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Toward a Coherent Theory of Strict Tort Liability for Trademark Licensors

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TOWARD A COHERENT THEORY OF STRICT TORT LIABILITY FOR TRADEMARK LICENSORS

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I. INTRODUCTION

In the past fifty years, trademark licensing[1] has become an increasingly popular method of structuring business relationships in the United

1. I define "trademark licensing" as any contractual arrangement wherein the owner of a trade name or trademark licenses its name or mark to another, usually, but not necessarily, for a fee. Under the agreement, the licensee then has a contractual right to produce and sell goods bearing the licensor's mark. Throughout the Article, I refer to trademark licensing simply as "licensing." Unless a different type of licensing is indicated, the reader should assume that I am referring to trademark licensing.

States. Today, trademark licensing can be found in every sector of the American economy. Michael Jordan's trademarks appear on Nike gym shoes. Coca-Cola's trademarks appear not only on soda pop produced by independent bottling companies, but also on Coke pants and Coke teddy bears. The logos of UCLA and other universities appear on millions of baseball caps, T-shirts, and other articles of clothing. Johnny Carson's name appears on sporting goods. The glassworks company, Corning Incorporated, licenses its marks to Owens-Corning, a maker of fiberglass products under the Owens-Corning label. McDonald's, Kentucky Fried Chicken, and thousands of other franchisors sell millions of products through trademark licensing arrangements.[2] These are only some of the businesses in which licensing plays a prominent role. Yet, despite the increased prevalence of trademark licensing arrangements, courts and legislatures have not developed clear rules for determining whether trademark licensors can be held strictly liable for personal injuries caused by their licensees' defective products.[3] This Article analyzes a particular strand of the problem.[4]

2. This Article focuses primarily on trademark licensing outside the franchise context. Unique issues arise in franchising cases. Frequently, the franchisor is sued for negligent provision of *services*, and strict liability does not apply. Product liability theories are discussed in some of these cases, but traditional agency theories are more common. Additionally, the franchise relationship typically contains contracts between the franchisor and franchisee that entangle the franchisor in the franchisee's business in ways that may exceed the involvement of other trademark licensors in the affairs of their licensees. Thus, many of these cases are not particularly germane to the issue of whether trademark licensors should be subject to strict liability outside the franchising context. For a more thorough discussion of franchisor liability, see, e.g., John W. Behringer & Monica A. Otte, *Liability and the Trademark Licensor: Advice for the Franchisor of Goods or Services*, 19 AM. BUS. L.J. 109 (1981); William R. Borchard & David W. Ehrlich, *Franchisor Tort Liability: Minimizing the Potential Liability of a Franchisor for a Franchisee's Torts*, 69 TRADEMARK REP. 109 (1979); Robert W. Emerson, *Franchisor's Liability When Franchisees Are Apparent Agents: An Empirical and Policy Analysis of "Common Knowledge" About Franchising*, 20 HOFSTRA L. REV. 609 (1992); John C. Monica, *Franchisor Liability to Third Parties*, 49 MO. L. REV. 309 (1984); Michael R. Flynn, Note, *The Law of Franchisor Vicarious Liability: A Critique*, 1993 COLUM. BUS. L. REV. 89; John F. Stuart, Comment, *A Franchisor's Liability for the Torts of His Franchisee*, 5 U.S.F. L. REV. 118 (1970); Note, *Liability of a Franchisor for Acts of the Franchisee*, 41 S. CAL. L. REV. 143 (1967).

3. It should be noted at the outset that under the generally prevailing approach, strict liability is not really "strict" in all cases that are brought under section 402a of the Restatement (Second) of Torts. As the authors of the newly released Restatement (Third) of Torts point out, "liability without fault" generally only applies to manufacturing defect claims. *See* RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 2 cmt. a (1997). By contrast, failure-to-warn and design defect claims are analyzed under a reasonableness standard that incorporates foreseeability into the equation. The reasonableness standard that is utilized in both design defect and failure-to-warn cases is the same as that used in negligence law. *See id.* Accordingly, in failure-to-warn and design defect cases, the issue presented is whether trademark licensors should be held vicariously liable for their licensees' negligence.

4. In a separate article, I consider in greater depth whether licensors should be strictly liable for their licensees' goods based on the theory that consumers buy those goods in reliance on the repu-

In several cases, courts have applied an enterprise theory of liability to impose strict liability on trademark licensors.[5] The enterprise theory was originally developed outside the trademark licensing context as a means to impose strict liability on entities that are not technically sellers, such as lessors and jobbers, but who nevertheless participate in the delivery of goods to consumers. Broadly stated, the enterprise theory holds that any entity that "significantly participates" in the enterprise that places a defective product into the stream of commerce will be treated as a "seller," and thus subject to strict liability under section 402A of the Restatement (Second) of Torts.

Although courts have applied the enterprise theory to trademark licensors based on factual findings that a particular licensor had a sufficient "participatory connection" to its licensee, or was "significantly enough involved" in its licensee's operations, they have not clearly defined what they mean by these terms. Nor have courts developed a coherent theory to explain why certain licensor conduct should be deemed significant for strict liability purposes. In short, their approach frequently boils down to nothing more than an "I-know-it-when-I-see-it" test.

Courts have had trouble articulating clear rules in this area for four primary reasons.[6] First, they are not explicit about what they are doing. Though courts purport to rely on strict liability rationales, they invariably cite evidence of the licensor's control, right to control, or general involvement in its licensee's affairs—evidence for determining vicarious liability.

Second, constructing a clear test is inherently difficult in this area because trademark licensing arrangements do not fit neatly into established vicarious liability categories, which generally are based on the level of control and decisionmaking shared between parties. Unlike traditional agency relationships or independent contractor arrangements where the law of vicarious liability is clear, trademark licensing arrangements vary with respect to shared control and decisionmaking. Thus, the relationship between licensor and licensee may fall into an area where vicarious liability law historically has been murky and makes it difficult to develop uniform rules.[7]

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tation of the licensor. *See* David J. Franklyn, *The Apparent Manufacturer Doctrine, Trademark Licensors and the Third Restatement of Torts*, 49 CASE W. RES. L. REV. (forthcoming May 1999).

5. *See infra* Part III.A.

6. *See infra* Part IV.B.

7. *See infra* Part II.C.

Third, the "quality control requirement"—as established at common law and codified in the federal Lanham Act[8]—has not been clearly defined. The Lanham Act requires licensors to exercise sufficient control over their licensees so as to ensure that all goods bearing the same mark are of the same quality; a licensor who fails to meet the quality control requirement "abandons" its mark and cannot prevent use of the mark by others.[9] However, neither the Lanham Act nor the cases construing it clearly define the scope of the quality control requirement to indicate how much control is necessary for a licensor to retain its interest in its mark. The confluence of an unclear regime of tort law and an uncertain interpretation of the Lanham Act require licensors to walk a "control tightrope."[10] If they exercise too little control, they risk a finding of abandonment, but if they exercise too much control, they risk a finding that they are strictly liable for their licensees' defective goods.[11]

Fourth, courts may be reticent in developing clear rules in this context because such rules may encourage strategic behavior among licensors and their licensees to escape liability. By manipulating their licensing arrangements, licensors may retain practical control over their licensees but be deemed not vicariously liable as a matter of law. Courts may fear that, even where there may be strong equitable justifications for imposing strict liability, they may lose the ability to do so under such conditions. This concern, however, is not unique to trademark licensing; it exists in every area of law.

In this Article, I argue that the control tightrope and the general indeterminacy of licensor liability law is neither necessary nor desirable. Once the courts acknowledge that the relevant task is to design a set of flexible vicarious liability rules—rules that account for licensor control and involvement but which do not require proof of agency—constructing a coherent theory of licensor liability should be possible. The challenge is to articulate a set of rules that will impose strict (vicarious) liability on licen-

8. Lanham Act, 15 U.S.C. § 1051-1127 (1994 & Supp. III 1997), *amended by* Trademark Law Treaty Implementation Act, Pub. L. No. 105-330, 112 Stat. 3064 (1998).

9. *See* 15 U.S.C. § 1064(5)(A).

10. *See* Kenneth B. Germain, *Tort Liability of Trademark Licensors in an Era of "Accountability": A Tale of Three Cases*, 69 TRADEMARK REP. 128, 140 (1979) (discussing the term "control tightrope").

11. The "control tightrope" can be illustrated with a hypothetical case. Suppose, for example, that Nike manufactures "Air Jordan" gym shoes under a licensing agreement with Michael Jordan. If Michael Jordan's attorneys are aware of the competing demands of the Lanham Act and the enterprise liability theory, they may advise him to institute a "minimalist" quality control program, which consists of just enough control to appear to satisfy the Lanham Act but not enough to make him appear "significantly involved" in Nike's operations.

sors who are not mere passive iuvestors but who exert substantial control over their licensees, and who use the licensing arrangement to *improperly* shield themselves from liability. Such rules should be clear enough to enable licensors to determine in advance the type of conduct that will expose them to strict liability and require them to insure against that risk. Finally, such rules should distinguish between Lanham Act control and the type of control that is likely to trigger strict liability.

Toward these ends, I argue that a more cogent theory of licensor liability can be constructed by borrowing the basic analytical framework as well as certain key precepts from corporate veil piercing law. In the corporate context, courts are faced with a similar dilemma of determining whether investors, who are not Iiable under traditional agency principles, have nevertheless exerted inordinate control over their corporations or otherwise abused the privilege of doing business in the corporate form such that they should be held liable for the acts of the businesses in which they have invested. In the corporate context, the law grants shareholders an initial presumption of limited liability on the theory that such a rule will stimulate investment and contribute to the overall good of the economy.

Courts have evolved fairly clear, yet flexible rules for disregarding this presumption. Under generally prevailing tests, the corporate veil will be pierced if a stockholder (1) completely dominates and controls corporate affairs such that he is the corporation's "alter ego"; (2) controls the area of corporate decisionmaking that gave rise to the lawsuit; or (3) grossly undercapitalizes the corporation or strips corporate assets such that the corporation cannot satisfy reasonably foreseeable financial obligations, including tort judgments.[12]

Licensor liability law might benefit from a similar analytic framework—that is, an initial presumption of limited licensor liability coupled with clear, flexible piercing tests.[13] Indeed, one may easily draw analogies between these two areas of law. In each situation, an entity invests its "capital" in an enterprise with the hope of financial gain. The stockholder invests her money; the licensor invests the value of her name or mark. In each situation, the investor's capital contributes to the overall success of the venture and the investor agrees to share profits, but not losses, with the enterprise. Further, the investor is legally required to exercise some type of control over the enterprise iu which she invests.[14] Finally, licensors,

12. *See infra* Part V.A.

13. *See infra* Part V.B.

14. By statute, stockholders together must elect corporate officers and ensure that they perform their basic functions. *See, e.g.*, 1 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW

like stockholders, may choose to be either active or passive participants in the enterprise, depending on a variety of factors.

The same rationale in corporate law that a presumption of limited liability for stockholders will stimulate investment and generally strengthen the economy can be applied to investing in the trademark licensing context. Indeed, the sheer volume of trademark licensing is evidence that it stimulates the free flow of capital and promotes economic growth. Like other investors, licensors are more likely to risk their "capital" if the courts afford them a similar initial presumption of nonliability,[15] and if there are clear ground rules for determining when such a presumption will be disregarded.[16]

While the shareholder analogy is compelling, it is not a necessary foundation for the general position I advance here. Even if one does not fully accept the licensor-stockholder analogy, there are sound reasons to afford licensors an initial presumption of limited liability.[17] Among other things, such a presumption would help organize the law in this area, and should enable licensors and licensees to allocate the costs of strict liability insurance more efficiently.

Moreover, an initial presumption of limited liability need not necessarily be as strong in the licensing context as it is in the shareholder context.[18] For a variety of reasons, it may be appropriate to pierce the licensing veil more frequently, or more easily, than the corporate veil. But there should be an explicit initial presumption and clear tests for disregarding that presumption.

Under the proposal advanced here, a licensor's presumption of nonliability would be disregarded if particular tests were satisfied. I propose that the presumption be disregarded when a particular licensor: (1) was the "functional equivalent" of a manufacturer of the defective goods; (2) controlled the particular activity that gave rise to the product defect at issue;

OF PRIVATE CORPORATIONS § 43.10 (rev. perm. ed. 1990). The Lanham Act requires licensors to exercise some form of control over the quality of the licensed goods. *See* 15 U.S.C. § 1064(5)(A).

