

The Construction of the Balancing Mechanism of Trademark License Interests

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Abstract: The trademark licensing system is an important system stipulated by the Trademark Law. How to allocate the added value during the trademark licensing process between the trademark licensor and the licensee, and how the licensee compensates or compensates the trademark licensor for the depreciation of the trademark value, are not stipulated in the Trademark Law and are legal gaps. Starting from the "Wang Lao Ji" trademark dispute case and the "Red Bull" trademark dispute case, studying how to construct a mechanism for balancing the interests of both parties after the termination of the trademark licensing contract has become an urgent practical problem that needs to be solved. Trademarks are intangible assets, and their value evaluation is the primary issue. Secondly, whether to apply the contractual obligations based on the trademark licensing contract or whether the parties to the contract reach a goodwill coexistence agreement through negotiation, and then study and formulate guiding legal provisions that balance the interests of the trademark licensor and licensee, in order to provide fair protection for the rights and interests of both parties while taking into account social and public interests.

Keywords: Trademark licensing, Value appreciation, Impairment of value, Goodwill, Interest balance mechanism.

1. Introduction

The trademark licensing system is an important regime stipulated by trademark law. In the process of trademark licensing, how to allocate the added value generated between the licensor and the licensee, and how the licensee should compensate or reimburse the licensor when the trademark value depreciates, have become pressing issues that need to be addressed. This aims to ensure fair protection of both parties' rights while considering the public interest. Since a trademark is an intangible asset, its value assessment is a primary concern.

In trademark licensing, the actions of the licensee often lead to changes in the trademark's value. After the expiration of the trademark licensing contract, there is no mechanism to balance the increased benefits between the licensor and the licensee, and the rights of both parties are not adequately protected. Even when the licensee's use of the trademark results in the depreciation of its value, there is no recourse for the licensor to seek compensation. The underlying reason is twofold: First, there is a lack of a legal basis for distributing and balancing the changes in trademark value. The licensee's request for a share of the increased trademark value during the licensing period and

the licensor's claim for compensation due to depreciation both lack a legal foundation. The current Trademark Law in China focuses on the conditions, procedures, and regulations for trademark registration, clarifying responsibilities and protecting the exclusive rights of trademark owners. However, in the trademark licensing process, ownership and usage rights are separated. Article 43 of China's Trademark Law stipulates the trademark licensing system, where a registered trademark owner can permit others to use their registered trademark. The licensor is obligated to supervise the quality of the goods bearing the registered trademark used by the licensee, who in turn must ensure the quality of these goods. The trademark licensing contract requires filing and public announcement procedures. However, the Trademark Law does not further clarify the rights and obligations between the licensor and the licensee. As a result, after the expiration of the trademark licensing contract, there is no legal basis for balancing the interests related to changes in trademark value. On the other hand, licensees often lack awareness of intellectual property protection. When entering into a trademark licensing agreement, they tend to focus only on the duration of the license, brand effects, and licensing fees, without pre-arranging the balance of interests after the contract expires. Moreover, there is uncertainty regarding the business operation of trademarked products, the enhancement of trademark value, and the potential for and methods of gaining increased trademark benefits. In the private law domain, the principle of respecting the autonomy of the parties' intentions should be upheld. A trademark licensing contract is formed based on the mutual consent of both parties, and the basis for claims should first be examined within the context of contractual claims [1]. If the parties agree on issues such as the distribution of increased trademark value after the expiration of the licensing period, the methods of enhancing trademark value, and the allocation of associated costs, this could effectively prevent disputes over trademark ownership and interests, encouraging the licensee to actively enhance the value of the licensed trademark, thereby achieving a win-win situation for both parties involved in the trademark licensing.

2. The Essence of the Added Value in Trademark Licensing is Goodwill

In trademark licensing, if the trademark's value appreciates, the essence of this increase is the enhancement of goodwill. In traditional commerce, goodwill represents the consumer's assessment of the products or services provided by a producer or service provider. In 1620, the British courts defined goodwill as "the friendly regard and patronage that customers form for a product" [2]. This evaluation is a comprehensive assessment by society that considers various aspects such as product manufacturing, quality, sales methods, and after-sales service. This perspective attempts to apply the theory of personal rights to the commercial domain, but its limitation lies in focusing solely on the evaluative function of goodwill while neglecting its property-like nature. Goodwill arises from the long-term excellent service of goods and service providers, but its impact is forward-looking. Generally, consumers prefer to choose goods or services provided by businesses with good goodwill, and thus the property-like nature of goodwill lies in the "advantageous trading opportunities and conditions" [3]. This property is intangible, and its property aspect is of particular concern and closely related to both consumers and goods or service providers.

