

Legal noose around quality control

Trusting the licensee to do the right thing is not good enough. A properly drafted license agreement is the only way.



JED FERDINAND

In every licensing programme, there is an inherent tension between brand owners, who seek to maintain product quality and the goodwill associated with their brands, and licensee-manufacturers, who want the freedom to develop products and to sell through the broadest possible distribution channels in an effort to maximise revenues. These considerations are not limited to luxury and high-end brands – virtually all licensors are concerned with maintaining brand standards

for quality and image. How does a licensor protect itself? If strong and clear brand standard protections are not included in the written license agreement, they may as well not exist because the licensee won't be bound by them.

There is a fundamental legal requirement of trademark and brand licensing so that the licensor can exercise a certain degree of control over the quality of the licensed products or there's a risk that the license is deemed a 'naked license', which may result in abandonment of the licensor's

rights. But this column will focus on the practical implications of brand standard protections, not the legal ones. The intent is to give brand owners a checklist of provisions related to the protection of product quality and brand image.

BRAND STANDARD CLAUSES

The most direct way to address the issue of brand image is to include a clause in the license agreement, requiring the licensee to maintain a specific and defined brand standard that compares the licensed brand with other brands or names of retail stores in particular. Here is an example of a brand standard clause from a license for a high-end jewellery line: "The Marks are and shall be associated with a first-class prestige luxury image that is equal to or greater than the image of the most prestigious fine jewelry brands and designers sold in jewelry specialty stores such as Tiffany's and department stores such as Saks, Neiman Marcus, Bergdorf Goodman and Bloomingdale's..."

Brand standard clauses like this are often found in celebrity and fashion licenses, where maintaining a first-class image is critical. To that end, it is very common to see specific references for famous brands or designers used as the brand standard by which licensed products are measured against. Yet, there is no reason that this type of provision could not be used in licenses for mid or

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lower-tier products as well, so long as the licensor identifies comparable brands and lists them as the brand standard.

QUALITY ACKNOWLEDGEMENT

As a corollary to the brand standard clause, the license agreement should also contain an express recognition by the licensee that if the licensed products were of inferior quality in design, material or workmanship, it would impair licensor's goodwill. There should be an express representation that the licensed products shall be of "high standard and of such style, appearance and quality" to protect and enhance the licensed brand and maintain the goodwill related thereto. It is also important to prohibit the licensee from selling damaged or defective merchandise, or products considered "seconds" based on industry standards.

PRODUCT APPROVALS

Licensors should have full approval rights throughout the entire production process. Depending on the type of licensed product, this could include the following elements – design or concept approval; prototype approval; pre-production approval and post-production approval which is critical to ensure that the shipments of manufactured licensed products conform to the designs and specifications that licensor previously approved. Licensees often complain about the timing of licensor's approval rights impacting tight production and shipping deadlines. Despite this reality, it is to the licensor's advantage to preserve full approval rights and to never allow silence (ie, a failure to respond to an approval request within a



certain defined time period) to be deemed approval.

DISTRIBUTION CHANNELS

The licensee will want the freedom to sell in all tiers through all possible distribution channels. For some licenses, this may be appropriate. Yet, for most, it is not because licensors will often have specific expectations about where products should be sold to conform to brand image. The most direct way to address the issue of distribution channels is to have a specific list of authorised retailers attached as a schedule to the license agreement. At the same time, the licensee can be given the freedom to explore other possible channels during the term of the license, subject to licensor's written approval. For licenses involving apparel and related goods, it is very common to have a tiered approach to distribution. This typically involves starting in the upper-tier with one brand in the first year or two of the license, and then moving down to the mid and mass tiers in later years, often with a brand that is a derivative of the upper-tier brand. At the same time the apparel licenses will also look to limit distribution to "off-



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price" retailers to later years and for secondary brands only.

RIGHT TO APPROVE MANUFACTURERS

If the licensee intends to utilise a third-party manufacturer, the licensor will want to maintain the right to approve the manufacturer and will want to require the licensee to have the manufacturer sign an agreement that binds the manufacturer to the obligations of the license agreement. An additional option would be to require the licensee and its manufacturer to be bound by LIMA's (Licensing Industry Merchandisers' Association) Code of Business Practices. Licensors want to do everything possible to avoid a repeat of a "Kathie Lee Gifford" labour situation at all costs.

TERMINATION OF CONTRACT

Finally, it is important to tie in a specific termination right in the event a licensee fails to comply with any of the brand standard, quality control, distribution and manufacturer provisions listed above. This is an important policing mechanism for the licensor, and it ensures a swift end to the license in the event of a non-performing licensee.

These are just some of the provisions available to the licensor to ensure that the licensed products conform to brand standards of image and quality. Again, it is critical not to leave these considerations to the parties' intent or expectations – in order to be enforceable they must be in the written agreement.

The author is a Principal, Jeffers Cowherd PC, heading the firm's intellectual property and licensing practices.

