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FRANCHISE MISUSE

Harold Brown and Jerry Cohen***

I. Introduction

Given the paucity of cases and statutory law governing franchising,¹ far too little attention has been focused on the law of industrial-intellectual property although the property values embraced under this hyphenated pleonasm are universally understood to lie at the heart² of the newly burgeoning franchise method of market distribution.³ The lack of attention can be attributed to the unwarranted compartmentalization of the law, and law practice, with industrial-intellectual property specialists often being as remote from general law practice as are the few and essentially defense-oriented antitrust counsel.⁴ In order to probe the nature of such property⁵ and its relationship with the abuses prevalent in franchising,⁶ it is first necessary to establish certain basic definitions regarding the "franchise" and the various classes of industrial-intellectual property merged into the franchise property rights.

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1 Although there has been a recent surge in franchise litigation, most of it has arisen under the federal antitrust laws (15 U.S.C. § 1 *et seq.* (1970)) and there has yet to develop a solid body of appellate decisions under federal or state laws. See H. BROWN, *FRANCHISING: REALITIES AND REMEDIES* (1973) [hereafter cited as *REALITIES*].

2 See *Kugler v. Aamco Automatic Transmissions, Inc.*, 337 F. Supp. 876, (D. Minn. 1971) *aff'd*, 460 F.2d 1214 (8th Cir. 1972) (the license of the trademark and the required advertising contribution are essentially a single product, obviating an antitrust "tying" violation). Numerous franchise systems are intimately involved with intellectual property such as that protected by patents, copyrights, or trade secrets, but such interests are subordinate to the trademark license which is the common denominator in all franchising. See Collison, *Trademark—The Cornerstone of a Franchise System*, 24 S.W.L.J. 247 (1970).

3 According to the U.S. Department of Commerce, in spite of the recession, there was a fifty per cent increase in sales through franchising in the three-year period from 1968 through 1971, reaching an annual level of over \$132 billion, or close to 13 per cent of the GNP and over 25 per cent of all retail sales.

4 Although there are no reliable figures as to the number of antitrust practitioners, of the Nation's 300,000 attorneys, but a handful engage in this area; most of them are concentrated in the Government or in major cities; and almost all of them represent major corporations in a consultative or defense posture. As for the trademark "bar," it is an imprecise segment of the highly specialized patent bar that handles patent and copyright matters, as well as trademarks, the full complement of which is but a few thousand.

5 Although the trademark can be strictly defined to include only the name or symbol identifying specific products or services offered to the public, in most franchising there are also involved a number of additional such identifications ranging from words in sentences or phrases, to physical signs and even including such devices as the shapes of buildings and various color combinations. Some franchisors and their attorneys have generically characterized these features as the "logo" of the franchisor. On the other hand, the trademark bar knows "logo" as a design which is used as a trademark device, usually as a principal or house mark for all of a firm's products alone or in addition to other trademarks.

6 See H. Brown, *Franchising: Fraud, Concealment and Full Disclosure*, 33 OHIO ST. L.J. 517 (1972) [hereafter referred to as *Fraud*]. See also *No Burned Fingers*, BARRON'S, Apr. 12, 1971, at 3, col. 1; *Franchises Shaken By Hard Times*, NATIONAL OBSERVER, July 8, 1971, at 8, col. 1; Wall Street Journal, Oct. 11, 1971, at 22, col. 1; Statement of Louis J. Lefkowitz, Atty. Gen. of New York, *Hearings, on the Impact of Franchising on Small Business Before the Subcomm. on Rural Economic Development of the Sen. Select Small Business Comm.*, 91st Cong. 2d Sess. 1970, and Lefkowitz, *Franchising Abuses—One State's Approach* 75 CASE AND COM., No. 4, at 13 (1970).

Among those terms one finds "misuse," a doctrine of patent law that enforcement of a patent is denied to a patentee who comes into court with unclean hands. It is submitted that a cross-discipline analysis will show that misuse is also applicable to other classes of industrial-intellectual property—trademarks, trade secrets, copyrights and franchises.

II. Definitions of Industrial-Intellectual Property Terms

The conventionally defined classes of industrial-intellectual property rights are patents, trademarks, copyrights and trade secrets. Another class of industrial property right is the franchise system, per se. Franchises almost always involve licenses of trademarks and often also involve licenses of patents, copyrights and trade secrets and something more—a feudal enfeoffment of the franchisee, the franchisee pledging service and commitment and the franchisor pledging aid and protection. This status relationship is often masked by the contract of adhesion drawn by the franchisor and the contract is often misleading in its statements of respective rights and responsibilities of the parties.

The legal attributes of a franchise are still in the formulative stage and subject to the vagaries of fifty state judicial systems, as well as those of the federal courts and regulatory agencies.⁷ Though there is no actual uniformity of definition in pending legislation and regulations,⁸ the following was adopted in the first two state statutes that provided for generic regulation of franchising, namely:

"Franchise" means a written arrangement for a definite or indefinite period, in which a person grants to another person a license to use a trade name, trademark, service mark, or related characteristics, and in which there is a community of interest in the marketing of goods or services at wholesale, retail, by lease, agreement, or otherwise.⁹

Such a definition has recently been accepted at common law in trial court judgments reached after a hearing on the merits, at which there was afforded a full opportunity to examine the numerous ramifications of franchising, as against the vigorous contention by the major oil companies that their dealers were merely sublessees.¹⁰ Indeed, those decisions are the first American cases to con-

⁷ See H. BROWN, REALITIES, *supra* note 1, at 520.

⁸ See Comment, *Franchise Regulation: An Appraisal of Recent State Legislation* 13 B.C. IND. & COM. L. REV. 529, 539 (1972); Note, *Franchise Regulation: Ohio Considers Legislation to Protect the Franchisee*, 33 OHIO ST. L.J. 643, 654 (1972).

⁹ N.J. REV. STAT. § 56:10-3 (Supp. 1972). WASH. REV. CODE ANN. § 19.100.010 (Supp. 1972). Compare CAL. CORP. CODE § 31005 (West Supp. 1971) excluding coverage unless a "franchise fee" is also required, such an illogical standard having been adopted as a matter of legislative expediency, under which any franchisor can avoid the impact of the statute by foregoing a "capital" charge at the inception and increasing the operating royalty fee commensurately. The definition adopted by Washington and New Jersey was originally proposed by the author in H. BROWN, FRANCHISING: TRAP FOR THE TRUSTING (1969) with new appendices in the 1971 printing including a proposed Franchise Fair Dealing Act at 160-77.

¹⁰ Shell Oil Co. v. Marinello, 1972 Trade Cas. ¶ 74,178 (N.J. Super. Ct. for Bergen County); Mobil Oil Corp. v. Rubinfeld, 5 TRADE REG. REP. (1973 Trade Cas.) ¶ 74,306 (N.Y. Civ. Ct. Dec. 27, 1972). Cf. Mariniello v. Shell Oil Co., 5 TRADE REG. REP. (1973 Trade Cas.) ¶ 74,320 (D. N.J. 1972).

sider and to rule favorably upon the assertions that franchising is a fiduciary relationship demanding the highest standard of conduct by the franchisor and that the franchisee acquires a vested property interest in his dealership, including its goodwill, that transcends the terms of any contract or lease.¹¹ Although there is not yet a universally accepted definition of franchising, such beginnings are far more acceptable than the simplistic standard devolving from the Lanham Act requirement that the licensed use of a trademark will entertain the risk of abandonment of the trademark unless its use is made subject to the quality control of the licensor.¹² Even so, the Lanham Act expressly provides that the control must be "legitimate" and that an antitrust violation is not condoned by trademark law and is specifically recognized as a defense to infringement actions.¹³

Trademarks and trade secrets have substantially different origins, purposes, statutory protection, and durability from their companions, the patent and the copyright. The patent and copyright federal grant(s) of monopoly to inventors and authors, respectively, are provided in a statutory system that is essentially a reward to encourage such creative effort and investment therein and which provides for exclusive right of exploitation during a specified time period.¹⁴

In the case of the trademark the property interest is essentially of common law equitable origin,¹⁵ partly as protection for the owner's investment in the

11 Although not binding in other states or even appellate decisions, those cases are the seminal judicial affirmation of such contentions by one of the authors in: *FRANCHISING: TRAP FOR THE TRUSTING*, cited note 9 *supra*; Brown, *Franchising: A Fiduciary Relationship* 49 *TEX. L. REV.* 650 (1971) [hereafter cited as *Fiduciary*]; Brown, *Franchising: Fraud, Concealment, and Full Disclosure*, 33 *OHIO ST. L. REV.* 517 (1972).

