surveys." Professor Treece calls consumer-focused analyses "difficult and administratively undesirable" for courts. See Treece, *supra* note 78, at 452-53. For a cogent examination of judicial motivations, see RICHARD A. POSNER, *OVERCOMING LAW* 109-44 (1995).

92. See *Dawn Donut*, 267 F.2d at 367 (citing S. REP. NO. 1333, 79th Cong., 2d Sess. (1946)) and *supra* text accompanying note 27. See also Harry L. Shniderman, *Trademark Licensing—A Saga of Fantasy and Fact*, 14 L. & CONTEMP. PROB. 248, 250-51 (1949).

IV. CHANGES IN TRADEMARK LICENSING AND CONSUMER BEHAVIOR HAVE DIMINISHED THE NEED FOR THE POLICING REQUIREMENT

As aforementioned, trademark law recognizes that trademarks communicate more than a product's or service's physical source. The Lanham Act, through permitting trademark use by licensees to inure to a trademark owner's benefit, recognizes that trademarks may also communicate a consistent source of quality.⁹³ Schechter also recognized the persuasive value of trademarks; that a trademark may create goodwill independent of the product or service it symbolizes.⁹⁴ Modern licensing arrangements utilize trademarks to symbolize both consistent quality and brand image; franchising utilizes trademarks to communicate a consistent level of quality, while merchandising utilizes trademarks to communicate brand image. These modern licensing arrangements illustrate why the old dichotomy between loss of rights through naked licensing and loss of rights through genericide no longer makes sense. First, with regard to merchandising, the policing requirement is of little value to consumers. Second, with regard to franchising, the policing requirement is impractical. Finally, modern trademark licensing reduces the market failures that arguably justify the dichotomy between naked licensing and genericide.

A. When Consumers Buy for Reasons Not Related to Quality or Price, the Policing Requirement Has Little Value

Merchandising includes what other commentators have called "promotional trademark licensing,"⁹⁵ "character licensing,"⁹⁶ and "collateral product licensing."⁹⁷ Consumers purchase licensed merchandise, not because they believe that the trademark symbolizes quality, but because they wish to express "loyalty, admiration, or sympathy with the organization represented by the trademark."⁹⁸ For instance, one buys a Green Bay Packer jersey to identify himself as a Packer fan. If he buys the more expensive authentic jersey, it is likely because of the enhanced image that such a jersey conveys, not because

93. See *Taco Cabana*, 932 F.2d at 1121 (quoting 1 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 3:4 (2d ed. 1984)) ("[T]he 'quality theory. . .' broadens the older source theory 'to include not only manufacturing source but also the source of the standards of quality of goods bearing the mark' or dress.").

94. See Schechter, *supra* note 69, at 337-38.

95. Keating, *supra* note 6, at 363.

96. Marks, *supra* note 64, at 646.

97. *Id.*

98. Keating, *supra* note 6, at 372.

he perceives that the authentic jersey is of higher quality.⁹⁹ Such consumers would be unwilling to pay extra to support the quality control expenditures necessary to satisfy the policing requirement.¹⁰⁰ Furthermore, if courts enforce the policing requirement in this context, they will be forced to decide whose quality standard should serve as the benchmark, and the answer is not readily apparent. The quality of a Packers jersey cannot be measured against standards established by the trademark owner because the trademark owner's product is entertainment.¹⁰¹ Therefore, a court would have to use the licensee's quality as a benchmark, and this poses a problem when a trademark owner has hundreds or thousands of licensees.¹⁰²

B. The Policing Requirement Is Impractical When Applied to Franchising

As aforementioned, trademark licensors commonly franchise their marks to thousands of franchisees.¹⁰³ *Dawn Donut* places an affirmative duty upon licensors to police and inspect their licensees' operations.¹⁰⁴ In fact, Judge Lumbard was not satisfied with inspections from "technically untrained salesmen";¹⁰⁵ apparently, a franchisor must hire quality control experts to visit every franchise in order to satisfy this standard. Other courts have justifiably called such a requirement

99. A Packer replica jersey is \$79.99, while an authentic jersey is \$199.99, even though both are made by REEBOK. See <http://www.nflshop.com>.

