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The Long Road to Resolving Conflicts Between Trademarks and Geographical Indications

*Burkhard Goebel and Manuela Groeschl*

The New Chinese Trademark Law

中国新商标法

*Paul Kossof*

Trademark Licensing: The Once and Future Narrative

*Neil Wilkof*

*Commentary:* Judge Richard Posner and Consumer Surveys

*Jerre B. Swann*

*Commentary:* Let's Kill the "Naked License" Defense

*Pamela S. Chestek*

## COMMENTARY

### LET'S KILL THE "NAKED LICENSE" DEFENSE

*By Pamela S. Chestek\**

You will search the Lanham Act in vain for the term "naked license." Nevertheless, there is a robust trademark defense called the "naked license," which strips companies of their trademark rights because they failed to adhere to a legal standard that has little relationship to the policy basis or the goals of trademark law. Worse, consumers are collateral damage; the doctrine is applied without any consideration of the consumer's interest in issues of trademark law. All of this when, remarkably, there is no statutory basis in the Lanham Act for the defense as it is currently defined. It's time to eliminate the defense and go back to the language of the statute when deciding whether a trademark owner has forfeited its rights.

In general terms, "naked" or "uncontrolled" licensing of a trademark is when a licensor allows a licensee to use the mark on any quality or type of goods or services that the licensee chooses without adequate oversight.<sup>1</sup> When courts cite a statutory basis for the naked license defense (and many do not), one of two sections of the Lanham Act<sup>2</sup> is typically mentioned: Section 5, which is about "related companies," and Section 45, which provides the definition of "abandoned."

Section 5 says, "Where a registered mark or a mark sought to be registered is or may be used legitimately by related companies [i.e., those whose use is controlled by the trademark owner],<sup>3</sup> such use shall inure to the benefit of the registrant or applicant for registration, provided such mark is not used in such manner as to deceive the public."<sup>4</sup> Those courts on the Section 5 side of the argument say that Section 5 imposes an affirmative duty on a trademark owner to control the quality of the goods and services

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1. *Stanfield v. Osborne Indus., Inc.*, 52 F.3d 867, 871 (10th Cir.), *cert. denied*, 516 U.S. 920, 116 S. Ct. 314, 133 L. Ed. 2d 217 (1995).

2. United States Trademark Act of 1946, as amended ("Lanham Act"), §§ 1-45, 15 U.S.C. §§ 1051-1127 (2012).

3. Lanham Act § 45, 15 U.S.C. § 1127 (2012) (defining "related company").

4. Lanham Act § 5, 15 U.S.C. § 1055 (2012).

and, absent that control, the mark has been abandoned through naked licensing.<sup>5</sup>

But parsing the statute shows this is a plain misreading: “Where a registered mark . . . is . . . used legitimately by related companies, such use shall inure to the benefit of the registrant or applicant for registration . . .” In other words, this is a one-way street: if one controls the use, and the use does not deceive the public, then the licensee’s use will inure to the benefit of the licensor. That is not the same as imposing a duty to control the quality of goods and services; it merely describes a benefit that accrues if the trademark owner does, in fact, exercise adequate control.<sup>6</sup>

Rather, the appropriate statutory basis for a naked license is that it may effect an abandonment under the second definition of “abandoned” in Section 45(2): “When any course of conduct of the owner, including acts of omission as well as commission, causes the mark to . . . lose its significance as a mark.”<sup>7</sup>

The Fifth Circuit explained why Section 45(2) is the correct statutory basis for the naked license defense:

Th[e] statutory directive reflects the policy considerations which underlie the naked licensing defense: if a trademark owner allows licensees to depart from his quality standards, the public will be misled, and the trademark will cease to have utility as an informational device. A trademark owner who allows this to occur loses his right to use the mark. Conversely, if a trademark has not ceased to function as an indicator of origin there is no reason to believe that the public will be misled; under these circumstances, neither the express declaration of Congress’s intent in subsection 1127(2) nor the corollary policy considerations which underlie the doctrine of naked licensing warrant a finding that the trademark owner has forfeited his rights in the mark.<sup>8</sup>

But consider the normative legal standard for a “naked license” in the Restatement of Unfair Competition.<sup>9</sup> It does not

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5. See, e.g., *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 51 (9th Cir. 1971).

6. See *Exxon Corp. v. Oxxford Clothes, Inc.*, 109 F.3d 1070, 1079, n.12 (5th Cir. 1997) (stating that “Section 1055 does not of itself establish a naked licensing defense” but merely describes a relationship).

7. Lanham Act § 45(2), 15 U.S.C. § 1127(2) (2012); 3 J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition* § 18:48 (4th ed.) (stating that the § 45(2) definition of abandoned is the basis for the naked license defense).

8. *Exxon Corp.*, 109 F.3d at 1079-80 (internal citations, quotation marks, brackets and ellipsis omitted).