12 Lanham Act §§ 5, 14(e)(1), 45, 15 U.S.C. §§ 1055, 1064(e)(1), 1127 (1970). *Morse-Starrett Products Co. v. Steccone*, 86 F. Supp. 796 (N.D. Cal. 1949); *E.I. duPont de Nemours & Co. v. Celanese Corp.*, 167 F.2d 484 (C.G.P.A. 1948).

13 Lanham Act § 33(b)(7), 15 U.S.C. § 115(b)(7) (1970). See *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); *Phi Delta Theta Fraternity v. Buchroeder & Co.*, 251 F. Supp. 968 (W.D. Mo. 1966). See also *Developments in the Law—Trademarks and Unfair Competition*, 68 *HARV. L. REV.* 814, 816-819, 895-906 (1955); Note, *Quality Control and the Antitrust Laws in Trademark Licensing* 72 *YALE L.J.* 1171, 1181-1182 (1963).

14 Article 1, section 8 of the Constitution gives Congress the power to promote the progress of science and the useful arts by granting to authors and inventors for limited times the exclusive right to their respective writings and discoveries. The concept follows the lead of the British Statute of Monopolies, 21 James I, c. 3 (1624) and was one of the noncontroversial provisions of the Constitution, *THE FEDERALIST* No. 43 (J. Madison). The patent is conceptually a contract exchange of full disclosure by the inventor of a new, useful and unobvious discovery in return for the right to exclude for a limited time the practice by others of tangible embodiments of the discovery embraced within the negotiated scope of claims of the granted patent. The copyright contract varies from the patent model by limiting protection to the right to exclude subjective copying, and in a lower threshold of merit (read uniqueness or unobviousness) for the subject matter of the grant. See Lutz, *A Clarification of the Patent Clause of the United States Constitution*, *GEORGE WASH. L. REV.* (Dec. 1929), reprinted 34 *J. PAT. OFF. Soc'y* 766 (Oct. 1952).

Patentable subject matter may include a useful machine, article, composition or process, an ornamental design or a plant, but not an abstract idea or scientific principle or a method of doing business, 35 U.S.C. §§ 1-293 (1970); 7 U.S.C. §§ 2321-2583 (1970); *Gottschalk v. Benson*, 93 S. Ct. 253 (1972); *O'Reilly v. Morse*, 56 U.S. (15 How.) 61 (1853); *Telephone Cases*, 126 U.S. 1 (1887); *LeRoy v. Tatham*, 55 U.S. (14 How.) 155 (1852); *Rubber-Tip Pencil Co. v. Howard*, 20 Wall 498 (1874); *Miller v. Eagle Mfg. Co.*, 151 U.S. 186 (1894); *Knapp v. Morse*, 150 U.S. 221 (1893); *Funk Bros. Seed Co. v. Kalo Inoculant Co.*, 33 U.S. 127 (1948); *Morton v. New York Eye Infirmary*, 3 Blatch 116 (1862).

15 Any attempt . . . to identify the essential characteristics of a trademark with inventions . . . or with the writings of authors will show that the effort is surrounded

identification of his product or service, but equally in order to protect the public from any passing off of a different product or service from that related to the trademark of its owner.¹⁶ The network of federal and state statutes for the registration of trademarks is principally a system of statutory notice, with no federal preemption, with no absolute assurance of singular ownership, and with continued dependence on equitable concepts.¹⁷ On the other hand, the ultimate owner of the trademark is not subjected to any time limit on his ownership, so long as certain standards are maintained.¹⁸

Trade secrets, a state law based right to maintain confidential relationships in information, exist as a viable alternative to protection under the federal patent system of open disclosure.¹⁹

In general, a trademark belongs to its first user, for a separate category of product, in a particular geographic area. If the mark is distinctive, such owner-

with insurmountable difficulties. The ordinary trademark has no necessary relation to invention or discovery . . . The trademark may be, and generally is, the adoption of something already in existence as the distinctive symbol of the party using it. At common law the exclusive right to it grows out of its use and not its mere adoption. . . .

Trade-Mark Cases, 100 U.S. 82, 93-94 (1879), (holding Trademark Registration Act of 1870 unconstitutional). Later, federal legislation for registration of trademarks was upheld under the interstate commerce clause. It is not necessary to obtain a federal or state registration but ownership depends on use and without use the registration is a nullity. United Drug Co. v. Theodore Rectanus Co., 248 U.S. 90 (1918). The law of trademarks has its origins in the guild laws.

16 See *Developments in the Law*, cited note 13 *supra*.

17 The federal law is the Lanham Act of 1946, 15 U.S.C. §§ 1051-1127 (1970) and most states have adopted the provisions of the model bill drawn by the U.S. Trademark Association and patterned after the Lanham Act.

18 Registrations are granted for 20-year terms renewable for an indefinite number of 20-year terms but renewals are liable to be refused or a registration cancelled if the owner has actually abandoned the mark through nonuse or constructively abandoned it through an assignment in gross or a failure to control the quality of goods and services rendered by licenses. At common law a trademark license was an indication of source, *McMahan Pharmaceutical Co. v. Denver Chemical Mfg. Co.*, 113 F. 468 (8th Cir. 1901). The "better" view of trademarks as a quality guarantee, with specific source being irrelevant, articulated in Note, *Traffic in Trade Symbols*, 44 HARV. L. REV. 1210 (1931), *Turner v. HMH Publishing Co.*, 380 F.2d 224 (5th Cir. 1967); *Dawn Donut Co. v. Hart's Food Stores, Inc.*, 267 F.2d 358 (2d Cir. 1959), was written into the related company provision, section 5, of the Lanham Act:

Where a . . . mark sought to be registered is . . . used *legitimately* by related companies, such use shall inure to the benefit of the applicant for registration and such use shall not affect the validity of such mark, provided *such mark is not used in such a manner to deceive the public*. 15 U.S.C. § 1055 (1970) (emphasis added) and a related company is defined as:

any person who *legitimately* controls or is controlled by . . . the applicant for registration in respect to the nature or quality of goods or services in connection with which the mark is used. 15 U.S.C. § 1127 (1970) (emphasis added).

The adverb "legitimately" was added in the legislative evolution to assuage fears of abuse expressed by the Attorney General, Note, *Quality Control and the Anti-Trust Laws in Trademark Licensing*, 72 YALE L. J. 1171, 1202-3 (1963).

19 The word property as applied to trademarks and trade secrets is an unanalyzed expression of certain secondary consequences of the primary fact that the law makes some rudimentary requirements of good faith. . . . The property may be denied but the confidence cannot be.

Dupont Powder Co. v. Masland, 244 U.S. 100, 102 (1917). A proposition of federal preemption of trade secret law by the United States Supreme Court's decision in *Lear v. Adkins*, 395 U.S. 653 (1969) was resolved in *Painton v. Bourns, Inc.*, 442 F.2d 216 (2d Cir. 1971), *rev'd* 309 F. Supp. 271 (S.D.N.Y. 1970). Trade secrets are comprehensively defined in section 757, comment b of the Restatement of Torts (1939). The first case recognizing the institution of trade secrets is believed to be the Massachusetts case of *Morrison v. Moat*, 9 Hare 241, 20 L.J. Ch. 513 (1851); it is a relative newcomer to the common law.

ship commences with first use. But a mark that is a proper name, a word descriptive of the product or a functional configuration of goods, is subject to the more stringent requirement of developing a so-called secondary meaning before private ownership may be acquired in it. In such cases, it is mandatory that there be extensive use and substantial advertising expenditure.²⁰

Undoubtedly, the most important consequence of this analysis is the general proposition that the monopoly granted to the trademark or the trade secret owner or both, without any time limit, is fundamentally equitable in origin and still fully governed by equitable concepts, with the federal and state statutes playing a collateral, though significant role. Within that network of current statutory and common law standards, a court of equity retains its full panoply of general principles and powers. In probing the areas of relief available to deter the abuses prevalent in franchising, it will be seen that some have their origin in such trademark or trade secret lore, while others derive by analogy from the more fully developed regulation of monopoly granted to the holder of a patent. And the antitrust standards are omnipresent in their growing familiarity as a prohibitor of unjustifiable restraints on trade.