100. See Keating, *supra* note 6, at 378-79; Parks, *supra* note 34, at 559. Of course, this ignores the fact that image-conscious consumers are normally not price-conscious. Nevertheless, the point is that image-conscious consumers see no value from quality control because they place greater importance on image. If consumers would not pay extra for quality control, why should the law force them to? One could argue that merchandising licensors do not actually police their licensees; therefore, image-conscious consumers are not hurt by the policing requirement. I do not dispute that few merchandising licensors actually police their licensees; however, the mere presence of the policing requirement doubtlessly convinces some to do so. Furthermore, this market reality would change if a court applied the policing requirement to deny protection to a merchandising licensor, and no court has held that the policing requirement would not apply.

101. See Parks, *supra* note 34, at 539.

102. After all, the goal of the policing requirement is to ensure consistent quality. See *Barcamerica*, 289 F.3d at 598 (quoting 2 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 18:55 (4th ed. 2001)). Furthermore, if licensees are allowed to set standards, they may engage in a race to the bottom. See 1 MCCARTHY, *supra* note 7, § 18:57.

103. See *Stenquist*, 16 U.S.P.Q. (BNA) 1705 and *supra* text accompanying note 45.

104. See *Dawn Donut*, 267 F.2d at 367.

105. *Id.* at 369.

“unconscionable.”¹⁰⁶ Arguably, such extensive policing should be required if consumers demand it,¹⁰⁷ but consumers have not demanded such policing; otherwise, they would prefer locally owned and operated businesses where the owner clearly controls the quality of the services offered, and franchising would be limited to serving travelers. Through patronizing franchise systems, consumers communicate to the market that familiarity and convenience are more important to them than quality.¹⁰⁸ If image-conscious consumers should not be forced to pay more than what they are willing for quality control,¹⁰⁹ then neither should franchise consumers, especially given that these consumers are more price-conscious than consumers who buy for image. Beyond the fact that the policing requirement increases the costs of goods and services sold by franchisees, the policing requirement also hurts consumers through potentially discouraging some companies from franchising altogether. This “consumer protection” is unnecessary because many consumers are pragmatic enough to realize that any franchise system has some bad apples; they punish those individual franchisees through not patronizing them.¹¹⁰ In sum, the consumer and his pocketbook are in a better position to police franchisees than the franchisor.¹¹¹

106. See *Hurricane Fence*, 468 F. Supp. 975 and *supra* text accompanying note 59.

107. Then again, laws should not be based on consumer demands. Many consumers would like to pay \$5 for a filet mignon, but that does not mean that the government should mandate the same. Such a distinction apparently eludes some commentators. See Genel, *supra* note 80, at 274:

Goodwill provides consumers with the ability to easily relocate and repurchase a certain product based on its brand name. Requiring brand owners to maintain consistent product quality strengthens goodwill and builds consumer trust in the entire trademark system. Consequently, the quality control requirement allows consumers to rely on trademarks as indicators of exactly what they are about to purchase, instead of merely who produced it.

Id.

108. Familiarity is not limited to product offerings; it includes the complete experience. See *Susser v. Carvel Corp.*, 206 F. Supp. 636, 640 (S.D.N.Y. 1962), *aff'd*, 332 F.2d 505 (2d Cir. 1964) (franchise manual regulated, among other things, restaurant décor and employee uniforms).

109. See *supra* note 100 and accompanying text.

110. Pre-Lanham Act courts permitted licensing based on similar assumptions about increasing consumer sophistication. See *Johnston*, *supra* note 60, at 23-24; *Parks*, *supra* note 34, at 533-34.

111. See LUDWIG VON MISES, *HUMAN ACTION* (Foundation for Econ. Educ., Inc., 4th rev. ed. 1996) (1949) <http://www.mises.org/humanaction/pdf/humanaction.pdf> (last visited Jan. 20, 2005):

The direction of all economic affairs is in the market society a task of the entrepreneurs. Theirs is the control of production. They are at the helm and steer

C. *Modern Licensing Reduces The Market Failures That Have Been Used To Justify The Policing Requirement*

Some courts and commentators believe that trademarks are self-enforcing;¹¹² that it is always in the trademark owner's best interests to control quality.¹¹³ In fact, many licensors take quality control measures beyond what the market demands.¹¹⁴ However, some courts and commentators believe that trademark licensing creates market failures. For example, the *Dawn Donut* court implied that deceptive licensors and licensees could profit during the period of market adjustment.¹¹⁵ Professor Treece argued that because licensees do not own the trademark's goodwill, they have no incentive to control quality,¹¹⁶ particularly when they are "financially-strapped."¹¹⁷ Finally, several commentators argue that licensors have an incentive to deceive consumers when their brand has no future.¹¹⁸

the ship. A superficial observer would believe that they are supreme. But they are not. They are bound to obey unconditionally the captain's orders. The captain is the consumer. Neither the entrepreneurs nor the farmers nor the capitalists determine what has to be produced. The consumers do that. If a businessman does not strictly obey the orders of the public as they are conveyed to him by the structure of market prices, he suffers losses, he goes bankrupt, and is thus removed from his eminent position at the helm. Other men who did better in satisfying the demand of the consumers replace him.