A trademark cannot simply be equated with a business identifier. It is more than just an external label on a product; it encompasses the entity using the trademark, the goods it represents, and the external form of the trademark itself, thus having a property-like nature. The trademark symbol carries the goodwill formed through long-term, interactive communication between the trademark user and consumers, making its position in the consumer's mind and the market irreplaceable [4]. Goodwill has a strong "exclusivity" for a company and is inseparable from the entity that created it. Goodwill is the "soul" of the trademark [5].

Before allowing other business entities to use the trademark, it has already gained consumer recognition, with the creator of this goodwill being the trademark owner. The licensee, as the

counterparty to the contract, hopes to leverage the licensor's trademark, which carries significant goodwill, to promote their own products or services. During the term of the trademark licensing contract, "subsequent goodwill" is generated through the prolonged use of the trademark [6]. The added value of the trademark is essentially the goodwill produced during the trademark licensing process.

In today's highly developed market economy, trademarks and goodwill are no longer inseparable. Goodwill has become an intangible asset with independent commercial value, grounded in tangible assets [7].

Firstly, with the development of the market economy, trademarks are no longer used solely by the original trademark owner on their own products. The original owner can license their trademark to other entities, leading to business models like "OEM manufacturing", "contract manufacturing", and multiple producers sharing a single trademark. During the trademark licensing process, the creator of goodwill is no longer limited to the original trademark owner.

Secondly, trademark law emphasizes that the trademark owner should control and supervise the quality of goods bearing their registered trademark to prevent consumers from being harmed by changes in product quality that might be overlooked by the licensee. In the marketplace, opportunities and risks coexist, and competition is an inherent aspect of the market. It is impossible for product quality to remain unchanged. If the trademark licensor's product quality remains the same, prohibiting the licensee from improving the product quality would undoubtedly be a rigid and inflexible approach. From the consumer's perspective, even if the registered trademark fails to indicate that the product quality has changed, consumers have the right to choose and can completely abandon products bearing that trademark if quality issues arise.

Thirdly, from a comparative law perspective, some countries no longer mandate that trademarks and goodwill must be transferred together. For instance, the United States' Lanham Act (Section 10) provides relevant provisions [8]. This indicates that the U.S. has adopted a more flexible approach to the free transfer of trademarks, clarifying that the relationship between trademark rights and goodwill can be separated, and they can be transferred independently, provided that this does not mislead the public regarding the source or quality of the goods, thereby harming the public interest. The U.S. no longer strictly requires that trademarks and goodwill must be transferred together, aiming to give parties greater flexibility and allowing for the "restrictive assignment" of goodwill.

Finally, from the perspective of the principle of autonomy in private law, China's current Trademark Law does not explicitly prohibit the separation of trademarks and goodwill. Therefore, the relationship between goodwill and the original trademark can indeed be separated.

However, goodwill, as an intangible and invisible asset, exists only in the minds of consumers. During a company's operation, it cannot be reflected on the financial statements and is akin to the company's "off-the-books assets", with its value being undefined and intangible [9]. Therefore, goodwill must be attached to a trademark. After the termination of a trademark licensing agreement, the subsequent goodwill created by the licensee can be separated from the original trademark and transferred to the licensee's own trademark.

The formation of goodwill is a result of the creator's business and management philosophy, after-sales service, technological innovation within the industry, corporate culture, and advanced management experience. Goodwill is the overall social evaluation of the goods or services provided by a business entity. With the development of e-commerce, these evaluations not only come from consumers but also from online platforms like JD.com. In other words, the formation of goodwill is the result of the intellectual activities of the business operator.

