

# The Protection of Licensee's Later Forming Goodwill in the Trademark Licensing

—The legal analysis of “Wanglaoji” Trademark Dispute

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**Abstract**—The allocation of later forming goodwill between licensor and licensee is a crucial issue with theoretical and practical significance after the trademark licensing termination. This paper will analyze the hot debating case throughout China due to the trademark licensing between GPHL and Hong Kong HDG involving the dispute of “wanglaoji” trademark. JDB Co. has created great later forming goodwill of “wanglaoji” trademark independently in the trademark licensing, but who should possess the added value of the trademark is uncertain thanks to the lack of appointment in the licensing contract and no regulation in Chinese Trademark Law. JDB Co. has used its own trademark, trade dress, unique commodity packaging and decoration to form the value-added benefits and later forming goodwill, so it is concluded that it's lawful for JDB Co. to transplant the goodwill from “wanglaoji” brand to “jiaduobao” brand because the licensee's interests should be also protected.

**Keywords**—later forming goodwill; wanglaoji trademark; licensing contract; trademark protection

## I. INTRODUCTION

Trademark international licensing has become a universally accepted commercial practice by signing a licensing agreement between the parties. The rationale has been formulated in common law that the licensing between licensor and licensee should be allowed as long as the licensor controls the licensee's product quality so as to ensure that the public is not deceived, and such rationale has greatly increased the widespread use of trademark licensing as a business model to maximize the value of the licensor's goodwill and reputation [1]. The quality guarantee given by the mark owner that his mark would show on goods of a certain quality is honored by consumers' consistent loyalties to the products. In order to ensure the consumers' reliance on the product quality level, the licensor has to provide quality control sufficient to assure the nature and quality of goods manufactured by the licensee [2]. The trademark licensing and “quality control” are introduced into Chinese trademark legislation. When a Multinational Co. (MNC) wants to expand its trademark or brand into a foreign market the use of a licensing agreement will be a good way to extend its reputation. Trademark licensing can supply the mark owner great opportunity to decide whether to take international strategy on the basis of its established brand image or identity for all related parties.

## II. THE VALUES AND GOODWILL OF THE TRADEMARKS

As a source identifier, a trademark distinguishes and identifies goods coming from a particular producer or distributor, and conveys valuable information of the mark holders to the public. The core value of a trademark lies in the goodwill that the mark embodies. The notion of goodwill has an elastic quality with the characteristic of stretching from brand to enterprise to goodwill, absorbing more and more elements of value along the way, and the elasticity will drive trademark law to expand its developing directions [3]. When the consuming public accepts the brand and identifies the producer of the brand, the goodwill of the brand will develop along with the brand, thereby the subsequent purchases will be stimulated owing to the consumers' loyalties to the brand. The value of the goodwill will be increased with the territorial scope, the length and the width of continuous use by the consumers, as well as the advertising and sales by the mark owner [4]. Since the brand stimulates the consumers' continuous purchase, the trademark not only symbolizes the value of goodwill, but also embodies the actual creation of the mark holders and eternity of goodwill [5]. A trademark with good reputation means that goods using this trademark are competitive in the market, own a higher market share and bring about profitable economic benefits for the particular business dealer with the mark. In the modern society, every enterprise wants to use trademarks to mark its products or goods so as to gain the consumers' recognition and acceptance by means of increasing its products' quality and perfecting its after-sale service. In this kind of situation some corporations would choose to go abroad by signing a licensing or franchising agreement to make profits.

## III. QUALITY CONTROL IN THE TRADEMARK LICENSING

The establishment of supervision obligation on trademark licensor is the expression of legal intervention in licensing contract itself [6]. Control over the nature and quality of the goods and services is a basic requirement in the trademark licensing for the validity of licensing [7] since trademark licensing was brought into the framework of trademark law in the common law jurisdiction. The rationale of the quality control theory lies in the fact that if the mark owner does not control their licensees and their product quality, the quality of

their products could be affected and not be guaranteed, the consuming public would be confused and deceived [2]. When the trademark is licensed and used by licensees, the only effective method to keep the consuming public from being deceived is to exert the mark owner responsibility of supervising and controlling the licensees' business activities in a reasonable manner to ensure that all the licensees can use the mark with the exactly the same quality related to the mark that the public has in the past [8]. The control exerted by the licensor may include many different kinds of actions, for example the licensees should provide detailed specifications and standards for their goods to be manufactured or services to be performed [2]. The licensor will require the licensees to submit their working plans, drawings, preliminary models and actual samples, as well as detailed rules on the placement, size, proportions and use of the trademark to be affixed [2]. The licensor will unexpectedly inspect the working plants, working spots, facilities and equipment [2], etc. Although the courts do not supply the specific standard on how much control the licensor must exert over licensee and his products, the licensor must ensure three methods, including direct control, delegation to a third party and reliance on the licensee, to be used to meet the requirement of quality standards [9]. The licensor will directly control the licensees or supervise their goods or designate a third party to control their product quality by means of specifying important ingredients, supplying specific production instructions, etc.