15. The presumption of nonliability for licensors could be thought of as a presumption of "limited liability," as it is called in the shareholder context, because under the proposed approach, licensors' investment in their licensees would continue to be at risk even if they were not personally liable for the acts of their licensees.

16. The law must make a starting presumption in one direction or the other—that is, that licensors generally are, or are not, subject to strict liability. Indeed, it would appear that a presumption of nonliability is already inherent in the enterprise liability theory, since it imposes strict liability *only* on licensors who are "significantly involved" in their licensees' affairs.

17. *See infra* Part V.B.

18. *See infra* Part V.B.

(3) knew, or reasonably should have known, that the licensee was not adequately insured against reasonably foreseeable product liability risks; (4) induced consumers to believe that the defective goods were manufactured by the licensor or that the licensor vouched for the safety of the defective goods, and plaintiff purchased the goods in reliance on such a belief; or (5) contracted with a foreign licensee/manufacturer not subject to personal jurisdiction in the state where the defective goods were sold.[19]

While these tests are intended to be fairly comprehensive, they are not necessarily the exclusive grounds for disregarding the presumption of licensor nonliability.[20] Other circumstances may justify holding a licensor liable for defective goods produced by its licensee. Nevertheless, these tests should provide a useful starting point for further development and refinement of law in this area.

The remainder of this Article is divided into four parts. Part II provides an overview of basic trademark law and the historical evolution of trademark licensing in the United States. Part III surveys the cases that have applied the enterprise theory (or similar theories) of strict liability to trademark licensors. Part IV identifies a number of problems with the current case law in this area. Part V attempts to construct a coherent model of strict liability for trademark licensors along the same lines sketched above.

II. THE FOUNDATIONS OF MODERN TRADEMARK LICENSING

A. BASIC DEFINITIONS

A "trademark" is a "word, name, symbol or device" used to identify goods and distinguish them from those manufactured or sold by others.[21] By contrast, a "trade name" is any name that identifies a business or an enterprise.[22] Of course, a trade name can also be a trademark, and courts often use these terms interchangeably.

Trademark ownership rights are acquired when a person combines origination of a mark with its *actual use* in trade.[23] A significant "stick" in the bundle of trademark ownership rights is the ability to exclude others

19. *See* discussion *infra* Part V.C.

20. *See* discussion *infra* Part V.C.

21. Lanham Act, § 45, 15 U.S.C. § 1127 (1994 & Supp. III 1997).

22. *See* J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 4:13 (1996).

23. *See id.* § 3:3. This understanding of ownership led some courts at one time to hold that a trademark owner could not license his mark until he had used it himself. This is no longer the prevailing view. Today, trademark owners are allowed to license marks that were not previously used.

from using the same or confusingly similar marks.[24] A corollary of the right to exclude is the right to permit others to use the mark—usually through a licensing arrangement. While trademark registration at both the state and federal levels is common, it is neither required, nor a prerequisite to establishing ownership of a mark. However, because federal registration offers the registrant a variety of benefits, most trademark owners register under the federal scheme, as set forth in the Lanham Act.[25]

B. THE QUALITY ASSURANCE THEORY AND THE EMERGENCE OF TRADEMARK LICENSING

At early common law, trademark owners were not permitted to license their marks to others because trademarks were viewed solely as indicators of the *physical source* of goods.[26] Licensing was considered illegal because consumers would be "misled" as to the physical source of goods if an entity's trademark appeared on goods that had been manufactured by someone else.[27] Beginning around the 1930s, a judicially led trend to permit trademark licensing gradually developed.[28] But licensing was permitted only so long as the trademark owner exercised control over the quality of the trademarked goods that were produced by its licensees. With the passage of the federal Lanham Act in 1946, the judicial trend became the prevailing rule.[29]

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24. *See id.* § 2:14.

25. The federal registration scheme is set out in the Lanham Act. *See* 15 U.S.C. § 1051, *amended by* Trademark Law Treaty Implementation Act, Pub. L. No. 105-330, 112 Stat. 3064 (1998). Under the Lanham Act, after a mark is registered, the owner is permitted to use the federal courts to protect her right against an infringer of the mark. Many states have enacted statutory registration provisions that largely parallel the Lanham Act, but the protection they afford is limited to the boundaries of the state and rarely exceeds that which is available under the Lanham Act. *See generally* MCCARTHY, *supra* note 22, § 22.

26. *See* Note, *Antitrust Problems in Trademark Franchising*, 17 STAN. L. REV. 926, 927 (1965); Note, *Quality Control and the Antitrust Laws in Trademark Licensing*, 72 YALE L.J. 1171, 1174 (1963).

27. *See* Macmahan Pharmacal Co. v. Denver Chem. Mfg. Co., 113 F. 468, 475 (8th Cir. 1901) ("The essential value of a trade-mark is that it identifies to the trade the merchandise upon which it appears as of a certain origin .... It is not by itself such property as may be transferred."). *See also* Bulte v. Igleheart Bros., 137 F. 492 (7th Cir. 1905) (invalidating complainants' title to a trademark for "White Swan" flour that was licensed unaccompanied by the transfer of the original trademark owner's business); Comment, *Trademark Licensing: The Problem of Adequate Control*, 1968 DUKE L.J. 875, 876-77 [hereinafter Comment, *Problem of Adequate Control*] (nothing that trademarks historically were relied upon to indicate the source of a good and trademark licensing was "considerably limited, since it was crucial for the consumer to be able to associate a trademarked product with its actual source").

28. *See* K mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988).

29. *See id.*

A system that allowed for trademark licensing held many benefits for an expanding economy. Trademark licensing permitted businesses with established trademarks to hire independent companies to manufacture their goods at a cheaper price. As a result, trademark licensing could lead to a greater diversity of goods and enhanced profits for the business class.

This trend was also facilitated by newly emerging theories about the functions of trademarks. In 1927, New York attorney Frank I. Schechter articulated the idea that trademarks served dual functions.[30] In addition to serving as indicators of source, Schechter argued, trademarks also held a "persuasive" function. As he wrote, "the trademark is not merely the symbol of good will but often the most effective agent for the creation of good will, imprinting upon the public mind an anonymous and impersonal guaranty of satisfaction, creating a desire for further satisfactions."[31] Schechter urged the adoption of a more expansive theory of trademarks that took into account "the fact that the *creation and retention of custom*, rather than the designation of source, is the primary purpose of the trademark today . . . ."[32]

Courts and commentators quickly followed Schechter in espousing the notion that trademarks do not necessarily function as indicators of the physical or manufacturing source of goods, but can also function as "guarantees of satisfaction." The new theory of trademarks was quickly dubbed the "guarantee theory."[33] This label probably was misleading, since Schechter never asserted that a trademark was equivalent to a legal guarantee of quality.[34] Nevertheless, the "gnarantee theory" was widely accepted and was later refined into the "quality assurance theory."[35] By the 1930s, courts had widely embraced the quality assurance theory and generally accepted the view that trademarks did not necessarily indicate physical source, but rather could indicate a "consistent" level of quality.

The quality assurance theory provided a theoretical justification for trademark licensing. Under the new view of trademarks, the public would not be misled as to product quality, so long as the licensor sufficiently

30. *See* Frank I. Schechter, *The Rational Basis of Trademark Protection*, 40 HARV. L. REV. 813 (1927).

31. *Id.* at 819.

32. *Id.* at 822 (emphasis in original).

33. *See* Elmer William Hanak, III, *The Quality Assurance Function of Trademarks*, 43 FORDHAM L. REV. 363 (1974).

34. *See* Ralph S. Brown, Jr., *Advertising and the Public Interest: Legal Protection of Trade Symbols*, 57 YALE L.J. 1165, 1184-91 (1948).

35. *See id.*

monitored its licensees to ensure that the licensed goods were of the same quality as other goods bearing the same mark. However, if the licensor failed to exercise appropriate quality control, licensing would be deemed improper because the trademarked goods might fail to conform to consumers' expectations. Public reliance on the mark as a symbol of a certain level of quality would thus be frustrated.[36] Under the quality theory, courts considered uncontrolled licensing, sometimes referred to as "naked" licensing, improper.[37] Those who engaged in such licensing risked a judicial finding that they had "abandoned" their mark and had forfeited their right to prevent use of the same or similar marks by others.[38]

The trend to allow controlled licensing became the established rule in 1946 with the enactment of the federal Lanham Act.[39] While the Lanham Act does not specifically provide for trademark licensing, it permits use of a trademark by a "related company."[40] A "related company" is defined as "any person whose use of the mark is controlled by the owner of the mark with respect to the nature and quality of the goods or services on or in connection with which the mark is used."[41] It is now firmly established that the Lanham Act definition of a "related company" is the same as that used at common law to determine whether adequate quality control is exercised over a trademark licensee.[42] It is equally clear that under the Lanham Act's definition of "abandonment," trademark licensing in the absence of quality control results in relinquishment of the trademark owner's right to exclude others from using the mark.[43]

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36. James M. Treece, *Trademark Licensing and Vertical Restraints in Franchising Arrangements*, 116 U. PA. L. REV. 435, 445 (1968).

37. *See* E.I. du Pont de Nemours & Co. v. Celanese Corp. of Am., 167 F.2d. 484, 489 (C.C.P.A. 1948).

38. *See id.*

39. *See, e.g.*, Dawn Donut Co. v. Hart's Food Stores, Inc., 267 F.2d. 358, 366-69 (2d Cir. 1959) (invoking the control requirement to determine if a wholesale distributor of donuts "sufficiently policed and inspected its [retail] licensees' operations to guarantee the quality of the products they sold under its trademarks to the public" to decide if it had abandoned its trademark); Huntington Nat'l Mattress Co. v. Celanese Corp. of Am., 201 F. Supp. 938, 945 (D. Md. 1962) (holding that a licensor has a duty to "take reasonable means to detect and prevent misleading uses of its mark by the affiliated companies" and that this affirmative duty on the part of the trademark owner is essential to protect the public's expectations based on past experiences with like-branded products).

40. *See* 15 U.S.C. § 1127 (1994 & Supp. III 1997).

41. *Id.*

42. *See, e.g.*, National Trailways Bus Sys. v. Trailway Van Lines, Inc., 269 F. Supp. 352 (E.D.N.Y. 1965) (finding no related company in the absence of control over user's nature and quality of services).

43. *See Dawn Donut*, 267 F.2d. at 367.

C. THE EVOLUTION OF TRADEMARK LICENSING BEYOND THE CLASSICAL MODEL

The quality assurance theory and the corollary rule requiring trademark licensors to control the quality of the goods or services produced by their licensees have dominated trademark licensing in the United States for the past fifty years. However, during this same period, trademark licensing has evolved beyond the model that gave rise to the "controlled licensing" concept. At least four different types of trademark licensing arrangements have emerged.

First, so-called "classical licensing," which began at least as early as 1930 and continues today, occurs whenever a manufacturer of goods with a recognized brand name essentially "outsources" the actual physical manufacturing processes to an independent company.[44] Because the classical licensor knows the manufacturing process, it usually demands strict compliance with its own standards and specifications, and closely supervises its licensees' operations. The fact that the licensee can make the goods cheaper than the licensor serves as the primary motivation for this arrangement.[45]

Second, in the years immediately following World War II, franchising arrangements became increasingly popular. Thousands of franchisors licensed their trademarks to franchisees who, in turn, sold the licensed goods in outlets across the country.[46] Indeed, a trademark license is included in virtually every franchise contract.[47] While there clearly exist important parallels between trademark licensing in the franchise context and trademark licensing in the manufacturing context, this Article focuses primarily on the latter, since strict liability is more likely to be at issue when the licensee is a manufacturer.[48]

Third, more recently, a business practice known as "collateral market" or "collateral product" licensing, which I will refer to as "collateral

44. *See* Alfred M. Marks, *Trademark Licensing—Towards a More Flexible Standard*, 78 TRADEMARK REP. 641, 646-47 (1988).

45. In 1980, for example, Questor Corporation "produced nearly all of its SPALDING products itself, and lost $12.6 million on sales of $273 million." *Id.* at 647. To remedy the situation, Questor decided to outsource its manufacturing operations to trademark licensees, and three years later "earned $12 million on $250 million of sales." *Id.*

46. *See* W.J. Keating, *Promotional Trademark Licensing: A Concept Whose Time Has Come*, 89 DICK. L. REV. 363, 364 (1985).

