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Consider TMs Before Reacting To NLRB McDonald's Complaints

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In December 2014, the National Labor Relations Board made waves when it named McDonald's USA LLC as a "joint employer" of franchise restaurant employees in a number of complaints for alleged labor violations by the franchise owners. As the NLRB describes on its webpage providing information on the cases, the agency's "investigation found that McDonald's, USA, LLC, through its franchise relationship and its use of tools, resources and technology, engages in sufficient control over its franchisees' operations, beyond protection of the brand, to make it a putative joint employer with its franchisees, sharing liability for violations of our Act."

The first of several hearings on the joint liability issue took place in New York City on March 30, 2015, but a decision regarding joint liability is likely many months away. In the meantime, the case has caused franchisors to take a second look at their policies in an effort to avoid the same type of potential liability. While companies and employment lawyers are focusing on how to frame the franchisor/franchisee relationship in light of this possible paradigm shift in franchisor liability, they should also be considering the impact any such change may have on their trademark rights.

A Trademark Must Indicate Source

The ultimate purpose of trademark law, which emanates from both common law and the federal trademark statutory scheme set forth in the Lanham Act[1] is to allow consumers to make efficient purchasing decisions based on words or symbols which communicate the source of goods or services and, in turn, the quality of those goods or services.

As such, a trademark is any "word, name, symbol or device, or any combination thereof" which is used to "identify and distinguish ... 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."[2] Trademarks are often words, such as brand names, product names, or slogans, or symbols, such as logos. Trade dress, which is a type of trademark, can be anything from the shape of product packaging, to the interior or exterior design of a restaurant.

For example, McDonald's uses dozens of words and logos to indicate the origin of its goods and services.

The word "McDonald's," the phrase "I'm Lovin' It," the design of the "Golden Arches" and the image of Ronald McDonald could all serve as trademarks because they tell consumers that they have arrived at a McDonald's restaurant. Further, these trademarks communicate that certain aspects of the service — the menu, the quality, the speed — will remain constant across any number of McDonald's experiences or locations. The type of service and meals McDonald's offers must not vary widely across locations, otherwise the McDonald's trademarks may cease to communicate anything about the quality of the McDonald's experience, and their validity as trademarks may be called into question.

"Naked" Licensing Could Lead to Trademark Abandonment

At its very heart, the franchisor/franchisee relationship is an elaborate trademark license. Maintaining consistency, and therefore the value of a brand, is the reason why franchisors have historically licensed their marks with very specific controls over franchisees' activities.

Moreover, the Lanham Act requires trademark licensors to exert a certain level of control over its licensees. To understand why, it is important to remember that in the United States trademark rights come from use of a mark in commerce — it is the extent and nature of that use that defines the scope and strength of an owner's trademark rights. The more widely and consistently a brand owner uses a mark, the stronger it is and the easier it is to protect. By the same token, a trademark owner can also lose its mark through various types of improper use, such as licensing a mark without sufficient quality controls, also known as "naked" licensing, which results in default abandonment of a trademark.

Historically, trademark licensing was not permitted at all. The theory was that licensing, by its very nature, meant that the goods or services were not emanating directly from the trademark owner, and therefore licensed marks could never indicate the true source of the goods or services. While the modern rule allows trademark licensing, it holds that a trademark licensor must sufficiently control the quality or characteristics of the licensed goods or services, otherwise the mark is truly no longer a "source identifier" and cannot serve as a trademark.[3] As the Second Circuit has explained, "unless the licensor exercises supervision and control over the operations of its licensees the risk that the public will be unwittingly deceived will be increased and this is precisely what the [Lanham] Act is in part designed to prevent."[4] As such, a trademark licensed without sufficient controls will be found invalid because is no longer indicates source.

For example, in Amscan Inc et al. v. Shutter Shades Inc. et al., a court in the Southern District of New York recently held that a California man who had federally registered the mark "Shutter Shades" for sunglasses with horizontal slats, had abandoned his trademark rights due to naked licensing.[5] In that case the owner had been selling "Shutter Shades" brand slatted sunglasses and had obtained a design patent for the same when he noticed several third parties were selling similarly designed glasses. After several rounds of cease and desist letters, he ultimately entered into licensing agreements with various third parties allowing them to use his Shutter Shades trademark and design.