III. The Patent-Quarantined Misuse Doctrine

A trademark or trade secret licensor who licenses on abusive terms may commit a *misuse* of the trademark or trade secret—analogous to the well-known misuse of patents. Then again it may not be a misuse. Any hypotheses of trademark or trade secret misuse cannot merely track the patent misuse remedy. There can be different consequences arising out of an application of misuse doctrine in patents on the one hand and trademarks and trade secrets on the other hand, chief among which is that patent enforcement can be suspended for a time and then reinstated after purging whereas suspension of trademark or trade secret enforceability can easily lead to a destruction of the trademark or trade secret right beyond hope of reclamation. Nevertheless, in appropriate circumstances the application of misuse doctrine (with adjustment of the remedy) is not too drastic, may be necessary to protect the interest of a licensee or the public (as represented by the licensee or other private attorney-general) and as a matter of policy is as warranted in the trademark or trade secrets or other franchise contexts as in the patent context.

20 See *Food Center, Inc. v. Food Fair Stores, Inc.*, 242 F. Supp. 785 (D. Mass. 1965), *vacated on other grounds*, 356 F.2d 775 (1st Cir. 1966) (interpreting an earlier decree, 38 T.M. Rep. 1085, 79 U.S.P.Q. 114, *aff'd*, 177 F.2d 177 (1949) (where large grocery chain had for many years employed the generic name "Food Fair" and had expended huge sums on advertising, it nevertheless failed to obtain fully preemptive rights in New England since it could only show a general purpose to expand into that territory). Even mammoth efforts could not get a federal registration for the Sun Oil Company on their "Custom Blended" gas pump signs, *In re Sun Oil Co.*, 165 U.S.P.Q. 718 (C.G.P.A. 1970), *aff'g* 155 U.S.P.Q. 600 (T.T.A.B. 1967); *see also* 144 U.S.P.Q. 103 (T.T.A.B. 1964) for an earlier futile try. *See Montessori, Madness over the Method*, NEWSWEEK, Nov. 20, 1972, at 83 describing the attempt of a Florida child day-care franchisor to preempt the trade name "L'Academie Montessori" even though the name of the founder of that system of child instruction has long been in the public domain and is widely used by numerous child care centers throughout the world.

A. Evolution of Misuse Doctrine in the Patent Context

In the patent field, abuses in the exercise of the patent monopoly have long been combated by the application of the antitrust laws or antitrust policy-based patent law development. Successful actions have been maintained since 1918 against agreements in restraint of trade in patented products and related products whenever the patentee tried to secure more to himself by agreement than was granted within the four corners of his patent.²¹ The early antitrust cases²² involved tying where the grant of a license was conditioned on dealing with the patentee or his designee in unpatented goods. *United States v. Univis Lens Company* invalidated a tying situation by broadly construing the scope of implied licenses granted by a patentee/manufacturer of goods.²³ Another large area of the watershed of patent misuse doctrine is the fraud doctrine, a hybrid of patent law and antitrust law barring assertion of an otherwise valid patent by way of enforcement against an infringer or as a shield to an antitrust complaint, in case of fraud in its procurement.²⁴

The transformation from an affirmative antitrust doctrine to a limitation of equity barring enforcement of a valid patent for conduct which was not necessarily an antitrust law violation was first clearly spelled out in *Morton Salt Company v. G. S. Suppiger Company*.²⁵ There, the Supreme Court held that the sale of unpatented salt tablets tied to the licensing of a patented salt tablet dispensing machine constituted a patent misuse and denied the patentee relief against an infringing user of the patented machine, regardless of the validity of the patent. The Court felt it unnecessary to state whether the owner had violated the Clayton Act, since the "maintenance of the present suit" was contrary to "public policy."²⁶ Two years later, it was held that it was not necessary to show that a patent licensing practice violated the antitrust laws because control of an unpatented article or device would not be sanctioned, even though such control fell short of a prohibited restraint of trade or a monopoly.²⁷

21 *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1916), *overruling* *Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912), taking into account the intervening passage of the Clayton Act in 1914. See *Agrashell, Inc. v. Hammons Products Co.*, 1973 Trade Cas. ¶74,446 (8th Cir. 1973).

22 *IBM v. United States*, 298 U.S. 131 (1936).

23 316 U.S. 241 (1942). Even before the era of conflict between the antitrust sword and patent shield, the common law hostility to restraints on alienation provided the basis of an implied license doctrine to limit the boundaries of patent property, *Adams v. Burke*, 84 U.S. (77 Wall) 453-56 (1873); *Mitchell v. Hawley*, 16 Wall 544-47 (1872); *Keeler v. Standard Folding Bed*, 157 U.S. 659 (1895); *Hobbie v. Jennison*, 149 U.S. 355 (1893). *Carbice Corp. v. American Patents Dev. Corp.*, 283 U.S. 27 (1931) and *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1916), are early patent law defense cases based on antitrust policy.

24 *Precision Instrument Mfg. Co. v. Automotive Maintenance Machinery Co.*, 324 U.S. 806 (1945); *Keystone Driller Co. v. General Excavator Co.*, 290 U.S. 240 (1933); *Monsanto v. Rohm and Haas Co.*, 312 F. Supp. 778 (1970), *aff'd*, 456 F.2d 592 (3d Cir. 1972), *cert. denied*, 407 U.S. 934 (1972). It is not necessary to show economic power amounting to monopoly, *cf. Walker Process Equip., Inc. v. FMC Corp.*, 382 U.S. 172 (1965).

25 314 U.S. 488 (1942).

26 *Id.* at 494. In *Mercoid Corp. v. Mid-Continent Investment Co.*, 320 U.S. 661 (1944) and *Stearns v. Tinker & Razor*, 252 F.2d 589 (9th Cir. 1958), misuse was expressed as an application of the equity "unclean hands" doctrine.

27 *Transparent Wrap v. Stokes & Smith*, 329 U.S. 637, 644 (1947). In addition to tying, the forcing of a licensee to abstain from dealing in competing goods is barred, *McCullough v.*

In general, it can be stated that every violation of the antitrust laws involving use of a patent is also a patent misuse, but that a misuse is not necessarily a violation of the antitrust laws—the misuse doctrine being substantially broader in scope.²⁸ The misuse doctrine today covers, in addition to the fraud and tying violation mentioned above, package licensing,²⁹ taking royalties after the patent expires,³⁰ and royalty discrimination.³¹

B. Suppression of the Misuse Doctrine in the Trademark Context

In *Manhattan Medicine Company v. Wood*³² it was held that a court of equity will extend no aid to sustain a claim to a trademark of an article which is put forth with misrepresentations to the public as to the manufacture of the article.³³ In *Morton Salt*³⁴ the Supreme Court recognized in dictum, the application to trademarks of the patent misuse doctrine, thus bridging the gap between the two classes of industrial property and enlarging the narrower misrepresentation fact-base of the early trademark cases.³⁵ In *Switzer Bros., Inc. v. Locklin*³⁶ a federal appeals court struck down a quality control justification of a patent-trademark licensed package as a sham where the licensee was obliged to purchase his requirements of unpatented parts for use in patented and unpatented fluorescent lights from the licensor and to use the licensed Day-Glo trademark. Trademarks have also been recognized as affected with a public interest justifying a broader, rather than a narrow, antitrust inquiry into their usage.

The leading case on an affirmatively actionable antitrust violation involving trademarks is *Timken Roller Bearing v. United States*.³⁷ There, a worldwide

Kammerer Corp., 166 F.2d 759 (9th Cir. 1948); *National Lockwasher Co. v. George K. Garrett Co.*, 137 F.2d 255 (3d Cir. 1943); *Park-In Theatres v. Paramount-Richards Theatres*, 90 F. Supp. 727 (D. Del. 1950), *aff'd per curiam*, 185 F.2d 407 (3rd Cir. 1950).