Id. at 269-70.

112. See Parks, *supra* note 34, at 537, 559. "[T]here is a certain minimum quality level below which the trademark owner 'cannot profitably go.'" *Id.* (quoting 1 JEROME GILSON, TRADEMARK PROTECTION AND PRACTICE § 6.01[4] (1991)). See William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & ECON. 265, 270 (1987) (discussing the "self-enforcing feature" of trademarks); Treece, *supra* note 78, at 444 (discussing "the self-interest of enlightened businessmen").

113. See *Application of E.I. duPont de Nemours & Co.*, 476 F.2d 1357 (C.C.P.A. 1973): It can be safely taken as fundamental that reputable businessmen-users of valuable trademarks have no interest in causing public confusion. The genius of the free competitive system is the paralleling of the interest of the entrepreneur and the consuming public so far as possible. Altruism aside, it is in his *pecuniary* interest, indeed a matter of economic survival, that the businessman obtain and retain customers, the very purpose and function of a trademark, and that he avoid and preclude confusion. Millions of advertising dollars are spent daily for that precise purpose. The history of trademark litigation and the substantial body of law to which it relates demonstrate the businessman's alertness in seeking to enjoin confusion. In so doing he guards both his pocketbook and the public interest.

Id. at 1362-63 (emphasis in original).

114. See Bannon, *supra* note 5, at 82-83.

115. See *Dawn Donut*, 267 F.2d at 367.

116. Treece, *supra* note 78, at 447.

117. *Id.* at 453-54.

118. See Nicholas S. Economides, *The Economics of Trademarks*, 78 TRADEMARK REP.

Modern licensing systems mitigate these market failures. Licensors are unlikely to deceive consumers because of the size of their endeavors. Specifically, a trademark must accumulate a substantial quantum of goodwill before it may be merchandised or franchised. Accumulating such goodwill requires trademark owners to invest significantly in their marks. When it becomes possible to exploit a trademark's goodwill nationally, the trademark owner must ensure that its trademark satisfies consumers for many years, or it will not receive a sufficient return on its investment in goodwill.¹¹⁹ Therefore, the end-game strategy hypothesized by several commentators seems unlikely unless the trademark in question represents a fad instead of a stable brand; in fact, no evidence shows that this hypothesis has been replicated in real life, even with mature trademarks that have presumably recovered their investment in goodwill.¹²⁰

Granted, these commentators may be correct that individual licensees may profit by cheating the system. This is especially true with franchisees that serve transient guests; no Cleveland Holiday Inn franchisee cares if a businessman badmouths it to his colleagues when he gets back to Milwaukee. Furthermore, licensors have been neutered in their dealings with their licensees through the enactment of Fair Dealership Laws.¹²¹ These laws, though well-intentioned,¹²² increase the cost of terminating a bad licensee.¹²³ However, as aforementioned, these modern licensing systems have created an environment where many consumers are pragmatic enough not to punish a licensing system for a bad licensee.¹²⁴ Furthermore, franchisees must incur substantial sunk costs in order to secure a franchise with national goodwill;¹²⁵ such sunk

523, 529 (1988); Landes & Posner, *supra* note 112, at 286.

119. See Landes & Posner, *supra* note 112, at 270.

120. Moreover, no formulation of the naked licensing doctrine would solve this alleged market failure because the naked licensing doctrine relies on infringement claims, and no trademark owner engaging in this end-game strategy would bother litigating such a claim.

121. See Thomas M. Pitegoff, *Franchise Relationship Laws: A Minefield For Franchisors*, 45 *BUS. LAW.* 289 (1989). See e.g., *WIS. STAT. § 135.01 et. seq.* (2003-04).

