AN OVERVIEW OF TRADEMARK PROTECTION
FOR FRANCHISEES AND FRANCHISEE ASSOCIATIONS

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I. Introduction and Scope of Article

Failure to carefully protect a trademark will result in both the loss of brand identity and of the exclusive use of a trademark. Franchisees and Franchisee Associations are often unaware of why franchisors, under the claim of protecting trademarks, take actions that seem unfair, capricious and Draconian. This article provides a background of trademark laws and an overview of franchisor's obligations to protect trademarks in order to help franchisees and franchisee associations understand how and why franchisors do what they do.

II. Definition of Trademark and Governing Law

A. Trademark Defined

Generally, a trademark includes any word, name, symbol, or device or any combination thereof used to identify and distinguish his or her goods, including a unique product, from those manufactured or sold by others, and to indicate the source of the goods, even if that source is unknown. A trademark generally refers to a mark associated with products. A service mark generally refers to a mark associated with services. For simplicity, in this article the terms "trademark", "mark", and "service mark" are used interchangeably.

Although trademark rights can exist without regard to any statutory authority, trademark rights are governed, for the most part, by federal law. The Trademark Act of 1946 (15 USC 1051, *et seq.*), commonly referred to as the "Lanham Act", defines the statutory and common law boundaries of trademarks. More specifically, the Lanham Act identifies the process through which trademark owners can obtain registration of their marks and it also sets forth the remedies that may be pursued upon the occurrence of any alleged trademark infringement. Additionally, states have propounded their own laws regulating trademark use which typically follow federal case precedent. (*See also, Illinois Trademark Registration and Protection Act, 765 ILCS 1036/1 et seq.*)

B. Disclosure Requirements

Franchisees' first exposure to a franchisor's rights to a trademark is typically from the initial disclosure documents provided as part of the franchise sales process. To comply with federal disclosure requirements, generally anyone offering a franchise in the United States is required to provide a prospective franchisee with a disclosure document, most often in the form of a Uniform Franchise Offering Circular ("UFOC"). If there are state specific franchise law where the franchisee is located or is to operate, then the franchisor must also comply with those states' disclosure laws. As to the disclosure requirements, this usually means providing a state specific rider. The first state franchise disclosure law was enacted in California in 1971.[1] Since then, seventeen other states have implemented "similar" laws. Of the eighteen states currently with such laws in effect, some require registration, some impose specified disclosures, and others simply prohibit misrepresentation.[2]

Many franchisees, franchisee associations and even franchisors are confused regarding the relationship between the federal and state disclosure laws. The easiest way to understand the core distinction is to recognize that there is no direct private right of action under the federal disclosure requirements. This means that only federal regulators have the right granted by the disclosure laws to bring an action against a franchisor for violations of the federal disclosure laws. In reality, only the most egregious violations are prosecuted by federal regulators. States are permitted, however, to provide more protection than what is available under federal law. State franchise laws usually provide for a direct private right of action for injured franchisees or prospective franchisees to sue franchisors. Franchisees located in states without state franchise laws typically are required to sue franchisors under contract law or by arguing that the failure to provide a proper federal disclosure document constitutes fraud under a consumer fraud or deceptive practices act. In other words, if a franchisor improperly discloses trademark information in a state with a state disclosure law, the franchisor will have violated both federal and state requirements and the injured party could sue for violation of the state disclosure law and perhaps under the state deceptive trade practices act.