28 *Waco-Porter Corp. v. Tubular Structures Corp.*, 220 F. Supp. 724, (S.D. Cal. 1963), *modified*, 22 F. Supp. 332 (S.D. Cal. 1963), *Laitram Corp. v. King Crab, Inc.*, 244 F. Supp. 9 (D. Alaska 1965) *motion to amend denied*, 245 F. Supp. 1019 (D. Alaska, 1965).

29 *Hazeltine Research, Inc. v. Zenith Radio Corp.*, 388 F.2d 25 (7th Cir. 1967), *aff'd*, 401 U.S. 321 (1971); *American Security Co. v. Shatterproof Glass Corp.*, 268 F.2d 769 (3d Cir. 1959), *aff'g* 154 F. Supp. 890 (D. Del. 1957).

30 *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).

31 *Peelers Co. v. Wendt*, 260 F. Supp. 193 (W.D. Wash. 1966).

32 108 U.S. 218 (1883).

33 *See also Worden v. California Fig Syrup*, 187 U.S. 516 (1903), holding that, while a trademark is property, one who seeks an injunction to prevent another's appropriation of it must not himself be guilty of misleading representations, citing *Leather Cloth Co. v. American Cloth Co., Ltd.*, [1865] 11 H.L. 523.

34 *Morton Salt Company v. G. S. Suppiger Company*, 314 U.S. 488 (1942).

35 Copyright is also subject, in principle, to the misuse limitation, *April Productions, Inc. v. G. Schirmer, Inc.*, 308 N.Y. 336, 126 N.E.2d 283 (1955). Trade secret property is also vulnerable, *MacDonald, Know-How Licensing and the Antitrust Laws*, 62 MICH. L. REV. 351 (1964). But copyright misuse and trade secret misuse must, together with trademark misuse, be characterized as late bloomers in contrast to the fully developed patent misuse doctrine. In the leading trademark text, "misuse" means generic usage of a trademark, *VANDENBURGH, TRADEMARK LAW AND PROCEDURE*, § 7.20 (2d ed. 1968), and in a leading trade secret service the unclean hands doctrine is described as being very limited, 12 *BUSINESS ORGANIZATIONS: MILGRIM, TRADE SECRETS* § 7.08(1) (e) (1972). Similarly, the "equitable unclean hands defense in [a] trade secret case [is] not as well developed as [in] patent misuse . . . [an] actual antitrust violation [is] usually necessary to establish [the] defense." *ATTORNEY'S GUIDE TO TRADE SECRETS* § 2.8 VII (Cal. Cont. Ed. at the Bar 1971).

36 297 F.2d 39 (7th Cir. 1961), *cert. denied*, 369 U.S. 851 (1962).

37 341 U.S. 593 (1951). The trademark not only provides no protection for the abuse of trademark privileges but rather confirms the actionability of such conduct even if it falls short of an antitrust violation. *See also Ford Motor Co. v. United States* 405 U.S. 562 (1972).

cartel, dividing territories and controlling manufacture and sale of articles, was punished by a divestiture decree. The Court held that the argument that the restraints of trade were justified as reasonable steps to implement a valid trademark licensing system had been met by district court findings that the central purpose of the arrangement was to allocate territories and that any trademark provisions were secondary to that main purpose. However, notwithstanding the *Morton Salt* dictum, *Timken* did not serve as an evolutionary starting point for a misuse defense analogous to the patent misuse defense,³⁸ although it has been applied to brush aside a trademark shield in a number of antitrust cases. Indeed, in those cases the courts controlled trademark licensing as a remedy.³⁹

The lag in realization of the obvious parallelism is traceable to differences in context. A misuse-asserting patent suit defendant who is a stranger to the patentee's licensing arrangements is a welcome private attorney general. If he wins, the licensees are liberated from the royalty obligation; they lose nothing but their chains. If he is a licensee, any hostility based on his possible windfall of relief from his contract bargain is overbalanced by the public interest in his unique knowledge of where the bodies are buried. A finding of misuse affords a temporary setback to the patentee who can, at least in theory, purge the misuse.

In trademarks and trade secrets, the third party infringer who makes out a misuse claim brings down the whole temple for a licensor and licensee(s) alike. A bare license in the nature of a covenant not to sue is the norm in copyright and patent licensing while a license coupled with an interest of greater or lesser degree is implicit in trademark or trade secret licensing. Too, the public interest can be adversely affected if trademark quality control by the licensor gives way to anarchic free access to the trademark.

Last, but not least, the situation is affected by the lack of communication among the antitrust, trademark and business law specialist counsel to the parties involved in trademark licensing and infringement practice.⁴⁰

Accordingly, the antitrust defense has been given a grudging application by the courts, which often find that while there may be an antitrust violation

38 The commentators repeatedly say that the trademark misuse doctrine has yet to emerge, Krayer, *Domestic Trademark Licensing*, 43 J. PAT. OFF. SOC'Y 574, 585 (1961); Note, *Quality Control and the Anti-trust Laws in Trademark Licensing*, 72 YALE L. J. 1171, 1202-03 (1963). But see Goodwin, *Franchising Law Matures*, 28 BUSINESS LAWYER 703, 720-24 (1973).

39 *United States v. Switzer Bros.*, 115 F. Supp. 49 (N.D. Cal. 1953) (consent decree prohibiting tie-in quality control); *United States v. General Electric* 115 F. Supp. 835 (D. N.J. 1954) (consent decree prohibiting licenses); *United States v. Sealy, Inc.*, 388 U.S. 350 (1967) and *United States v. Topco Associates*, 405 U.S. 596 (1972) (horizontal agreement among licensees held unlawful); *Ford Motor Co. v. United States*, 405 U.S. 562 (1972), McCarthy, *Trademark Franchising and Antitrust: The Trouble with Tie-ins*, 58 CALIF. L. REV. 1085 (1970); Treece, *Trademark Licensing and Vertical Restraints In Franchising Agreements*, 116 U. PA. L. REV. 435 (1968).

40 See, e.g., REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 260 (1955) where the antitrust lawyers had difficulty appreciating, reading or even quoting section 33(b)(7) of the Lanham Act and, over the dissent of several members, tried to limit the section to government enforcement. The American Bar Association's 1955-1968 and 1968-1971 Supplements to the Report include trademark-antitrust problems under Sherman Act, Section 1 problems although patent misuse is recognized as a doctrine of patent law and is not similarly subsumed under the Sherman Act, Section 1, category.

floating in the case, it is not so intimately related to the trademark as to bar enforceability.⁴¹

In *Baker v. Simmons Company*, the First Circuit went to great lengths to avoid ruling on the defense:

While we must confess to having experienced some initial reluctance to accept defendant's contention that the plaintiff's sign program might, under any view, be considered a tying arrangement within the meaning of the antitrust statutes, reflection has persuaded us that strictly speaking the program might be said to fall within the literal language of the Act. . . . [However] we are not at all convinced that [the arrangement] is an improper one. [Citing *Dehydrating Process Company v. A. O. Smith Corporation*, 292 F.2d 653 (1961), *cert. denied*, 368 U.S. 931, and *United States v. Jerrold Electronics Corporation*, 187 F. Supp. 545 (E.D.Pa. 1960) (*affd. per. cur.*, 365 U.S. 567 (1961)].⁴²

The doctrines of the cited cases do not fully explain the decision. *A. O. Smith* held that sale of what amounts to a "single product" does not amount to tying or unlawful pooling. In that case, a silo and silo unloader were sold together when experience demonstrated that either product would be improperly used alone and that they could only work effectively together.⁴³ The other citation, *Jerrold*, generally stands for the proposition that a new small business, struggling to establish a new technology in the field, has a special exemption from the full force of the antitrust laws, but that there is a limit of reasonable time and truly necessary scope on the exemption so granted.⁴⁴

The landmark *Timken*⁴⁵ case was not cited or discussed by the First Circuit in *Simmons*, although it was forcefully presented to them by appellant's counsel.⁴⁶ The court was apparently influenced by general bad conduct of the defendant

41 *Carl Zeiss Stiftung v. V.E.B. Carl Zeiss, Jena*, 298 F. Supp. 1309 (S.D.N.Y. 1969), *aff'd*, 433 F.2d 686 (2d Cir. 1970), *cert. denied*, 403 U.S. 905 (1971); *see also* *Rayette-Faberge, Inc. v. Riverton Labs, Inc.*, 1968 Trade Cas. ¶ 72643 (S.D.N.Y. 1968). An alternate approach is business justification as in *F.T.C. v. Sinclair Co.*, 261 U.S. 463 (1923), a pre-per se doctrine case. *But see* *International Business Machine Corp. v. United States*, 298 U.S. 131 (1936); *International Salt Co. Inc., v. United States*, 332 U.S. 392 (1947); *Standard Oil Co. v. United States*, 337 U.S. 293 (1949); *Siegel v. Chicken Delight*, 311 F. Supp. 847 (N.D. Cal. 1970), *aff'd and rev'd in part*, 448 F.2d 43 (1971).