47. In 1982, trademark licensing accounted "for $339 billion or 31 percent of merchandising in the United States." *Id.*

48. *See supra* note 2 and accompanying text (citing articles addressing trademark licensor liability in the franchise context).

licensing."[49] One legal commentator has defined collateral licensing as "the use of a mark on goods (or services) which are different, or which are used in media different, from those in connection with which the public recognition and demand [for the mark] were first created."[50] An example of collateral licensing would be a situation in which General Motors licensed its marks to an independent refrigerator manufacturer, which then made and sold refrigerators under the GM label. In the last twenty years, collateral licensing has grown rapidly in every sector of the economy and currently accounts for a substantial portion of total retail dollars earned through trademark licensing.[51]

A fourth type of licensing, which may be categorized as a subset of collateral licensing, is known as "promotional trademark licensing." This practice has been defined as the use of a mark in circumstances where its primary function is to engender consumer identification with the mark, as opposed to consumer reliance on the mark as an assurance of consistent quality.[52] Today, we can buy Coke pants, Coke toys, Coke stuffed animals, and Coke school supplies—not to mention IBM beach towels and Michael Jordan gym shoes. These are all examples of the phenomenal growth of promotional licensing.[53]

There are several important differences between classical and promotional licensing. In the classical forms of licensing, the consumer, at least theoretically, is "motivated to purchase a product bearing a trademark because of the consumer's expectation that the product will meet the quality standards that the trademark owner achieves."[54] Conversely, in promotional trademark licensing, the consumer is not motivated by the quality level of the product, but "rather wishes to identify with the trademark

49. *See* Marks, *supra* note 44, at 646. This practice has been growing in recent years but it is not new. *See also* Kevin Parks, *"Naked" Is Not a Four-letter Word: Debunking the Myth of the "Quality Control Requirement" in Trademark Licensing*, 82 TRADEMARK REP. 531, 539 (1992) (citing Finchley, Inc. v. George Hess Co., 24 F. Supp. 94 (E.D.N.Y. 1938), as an example of an "old" case involving collateral market licensiug).

50. Marks, *supra* note 44, at 646.

51. *See id.*

52. *See* Keating, *supra* note 46, at 372.

53. Promotional trademark licensing mushroomed in the 1970s, led by "such famous merchandising forerunners as BUSTER BROWN, RAGGEDY ANN, SHIRLEY TEMPLE, BATMAN and ROBIN and MICKEY MOUSE, and was followed by 007, STAR WARS, SNOOPY and STRAWBERRY SHORTCAKE, among others." Marks, *supra* note 44, at 646. Colleges and universities, the NFL and the Olympic Committee followed suit, licensing the use of their names and emblems to various manufacturers. *See id.* at 647.

54. Keating, *supra* note 46, at 372.

owner."[55] In promotional licensing, "the trademark proclaims the exhibitor's loyalty, admiration or sympathy . . . (the 'LAS' factor)."[56] Available empirical data suggest that in the promotional licensing context, consumers do not believe that the licensor made or established quality standards for a particular product, but rather that the licensor authorized the use of its name or mark in connection with the product and financially benefits from it in some way.[57] In promotional licensing, the trademark functions primarily as an advertising tool, not as an indicator of the physical source of the goods or that the goods are of the same quality as all other goods bearing the same mark.

Public perception is not the only area in which classical and promotional trademark licensing differ. They also differ with respect to the licensor's practical ability to establish quality standards and specifications for the licensed goods. In classical licensing, the licensor frequently is well situated to establish product specifications and to ensure that they are followed.[58] For example, "[t]he Coca-Cola Company has codified licensing and franchising specifications for its independent bottlers, and staffs of inspectors make certain that the licensing requirements are followed."[59] Conversely, when Coca-Cola authorizes the Murjani clothing company to use Coke's marks on hats, pants or shirts, it probably cannot supply Murjani with specifications or standards for these goods because no one at Coke knows "what standards to specify when licensing in an unfamiliar industry."[60]

In light of these practical realities, some courts have exempted promotional licensors from the quality control requirement altogether.[61] However, this clearly is not the general rule. Rather, the majority approach continues to be that promotional licensors, like all other licensors, risk a finding of abandonment if they fail to "control the quality" of the licensed goods. I now turn to an examination of that requirement.

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55. *Id.* (citing University of Pittsburgh v. Champion Prods., Inc., 686 F.2d 1040, 1047 (3d Cir. 1982) ("The entire impetus for the sale is the consumer's desire to identify with Pitt[sburgh] . . . .")).

56. *Id.*

57. *See id.*

58. *See* Marks, *supra* note 44, at 648-50.

59. *Id.* at 648.

60. *Id.*

61. *See, e.g.*, University of Pittsburgh v. Champion Prods., Inc., 686 F.2d 1040 (3d Cir. 1982 (holding that the university's delay in bringing action for trademark infringement did not bar its right to injunctive relief); Boston Prof'l Hockey Ass'n, Inc. v. Dallas Cap & Emblem Mfg., Inc., 510 F.2d 1004 (5th Cir. 1975) (finding that symbols need not be copyrighted in order to be entitled to protection).

D. The Quality Control Requirement

As several commentators have observed, "[n]either 'quality' nor 'control' is defined in the Lanham Act; they are common law creatures whose evolution is incomplete and inconsistent."[62] A separate examination of these terms will be helpful.

1. *"Quality"*

"Quality" in this context does not necessarily mean "high quality."[63] Rather, it is generally agreed that quality here means "even quality" or a consistent level of quality.[64] The rule is based on the theory that consumers come to associate trademarks with a certain level of quality, and they will be misled if items bearing that trademark no longer meet that same level of quality. For example, if a consumer normally associates the "K mart" trademark with a relatively low level of quality, the consumer will expect that same low level of quality whenever he buys goods bearing that trademark. If the merchandise is better than expected, the consumer is "deceived"—pleasantly deceived, but deceived nonetheless. If the merchandise is worse than expected, the consumer is also deceived—but this time, not pleasantly. Justice Stewart expressed the concept succinctly: "An important ingredient of the premium brand inheres in the consumer's belief, measured by past satisfaction and the market reputation established by [a company] for its products, that tomorrow's can will contain the same premium product as that purchased today."[65]

To protect consumer expectations, courts have held that trademark owners have a duty to police their licensees to ensure a "consistent level of quality." But courts have had difficulty defining precisely what the term "consistent level of quality" means in practice. One commentator has suggested that, "the standard of quality which the licensee must meet is that of the licensor's own goods, whether high, low or mediocre. If the licensor does not manufacture the [licensed] goods, the standard may be similar

62. Parks, *supra* note 49, at 538.

63. *See* McCarthy, *supra* note 22, § 3:10.

64. *See id.*

65. FTC v. Borden Co., 383 U.S. 637, 651 (1966) (Stewart, J., dissenting). *See also* Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F.2d 633, 636 (1st Cir. 1992) ("Every product is composed of a bundle of special characteristics. The consumer who purchases what he believes is the same product expects to receive those characteristics on every occasion.").

products of the licensor or other licensees, or similar articles produced by designated competitors."[66]

However, this standard is flawed in several respects. First, there is the "diverse quality" problem.[67] That is, goods produced under an established mark may have been of an "uneven" or inconsistent quality even when the trademark owner manufactured them. Manufacturers may sell a "bad batch" of goods because some product defects are difficult to spot. Additionally, the quality of any given line of goods may vary over time, depending on the vigilance with which manufacturers monitor quality. Thus, it may be meaningless to require a licensee to produce goods that are of the "same quality" as the licensor's own goods, since the licensor's own goods may not be of a consistent quality.[68] The diverse quality problem undermines the viability of quality control requirements, even in the classical licensing situation where the requirement originated and was thought most applicable.[69]

The quality control requirement is even more puzzling in the collateral and promotional licensing contexts.[70] In these situations, there usually are no other goods to set the relevant quality benchmark.[71] Hence, it is not reasonable to say that the quality level must be the same as other products produced by the licensor. For example, when Coca-Cola licenses its trademark to a teddy bear manufacturing company, Coke cannot possibly determine whether Coke teddy bears are as good as its soft drinks.[72] Nor can Coke teddy bears be compared with teddy bears produced by other manufacturers,[73] since it would be highly arbitrary to determine which other manufacturers to consider.

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66. William M. Borchard & Richard M. Osman, *Trademark Sublicensing and Quality Control*, 70 TRADEMARK REP. 99, 101 n.11 (1980) (citing MCCARTHY, *supra* note 22, §3:4; Sidney A. Diamond, *Requirements of a Trademark Licensing Program*, 17 BUS. LAW. 295, 300 (1962)). *See also* Ronald B. Coolley, *Related Company: The Required Relationship in Trademark Licensing*, 77 TRADEMARK REP. 299 (1987) (discussing trademark licensing legislation and the significance of the related company doctrine); F. Vern Lahart, *Control—The Sine Qua Non of a Valid Trademark License*, 50 TRADEMARK REP. 103 (1960) (discussing a licensor's control of a licensee's use of a trademark); Comment, *Problem of Adequate Control*, *supra* note 27, at 875 (examining the manner in which courts have dealt with the Lanham Act's control requirement).

67. *See* Parks, *supra* note 49, at 537.

68. *See id.*

69. *See id.* at 536-38.

70. *See id.* at 538-40.

71. *See id. See also* Marks, *supra* note 44, at 648-50 (proposing that existing trademark licensing rules regarding quality control should be clarified to more accurately reflect the "commercial reality" that most licensors do not exert much control over licensees under collateral or promotional licensing arrangements).

72. *See* Marks, *supra* note 44, at 648-50.

73. *See* Parks, *supra* note 49, at 539.

This difficulty has left collateral and promotional licensors in a bind. Because they have never manufactured the product they now wish to produce through a licensee, they are not in a position to point to a relevant and controlling quality standard for the new product line.[74] Nor are they in a position to supply their licensees with specifications or designs for the new product.[75] For these reasons, collateral and promotional licensors frequently cannot control the quality of the licensed goods in any meaningful sense.[76]

2. *"Control"*

Under the Lanham Act, a trademark is subject to cancellation "on the ground that the registrant (A) does not control, or is not able legitimately to exercise control over, the use of such mark . . . ."[77] Theoretically, control may include (1) the provision of detailed specifications and standards for goods to be produced; (2) the submission of plans, drawings, preliminary models, and actual samples; (3) unannounced spot inspections of the licensor's plant and facilities; (4) detailed rules about the placement size, proportions, and use of the trademark to be affixed; and (5) remedies for failure to meet such standards.[78]

However, it is impossible to discern from the cases a single test regarding which type, or how much, control must be contractually retained or actually exercised.[79] At one end of the spectrum, a few cases appear to hold that licensors must exercise extensive control over the licensee, establish specifications for manufacturing and designing the goods, and police their licensees to ensure that those specifications are followed.[80] At the other end of the spectrum, cases hold that the mere contractual *right* to exercise quality control is sufficient.[81] In between these extremes are cases upholding varying degrees of control, including cases finding no abandonment, despite the licensor's "reasonable reliance" on its licensees

74. *See* Marks, *supra* note 44, at 648-50.

75. *See id.*

76. *See id.*

77. 15 U.S.C. § 1064(5)(A) (1994), *amended by* Trademark Law Treaty Implementation Act, Pub. L. No. 105-330, 112 Stat. 3064 (1998).

78. *See* Marks, *supra* note 44, at 644.

79. *See id.* at 644-45. *See also* Parks, *supra* note 49, at 539-40 (discussing the wide range of outcomes reached by courts in resolving the fact-based inquiry of the issue of control).

80. *See, e.g.*, First Interstate Bancorp. v. Stenquist, 16 U.S.P.Q.2d (BNA) 1704 (N.D. Cal. 1990). *See also* Parks, *supra* note 49, at 540 This approach, however, appears to be a distinct minority view, and indced, this requirement would be impossible for many licensors to fulfill.

