Trademark licensing and conflicts with I-502 rules

Agreements are traditionally based on royalties on sales

By Neil Juneja

A trademark is a name, logo or slogan used in commerce that allows a consumer to identify the source of a good or service. Trademarks can even be packaging, or in some cases, a sound or smell. It is into these marks that a company's reputation, goodwill and customer loyalty are stored. In many cases, the trademarks are the most valuable asset of a company.

When you find a can of Coca-Cola anywhere on the planet, you can rest assured that it is essentially the same carbonic acid-laced sugar water that you have grown up enduring. The reputation of the product is well known and that goodwill is stored in the brand.

A trademark license allows a trademark owner to permit another party to use the same mark. Licensing a trademark is a beneficial method of extending the reach of a brand and increasing revenue without enduring the additional resource costs of production, logistics or sales. The one receiving the license gains the use of an established brand, saving substantial expense and time of market penetration. In the marijuana industry, trademark licenses are highly beneficial because each state has its own set of unique legal hurdles and market peculiarities. It would be a substantial burden for a single entity to enter so many markets with disparate rules.

There are several issues with traditional trademark license agreements that can be fatal to a Washington recreational marijuana license.

ROYALTIES

First, trademark license agreements traditionally have a royalty rate based upon the quantity of sales. For instance, for every branded unit sold, the trademark owner is paid a percentage of sales. Washington Administrative Code 314-55-035 states that a true party of interest is "any entity or person who is in receipt of, or has the right to receive, a percentage of gross or net profit..."

A royalty based upon sales would qualify a trademark owner as a true party of interest. In such a case, failing to properly inform the Washington State Liquor Control Board of this true party of interest is detrimental to one's future business prospects in the industry. Furthermore, non-Washington licensors are never permitted to be a true party in interest.

One possible solution is to charge a flat-rate royalty instead of a variable royalty based upon the number of units sold or the amount of revenue generated. A flat-rate annual fee does not violate the letter of the law. Other options that harmonize with the law are also available.

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NAKED LICENSING

When licensing a trademark, the owner must maintain consistent quality of the branded goods or services. Neglecting to do so results in a "naked license."

Naked licensing can lead to the abandonment of the trademark and all associated rights. This is due to the purpose of trademarks: to be a source identifier. If a mark is on products of inconsistent quality, the consumer is ultimately harmed and the mark no longer functions as intended. One court characterized a naked license as "inherently deceptive." (*First Interstate Bancorp v. Stenquist*).

A true party of interest, as defined by the WAC, is "any entity or person who exercises control over the licensed business in exchange for money or expertise."

In addition, "The board will conduct an investigation of any person or entity who exercises any control over the applicant's business operations." While any control is left undefined, most will agree that quality control over marijuana would be greater than "any" control.

There exists a direct conflict between retaining one's trademark rights while simultaneously not jeopardizing one's I-502 license. While direct control over the quality of goods must be avoided, other methods of control may suffice. One approach is to control the use of the mark as opposed to the quality of the product. In some cases, courts have upheld licensing agreements where the trademark owner is familiar and relies upon the licensee's own efforts to control quality. Exactly what threshold of familiarity is sufficient is not always clear.

TRADEMARK PECULIARITIES

Also, an interesting issue — previously rare, but surprisingly common in the marijuana industry — revolves around common law trademarks.

A federal trademark registration grants the trademark owner the right to prevent others from infringing the mark (or a confusingly similar mark) throughout the US. However, a federal trademark registration is generally unavailable for marijuana. Alternatively, common law trademark rights do, in fact, exist. These rights accrue in the regions in which the mark is used in commerce. Therefore, a brand used in commerce in other states but not in use in Washington has no actual trademark rights in Washington. Consequently, prior to use-in-commerce in Washington State, one is licensing a right that arguably does not even exist. When licensing a trademark for use in the recreational marijuana industry, it is incredibly important to work with counsel that knows exactly what they are doing and have a great deal of experience in respect to both intellectual property and I-502.

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