42 307 F.2d 458, 467, 468 (1st Cir. 1962).

43 *See also* *International Mfg. v. Landon, Inc.*, 336 F.2d 723 (9th Cir. 1964) applying the same immunity to multipatent licenses where the several patents are blocking patents, and *Kugler v. Aamco*, 337 F. Supp. 876 (D. Minn. 1971) holding a trademark license and other aspects of a franchise including parts purchase requirements to be a single product. *But see* *Advanced Business Systems & Supply Co. v. SCM Corp.*, 415 F.2d 55 (4th Cir. 1969), *cert. denied*, 397 U.S. 920 (1970).

44 This was a particularly inappropriate citation since *Simmons* was the leading company in the field and had been established for over half a century. And in *Jerrold* itself, it was held that the grace period had been exceeded.

45 *Timken Roller Bearing v. United States*, 341 U.S. 593 (1951), *see note 37 supra*.

46 [A] trademark owner who sues another user for infringement must come into court with clean hands, and if he is using the mark to violate the antitrust laws he is subject to be contested and to have his violation used as a defense.

Remarks of Sen. Hawkes explaining § 33(b)(7), 92 CONG. REC. 7636 (1946), quoted in Appellants' Brief at 38-40.

trademark infringer⁴⁷ and was uncomfortable with its decision which it limited in closing by avoiding the antitrust defense issue.⁴⁸

IV. A Thesis of Finally Emergent Misuse

As one prominent antitrust practitioner has said:

In short the courts have made clear that the franchisor who leans upon the law to justify any misuse of his power to regiment franchisees will find that its legal principles will bend and pierce him.⁴⁹

And as a further sermonal text:

We do question . . . the general proposition that the trademark is the entire source of value within the franchise system and the franchisee's business is simply an extension of the franchisor's and has no independent value apart from the physical assets of the business. . . . Without the hard work of the franchisee not only would the individual franchise outlet be a failure, but the entire system arguably would produce substantially less business than the franchisor could produce by his own efforts. It may be, then, that the franchisee's interest should be accorded some "goodwill" value when the franchise terminates.⁵⁰

Franchising cases have evolved a franchising law variation of the intellectual-industrial property antitrust doctrines of unclean hands and limits-of-government monopoly which evolved fully into a patent misuse doctrine but not as fully into trademark and trade secret misuse doctrines. The specially compassionate status and equities of the little brother franchisee, the special opportunities for abuse by the franchisor, and the broadly based outcry for reform have caused the courts to take the franchisor's legal principles, bend them and pierce him. And it happened in less than a decade.

The legal pinning of the franchise "boom" of the 1960's was to a large measure hinged on the guidance provided by the *Carvel* case,⁵¹ which supposedly allowed a soft-ice cream franchisor to tie the grant of the franchise to the

47 Including perjury by the defendant in a "brazen attempt to establish rights in the [infringing] Simmonds name extending back to 1899, the very year that plaintiff . . . began to use the name . . ." 307 F.2d at 466; instances of actual confusion; deceptive trade practices of defendant which had resulted in an earlier F.T.C. cease and desist order; and defendant's status as a stranger to the challenged licensing arrangements in a day and age when the concepts of the private attorney general and expanded standing to sue were less well developed in the law generally, and in industrial-intellectual property contexts, than they are today.

48 In view of our determination that Simmons has engaged in no violation of the antitrust laws it is unnecessary that we express any opinion on defendants' contention that an antitrust violation, if proven, would serve as an absolute defense to a trademark action under the Lanham Act.
307 F.2d at 469.

49 Van Cise, *Franchising—From Power to Partnership*, 15 ANTITRUST BULL. 443, 449 (1970).

50 Address by Alan Ward, Director of FTC Bureau of Competition, to Car and Truck Rental and Leasing Association Convention, Feb. 11, 1971.

51 *Susser v. Carvel Corp.*, 332 F.2d 505 (2d Cir. 1964), *petition for cert. dismissed*, 381 U.S. 125 (1965).

required purchase of the dairy-mix from designated sources. The franchisee had stipulated that the case was based solely on allegations of a "per se" violation, undoubtedly for the litigational economy arising from the fact that economic justification will not be tolerated for such a violation.⁵² A divided circuit court was thus able to find against the franchisee on the ground that although the burden was a heavy one, the franchisor should be allowed an opportunity to prove that it would have been too burdensome or too complex merely to have published the standards for its "quality control" privilege. A decade later a more severe application of that standard was exerted in *Siegel v. Chicken Delight*,⁵³ where evidence of justification for the tying of paper goods, supplies, and certain equipment was not considered. Further, the jury found that the franchisor had not met the burden of proof of such complexity, sufficient to warrant the franchisor's requirement that allegedly "secret" dip and spice mixes and certain cookers and fryers be purchased solely from the franchisor to insure "quality control."⁵⁴ In a somewhat less heralded case involving an attack on such an arrangement by the excluded third party vendor,⁵⁵ even greater vigor has been ascribed to the "per se" aspect of this tying violation as expounded by a dissenting judge in the *Carvel* case and by the *Siegel* court.

The *Siegel* case is also significant because of the collateral rulings that must necessarily flow from its reasoning. In its reference to "trade secrets" there is an accommodation with the common law monopoly which equity has granted to a person who devises and then protects from public disclosure, some confidential process, system, or mechanism. Although that variety of intellectual property has its source in the common law, it should be subject to roughly comparable limitations on the kind of material which can be protected under the federal patent laws.⁵⁶

While such common law protection has thus been accorded to the "Confidential Manual of Operations" which usually accompanies a fast-food franchise,⁵⁷ the validity of such intellectual property as a justification for contract provisions in incipient restraint of trade should be treated with circumspection. For example, one such manual for a Mexican food franchise commences, "1. Unlock the door, step in, and turn on the lights." And the erstwhile president of a now defunct fast food franchise which led the entire industry in the sale

52 [T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry into the precise harm they have caused or the business excuse for their use . . . [including] tying arrangements, *International Salt Co. v. United States*, 332 U.S. 392 . . . [This] avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry . . . in an effort to determine at large whether a particular restraint has been unreasonable . . . *Northern Pacific RR Co. v. United States*, 356 U.S. 1, 5 (1958).

53 *Siegel v. Chicken Delight, Inc.*, 311 F. Supp. 847 (N.D. Cal. 1970), *aff'd and rev'd in part*, 448 F.2d 43 (9th Cir. 1971), *cert. denied* 405 U.S. 955 (1972).

54 The business justification defense to a tying charge is treated in the cases cited at note 41 *supra*.

55 *Warriner Hermetics, Inc. v. Copeland Refrigeration Corp.*, 463 F.2d 1002 (5th Cir. 1972), *cert. denied*, 41 U.S.L.W. 3341 (U.S. Dec. 18, 1972).