However, several recipients of his letters would not agree to any license and ultimately brought a declaratory judgment suit against him, alleging that he had abandoned the "Shutter Shades" mark through naked licensing. On motion for summary judgment, the court agreed, stating:

To avoid abandonment, a licensor must exercise a reasonable degree of supervision and control over licensees under the facts and circumstances of the particular case. The critical question in determining whether a licensing program is controlled sufficiently by the licensor to protect [its] mark is whether the licensees' operations are policed adequately to guarantee the quality of the products sold under the mark. The sort of supervision required for a trademark license is the sort that produces consistent quality. If a licensor fails to play a meaningful role in holding its licensee's products to a standard of quality, it will have abandoned its mark ...

Defendants' licensing agreements do not permit them to dictate product specifications, monitor manufacturing, inspect product samples or otherwise control any aspect of the quality of the eyewear sold by their licensees under the "Shutter Shades" mark ...

[B]ecause there is no genuine dispute that Defendants did not exercise any contractual or actual control over their licensees' products, they have engaged in naked licensing. As a result, they have abandoned their trademark rights.[6]

Although the trademark owner there was found not to have exercised "any contractual or actual control," however naked licensing has also been found where the trademark owner arguably has at least some control. For example, in Halo Management LLC v. Interland Inc., the court found the licensor had abandoned its mark when it entered into a license containing the following controls over the licensees use of the mark: "one, to employ reasonable commercial efforts to maintain the positive business value of the HALO mark"; two, to limit mark use to that "substantially as shown in the pending applications and with services substantially as recited"; and, three, to cooperate with HM to "mitigate the confusion or likelihood of confusion between the parties' respective marks."[7]

Although the NLRB notes on its website that McDonald's "engages in sufficient control over its franchisees' operations, beyond protection of the brand, to make it a putative joint employer," that statement creates tension with the longstanding trademark rule that "[i]f a licensor fails to play a meaningful role in holding its licensee's products to a standard of quality, it will have abandoned its mark."

How Much Control Over Franchisees Is Appropriate?

Given the risk of trademark abandonment, how does a franchisor balance the need to exercise sufficient "supervision and control over the operations of its licensees" and the risk that doing so will subject a franchisor to joint employer liability?

A good place to start may be the general distinction between "quality" controls and "business operations" controls. For example, design input, packaging and advertising approval, and regular quality checks are narrow controls that do not necessarily impact business operations decisions, but are important to maintain the quality and consistency of goods and services bearing a franchisor's trademarks. On the other hand, accounting methodologies, business opening and closure times, and personnel decisions likely fall under business operations that are outside the scope of what is required to avoid naked licensing.

In the past, this distinction has been important in determining whether a trademark license is in fact a franchise, subjecting the franchisor to the Federal Trade Commission Franchise Rule and other state or industry specific statutes related to franchising. The more control the licensor has over a licensee's business decisions, versus quality control, the more likely it is that the licensee is actually a franchisee. While it seems unlikely the NLRB would draw so harsh a line because it would mean that essentially all franchisors are also joint employers, perhaps franchisors can feel comfortable maintaining such trademark "quality" controls knowing that these controls will generally not even create a franchise relationship, much less a joint employer relationship.

In any event, a bright-line rule from the NLRB spelling out which specific controls are “beyond the protection of the brand” in the context of joint liability would certainly help clarify how franchisors should move forward with protecting their brands, while avoiding joint liability. Until a resolution is reached in the McDonald’s case, companies considering this issue should keep in mind that these trademark issues are intertwined with the joint liability question, and, at a minimum, should avoid eliminating quality controls that could put them at risk of losing valuable trademark rights or brand equity.

—By Allyson Fair, Sideman & Bancroft LLP

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[1] 15 U.S.C. §§ 1051 et seq.

[2] 15 U.S.C. § 1127.

[3] 15 U.S.C. § 1055.

[4] Dawn Donut Co. v. Hart’s Food Stores, Inc., 267 F.2d 358, 367 (2d Cir. 1959)

[5] Case No. 13-cv-1112 (S.D.N.Y. April 20, 2015)

[6] Id. at page 8.

[7] Case No. 03-cv-1106 (MHP) (N.D. Cal. Aug. 10, 2004)