122. See *WIS. STAT. § 135.025*.

123. See *WIS. STAT. § 135.03* (termination only for "good cause"), § 135.04 (franchisee gets ninety days notice of termination and sixty days to cure). For an example of the consumer confusion that may occur during such a law's cure period, see *The Original Great Am. Cookie Co. v. River Valley Cookies, Ltd.*, 773 F. Supp. 1123 (N.D. Ill. 1991), *rev'd*, 970 F.2d 273 (7th Cir. 1992) (terminated franchisee continued to operate with unauthorized cookie dough).

124. See *supra* note 106 and accompanying text.

125. See McDonald's Corporation, *Frequently Asked Questions about McDonald's Franchising*, at <http://www.mcdonalds.com/corp/franchise/faqs.html> (last visited Jan. 20, 2005).

costs deter franchisees from intentionally deceiving consumers because the deceptive franchise would fail to recover these sunk costs before going out of business. Finally, deceptive behavior by isolated licensees does not justify denying protection to a trademark owner, for this would increase search costs for all consumers.¹²⁶

Therefore, the policing requirement is out of touch with modern marketing realities. These days, trademarks convey not only quality, but also brand image, familiarity, and convenience. To the extent that trademarks still convey quality, the market failures that once arguably justified the policing requirement have all but disappeared. To the extent that these market failures remain, the policing requirement does not remedy them; furthermore, it increases prices of licensed goods and services, stifles competition in the same, and increases the cost of infringement suits. If the policing requirement is no longer justified, trademark law needs a new standard by which to evaluate whether a trademark owner has abandoned its trademark through naked licensing.

V. IN DETERMINING WHETHER TRADEMARK RIGHTS HAVE BEEN ABANDONED THROUGH NAKED LICENSING, COURTS SHOULD USE A BALANCING TEST THAT CONSIDERS CONSUMER DECEPTION DISTINCTIVENESS

If the policing requirement is unjustified, and I conclude that it is, a consumer deception standard may present a solution. After all, consumer deception is mentioned in the operative related company provision.¹²⁷ Naked licensing cases preceding *Dawn Donut* placed more importance on consumer deception than on control.¹²⁸ Even the *Dawn Donut* court admitted that the Lanham Act was intended in part to prevent consumer deception; it merely assumed that consumers were deceived when licensors did not police their licensees.¹²⁹ However, consumer deception is an imprecise standard; moreover, such a standard would be unrealistic if it is strictly interpreted. That being said, courts should not focus on loss of distinctiveness because naked licensing is

Note that the initial fee paid to McDonald's Corporation, though likely higher than fees charged by other franchisors, represents less than 10% of these sunk costs.

126. See *supra* note 80 and accompanying text.

127. See 15 U.S.C. § 1055 and *supra* text accompanying note 16. However, this phrase was added to the 1940 House bill by the Senate without discussion. Shniderman, *supra* note 92, at 251 (citing 86 CONG. REC. 8990 (1940)).

128. See *E.I. DuPont de Nemours & Co. v. Celanese Corp. of Am.*, 167 F.2d 484, 488 (C.C.P.A. 1948).

129. See *Dawn Donut*, 267 F.2d at 367 and *supra* text accompanying note 31.

more harmful to consumers than genericide. Instead, courts should use a balancing test that considers both consumer deception and distinctiveness.

A. Consumer Deception Is an Imprecise and Potentially Unrealistic Standard

The Lanham Act forbids licensed trademarks from being used “in such manner as to deceive the public.”¹³⁰ It is unclear how much consumer deception is necessary before a trademark owner abandons its trademark through naked licensing. At least one commentator, in addition to assuming that failure to control equals deception,¹³¹ apparently believes that any fluctuation in quality justifies abandonment.¹³² Such a rule would prevent trademark owners from changing the nature of their product in response to new consumer preferences.¹³³ Moreover, a deceived consumer’s remedy is not trademark abandonment through the Lanham Act.¹³⁴ Instead, the consumer may patronize other businesses in the future or seek redress in the courts through a contract, tort, or statutory cause of action.¹³⁵

130. See 15 U.S.C. § 1127 and *supra* text accompanying note 17.

131. See Genel, *supra* note 80, at 275 (“Failure to supervise the manufacturing process of a product causes its quality to fluctuate, thus consumers cannot rely on its trademark to indicate exactly what they are buying.”).

132. See Genel, *supra* note 80, at 299 (“A court’s finding of abandonment . . . is proper whenever any trademark owner allows the quality of its products to fluctuate.”).