56 RESTATEMENT OF TORTS, § 757, comment *b* (1939). See note 14 *supra*.

57 *McDonald's Corp. v. Moore*, 243 F. Supp. 255 (S.D. Ala. 1965), *aff'd*, 363 F.2d 435 (5th Cir. 1966).

of franchises publicly avowed that he had copied every facet of the operation, including the Manual of Operations, from other supposedly successful franchise systems.⁵⁸ The "secret" recipe for a spice package used in a pizza franchise was in fact concocted by a group of the franchisees and manufactured by an independent third party, though the franchisor then adopted it and required the franchisees to pay \$21.00 for a package that cost \$3.50.⁵⁹

Even as to a genuine "secret," such as a unique food recipe, the law should be extremely wary in tolerating the abuse of hundreds of franchises, involving millions of dollars, when it may be hinged upon a formula that can be specially devised by a professional cook for as little as twenty-five dollars, this being the standard fee for a "special" ice cream mix recipe. Since the "trade secret" has its origin and sustenance in equity, it would be incongruous for such a court of conscience to tolerate abuse of its process. The origin of the private property right in a trade secret was to secure protection for its originator against competition from those to whom he discloses it in confidence, the eminent propriety of which does not require much probing as to the depth, value, or degree of ingenuity involved. But the ease with which such an alleged secret may then be employed to harass and exploit a large number of innocent franchisees requires that the court itself perform an unusual task of socioeconomic and engineering evaluation. Although there has been some violent criticism of the proficiency of the Patent Office in passing on patentability before the grant of a monopoly of limited duration,⁶⁰ the "trade secret" is otherwise subject to no administrative review and acquires monopoly rights forever, so long as confidentiality is retained.⁶¹

The second corollary of the *Siegel* case was its rejection of the concept that the licensing of the trademark was a single package, including the entire format of the franchisor's system.⁶² The court expressly found that the various pieces of equipment, the particular supplies, and even the allegedly secret recipe, were quite separate from the license of the trademark, thus confirming that the intellectual property embodied in the trademark was an independent entity, quite sufficient to constitute the tying product in an antitrust violation. That principle thus opens for consideration the many questions as to the applicability to the

58 John Jay Hooker, *The Amazing Story of Minnie Pearl*, FRANCHISING TODAY 1968-9.

59 *Klinzing v. Shakey's Inc.*, Civ. No. 69-C-344 (E.D. Wis.).

60 *See Pfizer, Inc. v. Lord*, 456 F.2d 532 (8th Cir. 1972), *cert. denied*, 406 U.S. 976 (1972). With regard to patent cancellation, see remarks of district court recommending that the Department of Justice investigate the Patent Office, characterized as "the sickest institution that our Government has ever invented" and "the weakest link in the competitive system in America." *Id.* at 542.

61 *Data General Corp. v. Digital Computer Controls, Inc.*, 297 A.2d 437 (Del. 1972) (summary judgment for defendant denied) involves the issues of whether distributing copies of the "secret" to hundreds of customers "in confidence" stretches the monkey's paw of the equity court too far. *See Van Prod. Co. v. General Welding and Fabricating Co.*, 419 Pa. 248, 213 A.2d 769 (1965), *Sarkes Tarzian, Inc. v. Audio Devices, Inc.*, 166 F. Supp. 250, (S.D. Cal. 1958) *aff'd*, 283 F.2d 695, *cert. denied*, 365 U.S. 869, and *J. T. Healey & Son, Inc. v. James A. Murphy & Son, Inc.*, 357 Mass. 728, 260 N.E.2d 723 (1970). Balancing of trade secret interests against other interests is found in many contexts including evidence; federal rule of civil procedure 30(b) and Model Code of Evidence 5-08 provide a qualified privilege for trade secrets "if the allowance of the privilege will not tend to conceal fraud or otherwise work injustice."

62 See notes 2 and 43 *supra*.

trademark "monopoly" of the case law which has developed for the other principal "intellectual-industrial property," namely the statutory patent monopoly. The first issue thus raised is whether a royalty on gross sales is itself illegal as an indirect tying sale. If such be the case, then the damage ruling in *Siegel v. Chicken Delight* will be drained of almost all significance.

By analogy, in the case of a patent or copyright, it is now established that a license based on a royalty on total-sales, for example, on sales of both the patented and unpatented articles, is invalid if the licensee can sustain the burden of proving that the grant of the license was conditioned upon such an arrangement.⁶³ Stated otherwise, the total-sales royalty would pass muster if it could be shown that it was adopted for the convenience of the parties, rather than through the use of patent power to override the licensee's protestations.⁶⁴ The mere fact of an all-sales royalty would not therefore be controlling;⁶⁵ and the licensee would have the burden of proving the coercion or conditioning.⁶⁶

Although the antitrust laws may not generally be employed as an affirmative defense against legal claims to enforce property rights unless the violation is intimately a part of the claim,⁶⁷ a patent licensee may contest the enforceability of the patent on grounds of fraud in its procurement or other misuse or on any ground of invalidity that could have been raised in connection with the original patent grant proceedings notwithstanding a license covenant not to contest

63 *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969). See *Warriner Hermetics, Inc. v. Copeland Refrigeration Corp.*, 463 F.2d 1002 (5th Cir. 1972) (sustaining claim of third party vendor against franchisor's tying arrangements, subscribing to the stronger viewpoint in the dissenting opinion in *Susser*). See also *Tastee-Freeze Int'l Inc.*, 3 TRADE REG. REP. ¶ 20,076 (1972 Trade Cas.) (proposed complaint against soft ice cream franchisor and eight regional franchisees alleging that subfranchisees were illegally required to purchase mix from designated third parties at excessive cost, including proposed order permitting the prescription of minimum standards and specifications, but barring all commissions or other payment by the third party vendors). Although *Siegel v. Chicken Delight* proscribed the tying of the purchase of equipment to the grant of a franchise, some doubt has been expressed as to whether there is such a tying violation when a franchisor sells an existing franchise business as an entity, including the grant of the franchise and the previously installed physical equipment. In *Beefy Trail, Inc. v. Beefy King Int'l Inc.*, 1972 Trade Cas. ¶ 74,127 (M.D. Fla.), the latter situation was not deemed appropriate for the allowance of a motion for summary judgment since it could be shown that a general practice was being used as an indirect means of circumventing the tying prohibition. See *Aamco Automatic Transmissions, Inc.* 3 TRADE REG. REP. ¶ 20,094 (1972) (F.T.C. consent order barring tie of original mechanical inventory, all repair parts and repair kits).

64 *Id.*

65 *Glen Mfg., Inc. v. Perfect Fit Industries, Inc.*, 420 F.2d 319 (2d Cir. 1970), *cert. denied*, 397 U.S. 1042 (1970).

66 *Plastic Contact Lens Co. v. W.R.S. Contact Lens Lab., Inc.*, 1970 Trade Cas. ¶ 73,274 (S.D.N.Y. 1970), *Frontier Contact Lenses, Inc. v. Plastic Contact Lens Co.*, 441 F.2d 67 (2d Cir. 1971), *cert. denied*, 404 U.S. 881 (1971).

67 *Kelly v. Kosuga*, 358 U.S. 516, 520-21 (1959), quoting Mr. Justice Holmes in *Continental Wall Paper Co. v. Louis Voight & Sons Co.*, 212 U.S. 227, 271 (1908); *Otto's Liquor, Inc.*, 1971 Trade Cas. ¶ 73,538 (D. Minn. 1970); see *Helfenbein v. Int'l Indus., Inc.*, 438 F.2d 1068 (8th Cir. 1971), *rehearing denied*, 1971 Trade Cas. ¶ 73,498, *cert. denied*, 404 U.S. 782 (1971) (allegation that state detainer was being used to enforce franchisor's illegal tying); Sobel, *Antitrust Defense to Contract Actions: A Question of Policy Priorities* 16 ANTITRUST BULL. 455 (1971). Note, however, that the royalty on gross sales was recognized as an implicit aid to antitrust violations in *Milsen Co. v. Southland Corp.*, 454 F.2d 363 (7th Cir. 1971). See *Cunningham v. A. S. Abell Co.*, 1972 Trade Cas. ¶ 73,880 (Md. Ct. App.) (confirming validity of termination of delivery carriers' contracts because of implicit antitrust violations of horizontal price-fixing and territorial division). See *AMF, Inc. v. James Polk*, 1973 Trade Cas. ¶ 74,445 (D. Ark. 1973).

validity.⁶⁸ There are many franchise systems in which a patent has been used as an essential ingredient of the licensed package, making such cases directly applicable. The same defensive remedies would appear to be applicable with reference to franchised trademarks except to the extent precluded by the Lanham Act.