9. For a discussion of the changing view of the quality assurance role in trademark licensing, and in particular the United Kingdom’s rejection of the “naked license” approach, see Neil Wilkof, *Trademark Licensing: The Once and Future Narrative*, 104 TMR 1, 9-11 (2014).

describe a situation where a naked license necessarily causes a loss of significance as a mark, and, in fact, acknowledges that loss of significance has nothing to do with it:

An uncontrolled or “naked” license authorizes use of the trademark on goods or services for which the trademark owner cannot offer a meaningful assurance of quality. When a trademark owner fails to exercise reasonable control over the use of the mark by a licensee, the presence of the mark on the licensee’s goods or services misrepresents their connection with the trademark owner since the mark no longer identifies goods and services that are under the control of the owner of the mark. *Although prospective purchasers may continue to perceive the designation as a trademark*, the courts have traditionally treated an erosion of the designation’s capacity for accurate identification resulting from uncontrolled licensing as a loss of trademark significance, thus subjecting the owner of the mark to a claim of abandonment . . . .<sup>10</sup>

If by statutory definition abandonment is only where there is loss of significance as a mark, how can the doctrine be a valid application of the statute if prospective purchasers continue to perceive the designation as a trademark even after it has supposedly been “abandoned” through naked licensing?

Two recent opinions from the Court of the Appeals for the Ninth and Seventh Circuits exemplify how this defense has lost all statutory grounding. The reproach for the plaintiffs’ behavior is clear in the decisions, but what is entirely absent is any examination of whether there has been a loss of trademark significance.

In *FreecycleSunnyvale v. Freecycle Network*,<sup>11</sup> the court examined a trademark used by loosely organized volunteer groups under the umbrella of “The Freecycle Network” (TFN).<sup>12</sup> Based only on evidence about the licensor’s behavior with one licensee,<sup>13</sup> which was the accused infringer, the court held that the use was a naked license and stripped TFN of its trademark rights in the word marks FREECYCLE and THE FREECYCLE NETWORK, as well as a very distinctive logo:

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10. Restatement (Third) Unfair Competition § 33 cmt. b (1995) (emphasis added).

11. 626 F.3d 509 (9th Cir. 2010).

12. *Id.* at 512.

13. *Id.* at 516-18. The control TFN exercised was a prohibition on commercial use, the general rule that the members “Keep it Free, Legal & Appropriate for All Ages,” and the use of democratic leadership structure in which decisions were made through a process of surveys and discussions among volunteer moderators.



As a result, FreecycleSunnyvale may continue to use the following logo:



What is interesting here is that FreecycleSunnyvale quite possibly could have shown, without resorting to any mention of a “naked license,” that the word “freecycle” had lost its significance as a mark. The originator of the term “freecycle” changed his mind about trying to enforce any trademark rights in the word,<sup>14</sup> so under proper scrutiny it could be that the word “freecycle” indeed has become a generic term. But rather than requiring some rigor in the application of the law as written, the court instead just punished behavior it considered too lax.

The Seventh Circuit similarly went astray in *Eva’s Bridal Ltd. v. Halanick Enterprises, Inc.*<sup>15</sup> This was an intra-family dispute; different family members ran different “Eva’s Bridal” stores. The court concluded that there was a naked license with this as the sole justification:

The written agreement did not require Nayef and Halanick to operate the Orland Park store in any particular way and did not give the licensor any power of supervision over how the business was conducted. Nancy conceded during her deposition that she and her husband Said never tried to control any aspect of how defendants’ shop operated or how the mark was used.

The court made a passing reference to trademark significance: “A person who visited Eva’s Bridal of Oak Lawn and then Eva’s

14. *Freecycle Network, Inc. v. Oey*, 505 F.3d 898, 901 (9th Cir. 2007).

15. 639 F.3d 788, 789 (7th Cir. 2011).

Bridal of Orland Park *might not* have found a common ambiance or means of doing business.”<sup>16</sup> But a court’s speculation shouldn’t be good enough when the law requires actual loss, yet the court never considered whether consumers might think the stores were a sole source. Did the stores co-market? Were the two stores in geographic locales that might lead a consumer to think they were related? Did they use the same logotype for the signage? Could one store get a dress sent over from another store? Those are signals understood by a consumer as indicating it was a chain of stores—that is, one source. If, instead, consumers never had reason to believe the two stores were related—store employees said to customers they weren’t related, they had different trade dress, or they were far apart geographically—then one might be able to agree that the original Eva’s Bridal had abandoned the mark with respect to the defendant store. But without any evidence whatsoever of this kind, and based solely on the trademark owner’s behavior, the court of appeals held that the mark was abandoned.

Note what else happens when a court considers only the trademark owner’s behavior: the consumer stake in the question is entirely absent from the court’s reasoning when instead it should be paramount. Certainly in the *Freecycle* case, based on the sheer similarity of the logos consumers will assume that the two entities are related to each other and may suffer harm as the result of true confusion about their relationship, like making a financial donation to one meant for the other. In *Eva’s Bridal*, we just don’t have enough facts to tell.

There are circumstances in which it may be inequitable to force a defendant to cease use of a mark, but invalidating an owner’s rights based on a naked license is not the solution. Implied license, laches, or equitable estoppel defenses may solve the parties’ conflict without having an outcome that is the ultimate penalty for a trademark owner and that deprives consumers of what, to them, remains an indicator of source. The trademark owner’s behavior toward its licensees may or may not have caused a loss of significance, but the ultimate legal question, as defined by the statute, is the effect, not the cause. It’s time to kill the naked license defense.

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16. *Id.* at 791 (emphasis added).