Contributory Liability — An Underutilized Trademark Remedy for Franchisors

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Franchise systems often confront the situation of a terminated franchisee who has failed to remove the franchisor's signage from the franchisee's leased location. This can be especially frustrating when the franchisee is insolvent and has little to risk by continuing to operate, or when the franchisee has simply abandoned the location. There may be another way to have those marks removed, without having to sue the franchisee.

Any person or entity that enables or assists another in infringing a federally-protected trademark may be held liable under the Lanham Act, 15 U.S.C. § 1051, *et seq*., under a theory commonly referred to as contributory trademark liability. Federal law allows treble damages or minimum statutory damages *and* attorneys' fees to the prevailing contributory liability claimant. The cause of action affords franchisors powerful leverage against third parties, such as landlords, who provide aid or assistance to a former franchisee that misuses the franchisor's trademarks.

Elements of Claim

The U.S. Supreme Court established the test for contributory liability in *Inwood Labs., Inc. v. Ives Labs., Inc.*, 456 U.S. 844 (1982). The Court concluded that liability may attach when the defendant: (1) intentionally induces another to infringe a trademark, or (2) continues to supply goods to a party whom it knows, or has reason to know, is engaging in trademark infringement. Subsequent federal decisions recognize that contributory liability may extend to the franchise relationship. *See Mini Maid Services Co. v. Maid Brigade Systems, Inc.*, 967 F.2d 1516 (11th Cir. 1992) (holding that "[a]lthough a franchisor may not be held liable for a single franchisee's infringement solely because the franchisor failed to exercise reasonable diligence to prevent the violation, a franchisor might be liable for contributory trademark infringement, even if the franchisor did not itself perform any infringing acts."); *see also Mister Softee, Inc. v. Amanollahi*, No. 2:14-CV-01687, 2014 WL 3110000, at *6-8 (D.N.J. July 1, 2014) (recognizing that contributory liability may apply within context of franchisee/franchisor relationship).

To establish a claim for contributory liability, the claimant must prove four factors:

1. The defendant had sufficient control over the instrumentality used to infringe;
2. The defendant possessed the requisite knowledge of trademark infringement activity;
3. The defendant continued to supply its service despite said knowledge; and
4. The defendant failed to take sufficient remedial steps to stop the infringing activity.

See Omega SA v. 375 Canal, LLC, No. 12-civ-6979, 2016 WL 7439359, at *2 (S.D.N.Y. Dec. 22, 2016).

Contributory Liability Allows Franchisors to Compel Third Parties to Take Remedial Action to Stop Infringing Conduct

Franchisors have used the theory of contributory liability effectively against former franchisees and against entities and persons related to the franchisees. For example, in *Mister Softee, Inc. v. Amanollahi*, the franchisor secured a preliminary injunction against a terminated franchisee that purportedly transferred franchises to four other people without the franchisor's consent. *See* 2014 WL 3110000, at *6-8. In *Tropical Smoothie Franchise Dev. Corp. v. Hawaiian Breeze, Inc.*, the franchisor defeated a motion to dismiss its contributory liability claim asserted against a former franchisee and related entity where the newly-formed entity was operating a similar business in the former franchise's location. *See* No. 804CV0054417, 2005 WL 1500886 (M.D. Fla. June 23, 2005). And in *Ramada Franchise Sys., Inc. v. Boychuk*, the franchisor prevailed on a contributory liability claim against an unlicensed

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entity operating at the former franchised location using the franchisor's trademarks. 283 F.Supp.2d 777 (N.D.N.Y. 2003).

The theory can also be applied against landlords and listing agencies, as well. Landlords who allow a terminated franchisee to continue to maintain the franchisor's signage on the leased premises and listing agencies that allow the terminated franchisee to continue to advertise the business under the franchisor's trademarks, can be seen as providing services to the infringing party in the form of space, amenities, or advertising. A franchisor is within its legal rights and would certainly want to put the third party on notice that continued use is an infringement of valuable trademark rights in the hope that the notice alone would accomplish the objective of motivating the landlord or listing agency to remove the signage or offending listings. However, from a legal standpoint, this may not even be necessary, as a franchisor need not prove that the third party had actual knowledge of the infringing activity; rather, the franchisor need only establish the defendant's constructive knowledge of the infringing conduct. *See Luxottica Grp., S.P.A. v. Airport Mini Mall*, 932 F.3d 1303 (11th Cir. 2019). As the court in *Luxottica* held, willful blindness—where a person "suspects wrongdoing and deliberately fails to investigate"—is sufficient to demonstrate constructive knowledge. *See id*.