C. UFOC Item 13 (Trademark Disclosures)

The fundamental idea behind a "uniform" disclosure document is to create a device whereby prospective franchisees will know where to look for specific information. Although a franchise agreement will cover trademark issues, there generally is no requirement that it cover such a topic in any specific section. In a UFOC, trademark information should be contained in Item 13. Beyond disclosing the principal trademarks to be licensed to the franchisee, there are five specific areas that must be addressed in Item 13. They are as follows:

(1) A statement as to whether the principal trademarks are registered with the United Stated Patent and Trademark Office;

(2) A statement disclosing currently effective material determinations of the patent and trademark office, trademark trial and appeal board, the trademark administrator of the state or any court; pending infringement, opposition or cancellation; and pending material litigation involving the principal trademarks;

(3) A statement disclosing agreements currently in effect which significantly limit the rights of the franchisor to use or license the use of trademarks listed in Item 13 in a manner material to the franchise;

[1] CCH-EXP, Bus. Fran. Guide, ¶300, Misrepresentation, Disclosure, and Registration.
[2] *Id.*

(4) A statement as to whether the franchisor must protect the franchisee's right to use the principal trademarks listed in Item 13, and must protect the franchisee against claims of infringement or unfair competition arising out of the franchisee's use of them; and

(5) A statement as to whether the franchisor actually knows of either superior prior rights or infringing uses that could materially affect the franchisee's use of the principal trademarks in this state or the state in which the franchised business is to be located.

In theory, disclosures in Item 13 should give franchisees what they need to know about the franchisor's trademarks. In practice, this is not always the case. For example, Item 13 might disclose that the franchisor has not registered the trademarks with the United States Patent and Trademark Office and has registered only in certain states because others may be utilizing similar names. If the franchisor does not "actually know" of a superior or prior use in the franchisee's territory, it may be sufficient to merely warn the franchisee of this potential problem. Moreover, franchisees and franchisee associations should be aware that, when properly disclosed, a franchisor is generally permitted to change a trademark without compensating franchisees.

III. Establishing Trademark Rights and Trademark Registration

There are generally two valid bases for which franchisors may establish trademark rights. These are by the common law and by registration. Under the common law, rights can be created by continuous use of a mark in commerce relating to one's business or trade. In such cases, so long as a franchisor was the first to use a trademark continuously, it could be afforded ownership rights to its mark. Under common law, "use" meant sales to the public of a product with the mark attached.[3] The justification for granting trademark rights to those first in the marketplace was that, over time, goodwill can be obtained through more and more awareness of the mark and it would be unfair to allow another party to benefit from such goodwill through the use of a confusingly similar mark. In the franchise context, however, it is increasingly uncommon for franchisors to rely solely on common law rights.

Through the Lanham Act, 15 U.S.C. 1051(b), "a person who has a bona fide intention, under circumstances showing the good faith of such person, to use a trademark in commerce, may request registration of its trademark on the principal register… by filing an application in the Patent and Trademark Office." Not only may ownership rights to a trademark be granted ***before*** its use in commerce, but the potential trademark user is moreover granted such ownership rights as of the date of application. Consequently, the race to establish trademark rights is more appropriately directed to the Patent and Trademark Office and not to the marketplace.[4] Yet, even though one has registered its mark at the Patent and Trademark Office, use of that trademark is only allowed if no other senior user, who has been continuously using the mark, has priority.[5] A

[3] *Zazu Designs v. L'Oreal S.A.*, 979 F.2d 499, 502-03 n. 1 (7th Cir. 1992).
[4] *See Zazu Designs*, 979 F.2d at 503.
[5] *Charter Nat'l Bank & Trust v. Charter One Fin., Inc.*, 2001 U.S. Dist. LEXIS 6531, *4 (2001); 15 U.S.C. 1065.

trademark application is therefore always subject to previously established common law rights of another party.[6]

In order to be federally registered[7] or to register in many states, a mark must be capable of distinguishing the applicant's goods from those of others.[8] Marks are often classified in categories of generally increasing distinctiveness; they may be (1) generic; (2) descriptive; (3) suggestive; (4) arbitrary; or (5) fanciful.[9] The latter three categories of marks, because their intrinsic nature serves to identify a particular source of a product, are deemed inherently distinctive and are entitled to protection.[10] In contrast, generic marks are not registerable as trademarks.[11]

While the benefits of registration might be intuitive, they include, among others, the following:

(1) Prima facie evidence of the registration's validity, of the registrant's ownership of the mark, and of the registrant's exclusive right to use the mark in commerce in connection with the goods or services specified in the registration certificate[12];

(2) Constructive use of the mark, conferring a right of priority, nationwide in effect[13], as of the date of application[14]; and

(3) Inconstestability of the right to use the mark (after continuous use of the mark for five years after registration).[15]

IV. What Franchisors Must Do to Protect the Brand

A. Quality Control

Registering and properly disclosing information regarding the marks are only the beginning of what a franchisor must do to protect its trademarks. To protect trademarks, a franchisor must have "adequate control" over the quality of goods or services offered under the mark. The Franchisor must also control certain aspects of the operations of its franchisees to ensure that the trademark is not used to deceive or mislead the public as to the quality of the goods or services bearing the name.[16] The rationale for this requirement is that marks are treated

[6] *Charter Nat'l,* 2001 U.S. Dist. LEXIS at *4-5.
[7] If it is not possible to get a federal trademark, franchisors not willing to change the mark often seek state registrations which are beyond the scope of this article.
[8] *Two Pesos v. Taco Cabana,* 505 U.S. 763, 768 (1992); 15 U.S.C. 1052.
[9] *Two Pesos,* 505 U.S. at 768.
[10] *Two Pesos,* 505 U.S. at 768.
[11] *Id.*
[12] 15 U.S.C. 1057(b).
[13] As mentioned *supra*, at 4, this nationwide priority may be subject to the rights of prior users or registrants.
[14] 15 U.S.C. 1057(c).
[15] 15 U.S.C. 1065.
[16] *Weber-Stephen Prods. Co. v. North American Prods.,* 1983 U.S. Dist. LEXIS 14926, *3.

by purchasers as an indication that the trademark owner is associated with the product.[17] Customers rely upon the owner's reputation when they select the trademarked goods and, if a trademark owner allows franchisees to depart from its quality standards, the public will be misled, and the trademark will cease to have utility as an informational device.[18] Consequently, a trademark owner who allows this to occur loses its right to use the mark. In this manner, naked, or uncontrolled franchising of a mark results in abandonment by the franchisor. The term "control" is not defined in the Lanham Act.[19] Many courts, however, hold that a trademark owner must exercise actual control over its licensee, and may not rely on a merely contractual or passive right to control.[20] The critical question is whether the owner of the mark sufficiently policed and inspected its licensees' operations to guarantee the quality of the products they sold under its trademarks to the public.[21]

Mr. Kaplan asserts that it is the interplay between the mandate of sufficient control to protect trademarks and the broad latitude courts give to franchisors to protect trademarks, which causes the most friction among franchisees. On the one hand, a franchisee with a myopic view of its business world would not view the harm of displaying an advertisement using the trademark that has been approved ten times before, but not for the current use. The franchisor, on the other hand, could easily argue that its failure to enforce the advertising requirement shows a lack of control and that this lack of control can not only hurt the brand, but it can result in the loss of the trademarks. Mr. Kaplan also states that it has been his experience that it is uncommon for franchisors to demand that franchisees follow the "system" without a good faith basis for doing so. Rarely, however, are those good intentions communicated effectively. "It is our way or the highway" is often the only message sent.

B. Trademark Infringement and Equitable Relief

Franchisors are also required to take affirmative action against any actual or perceived infringement of their trademarks upon having notice of the same. In other words, a franchisor that does nothing in the face of infringement will lose its trademarks. To protect franchisors from infringement, Section 32(1) of the Lanham Act was enacted to prohibit the "use in commerce… of any reproduction, counterfeit, copy, or colorful imitation of a registered mark in a manner that is likely to cause confusion, or to cause mistake or to deceive…"[22] Likewise, Section 43 of the Lanham Act prohibits the use "in commerce of any word, term, name, symbol or device which… is likely to cause confusion, or to cause mistake or to deceive as to the affiliation, connection, or association of… the mark, owner, and a third party."[23]