81. *See* Parks, *supra* note 49, at 540.

to establish specifications, set quality standards, and otherwise police quality.[82]

Despite the articulated rule that the failure to exercise quality control results in abandonment, courts have been reluctant to enforce this requirement.[83] This appears to be because the issue typically arises in the context of a licensor's suit against an infringer, and in such circumstances, courts are reluctant to reward a party with such "unclean hands."[84] Accordingly, as against a clear infringer, courts typically stretch to find some way to uphold the licensor's ownership rights in the mark. As a result of these decisions, courts have diluted the quality control requirement to the point where its meaning is no longer clear, if it even has any meaning at all.[85]

3. *"Minimalist" Quality Control Programs*

For some trademark licensors, an extensive quality control program is appealing for business reasons. For example, when Coca-Cola licenses independent bottlers to make, bottle and distribute Coca-Cola products, it probably is both possible and desirable for Coca-Cola to strictly control the entire manufacturing process. Indeed, Coca-Cola would not be able to maintain the uniform quality of its soft drinks if its licensees did not use the same ingredients and formula. Coca-Cola, no doubt, has an army of inspectors to ensure compliance with its extensive quality control program. In this type of "classical" licensing situation, the economic incentives and the means exist for the licensor to exercise extensive quality control.

Despite the apparent attraction of such programs, there is evidence that even in the classical licensing context, many licensors simply do not have quality control programs.[86] As Kevin Parks has observed, "[a]s long as thirty years ago Senate hearings revealed widespread evasion of the control requirement, even in traditional licensing contexts."[87] Such evasion appears to be even more prevalent in the collateral and promotional

82. *See, e.g.*, Printer's Servs. Co. v. Bondurant, 20 U.S.P.Q.2d (BNA) 1626 (C.D. Cal. 1991).

83. *See* Parks, *supra* note 49, at 541-44. *But see* Midwest Fur Producers Ass'n. v. Mutation Mink Breeders Ass'n., 127 F. Supp. 217 (W.D. Wis. 1954) (finding abandonment of mark and invalidity of license agreements because of nonexercise of quality control); Heaton Enter. of Nev., Inc. v. Lang, 7 U.S.P.Q.2d (BNA) 1842 (T.T.A.B. 1988) (same).

84. *See* Parks, *supra* note 49, at 541.

85. *See id.* at 545. *See also* Comment, *Problem of Adequate Control*, *supra* note 27, at 902.

86. *See* Parks, *supra* note 49, at 544.

87. *Id.* at 544; Comment, *Problem of Adequate Control*, *supra* note 27, at 899 & n.126 (discussing *Hearings on S. 1396 Before the Subcommittee on Patents, Trademarks, and Copyrights of the Senate Judiciary Comm.*, 87th Cong., 1st Sess. (1961)).

licensing contexts.[88] Here, the problem probably is due to the inability of such licensors to establish product specifications or to police their licensees' quality assurance operations in a meaningful way.[89]

As a result of these difficulties and the uncertain scope of the quality control requirement, licensors may institute "illusory" or "minimalist" quality control programs. Such programs might include boilerplate clauses in licensing contracts, giving the licensor the right to monitor the quality of the licensed goods, to inspect their licensees' premises, or to inspect product samples at regular intervals.[90] But beyond reserving such contractual rights, it appears that many collateral and promotion licensors do little to fulfill the quality control requirement.[91] Instead, the licensee goes about the business of designing, testing, and manufacturing the product with little or no input from the licensor. As long as the product sells and the royalty checks keep coming, both parties are happy.[92]

But when the licensor is sued for defects in its licensees' goods, the fact that the licensor's quality control has been illusory gains special significance. In these circumstances, the licensor may find itself in a "no-win" situation. If it acknowledges that its quality control program has been "illusory"—or even "minimalist"—it might severely impair its ability to prosecute a subsequent infringement suit if another entity appropriates its trademark. If the licensor does *not* admit that its quality control program is illusory or minimalist, it may have a difficult time obtaining summary judgment on plaintiff's enterprise liability claim because it may appear to be a "significantly involved" licensor. As the next section will indicate, the latter risk is magnified by the fact that courts applying the enterprise theory do not necessarily distinguish Lanham Act control from the type of control that should be the basis for imposing strict liability.

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88. *See* Parks, *supra* note 49, at 544-45.

89. *See* Marks, *supra* note 44, at 648-50. As Marks observes, in the increasingly prevalent collateral licensing situation,

> specifications cannot be supplied to the licensee because no one on the licensor's staff knows what standards to specify when licensing in an unfamiliar industry. At best, the agreement will call for merchandise based on some objective standard. . . . After the agreement is executed, samples will be furnished by the licensee, advertising and labeling will be prepared and approved. Proper trademark notices will be specified and utilized on the samples. Thereafter, active control over the licensee will be likely to cease. The business people will be concerned with their next business deal and will not be likely to continue reviewing the licensee's activities, so long as the royalty checks continue to arrive on time.

Id. at 648-49.

90. *See id.* at 649.

91. *See id.* at 651.

92. *See id.* at 649.

III. TRADEMARK LICENSORS AND CONTROL-BASED THEORIES OF STRICT LIABILITY

A. ENTERPRISE LIABILITY

Beginning in the early 1960s, state courts in California created a new common law doctrine holding that all entities that significantly participate in the overall "enterprise" that introduces a product into the "stream of commerce" are deemed "sellers," and thus are strictly liable for injuries caused by that product under section 402A of the Restatement (Second) of Torts.[93] The doctrine has become known as the "stream of commerce" or "enterprise liability" theory.[94] Like strict liability generally, the enterprise theory is based on two rationales: (1) that entities which both place products into the commercial arena and profit thereby are in a better position than injured consumers to bear the risk of loss from such products; and (2) that such entities are in a better position than injured consumers to prevent the injury from occurring. In this way, enterprise liability, like strict liability generally, is based on a "loss spreading" or "loss shifting" rationale.[95]

Several courts have used the "enterprise liability" theory, or a close facsimile, to impose strict liability on licensors. Although the formulation of this theory varies from case to case, courts have generally applied it whenever the licensor was "substantially involved in" or an "integral part of" an enterprise that placed a defective product into the stream of commerce. Such licensors are treated as "sellers" and held liable under section 402A of the Restatement (Second) of Torts, which by its terms applies to all commercial "sellers." The Ninth Circuit, applying Arizona law, stated the rule as follows:

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93. The Restatement (Second) of Torts section 402A provides as follows:

(1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if

(a) the seller is engaged in the business of selling such a product, and

(b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

(2) The rule stated in Subsection (1) applies although

(a) the seller has exercised all possible care in the preparation and sale of the product, and

(b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

RESTATEMENT (SECOND) OF TORTS § 402A (1965).

94. *See* Jerald E. Rosenblum & Kathy A. Fields, *Product Liability Risks of University Research Licensing and How They Affect Commercialization—Is It Time for a Legislative Solution?*, 7 J. PAT. & TRADEMARK OFF. SOC'Y 514, 514-15 (1991).

95. *See, e.g.*, Kasel v. Remington Arms Co., 101 Cal. Rptr. 314, 329-30 (Cal. Ct. App. 1972).

> [T]rademark licensors who *significantly participate* in the overall process by which the product reaches its consumer, and who have the right to control the incidents of manufacture or distribution, are subject to liability under the rules of the Restatement (Second) of Torts section 402A . . . [T]hey are the functional equivalents of manufacturers and sellers.[96]

Courts have considered a variety of factors to determine whether a trademark owner "significantly participates in" or is an "integral part of" an enterprise. Relevant factors have included whether: (1) the licensor retained the right to control the quality of the licensee's products; (2) the licensor *actually exercised* its quality control rights; (3) the licensor provided the licensee with design specifications for the product; (4) the licensor monitored production to ensure that its specifications were followed; (5) the licensor advertised the product; (6) the licensor received direct or indirect financial benefit from the sale of the product; (7) the licensor distributed the product; (8) the licensor was in a position to eliminate the unsafe character of the product; (9) consumers relied on a trade name or trademark which gave the impression that the trademark owner stood behind or vouched for the product; and (10) the stated rationales for strict liability support its application to a trademark licensor in a given case.[97]

Courts have not indicated that any one of these factors alone is determinative or that any one factor is entitled to greater weight than any other. Nor have they required plaintiffs to show that all of these factors were present in a given case. Rather, courts have held trademark licensors strictly liable upon a showing that a "sufficient combination" of these factors made the licensor an "integral link" in the enterprise that placed a defective product into the stream of commerce.

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96. Torres v. Goodyear Tire & Rubber Co., 901 F.2d 750, 751 (9th Cir. 1990) [hereinafter *Torres III*] (emphasis added) (quoting Torres v. Goodyear Tire & Rubber Co., 786 P.2d 939 (Ariz. 1990) (en banc) [hereinafter *Torres II*]). *See also Kasel*, 101 Cal. Rptr. at 322 (holding that trademark licensors are strictly liable under section 402A if they are "an integral part of the composite business enterprise which place[s] the defective [product] in[to] the stream of commerce").

The author devotes significant attention to an analysis of *Torres v. Goodyear Tire & Rubber Co*, a case which moved from the Ninth Circuit Court of Appeals to the Arizona Supreme Court and back to the Ninth Circuit. Thus, for clarity, these cases will be referred to throughout this Article as *Torres I*, *Torres II*, and *Torres III*. *See* Torres v. Goodyear Tire & Rubber Co., 867 F.2d 1234 (9th Cir. 1989) [hereinafter *Torres I*].

97. *See, e.g.*, *Torres III*, 901 F.2d at 752-53; *Kasel*, 101 Cal. Rptr. at 325; City of Hartford v. Associated Constr. Co., 384 A.2d 390, 393 (Conn. Super. Ct. 1978).

1. Kasel v. Remington Arms[98]

The seminal case articulating a theory of enterprise liability to impose strict liability on licensors is *Kasel v. Remington Arms*, decided by an intermediate California appellate court in 1972.[99] There, a person injured by a defective shotgun shell, manufactured by a foreign trademark licensee,[100] sued Remington Arms Company ("Remington"), the trademark licensor. The court found that the licensor (1) caused the manufacturing entity CDM to be created, (2) entered into three contracts with the licensed manufacturer,[101] (3) owned forty percent of the outstanding stock of the manufacturer, (4) created common and interlocking officers and directors, and (5) benefited financially from the arrangement. In light of these extensive relationships, the appellate court held that the trial court should have found as a matter of law that Remington was an integral part of the enterprise that placed the defective shell in the stream of commerce.[102]

In its subsequent discussion of the development of product liability law in California, the court acknowledged that strict liability actions had typically involved a manufacturer or downstream retailer, and that strict liability had not previously been applied upstream to a franchisor—here, a licensor permitting the licensee to use its trademark and business methods.[103] Nevertheless, given the relationship of the defendant licensor to the manufacturer and the benefits accruing to the defendant from this relationship, the court concluded that strict liability was appropriate in this case. The court reasoned that Remington had been an active participant in the enterprise bringing the product to market, and as such had been more

98. 101 Cal. Rptr. 314 (Cal. Ct. App. 1972).

99. *See id.*

100. The *Kasel* court may have been influenced by the fact that the licensee in that case, CDM, was a Mexican company that may not have been subject to the personal jurisdiction of a California court, and Mexican law did not recognize strict liability. Thus, in order to provide the injured California plaintiff with the same measure of recovery he would have received had the manufacturer been a California corporation, the extended strict liability to an American trademark licensor that had in fact extensively participated in its licensee's operations. *See id.* at 332-33.

101. The contracts included: (1) a trademark license giving the defendant the right to inspect and control the product on which its trademark was used; (2) a contract for the sale of technical information, whereby the defendant sold the manufacturer information about the scientific process relating to the production of ammunition; and (3) a technical services contract under which the defendant agreed to train and provide personnel for the manufacturer (licensee). Under the trademark license agreement, Remington retained the right to inspect and control the quality of all ammunition on which its trademarks were used. *See id.* at 318.

102. *See id.* at 322.