Goodwill is earned through the long-term operation and is the overall evaluation of the goods and service providers by society. It does not require application, registration, or granting procedures. Generally, companies with significant goodwill have an influence that extends beyond a single

country or region, with their goodwill potentially impacting the international market. Furthermore, goodwill does not have, nor can it have, a legally prescribed protection period. As mentioned earlier, although goodwill and trademarks can be separated, the existence of goodwill must be manifested through specific companies, products, or services. The dynamics of a market economy are unpredictable, and the lifespan of a company or product is difficult to foresee. Goodwill does not immediately vanish with the cessation of a legal entity possessing significant goodwill.

Lastly, changes in a company's operational capabilities and product quality can lead to rapid changes in goodwill. Unlike other intangible assets, which can be fixed through applications for protection, goodwill, as an intangible asset, must be attached to a specific trademark to receive the protective rights conferred by trademark law.

3. Limitations on the Distribution of Added Value in Trademark Licensing

3.1. Difficulty in Assessing the Added Value of a Trademark

A trademark itself cannot directly generate financial benefits; it must be associated with goods or services that gain consumer and societal recognition to realize its economic value. Currently, there is a lack of objective, standardized, and feasible criteria for assessing and valuing the value and benefits of a trademark. Typically, the value of a trademark is evaluated based on the overall valuation of the company. The assessment of the added value of a trademark encounters similar challenges.

Firstly, when disputes arise after the expiration of a trademark licensing agreement, there is a lack of institutions or entities capable of assessing the added value of a trademark. The qualifications required for these assessment agencies and the responsibilities they should bear are not stipulated by any law or regulation, nor are they explained by any existing theories.

Secondly, numerous factors influence the value of a trademark, such as whether it is registered, whether it is a well-known trademark, the manner in which the trademark is licensed, and the market share of the product. All these factors make it difficult to assess the added value of a trademark.

Furthermore, the goodwill embedded in a trademark is constantly changing during the licensing period. It may increase due to the licensee's proper management or decrease due to the licensee's mismanagement. Even after the expiration of the trademark licensing agreement, various factors such as disputes between the parties or bankruptcy can lead to changes in the associated goodwill. Even if there were entities and standards for assessment, evaluating and reviewing changes in trademark value cannot be accomplished in a single step. The need for dynamic assessment makes it even more challenging to evaluate changes in the benefits associated with a trademark.

Goodwill in a business entity is not solely embodied in the trademark but is also reflected through various factors such as sales channels, after-sales service, and reputation among consumers. The goodwill arising from factors other than the trademark undoubtedly belongs to the licensee. It is difficult to clearly distinguish between the goodwill embedded in the trademark and that reflected by other factors, leading to ambiguity in the object of distribution when allocating benefits.

3.2. Lack of Legal Basis for the Distribution of Added Value in Trademarks

The basic model of a claim relationship is: who has the right to assert a claim against whom, and based on what legal norms [10]. For parties in a civil legal relationship, when asserting a claim, the first step is to examine the contractual rights. Trademark licensing agreements fall within the domain of private law, where the principle of autonomy of will should be fully utilized. If, at the time of drafting the trademark licensing agreement, both parties failed to anticipate market developments and changes, and were unable to roughly estimate the appreciation or depreciation of the trademark due to the license, leading to no stipulation regarding the distribution of added value or compensation for

depreciation after the contract's expiration, then there would be no contractual basis for claims regarding the distribution of benefits after the trademark licensing agreement expires.

China's Trademark Law only stipulates the licensor's obligation to supervise the quality of goods associated with the trademark, the obligation to file the license, and the licensee's obligations to ensure product quality and label the goods. Regarding the nature of the trademark license contract filing process, since it does not involve changes to the original trademark ownership, it is generally considered that such filing is a condition for the contract's opposability, rather than a condition for its validity. As a result, there are no provisions regarding the distribution of any added value generated. If the licensee's use of the trademark results in its depreciation, the licensor has no legal grounds to claim damages from the licensee.

Even if one party demands compensation or indemnification for their losses based on the principle of fairness under civil law, the other party can defend against this claim by arguing that risks are inherent in the commercial market. Both parties, being commercial entities, should have anticipated these market risks when entering into the trademark licensing agreement and made rational judgments about their interests. Therefore, from a legal standpoint, there is a lack of a corresponding legal basis for the distribution of added value in trademarks.