To prevail in a trademark infringement claim, a franchisor must prove (1) that its trademark is inherently distinctive or has acquired secondary meaning and (2) that consumers are likely to confuse defendant's mark with the trademark holder's mark.[24] Since a federally

[17] *Weber-Stephen Prods. Co.,* 1983 U.S. Dist. LEXIS 14926 at *3.
[18] *Id.*
[19] *See Id. at *4.*
[20] *Weber-Stephen Prods. Co.,* 1983 U.S. Dist. LEXIS 14926 at *4.
[21] *Id. at* *4-5.
[22] 15 U.S.C. 1114.
[23] 15 U.S.C. 1125.
[24] *Empire Indus. v. Tony (U.S.A.), Inc.,* 1998 U.S. Dist. LEXIS 10904, *3.

registered mark is presumptively valid (although rebuttable[25]), the primary issue therefore usually involves the "likelihood of confusion". In determining a likelihood of confusion, courts consider several factors to be important: (1) the degree of similarity between the marks in appearance and suggestion; (2) the similarity of the products in which the marks and trade dresses are used, (3) the area and manner of concurrent use, (4) the degree of care likely to be exercised by consumers; (5) the strength of the complainant's trademark or trade dress; (6) actual confusion; and (7) intent on the part of the alleged infringer to "palm off" its product and packaging as the complainant's.[26] No single factor, alone, is dispositive, and some of these factors may weigh more heavily than others depending on the particular circumstances of the case.

When seeking relief from apparent infringement, franchisors most often look to the equitable forms of relief known as a motion for temporary restraining order or a preliminary injunction. Defined broadly, a preliminary injunction is an injunction that is issued to protect a plaintiff from irreparable injury and to preserve the court's power to render a meaningful decision after a trial on the merits.[27] When used effectively, in the context of trademark infringement, franchisors can enjoin unauthorized use of the mark, thereby relieving themselves of perceived negative activities that may be hurting the franchise system.

Whether a court will grant a preliminary injunction is based on the evaluation of certain elements. The party seeking the preliminary injunction has the burden of demonstrating that: (1) it has a reasonable likelihood of success on the merits of its underlying claim; (2) it has no adequate remedy at law; and (3) it will suffer irreparable harm without the preliminary injunction.[28] If the party seeking the preliminary injunction meets those burdens, the court then must consider any irreparable harm the preliminary injunction might impose upon the party against which the injunction is sought and whether the preliminary injunction would harm or foster the public interest.[29]

Since the presence or absence of irreparable harm is so influential to the grant or denial of a preliminary injunction, a common approach in defense of such an action is the demonstration of inexcusable delay on the part of the trademark owner in commencing the lawsuit. The rationale here is that, if a franchisor was aware of some sort of infringement and failed to seek relief immediately upon obtaining such awareness, then the defendant may have a relatively strong argument that the franchisor does not, in fact, have an immediate and irreparable injury of which to complain. The general rule in evaluating the issue of delay is that time should run from the date the complainant knew or should have known of the defendant's infringement to the date the complainant filed its preliminary injunction motion.[30] It has been Mr. Kaplan's experience, however, that if a franchisor has let a franchisee perform some non-conforming act, it will send a default notice revoking any prior authority to take such actions, thus starting the clock anew.

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[25] *See supra*, at 4.
[26] *Empire Indus.*, at *28-29.
[27] *Amsted Indus. v. National Castings*, 16 U.S.P.Q.2D (BNA) 1737, *66 (1990).
[28] *AM Gen. Corp. v. Daimlerchrysler Corp.*, 311 F.3d 796, 803 (2002).
[29] *AM Gen. Corp.*, 311 F.3d at 803.
[30] *See International Franchise Association Legal Symposium, May 2005,* presented by William M. Bryner & Marlene M. Gordon, at 16.