103. *See id.* at 323.

involved than a typical downstream retailer who also could be held strictly liable.[104] The *Kasel* court stated the governing principle as follows:

> It is the defendant's *participatory connection*, for his personal profit or other benefit, with the injury-producing product and with the enterprise that created consumer demand for and reliance upon the product (and not the defendant's legal relationship (such as agency) with the manufacturer or other entities in the manufacturing-marketing system) which calls for imposition of strict liability.[105]

2. City of Hartford v. Associated Construction Co.[106]

In 1978, a Connecticut court applied a similar theory in *City of Hartford v. Associated Construction Co.*[107] The City of Hartford sued Silbrico, trademark owner of "All-Weather Crete," to recover for property damage resulting from a leaking roof on a public school and for expenses incurred in repairing the roof. The City alleged that Silbrico was strictly liable under section 402A for the following reasons: (1) Silbrico formulated, designed, advertised, distributed, sold, and issued specifications and instructions for the product known as "All-Weather Crete," an insulating base for built-up roofing systems; (2) Silbrico licensed the application and use of its registered trademark throughout the country, and made the product available through its licensees only; (3) Silbrico retained and exercised the right to control the quality of the licensed goods; (4) Silbrico received "substantial" financial benefit from the sale of the goods through royalty payments; (5) Silbrico received other financial benefit through the sale of perlite ore, which it sold as a necessary component of "All-Weather Crete"; (6) the licensee, Skyway, prepared and applied the product to the roof deck of the school following the standards and specifications of Silbrico; (7) the product as applied was in a condition that conformed to the standards, formula, specifications and design provided by Silbrico; (8) the product as applied was unsafe and in a defective condition unreasonably dangerous to the property of the user or consumer in that moisture was introduced into it and, with changes in temperature, large cracks and crevices developed, creating tears in the roofing membrane and causing the roof to leak.[108]

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104. *See id.* at 323-24.
105. *Id.* at 323 (emphasis added).
106. 384 A.2d 390 (Conn. Super. Ct. 1978).
107. *See id.*
108. *See id.* at 392.

Citing *Kasel*, the court found that the plaintiff had properly stated a cause of action for strict liability against a trademark licensor.[109] The court noted that, while the case was factually different than *Kasel*, the same public policy rationales applied in *Kasel* justified the imposition of strict liability on the trademark licensor here.[110] The court reasoned that if Silbrico itself were manufacturing the product, a strict tort analysis would likely be applicable. Hence, "[i]t seems not to be in the public interest," the court opined, "to allow one to *escape this responsibility through the simple maneuver of entering a licensing agreement.*"[111]

3. Connelly v. Uniroyal, Inc.[112]

In 1979, the Supreme Court of Illinois decided *Connelly v. Uniroyal, Inc.*[113] There, the plaintiff sued Uniroyal, the licensor, for a defective tire manufactured in Belgium by its foreign and wholly owned subsidiary. Although Uniroyal was heavily involved in its licensee's operations,[114] the court stated that it was not holding Uniroyal liable under vicarious liability principles.[115] Instead, the court held that because the tire bore the trade-

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109. *See City of Hartford*, 384 A.2d at 394. Alternatively, the court held that the licensor could be subject to strict liability as an apparent manufacturer under section 400 of the Restatement (Second) of Torts. *See id.* at 396.

110. *See id.* at 394-96.

111. *Id.* at 397 (emphasis added).

112. 389 N.E.2d 155 (Ill. 1979).

113. *See id.*

114. Specifically, the parties' trademark and trade name agreement provided that Uniroyal would do the following: (1) provide its licensee with detailed information as to the methods, processes, and formulas used in the manufacture of tires; (2) supply technical services and instructions to its subsidiary, including recommendations and assistance in purchasing equipment, processes to improve operations, specifications, and testing procedure; (3) permit Uniroyal's licensee to visit Uniroyal's plant to investigate its manufacturing methods; (4) receive quarterly royalty payments; (5) permit Uniroyal's licensee to advertise that its manufacturing practices and technical methods were the same as Uniroyal's; (6) maintain knowledge at all times of the manufacturing operations associated with the Uniroyal trademark; and (7) enjoy preference when the licensee purchased any materials that were made by Uniroyal. *See id.* at 161. It is unclear from the reported decision whether Uniroyal ever exercised any of these contractual rights, beyond the fact that the licensee obviously exercised its right to manufacture tires bearing the Uniroyal trademark. The court specifically held that these facts, coupled with the fact that Uniroyal owned 96% of its licensee's stock, were not sufficient to justify the imposition of "vicarious liability" on Uniroyal under traditional agency or veil piercing principles. Uniroyal had no "control" or "direction" over production at its licensee's manufacturing plant. Separate books and records were kept. There were no shared bank accounts, employees, manufacturing facilities, or joint liability insurance agreements. Finally, there was no evidence of joint board meetings between the two companies' separate boards of directors. *See id.* at 161-62. However, Uniroyal's extensive involvement in the manufacturing, testing, designing, advertising, and marketing of the licensed goods, as evidenced by the parties' licensing agreement, provided significant background support for the court's willingness to extend the doctrine of strict liability to a trademark licensor such as Uniroyal.

115. *See id.* at 161-62.

mark Uniroyal, and Uniroyal financially benefited from its sale, there were material questions of fact that precluded summary judgment.[116] Because Uniroyal received financial benefit from the product, the court held that the same public policy concerns that support the imposition of strict liability on wholesalers, retailers, and lessors also support its application to licensors.[117] Purporting to follow *Kasel*, the court stated that the trademark relationship itself makes every licensor an integral link in an enterprise that places a defective product into the stream of commerce.[118]

4. Torres v. Goodyear Tire & Rubber Co.[119]

Under Arizona law, the Ninth Circuit Court of Appeals again applied the enterprise theory to a trademark licensor in *Torres v. Goodyear Tire & Rubber Co.*[120] In *Torres I*, the plaintiff sued for injuries resulting from an accident caused by tread separation on a Goodyear tire designed and manufactured by Goodyear's foreign subsidiaries/licensees.[121] The plaintiff did not allege that Goodyear caused the product defect or made any design or manufacturing decisions. Rather, the plaintiff alleged that Goodyear should be held strictly liable under the "enterprise theory" articulated in *Kasel* and its progeny.[122] The district court granted Goodyear's motion for summary judgment, and the plaintiff appealed.

116. In *Connelly*, plaintiff argued that liability should be premised on the "apparent manufacturer doctrine" as set forth in section 400 of the Restatement (Second) of Torts. The licensor argued that section 400 did not apply because it was neither a "seller" nor a "distributor" of the defective tire, as most cases applying that doctrine have required. The court rejected the latter argument and instead held that section 400 could apply even to a nonselling, nondistributing trademark licensor, at least where, as here, the identity of the actual manufacturer was not also indicated on the defective product. Moreover, the court appeared to premise the licensor's liability on a broader footing than section 400. The court suggested that a licensor *always* is an integral link in the enterprise that places a defective product into the "stream of commerce." Thus, the *Connelly* court blended a broad interpretation of the apparent manufacturer doctrine with an equally broad interpretation of the stream of commerce theory to justify the possible imposition of strict liability on a trademark licensor. The decision could have been grounded in either the apparent manufacturer or stream of commerce rationale, but the court apparently chose to rely on both to provide a stronger footing for its holding. *See id.* at 162-63.

117. *See id.* at 163.

118. *See id.*

119. *Torres I*, 867 F.2d 1234 (9th Cir. 1989).

120. *See id.* (certifying to Arizona Supreme Court the question of whether "enterprise theory of strict liability should be applied to trademark licensors"); *Torres II*, 786 P.2d 939 (Ariz. 1990) (en banc) (answering the certified question in the affirmative); *Torres III*, 901 F.2d 750 (9th Cir. 1990) (withdrawing *Torres I* and remanding the case to the district court for further consideration).

121. *See Torres I*, 867 F.2d. at 1235.

122. Plaintiff sought to hold Goodyear liable under four separate theories, including: (1) the "apparent manufacturer" doctrine; (2) principles of apparent agency; (3) the Arizona law of manufacturers' warranties; and (4) the "enterprise liability" theory of strict liability. *See id.* The district court granted summary judgment for Goodyear on all four theories. On appeal, the Ninth Circuit affirmed the district court's dismissal of the first three theories, finding that Arizona law did not recognize the

On appeal, the Ninth Circuit could not decide whether Arizona courts would extend the enterprise theory of strict liability to a trademark licensor like Goodyear, or whether Goodyear should be characterized as a "manufacturer," as that term had been defined by Arizona's product liability statute.[123] Accordingly, the Ninth Circuit certified the following question to the Arizona Supreme Court:

> [W]hether a trademark licensor is subject to strict product liability under section 402A of the Restatement (Second) of Torts by reason of being either (a) a manufacturer or seller within the meaning of [the Arizona products liability statute]; or (b) an integral part of an enterprise responsible for placing allegedly defective products on the market.[124]

The Arizona Supreme Court answered both parts of the certified question in the affirmative.[125] Although the court noted that strict liability may be inappropriate for a "mere licensor" of a trademark that does not significantly participate in the process by which the licensed goods reach their consumers, the court declined to decide that issue since Goodyear was much more than a "mere licensor."[126] Addressing plaintiff's "enterprise liability" claim, the court held that licensors

> who significantly participate in the overall process by which the product reaches its consumers, and who have the right to control the incidents of manufacture of distribution, are subject to liability under the rules of Restatement § 402A as adopted and applied in Arizona. [Such trademark licensors] are the functional equivalent of manufacturers and sellers.[127]

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apparent manufacturer doctrine, and that plaintiff failed to establish a genuine issue of material fact as to the agency and warranty claims. *See id.* at 1234-37.

123. Under the Arizona statute, all "manufacturers" are subject to strict liability. *See* ARIZ. REV. STAT. ANN. § 12-681 to 12-686 (West 1982).

124. *Torres I*, 867 F.2d at 1239. According to the concurring justice, the certified question should have reflected plaintiff's allegations that Goodyear had extensive control over the design and manufacturer of the tire. The operative licensing agreements provided that: (1) Goodyear's licensees would manufacture the tires in strict accordance with its formulas, specifications, and restrictions; (2) the licensees would use only materials approved by the licensor; (3) Goodyear had the right to inspect its licensees' plants and samples of the licensed goods; (4) Goodyear was to do all the basic product research for the licensed product; (5) Goodyear would perform the necessary quality control operations to ensure the quality of the goods; (6) Goodyear warranted the quality of the tires and agreed to honor the licensee's warranties; and (7) Goodyear would profit from the sale of the goods. In addition, Goodyear owned all or almost all of its subsidiaries' stock; the companies shared some common employees and board members; and the licensor, as a shareholder, was able to decide how much capital would be allocated to its licensees. *See id.* at 1240.

125. *See Torres II*, 786 P.2d at 939.

126. *See id.* at 945.

127. *Id.* at 946-47.

The court asserted that in all cases where courts had applied strict liability to a trademark licensor, the licensors had been substantially involved in their licensees' affairs.[128] The reservation of the *right to control*, coupled with evidence of significant involvement, provided a sufficient basis for applying the "enterprise liability" theory to trademark licensors.[129] Moreover, while it was not necessary for plaintiff to prove that the right to control was actually exercised, the court found it "naïve" to think Goodyear had not in fact controlled its *wholly owned* subsidiaries.[130]

The court also held that the "broad definition" of "manufacturer" set out in the applicable Arizona product liability statute could include certain trademark licensors.[131] That statute defined a manufacturer to include one "who otherwise prepares the product prior to its sale."[132] The court held that "[s]urely the entity that dictates and controls the design, specifications for formulation, technique for production, quality of production, marketing, advertising, sale, and warranty of a product can qualify as one who 'otherwise prepares' the product 'prior to its sale.'"[133] The court again stated its strong suspicion that Goodyear had in fact exercised such control.

On remand to the Ninth Circuit, the court simply stated that "[t]here is no question that Goodyear's involvement in the overall process by which the tires in question reached the Torres' fits the [Arizona Supreme Court's standard for applying enterprise liability to a trademark licensor]."[134] As to the statutory claim, the Ninth Circuit held that "[b]ecause Goodyear's involvement was extensive, albeit indirect . . . it fell within the Arizona Supreme Court's interpretation of [manufacturers, as set forth in the Arizona product liability statute]."[135] Hence, in addition to being potentially

128. *See id.* at 946.

129. *See id.*

130. *See id.* at 943 n.2.

131. *See id.* at 947.

132. *Id.*

133. *Id.* (citation omitted).

134. *Torres III*, 901 F.2d 750, 751 (9th Cir. 1990). After a jury verdict finding Goodyear USA strictly liable, but exonerating Goodyear's foreign subsidiaries, which had actually designed and manufactured the allegedly defective tire, Goodyear again appealed, arguing that the jury verdict was internally inconsistent because it could not be held derivatively liable under the enterprise theory if its subsidiaries were not liable. The Ninth Circuit disagreed, in part on the ground that, based on the evidence adduced at trial, the jury could have found that Goodyear USA's strict liability was "direct," not "derivative." *See* Torres v. Goodyear Tire & Rubber Co., Inc., No. 94-15092, 1995 U.S. App. LEXIS 20375, at *9 (9th Cir. July 13, 1995) (unpublished table decision).

