Brand Licensing

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This booklet has been prepared for general information. It is not an exhaustive statement of the law. For advice in applying this general information to your specific circumstances, and details of specialist commerce and technology law services Fox Williams provides, please contact Stephen Sidkin or Nigel Miller at Fox Williams.

1. Introduction

This booklet summarises the law of brand or trade mark licensing. It highlights the main points to consider when negotiating a licence for a brand. It sets out the principal items to be dealt with in a licence agreement by which a licensee is given the right to commercially exploit the value of a trade mark owned by another. It also provides practical guidance on the issues when choosing who to grant a licence to or to take from.

Not every point in this booklet will be relevant in all circumstances, nor is the checklist which is provided an exhaustive list of all matters that may apply in a particular case. As such, this booklet is not a substitute for specialist legal advice on a specific transaction or on the drafting of a licence itself.

2. What is a Brand?

A brand, or in legal terms a trade mark, provides an indication as to the origin of the goods or services to which it has been applied. In essence, a trade mark simply states "I made this". It distinguishes the goods or services of the trader from those of its competitors and rivals. From the point of view of the consumer, trade marks can be seen as an assurance of the identity and authenticity of a product. Depending on the reputation of the brand, a brand can indicate the exclusivity or quality of a product, its durability, its value for money, and so on.

3. The Importance of Brands

In the modern marketplace, the importance of brands can barely be overstated. Globalisation and the proliferation of mass produced competing goods mean that manufacturers and retailers are increasingly reliant on the brand loyalty of consumers. The value of brands is illustrated by the fact that brands such as Coca-Cola and Ford have estimated values running into billions of dollars. It was recently estimated that Grand Metropolitan's brands account for two-thirds of the company's assets.

4. Registered Trade Marks

There is no requirement in English law for trade marks to be registered, but registration has many advantages. It provides notice to other businesses of the registered proprietor's interest in the mark, and therefore acts as a deterrent against infringement. Proceedings brought against an infringer of a registered trade mark are straight forward when compared with an action against someone for infringing an unregistered trade mark (known as "passing off"). More information about how trade marks can be protected is set out in our practical booklet entitled *Brand Protection*.

The choice of a trade mark will be largely a commercial decision, but it will be important to ensure that the choice is governed by the legal restrictions on what can and cannot be registered as a trade mark. Under the Trade Marks Act 1994 (the "Act"), it is possible to register as a trade mark any sign which can be represented graphically and which is capable of distinguishing goods or services of one undertaking from those of other undertakings. In most cases, registered trade marks consist of words, numerals and graphic designs. It is also possible to register colours, music, sounds and smells (although the latter two categories in particular can be problematic).

The mark must be distinctive and it must not be possible to confuse it with another mark, whether registered or unregistered.

5. To Assign or to License?

It is possible to assign or license a trade mark. In an assignment the proprietor completely gives up his ownership of the rights transferred. In other words an assignment is a sale. By contrast, a licence merely grants someone the right to exploit the trade mark owner's rights in respect of the mark (or in respect of certain of the categories of goods and services for which it was registered).

Brand owners can use licensing arrangements to break into new markets. This applies equally to product markets and geographic markets. By way of example, a European clothes manufacturer could use a licensing arrangement to break into the American sunglasses market. If the arrangement is a success, the effect will be to strengthen the global value of the brand.

Trade mark licensing is particularly prevalent within certain sectors. One example is the fashion industry, where it is common for brand owners to license the rights to produce various goods to manufacturers. At the time this booklet was prepared it was reported in the trade press that Marks & Spencer had won the licence to produce a range of branded clothing for the 2002 World Cup. It was also reported that various Caterpillar licences had been transferred to new licensees.

6. Choosing a Licensee

The prospective licensor needs to consider carefully the suitability of any prospective licensee. In essence this requires an analysis of what are the attributes of a licensee which will make the licensing arrangement a success. Depending on the product or service in question, this can include a strong financial position (for example for capital expenditure, perhaps in plant and machinery) and an established and reliable distribution system.

A licensor will often want to see evidence of a proven track record in the manufacture, promotion, distribution and sale of comparable goods.

It is important for a licensor to have trust and confidence in a licensee. Trade mark licence arrangements will often require a significant degree of co-operation between the parties throughout the term of their relationship. It will also be imperative that the licensee does not act in a manner which could damage the overall value of the brand. This issue will be considered further below.