4. Constructing a Mechanism for the Distribution of Benefits from Trademark Licensing

4.1. Distribution of Added Value from Trademark Licensing in the United States

Section 10 of the U.S. Lanham Act stipulates that during the transfer of a trademark, goodwill may be fully or partially transferred, and it is not necessarily required to be closely related to the commercial reputation associated with its use. Regarding product packaging and trade dress, the United States, through legislation and case law, has established protection for the appearance rights of trademarks. The primary function of trade dress, similar to that of trademarks, is to distinguish the sources of products or services between different commercial entities, prevent consumer confusion, and identify the goodwill of the business. The United States, based on the Lanham Act and a series of court decisions, has established protections for the trade dress of products [11]. In addition to the Lanham Act, U.S. laws that protect trademark interests include the Federal Trademark Dilution Act, Trademark Law Implementation Rules, and others.

Although the Lanham Act does not explicitly prescribe how to distribute benefits generated during the trademark licensing process, a series of case laws have clarified that the licensee's legitimate use does not directly affect the original rights holder's legitimate interests. The benefits generated during the trademark licensing process should accrue to the trademark registrant or applicant, provided that the trademark or symbol has not been used in a manner that deceives consumers.

Apart from relevant legal provisions and case law, the legal community has also developed several model contracts for trademark licensing. These model contracts typically first stipulate that the licensee must not harm the legitimate interests of the trademark owner. Secondly, if the trademark's value appreciates during its use, the added value belongs to the original trademark owner, and the trademark licensee cannot claim trademark rights or other benefits from the use. After the trademark licensing agreement ends, the licensee is prohibited from continuing to use the original trademark or any similar trademark. These model contracts reflect the understanding within the U.S. intellectual property community regarding the distribution of added value generated during trademark licensing.

In the "Magna Doodle" case, the court ruled that the rights to the trade dress generated during the trademark licensing process belonged to the licensee. In this case, the defendant independently designed the relevant product's trade dress and obtained copyright protection for it during the term of the trademark licensing agreement. After the agreement expired, the defendant launched the independently designed product in the market under the registered trademark "Doodle Pro," which

had a trade dress similar to the plaintiff's "Magna Doodle" trademark. The United States District Court for the District of Connecticut held that "the plaintiff could not prove that their product's trade dress had distinctiveness", meaning that the plaintiff failed to demonstrate that the defendant's use of the trade dress caused consumer confusion. Furthermore, the court also held that "the defendant's trade dress design had acquired copyright protection," and thus ruled that the rights to the trade dress in question belonged to the trademark licensee. However, most scholars in the U.S. intellectual property community view this case as an exception regarding the ownership of trade dress rights. Chinese trademark law scholars also argue that "the court's understanding of the relationship between copyright and trade dress rights is debatable" and that "the court's method of assigning the burden of proof contradicts the quality assurance theory".

Research into relevant U.S. judicial precedents reveals several points: First, the trademark licensing agreement did not address how to handle changes in the trademark's value during the licensing process, highlighting the urgent need for companies to strengthen their trademark protection awareness. Second, the successive revisions of China's Trademark Law, as well as the trademark laws of other countries, have not provided detailed or guiding provisions on the distribution of benefits during and after the trademark licensing process. The lag in trademark legislation fails to guide and regulate new trademark issues arising under the current economic conditions, nor has it established corresponding guiding clauses to outline the rights and obligations of both parties, leading to disputes over the distribution of added value from trademarks.

In civil law countries, the legal system does not proactively protect goodwill with an empowering approach but rather employs a method of post-hoc relief when rights are infringed, prohibiting certain behaviors. This approach focuses more on regulating market economic order. Additionally, civil law countries tend to equate goodwill simply with the unique packaging and decoration of well-known products, without recognizing that goodwill encompasses multiple aspects beyond just packaging and decoration. However, in certain corresponding judicial rulings in civil law countries, there has been some response to the distribution of added value from trademark licensing, such as the "contribution principle", which determines the ownership of commercial identifiers that carry goodwill. This provides a reference for China in solving related issues during legislative processes and judicial practices.