135. *Torres III*, 901 F.2d at 751. *But see* Yoder v. Honeywell, Inc., 104 F.3d 1215 (10th Cir. 1997) (upholding the trial court's determination that Honeywell, which had licensed the "Honeywell" trademark to its subsidiary for use on computer keyboards, was not liable as a "manufacturer" or

strictly liable under the enterprise theory, Goodyear could be strictly liable as a "manufacturer" under Arizona law.

5. Burkert v. Petrol Plus of Naugatuck, Inc.[136]

In 1990, the same year that the Arizona Supreme Court decided *Torres II*, the Connecticut Supreme Court handed down *Burkert v. Petrol Plus of Naugatuck, Inc.*[137] There, consumers sued a retailer of automatic transmission fluid when the fluid turned out to be defective. After settling those claims, Petrol Plus brought an action for indemnification against two parties: Atlantic Coast Oil Company ("Atlantic") and General Motors Corporation ("GM"). Petrol Plus had purchased the fluid from Atlantic. Atlantic had purchased the fluid from another entity and labeled it as "Kenmore Dexron II." "Kenmore" was a registered trademark of Atlantic, and "Dexron II" was a registered trademark of GM. GM had licensed the use of the Dexron II mark to Atlantic for use in connection with any fluid that met GM's performance standards.

Under the licensing agreement, GM did not dictate specifications for the product or in any way control its production. However, before a licensee could properly place the Dexron II mark on a can of fluid, it had to submit the fluid to one of only two independent testing agencies that were approved by GM. GM received no royalties or other direct financial benefit from the use of the Dexron II trademark.[138]

The court, citing *Kasel* and other stream of commerce cases, nevertheless found that because GM had an unusually limited role as a trademark licensor, it did not meet the test set forth in *Kasel*. Specifically, the court noted that GM had not sold or distributed the product, that GM did not receive any financial benefit from the product, and that GM did not exercise control over the operations of its licensees. The court did not think it dispositive that GM had required the licensees to meet performance standards set by GM and to test the fluid only at GM-approved independent labs.[139] *Burkert* is thus a rare example of a case in which a minimally involved licensor was held *not liable* under a stream of commerce theory.[140]

"apparent manufacturer" for injuries allegedly caused by the keyboards under Colorado's product liability statute that similarly defined a "manufacturer" as one who prepares a product for sale).

136. 579 A.2d 26 (Conn. 1990).

137. *See id.*

138. *See id.* at 29.

139. *See id.* at 35-36.

140. Petrol Plus sought to hold GM liable under two other theories. First, it alleged that GM should be held liable under negligence principles for failing to implement a quality control program to

B. *KOSTERS V. SEVEN UP CO.* AND THE "IMPLIED WARRANTY THEORY"

A number of courts have used the "implied warranty" label to describe a theory closely resembling the enterprise liability theory articulated in *Kasel*. *Kosters v. Seven-Up Co.* is the seminal case applying this theory of liability.[141] In *Kosters*, the court applied Michigan's version of strict liability to Seven-Up, a trademark licensor/franchisor, in an action for injuries resulting from a poorly designed soda pop carton. Seven-Up neither manufactured nor supplied the defective carton, nor did it require its franchisees to use it. However, Seven-Up did specifically consent to the carton's use by its franchisee, The Brooks Bottling Company, which had bottled the soft drink contained in the carton.

The court held that when a trademark licensor/franchisor *consents* to the distribution of a defective product bearing its name, its obligation to compensate an injured consumer for breach of implied warranty arises from several factors in combination: (1) the risk created by approving for distribution an unsafe product likely to cause injury; (2) the franchisor's ability and opportunity to eliminate the unsafe character of the product and to prevent loss; (3) the consumer's lack of knowledge of the danger; and (4) the consumer's reliance on the trade name which gives the intended

police the transmission fluid that was manufactured and sold under the Dextron II trademark. It asserted that the Lanham Act placed an affirmative duty on GM to implement such a program and that GM's failure to do so was a basis for imposing negligence liability on GM. The court disagreed, finding that no court had imposed a tort duty on a trademark licensor as a result of the Lanham Act's quality control requirement. *See id.* at 33-34. Second, Petrol Plus argued that GM should be held strictly liable under the "apparent manufacturer" theory as set forth in section 400 of the Restatement (Second) of Torts. The court erroneously stated that there is no difference between the apparent manufacturer doctrine and the stream of commerce theory articulated in cases like *Kasel*. *See id.* at 33 n.11. The court then proceeded to analyze Petrol Plus' claim against the backdrop of both doctrines. The court noted that the apparent manufacturer doctrine does not apply unless a trademark licensor "puts out" a product as its own by "sale, lease, gift or loan." *See id.* The court then held that because GM had done none of these things, it could not be liable as an apparent manufacturer. The court also observed that the apparent manufacturer doctrine had been applied only when the use of a trademark led a purchaser to believe that the licensor had itself produced the goods. The court found that this requirement was not met here because "[a]lthough the Dextron II trademark did appear on Atlantic Coast's packaging, Atlantic Coast also used its own trade name 'Kenmore' on the containers." *Id.* at 26.

141. 595 F.2d 347 (6th Cir. 1979). *See also* Harris v. Aluminum Co. of Am., 550 F. Supp. 1024 (W.D. Va. 1982) (following *Kosters* and holding a franchisor/licensor liable under warranty theory where the franchisor caused the product to enter commerce, extensively promoted the sales of the product, and controlled the specifications and requirements of the product). *But see Burkert*, 579 A.2d at 35-36 (rejecting application of the implied warranty theory to a trademark licensor who published performance standards for the licensed product and required licensees' products to be tested by an outside laboratory, but who was not otherwise involved in the manufacture, distribution, or sale of the product, and did not profit from it).

impression that the franchisor/licensor is responsible for and stands behind the product.[142]

While the *Kosters* language is sweeping, the case turned on the fact that Seven-Up expressly approved the use of the defective carton.[143] Seven-Up also required its licensee to submit specimens of its products for safety inspection, and such an inspection did actually occur.[144] The court stated that "[w]ith knowledge of its desigu, Seven-Up consented to the entry in commerce of the carton from which the bottle fell, causing the injury."[145] The court found that Seven-Up's liability was "based on [its] control and the public's assumption, induced by the franchisor's conduct, that it does in fact control and vouch for the product."[146]

In cases applying the enterprise liability theory and other similar theories, courts tend to treat heavily involved licensors as the trne producers of the licensed goods and treat their licensees as subordinate entities. Courts frequently state that they do not rely on traditional agency principles, presumably because a common law agency relationship requires a showing of day-to-day control which cannot be established. Instead, courts purport to rely on strict liability rationales generally, and on the vague notion that certain licensors can fall within these rationales if they have a "participatory connection" or are "significantly involved" with the operations of their licensees. In making this assessment, courts look at a variety of factors, including whether the licensor retains the rights to control the quality of the licensed goods, and does in fact exercise that right in some manner. Courts also consider whether consumers are likely to rely on the licensors' trademark as a symbol of quality. Finally, in most of these cases, courts have imposed strict liability on licensors who supplied their licensees with specifications or standards for manufacturing, designing, or warranting the goods. As I show below, the enterprise liability theory is unnecessarily vague and muddled in several respects.

IV. UNTANGLING THE ENTERPRISE LIABILITY WEB

In this part, I first discuss the general problems with the enterprise liability theory, focusing on the fact that courts have not developed clear tests for imposing strict liability on trademark licensors. I then set forth some of the reasons why courts have had difficulty articulating clear tests

142. *See Kosters*, 595 F.2d at 353.
143. *See id.*
144. *See id.*
145. *Id.*
146. *Id.*

in this area. Finally, I focus particularly on the *Torres* cases, because they illustrate many of the problems with the enterprise liability theory in the trademark licensing context.

A. General Problems with the Enterprise Theory

In the case law to date, the application of enterprise liability theory to trademark licensors poses a number of problems. First, courts have failed to develop a coherent theory about the proper role of a trademark licensor. This failure has resulted in the lack of a clear, formalized starting presumption as to whether a trademark licensor generally should be subject to strict liability. For example, some courts have suggested that a "mere licensor" might not be subject to strict liability,[147] while other courts have suggested that all licensors should be subject to strict liability because of factors that are inherent in every licensing arrangement.[148]

The lack of a clear theory regarding the proper role of a trademark licensor has also resulted in vague and highly indeterminate "tests" for establishing when to hold a particular licensor strictly liable. Courts have justified the imposition of strict liability on trademark licensors on the grounds that they had a "participatory connection" with, were an "integral link in," or "substantially participated" in the enterprise that placed the defective goods into the stream of commerce.[149] However, courts have neither defined these terms nor articulated clear standards for determining whether or why particular licensor conduct should be deemed sufficiently "significant" to justify imputing a manufacturer's strict liability to a trademark licensor. Similarly, although courts have recited a number of "factors" that should be considered in assessing licensor liability, they have not indicated whether any one of these factors is more important than others, or whether a certain number of factors must be present before strict liability will be imposed. Instead, courts frequently "mix" together loosely-defined vicarious liability concepts with products liability rationales to create a "soup" of factors that somehow justifies imposing strict liability on a particular trademark licensor. The failure to untangle separate

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147. *See Torres II*, 786 P.2d 939, 945 (Ariz. 1990) (en banc) ("If we were to deal with 'nothing but a mere licensor'—one who merely licenses a manufacturer to use a particular... trademark—it might well be inappropriate to impose strict liability.").

148. *See* Connelly v. Uniroyal, Inc., 389 N.E.2d 155, 163 (Ill. 1979) ("A licensor is an integral part of the marketing enterprise, and its participation in the profits reaped by placing a defective product in the stream of commerce... presents the same public policy reasons for the applicability of strict liability which supported the imposition of such liability on wholesalers, retailers and lessors.").

149. *See supra* Part III.

and distinct theories of liability renders the opinions in this area highly indeterminate and of little predictive value.

The lack of a clear theory of a trademark licensor role has also resulted in confusion regarding the differences between licensor involvement and licensor control. In other contexts, vicarious liability typically follows control, not mere involvement. Courts have not explained why vicarious liability in the trademark licensing context should be any different. Moreover, to the extent "control" is determinative in these cases, courts have not adequately addressed the following factors: (1) the distinction between the right to control and the exercise of control; (2) the type of control that should be grounds for strict liability; or (3) the weight that should be given to Lanham Act control.

Finally, as a general matter, courts have not considered the economic and insurance implications of exposing trademark licensors to strict liability. Strict liability has been subjected to mounting criticism, principally on the ground that it is an inefficient form of product accident insurance.[150] There may be merit to this criticism, especially given the escalating costs of strict liability insurance and legal defense against strict liability claims. These costs are invariably passed onto consumers in the form of increased prices.

The question of whether the collective costs of such insurance are worth the benefits has been the subject of much debate.[151] In light of this debate, it would seem advisable for courts and legislatures to carefully consider the economic consequences of extending strict liability to trademark licensors. Indeed, if other entities in the chain of distribution—manufacturers, wholesalers, retailers—already purchase strict liability insurance for a particular product, and if it is questionable whether the costs of such insurance are worth its benefits, it would appear to be more questionable to make yet another entity—a trademark licensor—purchase an overlapping layer of insurance for the same product. To date, these issues have not been adequately addressed in enterprise liability cases. Below, I

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150. *See* PETER W. HUBER, LIABILITY: THE LEGAL REVOLUTION AND ITS COSTS, 165-69 (1988); JAMES S. KAKALIK & NICHOLAS M. PACE, COSTS AND COMPENSATION PAID IN TORT LITIGATION 74 (1986); Richard A. Epstein, *Products Liability as an Insurance Market*, 14 J. LEGAL STUD. 645, 668-69 (1985); Deborah R. Hensler, *Trends in Tort Litigation: Findings from the Institute for Civil Justice's Research*, 48 OHIO ST. L.J. 479, 493 (1987); Jeffrey O'Connell, *Alternatives to the Tort System of Personal Injury*, 23 SAN DIEGO L. REV. 17, 21 (1986); George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1534-39 (1987); Stephen D. Sugarman, *Doing Away with Tort Law*, 73 CAL. L. REV. 555, 596 (1985).