133. See Parks, *supra* note 34, at 537.

134. See *id.* at 559-61.

135. I specify “contract, tort, or statutory cause of action” because consumers are commonly expected to waive all warranties when they purchase a product or service; a deceived consumer would need to plead a tort or statutory cause of action under these facts. The economic loss doctrine may prevent a consumer from suing in tort for the failure of a product or service to meet his expectations. However, some states do not apply the economic loss doctrine to service contracts. See, e.g., *Ins. Co. of N. Am. v. Cease Elec. Inc.*, 2004 WI 139, 276 Wis. 2d 361, 688 N.W.2d 462. Furthermore, Wisconsin consumers have a statutory cause of action if they suffered a pecuniary loss because another made a deceptive “advertisement, announcement, statement or representation” with the intent of selling a good or a service. WIS. STAT. § 100.18(1),(11)(b)2. The Wisconsin Court of Appeals has held that a cause of action under § 100.18 is not barred by the economic loss doctrine. See *Kailin v. Armstrong*, 2002 WI App 70, ¶¶ 37-43, 252 Wis. 2d 676, 643 N.W.2d 132. *But see* *MBI Acquisition Partners, L.P. v. Chronicle Publ’g Co.*, 301 F. Supp. 2d 873, 885-86 (W.D. Wis. 2002). Though no case has addressed this question, it seems clear that a trademark would fall within the class of communications regulated by this statute. See *Dorr v. Sacred Heart Hosp.*, 228 Wis. 2d 425, 445, 597 N.W.2d 462, 473 (Wis. Ct. App. 1999) (“Section 100.18 prohibits deceptive, misleading, or untrue statements of any kind to the public made in a commercial setting, no matter how made.”); *Tietsworth v. Harley-Davidson, Inc.* 2004 WI 32, ¶ 81, 270 Wis. 2d 146, 677 N.W.2d 233 (Abrahamson, C.J., dissenting) (“The language of [Section

Furthermore, even assuming that a licensee has deceived scores of consumers, this insular minority should not have the power to increase search costs for all consumers, and trademark abandonment causes increased search costs because it means that anyone can use the abandoned trademark.¹³⁶

B. A Loss of Distinctiveness Standard Would Obscure the Fact That Trademark Protection for Deceptive Trademarks Hurts Consumers More Than Trademark Protection for Generic Trademarks

Loss of distinctiveness arguably provides a workable standard; moreover, like the consumer deception standard, it has support in the Lanham Act.¹³⁷ However, naked licensing harms consumers and the trademark system more than genericide, and this dooms the loss of distinctiveness standard as the sole test for naked licensing. For example, continued protection of the generic PILATES mark would hurt consumers through stifling competition in Pilates-related goods and services. Arguably, consumers would receive lower quality goods and services at inflated prices. However, Pilates' efforts to secure monopoly rents would be limited by the ability of dissatisfied consumers to substitute other goods and services for those offered by Pilates.¹³⁸ In contrast, if licensees of Servicemaster subsidiary Merry Maids habitually steal valuables from their customers' homes,¹³⁹ consumers are severely injured by the continued protection of this trademark. Nationally recognized trademarks, such as MERRY MAIDS, communicate trust and reliability to consumers.¹⁴⁰ This is especially important with service marks because the quality of a service is unobservable until after the

100.18] is broad in scope, affecting numerous . . . means of communication.”). A licensee’s use of a trademark would be deceptive if it sold goods and services under the trademark that does not meet the quality standards established by the trademark, and a licensor’s use of its trademark would be deceptive if it allowed licensees to sell goods and services not meeting the trademark’s standards. Therefore, a consumer who has purchased a substandard good or service from a licensee could arguably sue both the licensee and the licensor under § 100.18(1).

136. See *supra* note 80 and *supra* accompanying text.

137. See 15 U.S.C. § 1127 and *supra* text accompanying note 14.

138. For example, JAZZERCISE, 24 HOUR FITNESS, or the YMCA could serve as substitutes for Pilates’ services; and products offered by PRECOR and CYBEX could serve as substitutes for Pilates’ goods.

139. See Hoover’s Online, *Merry Maids, L.P. – Fact Sheet* at http://www.hoovers.com/merry-maids/—ID__105979—/free-co-factsheet.xhtml (last visited Jan. 20, 2005). I do not imply that MERRY MAIDS franchisees steal from their customers; I only use MERRY MAIDS as an example.