Any franchisee involved with an emergency injunction proceeding is aware that it may occur within a very short time after a lawsuit is filed, sometimes the same day. When Mr. Kaplan represented franchisors in seeking emergency relief, he would prepare all the witnesses before the lawsuit was filed, serve the papers on the franchisee by facsimile or personal delivery a few minutes before filing the papers with the court and then request that the judge's clerk schedule an initial hearing that afternoon. Typically, the initial hearing would be scheduled that afternoon or the following morning. If a franchisee or franchisee association is presented with a motion for temporary restraining order or preliminary injunction, it is critical that they immediately seek counsel familiar with franchise issues and such motions. Typically, the party that "wins" the preliminary injunction "wins" the case.

i. Holdover Franchisees

Once a franchisee is terminated, per its terms or otherwise, the franchisee has no right to continue using the marks.[31] Despite this universally accepted rule, many trademark infringement matters arise in connection with a "holdover" franchisee. This situation commonly occurs when a former franchisee continues to use the franchisor's principal trademarks after the termination or expiration of the franchise agreement, or, when the franchisee does not remove all such vestiges of the trademark, which is often nearly impossible to do. In such cases, the franchisor must show that the marks were being used without the consent of the franchisor and that the unauthorized use is likely to deceive, cause confusion, or result in a mistake. If a plaintiff franchisor is successful in meeting this burden, the courts are empowered to require an infringing franchisee to "deidentify" from the franchisor. In other words, an infringer can be compelled to distinguish its goods or services from those of the trademark owner. Such relief is granted to the franchisor so as to combat the perception that a franchisor has failed to meet its "quality control" obligations and to prevent the franchise's reputation from suffering injury to its goodwill. It should also be noted that merely removing the trademarks before a hearing does not necessarily prevent the issuance of an order and an award of attorneys' fees and costs. It also has been Mr. Kaplan's experience that if the franchise agreement contains an arbitration clause and the franchisee can argue in good faith that the termination was wrongful and present evidence to that effect, many judges are reluctant to require franchisees to deidentify before a ruling on the merits by the arbitrator.

ii. Domain Name Disputes

Since the advent of the Internet, concerns with respect to imitation and misappropriation of others' creative efforts have grown substantially. Although a domain name, alone, is not characterized as a "trademark", it can become a protectible mark through establishment of its use in commerce.[32] For instance, if a domain name acts as a source identifier overall (i.e. www.dominos.com), it can be claimed as a mark; and, consequently, if a third party uses such name in a manner likely to cause confusion, it can be the subject of an infringement suit.[33] It has

[31] *Jake Flowers, Inc. v. Kaiser*, 2002 U.S. Dist. LEXIS 24929, *16.
[32] *See International Franchise Association Legal Symposium, May 2005*, presented by William M. Bryner & Marlene M. Gordon, at 32.
[33] For a general discussion on domain name issues, s*ee Id.* at 32.

been Mr. Kaplan's experience that franchisors are very reluctant to allow franchisee associations to utilize any portion of the franchisor's name in the association's domain name.

The various types of misuse found on the Internet include: cybersquatting, typosquatting, domain name hijacking, wrongful use of metatags and linking. Just as with any other alleged unauthorized use of a mark in commerce, franchisors may seek to enforce their rights to domain names through the court system on the basis of infringement or unfair competition. Almost all new franchise agreements now have provisions specifically addressing Internet and domain name usage.

C. Prevention of Dilution

In 1995, federal legislators created a new basis for which owners of famous trademarks could pursue relief. The Federal Trademark Dilution Act (FTDA, effective in 1996) protects trademark owners from "dilution" of the distinctive quality of their marks. Until 2006, dilution was defined as "the lessening of the capacity of a famous mark to identify and distinguish goods or services, regardless of the presence or absence of (1) competition between the owner of the famous mark and other parties, or (2) likelihood of confusion, mistake or deception". Independent from traditional trademark theory, the FTDA differs in at least one significant way: the plaintiff need not show likelihood of confusion between the trademarks at issue. In other words, a mark may dilute a famous mark even though that mark is used in an entirely different market for an entirely different class of products.[34] As an illustration, if a sporting goods manufacturer began selling Exxon brand tennis racquets, there would be little, if any, confusion between that brand and Exxon, the gas company. However, despite the apparent lack of consumer confusion, there is still the possibility of dilution of the Exxon gas company mark.