7. Choosing a Licensor

A prospective trade mark licensee will have his own agenda. Above all, he will require confidence in the commercial potential of the brand in the territory in which he operates. This will be particularly important where the licensee is providing a commitment to make minimum royalty payments.

8. The Licence: Legal and Practical Issues

8.1. Exclusive / sole / non-exclusive

The licensee may be appointed on an exclusive, sole or non-exclusive basis. An exclusive licence authorises the licensee to exploit the mark in the territory to the exclusion of all others, including the licensor, and therefore the licensee is (in theory at least) protected from competition. A sole licensee is granted a more limited protection from competition: the licensor himself reserves the right to compete with his licensee in the territory, but he promises not to appoint any other licensees. A non-exclusive licensee is not offered any protection from competition whatsoever and the licensor remains free to appoint other licensees in the territory.

Exclusive licences in particular can create competition law concerns. Nevertheless, exclusive licences are common in practice.

8.2. Territory

It is possible to grant a global licence in respect of a trade mark. However, it is much more common to grant licences country by country.

8.3. Activities to be covered by the licence

A licence may be granted in respect of the full range of commercial activities (manufacture, promotion, distribution and retail). Alternatively it is possible to grant one party a licence to manufacture the product, another to distribute it, and others to sell it to the consumer. The permutations are considerable, although there may be competition issues to consider.

8.4. Royalties

The royalties clause will often involve protracted negotiations. As a general rule, the greater the degree of exclusivity, the greater the royalty rate. The licensor frequently attempts to impose minimum royalty rates on the licensee. These guarantee a minimum return for the licensor and at the same time should incentivise the licensee.

The issue of royalties is in many respects a commercial one. However, from a legal perspective it will be crucial that the clause is carefully drafted so that it works well in practice. It is not sufficient for the clause to barely state the rate of royalty. Numerous other practical points should be considered. What is the method and currency of payment? When is payment due? How is it calculated? In respect of the last question, this will often be by reference to the net sale price, in which case this term must be clearly defined.

8.5. Usage and quality control

The value and importance of brands has already been discussed. A successful licensing arrangement will tend to increase the value of the owner's brand. However, there is also substantial scope for a licensee to damage the value of the brand. For this reason, it is of fundamental importance for the licensor that the licence contains suitable provisions on usage and quality control.

This is not just a concern for the licensor who uses his mark concurrently with his licensee. The licensor retains a reversionary interest in the mark in respect of which he grants a licence. When the licence comes to an end, the rights which were vested in the licensee will return to the licensor. If the usage of the mark was not carefully regulated during the currency of the licence, on termination the value of the mark may be damaged, possibly beyond repair. In the worst case scenario, the licensee's usage of the mark will compromise its validity.

Accordingly trade mark licences should contain usage and quality control provisions which will protect the licensor's interests. The licensee must be prevented from using the mark in any manner which could mislead the public with regard to the origin of the goods or lead to the mark becoming generic. The representation of the mark must be completely accurate at all times and carried out in accordance with the detailed instructions of the licensor. In order to police these provisions, it will be advisable to include rights to inspect samples of the goods, possibly at the licensee's expense.

These provisions will have to cover all aspects of the goods (such as their packaging and promotion). The licensor will wish to reserve the right to terminate the licence in cases of material breach.

8.6. Assignment and sub-licensing

The licence should specify what rights the parties have to assign or sub-license their interests. It is common for the licensor to specify that no assignment or sub-licensing is to be permitted by the licensee. This is because of the danger that the brand could be damaged by the activities of an assignee or sub-licensee, over whom the licensor would have no contractual control. One compromise is to allow the appointment of sub-licensees in respect of whom the licensor has indicated his written approval.

8.7. Advertising and marketing

The licensor may want to impose advertising and marketing obligations on the licensee, in order to maximise the likely return on the licence. At the very least the licensor should reserve rights of approval over advertising and marketing materials produced by or on behalf of the licensee (see section 8.5 above, “usage and quality control”).

8.8. Rights on third party infringement

Under the Act, a registered exclusive licensee can sue for trade mark infringement in the place of the registered proprietor. A non-exclusive licensee, by contrast, may only bring infringement proceedings if the registered proprietor fails to take action within two months of a request to do so by the licensee.

