

## Legal Issues in ‘Licensing and Franchising’

Issue: Whether Quality Control Provisions under the Trade Marks Act, 1999 can be sidestepped?

## Introduction

*“Trademarks are no longer merely indicators of origin but an anonymous and impersonal guarantee of satisfaction” - Frank Schechter*

- ❖ **Trademark License:** Limited right to use a trademark granted by the owner (licensor) to a third party (licensee) on mutually agreed terms and conditions.
- ❖ **Naked License:** License under which licensor allows use of its trademarks by a licensee without incorporating any quality control covenants.
- ❖ **Quality Control:** Refers to the control required to be exercised by a licensor over quality of the licensed products/services.

## Rationales of Quality Control

### ❖ McCarthy on importance of Quality Control:

*“the consumer assumes that products sold under the same trademark will be of equal quality regardless of the actual physical source or producer of goods”.*

### ❖ Two justifications for Quality Control:

- I. Public Interest-To maintain uniformity in quality of the products by ensuring a single source, thereby avoiding consumer confusion and deception.
- II. Self Interest of the Parties – To maintain the value of a brand name/mark.

## Birth of “Quality Control”

- ❖ **Source Theory:** Purpose of a trademark is to identify source of goods.
- ❖ **Quality Assurance:** Developed as another important function of trademark.
- ❖ **Concept of Unrestricted Licensing:** Anti-thesis of the source theory and the inherent philosophy of trademark law viz. avoiding consumer confusion.
- ❖ **Connection in course of trade:** Licensing can be permitted in so far as a connection in course of trade is maintained between the goods and the proprietor of trademark.

## Birth of “Quality Control” (Contd.)

Delhi High Court in *Double Coin Holdings Ltd. and Anr V. Trans Tyres (India) Pvt. Ltd. and Anr* [2011(46)PTC194(Del)]-

*“Goodwill in a brand does not come to be created only on account of its promotion and advertising. The primary reason for a trademark acquiring goodwill in the market is the quality of the product, which is sold under that name. If a product is of inferior quality, no amount of advertisement and promotion can build the brand under which the product is sold. Of course, the brand building and promotion supplements the efforts of the manufacturer, who is primarily responsible for maintaining quality of the product.”*

## Relevant Provisions of the Trade Marks Act, 1999

- ❖ **Section 2(1)(x):** “Registered user means a person who is for the time being registered as such under section 49”
- ❖ **Section 2(1)(r):** “Permitted Use, in relation to a registered trade mark, means use of trade mark-
  - (i) by a registered user of the trade mark in relation to goods or services...
  - (ii) by a person other than the registered proprietor and registered user in relation to goods or services...”
- ❖ **Section 49(1)(b)(i):** Registration as registered user-

“Where it is proposed that a person should be registered as a registered user of a trade mark... the registered proprietor and the proposed registered user shall jointly apply in writing... and every such application shall be accompanied by...—



## Relevant Provisions of the Trade Marks Act, 1999 (Contd.)

*(b) an affidavit ...(i) giving particulars of the relationship, existing or proposed, between the registered proprietor and the proposed registered user, including particulars showing the degree of control by the proprietor over the permitted use which their relationship will confer...*”

❖ **Section 50(1)(d):** *Power of Registrar for variation or cancellation of registration as registered user—*

*“...the registration of a person as registered user...-*

*(d) may be cancelled by the Registrar on his own motion or on the application in writing in the prescribed manner by any person, on the ground that any stipulation in the agreement between the registered proprietor and the registered user regarding the quality of the goods or services in relation to which the trade mark is to be used is either not being enforced or is not being complied with...”*

## Relevant Case Laws

❖ *Rob Mathys India Pvt. Ltd v. Synthes Ag Chur* [1997-(SUP)-ARBLR -0218 -DEL]

*“Control may be exercised or presumed to be exercised in various ways. In some cases, the very relationship between the licensor and the licensee will imply sufficient degree of control for example, where the licensor stipulates that the licensee should manufacture the goods only in accordance with the specifications and the standards of quality prescribed by the licensor or reserves the right to inspect the goods and methods of manufacture of the licensee. Lack of adequate control or lessening of control over a period of time would be fatal to the distinctiveness of a trade mark.”*



## *UTO Nederland B.V. and Ors. v. Tilaknagar Industries Ltd., [2012 (49) PTC 249 (Bom)]*

- ❖ **Issue:** Whether the act of Plaintiff in not exercising quality control led to abandonment of their rights in the mark?

**Held:** “They permitted the defendant unrestricted use of the mark, unhindered by any form control. They exercised no quality control...Even assuming that the plaintiffs had throughout been of the view that they had not transferred their title to the marks to the defendant, their conduct establishes that they abandoned their rights as the proprietors thereof... They did nothing to restrain the defendant from using the marks leading the defendant thereby to develop an enormous business around the marks. It would therefore be unconscionable to grant an injunction in their favour...”

## *KR Jadayappa Mudaliar v. KB Venkatachalam, [(1990)2MLJ423]*

### ❖ **Issue: Whether the Respondent abandon its rights in the mark by licensing its use to 22 different entities?**

On an analysis of the agreements between the respondent and the licensees the court concluded-

- each ‘licensee’ was in effect manufacturing the licensor’s products and applying the trademark thereon for the sole purpose of supplying the products to the licensor, which retained exclusive rights to sell the products;
- each licensee acknowledged absolute proprietorship of the licensor over the licensed trademark; and
- no licensee indulged in any actual sales of the licensor’s product in the open market

In light of above it was held-

“... at no point of time did the respondent abandon its trade mark, neither did the respondent indulge in trafficking in its trade mark nor could it be said that the distinctiveness has been lost...”

## Can Quality Control Provisions be Side-Stepped?

- ❖ In absence of these provisions in the agreement, registration of the registered will be denied under Section 49.
- ❖ If the quality control provisions are not enforced- licensor runs the risk of cancellation of the registration of license agreement under Section 50 of the Act.
- ❖ There is also a risk of the licensor's rights in the mark being declared as abandoned by the court.

**Conclusion**- The two concepts 'licensing' and 'no quality control' evidently are an inherent contradiction under the current framework in India and cannot be side-stepped.

## Drawbacks of Direct Quality Control Provisions

- ❖ Frivolous litigation by competitors challenging the validity of licenses.
- ❖ A defense to infringers – legitimate claims of infringement are met with unfounded claims of naked licensing, that could turn the direction of the case.
- ❖ Causes hinderance in conducting licensing activities due to the added burden of maintenance of quality control and unfounded claims of naked licensing.
- ❖ COVID-19 pandemic has caused a serious trouble for companies to ensure quality control provisions are fulfilled- leading to overseas companies rescinding contracts with their off-shore manufacturers.

# THANK YOU!

## Questions?

**Aishwarya Pande**, Associate

© ALG India Law Offices LLP, 2021.

*Disclaimer: Views, opinions, and interpretations are solely those of the presenters, not of the firm (ALG India Law Offices LLP) nor reflective thereof.*

*This presentation hosted at [https://www.algindia.com/wp-content/uploads/2021/05/LIS\\_Whether-Quality-Control-Provisions-under-the-Trade-Marks-Act-1999-be-sidestepped-Final.pdf](https://www.algindia.com/wp-content/uploads/2021/05/LIS_Whether-Quality-Control-Provisions-under-the-Trade-Marks-Act-1999-be-sidestepped-Final.pdf)*