Courts recognize two principal forms of dilution: tarnishing and blurring. Dilution by tarnishing occurs when a junior mark's similarity to a famous mark causes consumers mistakenly to associate the famous mark with the defendant's inferior or offensive product.[35] Dilution by blurring occurs when consumers see the plaintiff's mark used on a plethora of different goods and services, raising the possibility that the mark will lose its ability to serve as a unique identifier of the plaintiff's product.[36]

For purposes of the FTDA, a mark is "famous" if it is widely recognized by the general consuming public of the United States as a designation of source of the goods or services of the mark's owner.[37] In determining whether a mark possesses the requisite degree of recognition, the court may consider several relevant factors, including the following: (i) the duration, extent, and the geographic reach of advertising and publicity of the mark, whether advertised or publicized by the owner or third parties; (ii) the amount, volume, and geographic extent of sales of goods or services offered under the mark; and (iii) the extent of actual recognition of the mark.[38]

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[34] *Nike, Inc. v. Nike Sec.,* L.P., 50 U.S.P.Q.2D (BNA) 1202, *5 (1999).
[35] *Eli Lilly & Co. v. Natural Answers, Inc.,* 233 F.3d 456, 466 (2000).
[36] *Eli Lilly & Co.,* 233 F.3d at 466.
[37] 11 U.S.C. 1125(c)(2).
[38] *Eli Lilly & Co.,* 233 F.3d at 466.

In 2003, the United States Supreme Court rendered a famous decision that severely impeded plaintiff franchisors' ability to sustain a claim under the FTDA.[39] The *Moseley* case involved a small store in Kentucky called "Victor's Little Secret" that sold adult novelty items. Victoria's Secret, the women's lingerie retailer, sued for trademark dilution, claiming that such use of the name Victor's Little Secret would tarnish its goodwill and reputation. The Court held that the FTDA (15 U.S.C. 1125) "unambiguously requires a showing of *actual* dilution, rather than a *likelihood* of dilution."[40] Since proving actual dilution is so difficult in practice, the Court's decision had the effect of almost negating the FTDA. However, on October 6, 2006, a revision to the FTDA was made effective which overturned the *Moseley* decision and substantially altered the pleading requirements under the FTDA.

The revised FTDA now states, in pertinent part, the following: Subject to the principles of equity, the owner of a famous mark that is distinctive, inherently or through acquired distinctiveness, shall be entitled to an injunction against another person who, at any time after the owner's mark has become famous, commences use of a mark or trade name in commerce that is *likely to cause dilution* by blurring or dilution by tarnishment of the famous mark, regardless of the presence or absence of actual or likely confusion, of competition, or of actual economic injury.[41] These less stringent pleading requirements (*i.e.* asserting "likelihood of dilution" instead of "actual dilution") will likely have the effect of franchisor's again pleading dilution in claims against franchisees.

V. Conclusion

When Mr. Kaplan was a child and a small problem seemed like the biggest issue in the world, his father's favorite expression was "don't make it a federal case." This might be good advice for franchisors even though it is rarely taken. In the area of trademark law, even the smallest issue can be, and often is, made a federal case under the "requirement" to protect a trademark. It has been Mr. Kaplan's repeated experience that judges will generally not seek to ascertain whether a particular component of the franchisor's "system" is necessary because uniformity is a hallmark of franchising. Accordingly, the best place to attempt to resolve a dispute with a franchisor over trademark issues is through communication with the franchisor, not communications with a judge.

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[39] *Moseley v. V Secret Catalogue, Inc.*, 537 U.S. 418 (2003).
[40] *Moseley,* 537 U.S. at 433.
[41] 15 U.S.C. 1125(c)(1).