#### IV. TRADEMARK LICENSING AND THE ALLOCATION OF THE LATER-FORMING GOODWILL AND BENEFITS

Trademark licensing is considered to be one of the best approaches to make use of the established brand goodwill to carry out an international marketing strategy. It offers the trademark owner with goodwill a marvelous chance to take advantage of the established brand image and fame to expand its business outside its country's territories [10]. However, if the licensee has made much contribution to the added value of the brand, who (the licensor or licensee) should own the later forming goodwill and benefits in the trademark licensing?

##### A. Allocation of the Goodwill in the American Trademark Legislation and Licensing Contract

The Lanham Act establishes the legal requirements of using the registrant's trademark. The U.S. judicial cases establish the fact that the licensor's goodwill should be protected from the aspects of the licensor's rights and licensee's obligations [11]. On the one hand, from the licensor's rights the U.S. case law sets the regulation that the goodwill accumulated on the goods sold by the licensor should be attributed to the trademark owner, the licensing agreement cannot grant any property rights in connection with the trademark to the licensee [12]. On the other hand, from the licensee's responsibility the licensee should not doubt, claim and challenge the licensor's trademark rights, should not doubt the mark's validity and declare that the licensee himself, but not the licensor owns the trademark property [12]. This can be referred to as "no-challenge" provision in the license agreement to make estoppel rule more explicit [11]. In theory the licensing agreements also set the guiding articles that the licensor can protect the goodwill

established on his products as long as the appointment in the agreement is not contradictory to the mandatory provisions in the statutory law and case law, and this appointment should have priority [13]. The U.S. trademark law and judicial cases establish the fact that the benefits and goodwill of the trademark licensing belong to the licensor, which is the core of rights and obligations in the U.S. trademark licensing agreement.

##### B. The Argument on Allocation of the Added Benefits or Later Forming Goodwill in China

The Chinese Trademark Law (CTL) sets the regulation of trademark licensing, requiring the licensor to supervise and control the quality and nature of the merchandises manufactured by the licensee, yet it does not provide a stipulation who (the licensor or licensee) should possess the the later forming goodwill in the trademark licensing. If the parties of the licensing agreement don't make an appointment who will own the later forming goodwill or related benefits, a fierce argument or debate will take place if the licensee has significantly contributed to the later forming goodwill. The sensational and eye-catching trademark battle throughout China between "Wanglaoji" and "Jiaduobao" (JDB) reflects the acute and sharp argument between the parties. It also aroused the great concern and study on the theoretical and practical trademark licensing among the academic circles and judicial practical circles in which two sharp contrasting points of view are formed. One faction is in favor of the view that the "Wanglaoji" Co. should own the exclusive right of the later-forming goodwill because "Wanglaoji" Co. is the trademark licensor. While the other faction holds the idea that "JDB" Co. has contributed much to the forming of the added value and created significant later-forming goodwill for the "Wanglaoji" brand. The later-forming goodwill can be separated from the "Wanglaoji" trademark and it is legal and appropriate for "JDB" Co. to transplant the later-forming goodwill to its own brand after the termination of the licensing contract. After the termination of licensing agreement, a fierce argument happened between them on the dispute of "Wanglaoji" trademark, but who should possess the added value of the trademark is uncertain thanks to the lack of appointment in the licensing contract. This thesis will conduct a detailed analysis on the hot debating case throughout China.

Guangzhou Pharmaceutical Holdings Limited (GPHL), who has the registered trademark "Wanglaoji" for the herbal tea, reached an agreement with the licensee, Hong Kong Hongdao Group (HDG), which further authorized the trademark to its subsidiary corporation JDB Co. to be applied on JDB Co.'s herbal tea sold in mainland China. Among all the arguments the most significant and influential debate is fighting for the allocation of the red canned packaging and decoration and the legal controversial focus in this case is meaningful to the development of intellectual property because nobody in the academic circles and judicial practice has discussed and demonstrated whether the packaging and decoration of the commodities of famous brands are separate from the trademark of the commodities. So this thesis will put emphasis on the discussion and analysis of this point. Now

let's first look at the differences and similarities of the packaging and decoration between "Wanglaoji" and "JDB".