The Lanham Act, while making a federal registration *prima facie* evidence of the registrant's exclusive right to use the registered mark in commerce for the goods or services specified in the registration,⁶⁹ preserves for at least the first five years following registration all legal or *equitable* defenses or defects which an opposing party might have asserted if the mark had not been registered.⁷⁰ However, upon showing five years of continuous use the registrant can obtain an incontestable right to use his mark except when one of seven specified defects or defenses is established, including:

- (1) fraud in obtaining the registration or the incontestable right to use the mark;
- (2) abandonment of the mark;
- (3) use of the mark to misrepresent the source of goods or services;
-
- (7) the mark has been used to violate the antitrust laws.⁷¹

The literal language of the statute makes no provision for a defense of misuse not wholly coextensive with the antitrust laws, certain specific occasions of fraud or misrepresentation, or abandonment. But it must be recalled that what is involved here is the question of defense to a registrant's exclusive right to use a mark. In the franchise situation the registrant's exclusive right to use the registered mark is not in question. What is in question is the willingness of a court of equity to abide the terms on which the registrant has licensed the franchisee to share in that exclusivity.

Accordingly, whatever the limits of Lanham Act incontestability to defenses of a trademark infringer who is a stranger to the franchise family, such limits do not apply within the family, and the industrial-property unclean hands doctrine called "misuse" is fully available to a member of the family (including summarily disowned-terminated-members).

68 *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969), overruling, *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827, 836 (1950). But a covenant not to contest a patent may not be per se a misuse or antitrust violation since *Lear* makes it a nullity, *Massillon-Cleveland-Akron Sign Co. v. Golden State Advertising Co.*, 444 F.2d 425, 427 (9th Cir. 1971). *Bendix Corp. v. Balax Inc.*, 176 U.S.P.Q. 33 (7th Cir. 1972), *rev'g* 321 F. Supp. 1095 (E.D. Wis. 1971). However, the forgiveness of *Massillon* and *Bendix* is probably limited to pre-*Lear* licenses. If the ground of invalidity is fraud and the requisite effect on commerce is shown, the defendant can counterclaim for monopolization under 15 U.S.C. § 2 (1970). *Walker Process Equip., Inc. v. Food Machinery and Chemical Corp.*, 382 U.S. 172 (1965); *but see Beckman Instruments, Inc. v. Chemtronics, Inc.*, 328 F. Supp. 1132 (W.D. Tex. 1971) and *PPG Industries Inc. v. Celanese Coatings Co.*, 176 U.S.P.Q. 235 (D. Md. 1972) (degree of particularized pleading and proof of fraud).

69 15 U.S.C. § 1115(a) (1970).

70 *Id.*

71 *Id.* § 1115(b).

Most franchise agreements commence with the recitation of the franchisor's expertise and success based upon the promotion of specified trademarks, then follow with a covenant by the franchisee conceding the validity of the mark and agreeing never to contest it. It would also be relevant to inquire whether an unenforceable trademark claim or invalid or fraudulently procured trademark registration could legally be used as a tying product under any circumstances. At the very least, there would appear to be grave questions of inherent fraud.⁷²

The root difficulty provided for all franchisees by the Lanham Act is its codification of the rule that the licensing of a trademark will not result in its abandonment if the licensor exercises quality control over the use of the trademark by the licensee, designed to assure that the licensee maintains the licensor's standards.⁷³ But it has long been held that the franchisor's authority only encompasses such disciplinary controls as are reasonably necessary to assure that there is no confusion for the ultimate purchaser.⁷⁴ Even though the franchisor's privilege is thus supported by a federal statute, it has been almost completely ignored that the statute does not grant the licensor any right of control; it merely provides that the trademark will not be deemed to have been abandoned if quality control is maintained. As with every other privilege granted by the law, its umbrage will disappear if its boundaries are exceeded. Seldom has there been a more appropriate need for the application of such principles than in the case of the severe repression exercised in so many franchise systems. If the control privilege terminates, then the trademark could be considered as "abandoned," thus destroying such conditional protection as the franchisor enjoyed under the monopoly granted by the trademark statute. As a result, the franchisor would be vulnerable to a claim of attempted monopoly under section 2 of the Sherman Act, as well as restraint of trade under section 1. The power to employ a government sponsored monopoly as an instrument of repression was unequivocally condemned by the United States Supreme Court when it said:

Even constitutionally protected property rights such as patents may not be used as levers for obtaining objectives proscribed by the antitrust laws. . . .

The trademark may become a detrimental weapon if it is used to serve a harmful or injurious purpose. If it becomes a tool to circumvent free enterprise and unbridled competition, public policy dictates that the rights enjoyed by its ownership be kept within their proper bounds.⁷⁵

72 See section 43 of the Lanham Act 15 U.S.C. § 1125 (1970) creating a new federal remedy for private suit for the use of any false representation in the sale of goods in or affecting interstate commerce. See: *American Rolex Watch Corp. v. Jack Laufer & Jan Voort, Inc.*, 176 F. Supp. 858 (E.D.N.Y. 1959); *Arnesen v. Raymond Lee Organization, Inc.*, 333 F. Supp. 116 (C.D. Cal. 1971); *contra*, *Colligan v. Activities Club of N.Y.*, 442 F.2d 686 (2d Cir. 1971), *cert. denied*, 404 U.S. 1004 (1971); See also, C. Bunn, *The National Law of Unfair Competition*, 62 HARV. L.R. 987 (1949); Star, *The Consumer Class Action—Part I: Considerations of Equity* 49 B.U.L. REV. 211, 244-247 (1969).

73 See opinion of Judge Dawson in *Susser v. Carvel Corp.*, 206 F. Supp. 636 (S.D.N.Y. 1962), *aff'd*, 332 F.2d 505 (2d Cir., 1964), *petition for cert. dismissed*, 381 U.S. 125 (1965).

74 *Huntington Nat'l Mattress Co. v. Celanese Corp.*, 201 F. Supp. 938 (D. Md. 1962).

75 *Ford Motor Co. v. United States*, 405 U.S. 562, 576, n.11 (1972), citing with approval the strong views expressed earlier in *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).

It would be against the interests of franchisor and franchisee to hold that the franchised trademark or trade secrets are unenforceable as a result of the franchisor's unclean hands. But, given the equitable nature of the source of such property rights and the continued validity of such property rights, chancery may well fashion the remedies in such a manner as to recognize the valid interests of both the franchisor and the franchisee.

At the threshold, in a private antitrust case involving the essential proof of the actuality of damages, the Seventh Circuit Court of Appeals had occasion to observe that "we are in a day and age in which the value of the nationally advertised franchise is a matter of general recognition," the illegal destruction of which would involve "implicit" damage.⁷⁶ And much more recently, the same court expressly recognized "the vested interest a franchisee builds in his business through years of effort and expenditures."⁷⁷ In one of the leading franchise cases the court held that:

In the economic context of present franchising trends, it is clear that a franchise license is marketable, separate and apart from the various products which the franchisees are required to purchase from and through the franchisor.⁷⁸

And in recently holding that there could be no "tying" of the grant of a franchise with a compulsory contribution to the advertising fund based upon a percentage of the franchisee's gross sales, the court ruled that the franchise and the advertising were so intimately entwined as to constitute a single product thus obviating the possibility of the "tying" of two products.⁷⁹ Finally, in acknowledging the franchisee's right to a renewal of his franchise except for "good cause," even in the absence of an express contractual right, both common law and statutory recognition is being accorded to the vested property right of the franchisee.⁸⁰

In bankruptcy proceedings, it is thus improbable that a franchise can be terminated as an "executory contract." For example, in a reorganization proceeding, a motion picture producer was not allowed to terminate a license granted for the marketing of motion pictures.⁸¹ Earlier, it had been held that in a publisher's bankruptcy proceedings, while recognizing a composer's equitable lien on a copyright, the trustee was not allowed to ignore the publisher's common law property right in the copyright.⁸²

The composite of these cases is that the franchisee has a substantial asset in the goodwill of the business conducted under the licensed trademark. Econom-

76 *Fontana Aviation, Inc. v. Beech Aircraft Corp.*, 432 F.2d 1080, 1086 (7th Cir. 1970), *cert. denied*, 401 U.S. 923 (1970).

77 *Milsen Co. v. Southland Corp.*, 454 F.2d 363, 366 (7th Cir. 1971).

78 *Siegel v. Chicken Delight, Inc.*, 311 F. Supp. 847, 849 (N.D. Cal. 1970), *aff'd*, 448 F.2d 43 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972).

79 *See Kugler v. Aamco Automatic Transmissions, Inc.*, note 2 *supra*.