151. *See* sources cited in *supra* note 150.

explore some of the reasons why conrts have had difficulty developing a coherent theory and clear tests in this area of law.

B. THE DILEMMA

A review of the cases indicates that a number of reasons exist for the courts' difficulty in articulating a cogent theory of, and clear tests for, trademark licensor liability. First, the decisions are not based on a coherent theory about the proper role of a trademark licensor. That is, the decisions lack a general view as to whether licensors should or should not participate in their licensees' affairs, and if so, to what extent or in what manner. Many of the cases apply the notion that extensive or substantial participation is grounds for imposing vicarious liability on a trademark licensor. While this notion implies that a passive licensor will not be exposed to such liability,[152] courts do not explain why this should be so.

Second, courts have not been explicit about what they are doing. Courts applying the enterprise liability theory imply or expressly state that they are not applying vicarious liability principles.[153] They assert that they merely apply "the underlying rationales" of strict liability, where warranted, to particular trademark licensors. This cannot be correct. If conrts were simply analyzing whether the underlying rationales of strict liability support its extension to licensors, they would not need to discuss whether a particular licensor "controlled," "had the right to control," or was "significantly involved" in the affairs of its licensee. These issues are not normally relevant to whether a manufacturer or other seller is subject to strict liability. The intensive focus on "control," "significant involvement," and "participatory connection" indicates that courts are in fact applying some form of vicarious liability. Indeed, one can view the enterprise liability theory primarily as a muddled form of vicarious liability dressed up in products liability garb.

Third, the nature of the trademark licensing relationship makes it difficult for courts to develop a clear test for imposing strict liability on licensors based on vicarious liability principles. Normally, vicarious liability is imposed when two parties are involved in an agency relationship. In an agency relationship, because the principal clearly controls the agent's acts, the principal is thus liable for those acts because liability follows control. At the opposite end of the spectrum are independent contractors. The independent contractor usually is not under the control of the entity that

152. *See Torres II*, 786 P.2d at 945.

153. *See, e.g.*, Kasel v. Remington Arms Co., 101 Cal. Rptr. 314, 323 (Cal. Ct. App. 1972).

hired it; the relationship between the parties is contractual and neither party is liable for the acts of the other. The licensing relationship, on the other hand, generally does not fit neatly into either of these categories, but rather fits somewhere between these two extremes.[154] Some licensors may completely control and dominate their licensees, while other licensors may share control and decisionmaking with their licensees. Further along the spectrum, some licensors may merely offer advice or suggestions to its licensees but exercise no control. Still other licensors may have no involvement whatsoever and leave all the decisionmaking and control to the licensees.

Fourth, the quality control requirement, as established under the common law and in the federal Lanham Act, adds another layer of ambiguity to these cases. Licensors are required by the Lanham Act to maintain sufficient control over licensees to ensure a consistent quality of all goods bearing the same mark.[155] This requirement helps protect consumers who expect that similarly branded goods are of a similar quality.[156] Failure to meet this requirement leads to a licensor's loss of the right to prevent others from using the mark, for the licensor is deemed to have abandoned its mark. Despite the grave consequences of failing to meet the control requirement, neither the Lanham Act nor the courts have clearly defined the scope of the requirement. Some courts, for example, have held that the licensor must actually *exercise* some type of quality control; others have upheld licensing arrangements that merely provide the licensor with the contractual *right* to exercise such control. Still others have permitted licensors to rely on their licensees for quality control.

Because of this quality control requirement, virtually every trademark license contains boilerplate language giving the licensor the "right to control the quality" of the licensed goods. Thus, even if a particular licensor is not involved at all in its licensee's operations, it will *appear* to be involved by virtue of the licensing agreement. Such clauses make it difficult for courts to determine the extent, nature, or purpose of a licensor's control in a particular case. As a result, the quality control requirement may make it difficult for judges to articulate an all-encompassing test or to dispose of these cases as a matter of summary judgment.

Although the licensing relationship cannot easily be categorized either as an agency relationship or as an independent contractor relationship,

154. *See supra* notes 72-85 and accompanying text.

155. *See* 15 U.S.C. § 1064(5)(A) (1994), *amended by* Trademark Law Treaty Implementation Act, Pub. L. No. 105-330, 112 Stat. 3064 (1998).

156. *See supra* Part II.D.

judges frequently find that a particular licensor is sufficiently involved or sufficiently in control to justify imputing the licensee's strict liability to the licensor. In these cases, courts have been persuaded that the licensors were in some sense the "masterminds" behind, or at least significant players in, the enterprise that produced the defective product. In such circumstances, courts reason that it would be inequitable to allow the licensor to escape liability through the "simple maneuver" of entering into a licensing arrangement—particularly where the plaintiff's ability to recover against the manufacturer was uncertain.

However, courts do in fact apply a loosely defined form of vicarious liability in the enterprise liability cases.[157] Indeed, if vicarious liability was not the predominant issue, courts would not need to extensively cite any available evidence of licensor control and involvement to support their decisions. The courts are not "wrong" in most of these cases in terms of fundamental fairness or justice; they have simply not developed a consistent set of rules or even a coherent theory to explain their decisions. An examination of these cases results in the knowledge that the decisions were correct, but one cannot articulate a test, principle, or standard to explain *why* the cases were correctly decided. Nor can one predict when a licensor will be held liable in similar circumstances in a subsequent case.

Finally, courts may be reluctant to develop clear rules here for fear that such rules will enable licensors to carefully manipulate licensing arrangements to retain practical control over their licensees without facing liability under the letter of the law. Courts may fear that, as a result of such manipulation, they will not be able to impose strict liability on licensors though strong equitable reasons exist for doing so.

While this may be a valid concern, it is not distinctive of trademark licensing. Every area of law faces the same dilemma. The clearer the rule, the better one can avoid it. The fear of manipulation alone, however, cannot justify a standardless, ad-hoc approach. Even putting aside the fact that people have a fundamental right to know what the law is *before* they break it,[158] it is generally recognized that clear rules enable more efficient business planning which, in turn, should inure to the benefit of society.

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157. Enterprise liability theory is rooted in a long tradition of vicarious liability principles. *See* George Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law*, 14 J. LEGAL STUD. 461, 463-64 (1985).

158. *See* Secretary of Labor, U.S. Dep't of Labor v. Lauritzen, 835 F.2d 1529, 1539 (7th Cir. 1987) (Easterbrook, J., concurring).

> People are entitled to know the legal rules before they aet, and only the most compelling reason should lead a court to announce an approach under which no one can know where he stands until litigation has been completed. Litigation is costly and introduces risk into any

C. FOCUSING ON *TORRES* AS AN ILLUSTRATIVE CASE

The Arizona Supreme Court's decision in *Torres II* and its application by the Ninth Circuit in *Torres III* illustrate several of the fundamental problems with the enterprise liability theory. In *Torres II*, the Arizona Supreme Court held that a trademark licensor is subject to strict liability under the enterprise liability theory if it "significantly participates" in the operations of its licensee.[159] Applying this test, the Ninth Circuit held that Goodyear could be held strictly liable for an allegedly defective tire that was designed, manufactured, and sold by its foreign subsidiaries under a trademark licensing contract with Goodyear.[160] The courts' decisions in *Torres II* and *Torres III* are problematic for several reasons.

First, both courts ignore the realities of trademark licensing generally, and the quality control requirement in particular. The Arizona Supreme Court announced a test that requires the plaintiff to prove only that a trademark licensor had the "right to control" the "incidents of manufacture;" the plaintiff need not show *actual* control by the licensor.[161] But the court did not discuss the fact that nearly all trademark licensors, by virtue of their duties under the Lanham Act, are required to contractually retain the *right* to control the quality of the licensed goods.

Hence, any trademark licensor who does not wish to abandon its mark will include boilerplate quality control provisions in its licensing agreement with its licensees. Indeed, those provisions may even refer to a nonexistent quality control program as if it were, in fact, in operation. This is especially likely to occur in the collateral and promotional licensing contexts because such licensors are not well positioned to monitor the quality of the licensed goods. When licensors with such programs are sued, they

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> some obstacle such as inexperience with the subject, a dearth of fact, or a vacuum in the statute books intervenes, we should be able to attach legal consequences to recurrent factual patterns.

Id. *See also* R. Bales, *Libertarianism, Environmentalism, and Utilitarianism: An Examination of Theoretical Frameworks for Enforcing Title I of the Americans with Disabilities Act*, 1993 DET. C.L. REV. 1163, 1220 (arguing that indeterminacy breeds litigation).

159. *See Torres III*, 901 F.2d 750, 750-51 (9th Cir. 1990).

> As a common law matter, trademark licensors *who significantly participate* in the overall process by which the product reaches its consumers, and who have the right to control the incidents of manufacture or distribution, are subject to liability under the rules of Restatement § 402A as adopted and applied in Arizona.

Id. (quoting *Torres II*, 786 P.2d 939, 946 (Ariz. 1990) (en banc)) (emphasis added).

160. *See id.* at 751 ("There is no question that Goodyear's involvement in the overall process by which the tires in question reached the Torres' fits the above description.").

161. *See Torres II*, 786 P.2d at 946-47, 948.

are unlikely to argue that they did not exercise control, since such an admission could provide the basis for a finding of abandonment.

Thus, any test that relies on contractual averments of control, or on the mere right to control, will probably include virtually all licensors. In *Torres II*, the court was willing to premise liability on the "right to control" because that was all the plaintiff was able to prove at the summary judgment stage. The court, however, strongly suspected that Goodyear had in fact *exercised* substantial control over the product through its status as a parent corporation. By articulating the standard in this manner, the court adopted a test that is incapable of distinguishing among licensors, since almost all licensors have a contractual right to control the quality of the licensed goods.

More fundamentally, the courts in *Torres II* and *Torres III* failed to explain why a mere "right to control" provides any support for imposing strict liability on a trademark licensor. Ordinarily, a "right" does not create a "duty." Indeed, the courts' reliance on the "right to control" as a basis for strict liability is particularly odd given the fact that the vast majority of courts have held that a licensor's Lanham-Act-based right to control does *not* create a legal duty to control, such that the failure to control is grounds for a negligence claim.[162]

Second, the *Torres II* court's significant involvement test was highly indeterminate. The court did not provide any gnidelines for lower courts to use in deciding what constitutes siguificant involvement. Rather, the court referred to two conceptually distinct categories: "mere licensors" and "significantly involved licensors." The court implied that the former should not be subject to strict liability and held that the latter should be subject to such liability.[163] However, aside from pointing to the facts of the case before it, the court did not set standards to determine either how much or what type of involvement should be considered significant. Although the court did say that licensors who meet the siguificant involve-

162. *See, e.g.*, Mini Maid Servs. Co. v. Maid Brigade Sys., Inc., 967 F.2d 1516, 1520 (11th Cir. 1992) ("[A] trademark owner's failure to exercise control [does not] subject[] the owner to affirmative liability in tort . . . .'") (quoting *Burkert*, 579 A.2d at 32); Oberlin v. Marlin Am. Corp., 596 F.2d 1322, 1327 (7th Cir. 1979) ("[s]cope of the duty of supervision associated with a registered trademark is commensurate with th[e] narrow purpose" of ensuring the integrity of the mark); Burkert v. Petrol Plus of Naugatuck, Inc., 579 A.2d 26, 32 (Conn. 1990) (holding that the Lanham Act requirement that a licensor of trademarks exercise control over its licensees and over quality of product bearing its trademarks does not give rise to a duty owed to persons upon whom a negligence action could be based; the sole consequence of a violation of the Lanham Act requirement is loss of rights associated with the trademark).

163. *See Torres II*, 786 P.2d at 945.

ment test are "the functional equivalent of manufacturers and sellers," it did not explain what type of conduct makes a licensor the functional equivalent of either a manufacturer or a seller.[164] Indeed, the court did not even identify the *particular* involvement of Goodyear which it considered especially significant.

Thus, under *Torres II* and *Torres III*, plaintiffs are free to discover everything they can about a licensor's involvement and to argue that that involvement is "significant." Judges who wish to hold trademark licensors liable can simply agree and label the involvement "significant." Conversely, judges who do not wish to hold trademark licensors liable can dismiss as "insignificant" virtually any involvement that falls short of extensive and actual control over day-to-day operations. The *Torres II* court has thus created a "rule" that amounts to nothing more than "I know it when I see it." Applying this rule, lower courts have virtually uncontrolled discretion to impose or not impose strict liability on trademark licensors. In short, the *Torres* courts have created a "test" that is no test at all.