These rules are subject to agreement to the contrary. As such the issue of the parties’ rights in respect of third party infringements should be dealt with in the licence. Licensees may wish to be granted substantial rights in addition to the above statutory rights. For example, to call on the registered proprietor to co-operate fully (possibly at his own expense) in infringement proceedings brought by the licensee. However, it is common for the licensor to refuse to grant his licensee any rights in respect of third party infringements, including the statutory rights which would otherwise apply. This is because there is a risk for the licensor in giving up control of infringement proceedings: the Act permits a defendant to infringement proceedings brought by an exclusive licensee to challenge the validity of the registered mark.

8.9. Competition law

It will be important during the negotiations for a trade mark licence to consider UK and EU competition law (although as a result of recent reforms to UK competition rules there is now greater consistency between the two systems).

European competition law

It will usually be necessary to have regard to European competition rules, even if the licence will only cover the UK.

Article 81(1) of the EC Treaty prohibits agreements between independent undertakings which may affect trade between Member States of the EU and which have as their object or effect the prevention, restriction or distortion of competition within the common market.

Agreements which contravene Article 81(1) are automatically void - at least in respect of their “anti-competitive” provisions - unless they have been “notified” to and “exempted” by the European Commission. Notification is a cumbersome process and the Commission adopts very few formal decisions of exemption each year.

Infringing undertakings may also face substantial fines levied by the European Commission and actions for damages brought by third parties who have sustained damage as a result of the infringement.

UK competition law

The Competition Act 1998, which came into force in March 2000, introduced a new regulatory regime within the United Kingdom. The competition regime in the UK is now modelled on the EU system.

The Competition Act 2000 prohibits all agreements between undertakings which may affect trade within the UK and which have as their object or effect the prevention, restriction or distortion of competition within the UK or a part of the UK.

Anti-competitive behaviour or arrangements in whatever form - written, unwritten, formal or informal – are caught.

An agreement of any kind, including a trade mark licence, will be caught by the prohibition only if it has an "appreciable" effect on competition within the UK. In general an agreement will have no appreciable effect on competition if the parties' combined share of the relevant market does not exceed 25 per cent. Exceptions to this are agreements which directly or indirectly fix prices, impose minimum resale prices, or share markets. Such agreements will be judged by the Director-General of Fair Trading as having an appreciable effect on competition (even where the parties' combined market share is less than 25 per cent.).

Competition law – practical guidance

Depending on the circumstances, it may be that the licence can be brought within an exemption or an exception. As a general rule, terms which are necessary to maintain the reputation of the trade mark will not normally fall foul of the competition rules provided that they do not go beyond what is necessary.

Accordingly, it is unlikely that terms regulating the quality of the marked goods will infringe. It will also generally be acceptable to tie the use of the mark to the purchase of ancillary goods or services from the licensor if this is necessary to maintain the quality of the branded goods.

However, certain provisions should be avoided. For example, price-fixing terms and absolute bans on the export of marked goods outside the territory. With reference to the latter example and depending on the circumstances, it may be acceptable for the licensor to seek to prevent the licensee from actively marketing the goods outside the territory.

8.10. Registration

In the UK trade mark licences are registrable transactions under the Act. Registration is not mandatory but it is advisable. Until an application is made to register the transaction:

- the grant of the licence will be ineffective against a person who acquires a "conflicting interest" in the mark in ignorance of it; and
- the licensee will not obtain the statutory rights to take infringement proceedings in certain circumstances.

Further, a licensee will be precluded from obtaining damages or an account of profits relating to any period when the licence was unregistered.

8.11. Taxation

In most cases the royalties which are received by the licensor will be treated as income or trading receipts in the hands of the licensor for corporation or income tax purposes. From the point of view of the licensee, the royalties paid for the use of the trade mark will usually be treated as trading expenses and, accordingly, they will be deductible in the calculation of its profits.

Fees and expenses of applications for registration and extensions are allowable as a deduction against trading profits. The obligation to withhold tax on royalties by the licensee is a complex one but since 6 April 2001, there is no withholding requirement where the licensor is within the charge to UK corporation tax. From 1 April 2002, assignments or transfers of trade marks will more closely follow the accounting treatment of such sales and will, usually, be taxed as income rather than as capital.