4.2. Balancing the Rights of Both Parties Through the Trademark Coexistence System

The trademark coexistence system allows for the continued use of a trademark by a user who, in good faith, uses an identical or similar trademark on the same or related goods or services in a market or region distant from the trademark owner. In the "Hanover Milling" case, the U.S. Supreme Court ruled that the plaintiff could not prevent another honest and innocent user from using the same mark in a distant location simply because they had prior possession of the mark. This case established a rule in Anglo-American law that a prior trademark user cannot monopolize a trademark beyond their operational scope and reputation. This is because trademarks are not only the property rights of their owners but also a tool of competition among businesses. By managing their trademarks, businesses can gain a competitive edge in the market. Trademark law should not solely protect the interests of trademark owners but also uphold the responsibility of maintaining fair competition in the market.

For trademark coexistence to be viable, four criteria must be met: "the trademarks are identical or similar, the trademarks belong to different entities, the trademarks have acquired a certain level of recognition, and there is no likelihood of confusion."

4.3. Constructing a Balance Mechanism for Trademark License Benefits

The true value of a trademark is not reflected in its appearance or mark but in the goodwill it embodies. At the inception of the trademark licensing system, commercial entities enter into licensing agreements with trademark owners to access the goodwill embedded in the trademark, paying consideration for this access. During the trademark licensing process, the licensee's use of the trademark inevitably results in either an increase or decrease in the goodwill associated with the trademark. As fully capable civil entities, the parties involved in the licensing agreement should anticipate potential increases or decreases in the trademark's value from the outset of the contract. However, with the rapid changes in socio-economic activities, the magnitude of trademark value fluctuations has significantly increased, surpassing the reasonable expectations of both parties. Current laws do not provide direct or clear regulations on balancing the increased or decreased value interests between the parties.

Based on the principles of interest balance and intellectual property rights, a balancing mechanism should be established to address the significant increases or decreases in trademark value resulting from the licensee's use. This mechanism should first respect the autonomy of the parties involved, acknowledging their judgments and choices regarding their interests. In the trademark license agreement, mechanisms for transferring goodwill and distributing trademark benefits should be established, granting both parties contractual rights. Alternatively, the coexistence agreements used in trademark coexistence arrangements can be adapted to create agreements for post-license goodwill coexistence.

Secondly, from a legislative perspective, guiding provisions for balancing trademark license benefits could be established. These provisions might allow the licensee to change the carrier of the goodwill to their own trademark, setting a transitional buffer period for such changes. The licensor would have an obligation to tolerate and assist in this process. If the trademark value diminishes, the licensor should be entitled to seek appropriate compensation or reimbursement from the licensee.

5. Conclusion

In conclusion, constructing a balanced mechanism for trademark licensing interests is crucial for addressing the current legal gaps in the Trademark Law. The existing framework does not adequately provide for the distribution of added value generated during the licensing process or the compensation for value depreciation. This issue becomes particularly evident in high-profile cases like the "Wang Lao Ji" and "Red Bull" trademark disputes, where the absence of clear legal guidance led to significant conflicts between licensors and licensees.

A well-constructed mechanism would ensure that the economic benefits of trademark use, such as the enhancement of goodwill and brand value, are fairly shared between the licensor and the licensee. This involves not only recognizing the trademark as an intangible asset with fluctuating value but also establishing a legal basis for claims related to value changes after the expiration of a licensing agreement. Such a framework would require the inclusion of contractual terms that preemptively address the allocation of benefits and risks, such as stipulations on how to handle the appreciation of trademark value or the distribution of "post-licensing goodwill."

Moreover, the mechanism should provide for legal provisions that protect the interests of both parties while considering the public interest. This could include allowing for the separation and transfer of goodwill created during the licensing period to the licensee's own brand, with a transitional period facilitated by the licensor. It is also necessary to develop standardized methods for the assessment of trademark value to reduce disputes over value distribution.

By integrating these contractual and legislative measures, the proposed mechanism would not only enhance the predictability and fairness of trademark licensing but also encourage innovation and

responsible brand management among licensees. Ultimately, a balanced approach that respects the autonomy of both parties while providing clear legal guidance will foster a more harmonious and efficient trademark licensing environment, benefiting the licensors, licensees, and society.

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