It is clear that the consumers can easily distinguish "Wanglaoji" herbal tea with the green paper box packaged variety and the red canned JDB herbal tea, however consumers will be confused by the two brands with the red canned packaging and decoration except the only difference of Chinese words "Wanglaoji" and "jiaduobao" peered on the packaging and decoration. It is after Guangdong High People's Court decided JDB Co. constituted an infringement in 2014, ordered JDB Co. to cease using red canned packaging and decoration on its products and compensate GPHL economic loss 150 million RMB that JDB Co. began to use golden packaging and decoration on its herbal tea from April 2015. In the written decision given by the SPC, the focuses of the disputes between GPHL and JDB Co. are reflected in the four aspects [14]: (1) what are the specific contents and carriers of special packaging and decoration of the famous goods that both JDB Co. and GPHL group request for protection? (2) What are the facts and the legitimate basis for both JDB Co. and GPHL group to claim for the possession of the special packaging and decoration of the famous goods? (3) Whether the sued infringement of the GPHL constitutes an unfair competition? (4) Whether the court of first instance violates the legal procedure in its trial? In order to make clear who has the legal basis to claim for the possession of the special packaging and decoration of the famous goods, the following aspects should be clarified: (1) whether the licensing contract has made an appointment on the allocation of the packaging and decoration of the goods involved in the case. GPHL maintains that as per the licensing contract, the red decoration is first proposed and licensed to HDG to use, thus, the design of the packaging and decoration of "Wanglaoji" products is based on the authorization of the trademark owner [15]. However, the SPC upheld the decision of the court of first instance that GPHL and JDB Co. did not make a definite appointment on the allocation of the packaging and decoration of red-canned "Wanglaoji" herbal tea in their licensing contract. The SPC contends that the special packaging and decoration of famous goods involved in the case are comprehensive forms of expression with several elements including words, graphics, and color matching, etc. In the "Wanglaoji" trademark licensing contract, although an appointment has been made that GPHL has the exclusive right to use "Wanglaoji" trademark on the red-canned herbal tea as well as the production and sales of red-canned "Wanglaoji" herbal tea, yet the concrete forms of packaging and decoration have not been made clear in the contract [16]. The expression of "red canned packaging" in the licensing contract does not mean that the packaging and decoration with several elements involved in the case have existed and no evidence has shown that GPHL has designed or actually used the packaging and decoration involved in the case [16]. 2) Whether the manufacturer's information can be used as direct evidence of ascertaining the ownership of packaging and decoration of the goods. JDB Co. believes that the manufacturer's information

labeled on the packaging and decoration is enough to indicate the factual evidence of defining the allocation of the packaging and decoration. JDB Co. further deems that all the information about the producer labeled on the packaging and decoration of the goods is closely related to JDB Co., which can enable the consumers to steadily and solely associate this packaging and decoration with JDB Co. [16] Hence, JDB Co. should own the rights of the packaging and decoration. However, the SPC does not support JDB Co.'s idea for its claims. First of all, the labeled information of manufacturer on the packaging and decoration is the obligation that the producer must fulfill according to Product Quality Law of PRC. Secondly, the packaging and decoration involved in the case is shown as a total image with several elements, including "Wanglaoji" character, trademark logo, collocation and selection of line and color, as well as other Chinese characters with manufacturer's name [16]. Hence, the labeling of JDB Co.'s information and its propaganda to the consumers, claiming it to be the actual business dealer of red-canned "Wanglaoji" herbal tea, allow the related consuming public to associate the involved packaging and decoration with JDB Co., but what cannot be denied is that "Wanglaoji" brand has entered the market with a reputation on some degree, and it is hard for consumers to completely ignore the "Wanglaoji" character and trademark, as well as the relationship between the trademark and mark holder [16]. (3) Who owns the property of the special packaging and decoration of the famous goods? The dispute on the packaging and decoration of famous goods involved in the case originates from the fact that GPHL and JDB Co. did not make a definite appointment on how to allot the added benefits in course of trademark licensing in their contract. It is generally considered that the licensee should stop using the trademark after the termination of licensing contract and give back the goodwill accumulated on the trademark to the licensor [17]. The licensee cannot transfer the added value and its later forming goodwill to its own brand because goodwill transfer can only happens in the same trademark, however, what is special in this case is that the special packaging and decoration in the trademark licensing is closely connected with the use of licensed trademark, and the packaging and decoration gains the property of independent rights and interests under the Anti-Unfair Competition Law (AUCL), which brings about the characteristics of goodwill outside the trademark right [18]. In determining the allocation of special packaging and decoration of famous goods, it should be considered that both "Wanglaoji" brand and JDB Co. have made great contributions to the establishment of rights and interests of packaging and decoration [18]. Since China's time-honored brand "Wanglaoji" has a history of more than one hundred years, GPHL, as the right holder of "Wanglaoji" registered trademark, maintains the historical heritage and market value of "Wanglaoji" brand by developing "Wanglaoji" herbal tea [16]. The efforts of GPHL for the brand awareness and reputation maintenance constitute an important basis of forming popularity, continuity and development of "Wanglaoji" herbal tea [16]. After signing the licensing contract, HDG began to appoint others to design the packaging and decoration for "Wanglaoji" herbal tea and apply for industrial design patent, and then launch the "Wanglaoji" herbal tea with above packaging and decoration to the market [16]. JDB Co. continued to expand the production scale,