80 *See Mobil Oil Corp. v. Rubenfield*, 5 TRADE REG. REP. (1972 Trade Cas.) ¶ 74,306 (N.Y. Queens County Ct.); *Shell Oil Co. v. Marinello*, 1972 Trade Cas. ¶ 74,178 (N.J. Super. Ct.) and New Jersey statute therein discussed, cited note 9 *supra*; *Brown, A Bill of Rights for Auto Dealers*, 12 B.C. IND. & COM. L. REV. 757, 811 (1971).

81 *United Artists Corp. v. Strand Productions*, 216 F.2d 305 (9th Cir. 1954).

82 *Waterson, Berlin, Snyder & Co. v. Irving Trust Co.*, 48 F.2d 704 (2d Cir. 1931).

ically, that is the precise nature of the bargain struck with the franchisor, no matter what may have been involved in the particular system. For example, in many of the newer franchises there is a capital charge levied for the franchise, representing a pro rata payment for the established goodwill in the trademark. But even if no such capital payment be exacted, the franchisee is both directly and indirectly induced to contribute his aliquot share to the enhancement of the "image." This may be in the form of direct advertising by the franchisee or through royalty payments into an advertising fund. But in every case, the very operation of the business under the licensed trademark contributes to the accretion for goodwill. It is the franchisee's undivided share in that intangible asset which represents his "vested property."

The vital requirement of a valid trademark right is use.⁸³ The source of that vital requirement having been the franchisees as a composite group, there should be no hesitancy in the equitable recognition of their joint ownership of the intangible goodwill in the trademark. Quite simply, the franchisor would then have legal title to the asset as a trustee for the benefit of itself and all the franchisees. That very relationship would thus highlight the mutual obligations of good faith among those sharing such a community of interest.⁸⁴

V. Conclusion: The Word Is Misuse

Whether presented as an equitable defense or as a demand for declaratory relief,⁸⁵ and in any field of law, the omnipresent unclean hands doctrine is:

He who has acted in bad faith, resorted to trickery and deception, or been guilty of fraud, injustice, or unfairness will appeal in vain to a court of conscience, even though in his wrongdoing he may have kept himself strictly "within the law." Misconduct which will bar relief in a court of equity need not necessarily be of such a nature as to be punishable as a crime or to constitute the basis of a legal action. . . . [A]ny willful act in regard to the matter in litigation, which would be condemned or pronounced wrongful by honest and fair-minded men, will be sufficient to make the hands of the applicant unclean. . . .⁸⁶

But further, in regard to industrial-intellectual property:

⁸³ See note 15, *supra*.

⁸⁴ See *Fiduciary*, *supra* note 11.

⁸⁵ *Samuels v. Mackel*, 401 U.S. 66, 70 (1971) (applicability of equitable principles in declaratory judgment proceedings).

⁸⁶ 1 J. STORY, COMMENTARIES ON EQUITY JURISPRUDENCE § 99 (14th ed. 1918). But note also:

The maxim, considered as a general rule controlling the administration of equitable relief in particular controversies, is confined to misconduct in regard to, or at all events connected with, the matter in litigation, so that it has in some measure affected the equitable relations subsisting between the two parties, and arising out of the transaction; it does not extend to any misconduct, however gross, which is unconnected with the matter in litigation, and with which the opposite party has no concern. . . . The dirt upon his hands must be his bad conduct in the transaction complained of. If he is not guilty of inequitable conduct toward the defendant in that transaction, his hands are as clean as the court can require.

2 J. POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 399 (5th ed. 1941).

Moreover, where a suit in equity concerns the public interest as well as the private interests of litigants . . . if an equity court properly uses this maxim to withhold its assistance . . . it not only prevents a wrongdoer from enjoying the fruits of his transgression but averts an injury to the public. . . .⁸⁷

The various fields of industrial-intellectual property—patent, copyright, trade secret, trademark, franchise—command equal public importance, are all available more or less as shields to the general policy against monopoly or restraints on competition and are all equally vulnerable to abuses of the shielding effect.⁸⁸ The policy considerations which fueled the growth of the misuse doctrine in the patent field apply equally to the other fields in all relevant respects. But the remedies may differ.

Turning from the public to private interest aspects of a misuse doctrine, the family-like relationship of franchisor and franchisees presents unique opportunities to find “willful acts which would be condemned or pronounced wrongful.” That is a charter of sufficient breadth to meet the challenge of the growing, ever-changing franchise institution and it forms the basis of a *per se* holding implemented through temporary and flexible remedies.

There is an increasing awareness in courts that the obligations they enforce at the instance of Hohfeldian plaintiffs or defendants derive less and less from the private law obligations contracted for between them as free-will actors of approximately equal bargaining power, but rather are based increasingly on status relationships which are defined by the needs of society, as best as courts can track such needs without excessive time-lags. What we have here is a reversal of the societal movement expressed in the Henry Maine theorem:

The movement of the progressive societies has been uniform in one respect. Through all its courses it has been distinguished by the gradual dissolution of family dependency and the growth of individual obligation in its place. The individual is steadily substituted for the Family, as the unit of which civil laws take account. . . . Nor is it difficult to see what is the tie between man and man which replaces by degree those forms of reciprocity in rights and duties which have their origin in the Family. It is Contract. Starting, as from one terminus of history, from a condition of society in which all the relations of Persons are summed up in the relations of Family, we seemed to have steadily moved towards a phase of social order in which all these relations arise from the free agreements of individuals. . . . The word Status may be usefully employed to construct a formula expressing the law of progress thus indicated we may say that the movement of the progressive societies has hitherto been a movement *from Status to Contract*.⁸⁹

It can be said in terms of the Maine theorem that the courts are enforcing (and in so doing, reflecting) a movement of the progressive societies from con-

87 Precision Instrument Mfg. Co. v. Automotive Maintenance Mach. Co., 324 U.S. 806, 815 (1945) (Frankfurter, J.) (patent fraud case).

88 For instance, few patent portfolios extant today could match the economic importance of the trademark and trade secret portfolios of the Eastman Kodak or Coca Cola companies.

89 H. MAINE, ANCIENT LAW: ITS CONNECTION WITH THE EARLY HISTORY OF SOCIETY AND ITS RELATION TO MODERN IDEAS 163-65 (1st ed. 1864).

tract to status whenever the underlying premises of a fair contract fail of realization in actual practice.⁹⁰

Such status should be exemplified in the categorization of a franchise as a license coupled with an interest or implemented in a requirement that a franchise cannot be terminated or subjected to a failure to renew unless the franchisor can sustain the burden of proving "good cause." Even upon such proof, there must be fair compensation for the property of the franchisee, including the goodwill of the business, just as the default of a mortgage would not tolerate the seizure of the mortgaged property without adequate compensation.⁹¹ In this case, the goodwill must encompass the fractional share of the franchisee in the proprietary interest in the trademark.

During the existence of the relationship, the parties to a franchise must be governed by mutual obligations of good faith, especially in the manner of their protecting the goodwill in the trademark and the secret status of any genuine trade secrets. Such standards have long prevailed wherever substantial rights of one party are entrusted to the independent administration of another. While the franchisee necessarily places his faith and confidence in the franchisor, the latter may also be substantially reliant on each franchisee, not merely for its own interest, but also as guardian for the interests of the other franchisees in the system.

Such reliance upon status properly assigns the family members of the franchise system to the community of interest they share in the business enterprise. While the trademark must continue to occupy a focal center, its umbrage would then be devoid of the power of abuse, on threat of all the sanctions at the disposal of a court of equity.

90 For the legal development of "contract" see: O. HOLMES, *THE COMMON LAW* 247-248 (1881); L. FRIEDMAN, *CONTRACT LAW IN AMERICA* 20 (1965); H. BERMAN & W. GREINER, *THE NATURE AND FUNCTIONS OF LAW* 497-644 (2d ed. 1966); A. SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* (1793); M. WEBER, *THE PROTESTANT ETHIC AND THE SPIRIT OF CAPITALISM* (1904-05).

91 See S-840, 93d Cong., 1st Sess. (1973) introduced on February 8, 1973, by Senator Philip A. Hart, providing no restriction for the termination or nonrenewal of a franchise, but requiring that if the franchisee be without fault, he shall be entitled to compensation for his loss, including his goodwill.