140. See *Hurricane Fence*, 468 F. Supp. 975 and *supra* text accompanying notes 57-58.

time of purchase.¹⁴¹ Loss of distinctiveness may not result when a trademark owner's licensees use that trademark to misrepresent the quality of the underlying good or service; however, what one commentator calls "badwill" would result,¹⁴² and badwill damages consumers far more than loss of distinctiveness.¹⁴³ Though some courts and commentators exaggerate the market failures involved in licensing,¹⁴⁴ those market failures are still significant enough to justify a minor distinction between the standards courts use to evaluate loss of trademark rights through genericide and loss of trademark rights through naked licensing.

C. Courts Should Balance Consumer Deception and Distinctiveness in Determining Whether a Trademark Has Been Abandoned Through Naked Licensing

A goal of trademark law is to reduce consumer search costs.¹⁴⁵ Trademark protection is no longer justified when a trademark has become generic because generic trademarks stifle competition more than they reduce search costs.¹⁴⁶ Likewise, trademark protection is no longer justified when a trademark deceives consumers more than it reduces search costs. As aforementioned, isolated consumer deception does not justify a judicial holding of abandonment when the trademark in question still reduces search costs.¹⁴⁷ However, certain licensors may acquiesce in systematic deception by their licensees that is so damaging to the trademark system that the trademark's detriment as a source of deception exceeds its value as an information economizer. Therefore, when faced with a naked licensing defense, courts should balance the costs and benefits of continued trademark protection for the mark in

141. See Economides, *supra* note 112, at 526 (one purpose of a trademark is to help consumers identify the unobservable features of goods).

142. See Note, *Badwill*, 116 HARV. L. REV. 1845, 1845 (2003).

143. Though *Badwill* argues that trademark protection for badwill has some value, it never argues that trademarks that communicate badwill are exempt from abandonment. See *id.* at 1850. Cf. Parks, *supra* note 34, at 537 (Deceptive trademarks have value because they communicate that the trademark owner is "a source of quality control that cannot be trusted."). Instead, *Badwill* offers suggestions to prevent trademark owners from obtaining trademark protection for a new mark, thus shedding the badwill inherent in the old trademark. See *Badwill*, *supra* note 142, at 1851 (comparing this practice to reorganization under the bankruptcy laws), 1860-64 (proposing two solutions, both involving interference with future trademark registration).

144. See *supra* Part IV.C.

145. See *supra* note 7.

146. See *Door Sys., Inc. v. Pro-Line Door Sys., Inc.*, 83 F.3d 169, 171 (7th Cir. 1996).

147. See *supra* note 120 and accompanying text.

question. Granted, this test will arguably consume more judicial resources than the policing requirement because it will require courts to consider evidence of both distinctiveness and deception.¹⁴⁸ However, most courts that use the policing requirement only consider whether the licensor has exercised control. Presumably, actual consumer deception did not exist in those cases; otherwise, the defendant would have presented such evidence. Without evidence of actual consumer deception, courts using my test would summarily reject the naked licensing defense before proceeding to a fact-intensive inquiry. Therefore, this test would not only further the goals of trademark law more than the policing test; it would also better utilize judicial resources.

VI. CONCLUSION

Most courts evaluate naked licensing defenses in a way that does not further the purposes of trademark law. Specifically, a successful naked licensing defense increases search costs through allowing anyone to use a trademark, even when that trademark remains distinctive. Moreover, the mere presence of the naked licensing defense increases search costs through increasing the cost of infringement suits and through discouraging licensing itself. Granted, trademark law is also concerned with encouraging the production and delivery of quality goods and services. However, modern consumers often care less about quality than they care about intangible values, such as image, familiarity, and convenience. Furthermore, to the extent that consumers care about quality, modern licensing relationships, which rely on substantial upfront investments in goodwill, provide licensors with great incentive to control the quality of the goods and services emanating from their licensees, irrespective of any such requirement in the Lanham Act.

Of course, some market failures that have previously plagued trademark licensing remain. However, the policing requirement does not remedy those market failures. A new standard balancing distinctiveness with deception would remedy these market failures just as well. Though a standard focusing on consumer deception alone was arguably intended by Congress, courts should not allow isolated consumer deception to result in increased search costs for all consumers. Though a standard focusing on distinctiveness alone would achieve parity with the standard used to evaluate genericness, a court evaluating a naked licensing defense must also consider the market failures

148. See 15 U.S.C. § 1064(3).

inherent in licensing, as well as the impact of badwill on the trademark system. Therefore, a balancing test between deception and distinctiveness would best further the goals of trademark law.

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