strengthen the propaganda of the tea for several years, which not only clearly delivers the public the information that the red-canned “Wanglaoji” herbal tea is operated by JDB Co., but also significantly enhance both JDB Co.’s market popularity and the herbal tea [16]. Hence, JDB Co. has also contributed a lot to forming the rights and interests of packaging and decoration involved in the case. The basis that Chinese AUCL provides legal protection for the special packaging and decoration of famous goods is that the packaging and decoration attached to a commodity with a certain degree of popularity have distinctive feature of identifying the origin of goods [19]. As the actual business operator of red canned “Wanglaoji” herbal tea, JDB Co. has made an excessive and steady use and promotion for the tea, which not only notably promotes the popularity of red canned “Wanglaoji” herbal tea, but also helps the packaging and decorating of significant recognition parts such as red background, the yellow Wang Laoji to be protected by the AUCL [16]. It can be concluded that JDB Co. has used its own trademark, trade dress, unique commodity packaging and decoration by marketing and advertising, meanwhile accumulating its goodwill and it’s lawful for JDB Co. to transplant the later forming goodwill from “Wanglaoji” brand to “JDB” brand because the licensee’s interests should be protected as well. On the premise of Bona Fide Doctrine and respecting consumer cognition without damaging the legitimate rights and interests of others, the SPC made the final verdict in August 2017 that both GPLH and JDB company co-shared the packaging and decoration of red-canned “Wanglaoji” herbal tea embodying the belief that the purpose of intellectual property is to safeguard and stimulate innovation, as well as the spirit of rule of law that the conducts of the business operators’ creating and accumulating social wealth in good faith should be equally protected by Chinese law no matter whether it is a state owned enterprise or a private company.

## V. CONCLUSION

Establishing a sound legal system is the prerequisite and basis for implementing the rule of law. The perfection of CTL provide an effective guarantee and institutional arrangement for protecting the lawful rights and interests of the mark owners in safeguarding fair and competitive market order, ensuring the effective use of intangible assets of trademarks and promoting the healthy development of economy and society. The trademark international licensing has become an important strategy for a MNC to squeeze into the other countries’ market. The modern trademark licensing has exceeded the sole manufacturing of the identical or similar products with an aim of enhancing and exploiting the brand image symbolized by a trademark [20]. Control over the nature and quality of the goods and services is essential in the trademark licensing under the rational that the product quality cannot be guaranteed and the consumers will be confused and deceived without mark owner’s controlling the licensees and their product quality. In the trademark licensing the allocation of later forming goodwill is vital for the mark owner when the licensor and licensee don’t make appointment in the licensing contract on the allocation of the added benefits when the licensee has contributed a lot to the added value of the brand. For the international brand owners, trademark licensing is unavoidable in the brand expansion, how to ensure the mark holders’ brand interests, how to perfect

the user protection system, how to balance the interests between mark owners and users and create a benign mode of operation for trademark licensing and use are difficult problems for China’s domestic enterprises. The mark owner should be cautious in his trademark licensing, making definite the allocation of the brand. Due to the lag of the law, our current trademark legislation on how to determine the allocation of a brand lease, especially the allocation of added interests or later forming goodwill, indeed has some legal loopholes. What is the most important for the international brand is that the international mark owners should make clear in the licensing contract that they possess the exclusive rights of their trademark and the added interests forever no matter what happens.

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