Since 28 March 2000, stamp duty has not been levied on transfers of intellectual property rights.

The assignment or transfer of a trade mark will almost certainly constitute (or form part of) a supply of goods or services made in the course of business which is potentially subject to VAT.

The tax consequences of a trade mark licence may be a factor in deciding on a trade mark licensing strategy. It is advisable to take specialist tax advice.

8.12. Confidentiality

Depending on the type of goods or services concerned, it may be prudent for the licensor to seek a confidentiality undertaking from the licensee. This will be particularly the case where the licensor will be providing the licensee with related know-how or other intellectual property rights under the terms of the licence. It may also be advisable for the licensor to insist upon a confidentiality agreement before negotiations for the licence begin.

9. Trade Mark Licence Agreement Checklist

9.1. Parties

- state clearly the identity of the parties. If a company, state the place of incorporation, registered/principal office and any registered number

- are the obligations of the licensee to be guaranteed?

9.2. Recitals

9.3. Definitions

- the Commencement Date
- the Territory
- Net Sale Price
- the products/services which are the subject of the licence
- the Trade Mark(s)

9.4. Scope of the appointment

- is the licence exclusive / sole / non-exclusive?
- “active” sales beyond the territory not permitted; “passive” sales may be made

9.5. Duration of the licence

- fixed period
- any initial minimum period
- right to renew/automatic renewal
- right to terminate by notice
- length of notice period

9.6. *The licence i.e. rights granted*

9.7. *Responsibilities of the licensee*

- quality of products and usage of mark
- to supply promotional literature and/or samples for licensor's approval
- to supply accounts to the licensor

9.8. *Responsibilities of the licensor*

- to provide the requisite know-how and assistance
- maintenance of registration of the mark(s)

9.9. *Registration of the licence*

9.10. *Ownership of the trade mark and goodwill*

- acceptance of the licensor's ownership of the trade mark and goodwill by the licensee and agreement not to challenge

9.11. *Infringements*

- control of proceedings
- co-operation in proceedings
- costs of proceedings
- rights in respect of damages or settlements

9.12. *Assignments and sub-licensing*

9.13. *Warranties and indemnity*

- warranty from licensor in respect of valid ownership of mark
- indemnity from licensor in respect of claims that licensee's use of the mark infringes rights of third party
- indemnity from licensee in respect of any other claims arising from licensee's use of the mark (e.g. product liability)

9.14. Royalty

- basis of royalties
- time, manner and place of payment
- currency of payment
- minimum royalty?

9.15. Termination

- on material breach by licensee / either party
- on insolvency of the licensee / either party
- on change in control of licensee
- on failure to achieve sales targets
- on notice
- on purported assignment by licensee
- if the agreement becomes illegal

9.16. Consequences of termination

- royalty entitlements of licensee on termination
- obligations of licensee on termination
- rights and liabilities of the parties to survive termination

9.17. Insurance

9.18. Taxation

- all sums exclusive of VAT etc.
- withholding tax

9.19. Choice of law, alternative dispute resolution, submission to the jurisdiction and address for service

9.20. Whole agreement provision

9.21. No joint venture or partnership

9.22. Other boilerplate (e.g force majeure)

10. Fox Williams

Fox Williams is an independent business law firm based in the City of London. We have a strong reputation for our core areas practice of corporate, employment, e-commerce and partnership law.

The firm's areas of specialisms include corporate, employment, dispute resolution, commerce & technology, property and partnership. Operating as business partners with our clients, we have built a solid reputation for advising on complex legal and regulatory issues in our core areas of expertise. A distinguishing feature of Fox Williams is that it is often first choice for referrals of work from other law firms when City expertise is required.

The firm's foundations are built upon an entrepreneurial spirit – which enables us to understand our clients aspirations, current needs and future requirements. We give clients a high degree of partner involvement, with the objective of delivering a fast and responsive service. At the same time, we strive to create a happy and efficient working environment for all members of the firm, which has resulted in an Investors in People accreditation.

We adopt a particular approach to our work, which involves making a special effort to understand the business needs of our clients, and delivering a fast, responsive service. This was recently acknowledged in our nomination for **Niche Firm of the Year 2003** by The Lawyer magazine.

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