The recent *Luxottica* case gives precedent for a claim against landlords. Plaintiff Luxottica manufactured sunglasses and owned trademarks for Ray-Ban and Oakley products. The defendant landlord operated an indoor flea market in a shopping center and leased space to several vendors. Luxottica investigators found that vendors in the shopping center were displaying and selling counterfeit merchandise. Law enforcement officials seized the counterfeit goods and arrested the vendors. Despite these actions, sales of counterfeit Luxottica merchandise continued at the flea market. Luxottica sent a cease and desist letter to the landlord, notifying it that certain tenants were selling counterfeit merchandise. The landlord's property manager (1) gave each tenant a notice about counterfeit sales; (2) directed the tenants to stop selling counterfeit merchandise; and (3) instructed the tenants that the sale of counterfeit goods violated their leases. Despite these actions, further counterfeit sales continued.

Luxottica brought suit alleging the landlord was contributorily liable under the Lanham Act. The trial court denied the landlord's summary judgment motion. The jury found in favor of Luxottica and awarded $1.2 million in damages based upon twelve counterfeit sales. The landlord then moved for judgment notwithstanding the verdict, arguing that it did not have sufficient notice of counterfeit sales because the cease and desist letters did not specify the individual tenants responsible for the counterfeit activity. Luxottica argued that the duration, frequency, and visibility of law enforcement raids established the landlord's actual or constructive knowledge of the tenants at issue. Luxottica contended this prior knowledge was relevant to the landlord's contributory liability. The trial court held there was sufficient evidence for a reasonable jury to find that the landlord:

a. Played a major role in the operation and management of the flea market;
b. Had the ability to take steps under its leases and state law to halt the counterfeit sales;
c. May have had reason to suspect infringement by the tenants;
d. May actually have known of the counterfeit sales; and
e. Deliberately failed to investigate and take corrective action.

The district court found that a landlord could be contributorily liable under the Lanham Act even without actual knowledge of infringement by tenants. It observed that courts have ruled landlords liable if they have reason to know of trademark violations or if they are willfully blind by deliberately failing to investigate suspected infringement by tenants. The court therefore denied the landlord's motion for judgment as a matter of law. The Eleventh Circuit Court of Appeals affirmed the landlord's liability in August 2019. *See also Century 21 Real Estate Corp. of Northern Illinois v R.M. Post, Inc.*, (CCH) Bus Franch Guide ¶ 9429 (N.D. Ill., August 8, 1988), for an example of a claim being made against a listing agency that allowed a former franchisee to continue using the franchisor's trademark in a directory listing.

Franchisor Contributory Liability for Infringing Acts of Franchisees

When it comes to contributory liability, what is good for the goose is good for the gander.

Just as third persons can be held liable for the infringing conduct of the former franchisee, a franchisor can similarly be liable for the infringing acts of its franchisees. In *Mini Maid Services*, the Eleventh Circuit concluded that a franchisor was not liable for the trademark infringement of a franchisee solely on the basis that the franchisor failed to exercise reasonable diligence to prevent the infringement. However, the Court held that a franchisor might be liable in such a case, even if the franchisor itself performed no infringing acts, if the franchisor intentionally induced the infringement, or knowingly participated in a scheme of trademark infringement carried out by a franchisee. *See Mini Maid Services*, 967 F.2d at 1522. Liability may also attach to the franchisor's officers and agents depending upon their knowledge of the infringement.

Conclusion

Contributory liability provides powerful leverage against third persons who are aiding and abetting a former franchisee's trademark infringement. In the franchise context, the theory could be applied against entities related to the franchisee, the franchisee's officers or agents, landlords, management companies, listing agencies, and others who are knowingly aiding and abetting trademark infringement. To the extent these third parties have more assets at risk than the franchisee, a well written letter may accomplish the franchisor's objective. ■