Third, the "significant involvement" test does not appear to be based on any coherent theory of tort liability. Normally, vicarious liability follows control, not mere involvement. While control is itself a nebulous concept, it is not as nebulous as the significant involvement test established in *Torres*. Indeed, *Torres* can be seen as simply displacing traditional vicarious liability principles with vague involvement principles.[165] In the name of enterprise liability, the court blends traditional rationales underlying strict liability with loosely defined principles of "involvement." However, it is not clear why an entity which is merely involved in the affairs of another company should be held liable for the latter company's acts.

In no other area of law is mere involvement a basis for liability. In fact, one could argue that licensors *should* be involved in the affairs of their licensees, and *should* give their licensees advice when appropriate without thereby incurring the risk of strict liability. A legal regime that

164. *Id.* at 947.

165. For a discussion of the Ninth Circuit's affirmation of the jury verdict on remand that Goodyear USA was strictly liable but its foreign subsidiaries were exonerated, see *supra* note 134. The Ninth Circuit's holding that Goodyear's liability was "direct" rather than "derivative" is puzzling. To justify its finding that Goodyear's liability was "direct," the Ninth Circuit stated that the jury could have found Goodyear liable based on its "extensive control" over its foreign subsidiaries. *See* Torres v. Goodyear Tire & Rubber Co., Inc., No. 94-15092, 1995 U.S. App. LEXIS 20375, (9th Cir. July 13, 1995) (unpublished table decision). But the court nowhere found, or indicated that the jury could have found, that Goodyear's conduct was a *direct* cause of the product defect or plaintiff's injuries. Thus, it is difficult to understand why the court believed Goodyear's liability was "direct."

encourages instead of punishes such involvement would create incentives for licensors to enhance product safety.

It might be argued that the *Torres* test is justified on some form of "partnership" or "joint venture" principles. Generally, partners or joint venturers are independent entities doing business in a "partnership" form. Each joint venturer or partner has a share of "control" over the partnership's affairs. Each is fully liable for the acts of the partnership, even if the partner who is sned did not personally participate in those acts. The *Torres* court may have seen "significantly involved" licensors as "partners" with their licensee. But if this is so, the court completely sidestepped the fact that in a partnership there is "shared control," not merely shared "involvement," and there is a sharing of both profits and losses. By contrast, in a licensing arrangement the licensor's control may be illnsory and typically there is no loss sharing.

Fourth, in *Torres II*, the court essentially performed an "end run" around the doctrine of limited liability when it cited Goodyear's "indirect" control over its subsidiaries to establish the reqnisite nexus of significant involvement. If the opinion is taken literally, then any licensor who is also a controlling shareholder is "significantly involved" in the overall process by which the licensed goods reach their consumers. If this is the rule, a parent corporation automatically forfeits the protection of the corporate veil when it enters into a trademark license with its subsidiary. As I discuss more fully in Part V, it is not altogether clear why a trademark license should so easily destroy the protections afforded by the veil.

Fifth, in *Torres I*, the Ninth Circuit invited the Arizona Supreme Court to consider a number of economic issues when deciding the certified question. Specifically, the Ninth Circuit suggested that the Arizona court consider whether holding trademark licensors strictly liable would adversely affect the economy by increasing the total amount of dollars spent on product liability insnrance and legal fees—costs which invariably are passed onto consumers in the form of increased prices.[166] The Ninth Circuit noted that "[t]hings are not what they were twenty-five years ago" when section 402A was first introduced, that "it is now realized that the cost of 402A insurance is very substantial," and that it "is a significant part of the cost of many items."[167]

The Arizona Snpreme Court dismissed these concerns out of hand. It noted that although *Kasel* applied strict liability to licensors in California,

166. *See Torres I*, 867 F.2d 1234, 1238-39 (9th Cir. 1989).

167. *Id.*

there was no mass exodus of manufacturers or other business entities fleeing California for Arizona.[168] The Supreme Court also noted that the imposition of strict liability on Goodyear in this case would likely have no discernible impact on insurance payments, since the related companies probably had joint insurance.[169] As demonstrated more fully below, the Arizona court's analysis of the economic issues at stake is entirely too superficial,[170] focusing too much on this particular case, with little thought to the larger economic implications. Strong arguments can be made that the "tests" articulated in *Kasel* and *Torres* will make it commercially necessary for *all* trademark licensors to purchase 402A insurance—neither a desirable nor necessary result.

Sixth, *Torres* is another example of a case where a *foreign* subsidiary/licensee may have been outside the jurisdiction of the court.[171] The possibility that the plaintiff would not have had any recovery if the trademark licensor was not held strictly liable loomed large in the court's mind. Indeed, the Arizona Supreme Court *expressly* stated that the foreigu tire manufacturer and foreign design firm might not have been subject to personal jurisdiction in Arizona.[172] The court also noted that the district court had denied plaintiff's motion to add the foreigu companies.[173] Although the court mentioned this concern near the end of its opinion, it may in fact have been a driving force in the court's thinking. The court undoubtedly was correct in noting it would be unfair to allow an American company to shield itself from product liability by "outsourcing" the desigu or manufacture of its goods to foreign licensees who were beyond the jurisdictional reach of American courts. However, as demonstrated below, there may be a way around this problem without resorting to the broad and indeterminate "siguificant involvement" test adopted in *Torres.*

V. TOWARD A MORE COHERENT MODEL OF LICENSOR LIABILITY LAW

This part explores whether it is possible to construct a more coherent model of licensor liability law. The challenge is to construct a set of clear, yet still sufficiently flexible, vicarious liability rules that (1) do not require

168. *See Torres II*, 786 P.2d at 947 n.6. Perhaps the exodus was not as pronounced then as it is now.

169. *See id.* at 946.

170. *See infra* Part V.

171. *See also* Kasel v. Remington Arms Co., 101 Cal. Rptr. 314 (Cal. Ct. App. 1972); Connelly v. Uniroyal, Inc., 389 N.E.2d 155 (Ill. 1979).

172. *See Torres II*, 786 P.2d at 946 n.5.

173. *See id.*

a showing of an agency relationship; (2) account for the fact that licensors and licensees often share control or jointly participate in the production of the licensed goods; (3) distinguish between Lanham Act control and the type of control that ought to be the basis for imposing strict liability on licensors; (4) identify *in advance* the types of involvement that will be deemed sufficiently significant to justify imputing a manufacturer's strict liability to a trademark licensor; and (5) capture licensors who attempt to *improperly* shield themselves, or their licensees, from strict liability.[174] It is possible to construct a model of licensor liability law that fulfills these goals by borrowing the basic analytical framework and certain key concepts from corporate veil piercing law.

A. TREATING LICENSORS LIKE OTHER INVESTORS

In the corporate context, courts have been faced with the similar dilemma of identifying the circumstances under which it is appropriate to impose vicarious liability on a particular stockholder in the absence of an agency relationship between the investor and the corporation in which the investor owns stock. The challenge in that context has been to develop a set of clear, flexible rules for imposing vicarious liability on stockholders who either exercise inordinate control over their corporations, or who otherwise improperly manipulate their relationship with the corporation to escape personal liability.

Over a long period of time, courts have developed a basic organizational structure and a fairly clear set of tests to deal with this problem. The structure begins with a presumption that stockholders who are mere investors are not personally liable for the acts of the corporation in which they own stock.[175] In common parlance, this presumption is referred to as the rule of "limited liability" for stockholders.[176] It is called "limited liability," as opposed to "nonliability," because stockholders remain at risk to lose their capital investment in the corporation if the corporation goes bankrupt. For all practical purposes, however, the presumption of limited liability is, in reality, a presumption of shareholder nonliability.

174. This Article focuses on vicarious licensor liability, not direct licensor liability. A licensor would be held directly liable for its licensee's torts if the licensor was directly involved in the licensee's tortious conduct, and if the licensor's wrongful conduct was a proximate cause of the plaintiff's harm. It is the absence of such a direct causal relationship between the licensor's acts and the plaintiff's harm that distinguishes vicarious liability from direct liability.

175. *See, e.g.*, Johnson v. Flowers Indus., Inc., 814 F.2d 978, 980 (4th Cir. 1987) ("Under the doctrine of limited liability, a shareholder is not responsible for the acts of a corporation.").

176. *See generally* FLETCHER, *supra* note 14, §§ 41-44.

The rationale for the rule of limited liability is that it will encourage more people to invest in more companies, thereby strengthening the overall economic well being of the community.[177] Although the soundness of this rationale has been questioned,[178] the presumption of limited stockholder liability continues to be the general rule throughout the United States as well as in many countries around the world.

In the corporate law context, the presumption of limited liability remains intact so long as the investor plays by the rules of corporate law. Those rules include, inter alia, adequately capitalizing the corporation, electing a board of directors to manage the corporation, not exercising excessive control over corporate affairs, and otherwise recognizing the "separate corporate existence" of the corporation.[179] If a stockholder breaks these rules, the presumption of limited liability may be discarded.

After a long experience with investors who attempted to manipulate the corporate form—that is, those who attempted to take advantage of the protection of limited liability without playing by the rules of corporate law—courts developed a panoply of tests for "piercing" through the fiction of the corporate veil in particular circumstances.[180] The precise character of these tests varies from state to state. As a general matter,[181] the corporate veil may be pierced if a particular stockholder (1) exercises such extensive control over corporate affairs that it is the "alter ego" of the corporation;[182] (2) exercises control over the particular area of corporate

177. *See Johnson*, 814 F.2d at 980 ("The underlying purpose of limited liability is to stimulate business investment by permitting individuals to take action in corporate form without the risk of direct liability or involvement.") (citing Labadie Coal Co. v. Black, 672 F.2d 92, 96 (D.C. Cir. 1982). As the Fourth Circuit noted in *Johnson*, "[b]usiness investment is further encouraged by granting limited liability to corporations that form subsidiaries because 'if a parent corporation is held liable for the obligations of its subsidiary, the shareholders of the parent are hurt, through the lowering of the value of their investment in the parent.'" *Id.* (quoting William P. Hackney & Tracey G. Benson, *Shareholder Liability for Inadequate Capital*, 43 U. PITT. L. REV. 837, 872-73 (1983)).

178. *See, e.g.*, David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1619 (1991) (arguing that veil piercing should be more common in tort cases).

179. *See generally* FLETCHER, *supra* note 14, §§ 41, 41.10, 41.25, 44.1.

180. *See id.*

181. This is offered as an illustrative list of piercing factors. It is not intended to be a comprehensive list of piercing tests in the corporate law context. For a comprehensive discussion of the various grounds courts have used to pierce the corporate veil, see FLETCHER, *supra* note 14, §§ 41-45. As Fletcher makes clear, veil piercing is an "equitable remedy" which should remain sufficiently flexible to capture shareholders that abuse the privilege of doing business in the corporate form. *See id.* § 41.25.

182. *See, e.g.*, FLETCHER, *supra* note 14, §§ 41.10 (discussing "alter ego" piercing test), 43.10 (discussing "mere instrumentality" piercing test).

decisionmaking that gave rise to the plaintiff's claim;[183] or (3) has stripped the corporation of assets such that it cannot meet reasonably foreseeable obligations, including tort claims.[184]

It is my central contention in this Article that licensor liability law, particularly in the strict liability context, would benefit from an organizational structure that mirrors the basic structure of corporate veil piercing law. By basic structure, I mean an explicit and formalized initial presumption of nonliability, coupled with clear yet flexible piercing tests. In the licensing context, these tests should similarly focus on whether the licensor has exercised excessive control, operated through a grossly undercapitalized "shell" or "front" licensee, or otherwise improperly manipulated the licensing arrangement to shield itself or its licensees from strict liability. Although the specific equitable grounds for piercing in the licensing context probably will be somewhat different than in the shareholder context, the general approach should be the same.

In the sections that follow, I first explore the feasibility and justifiability of adopting an initial presumption of nonliability for trademark licensors. I then consider five tests that might be used to pierce the "licensing veil" in appropriate circumstances.

B. JUSTIFYING AN INITIAL PRESUMPTION OF NONLIABILITY FOR TRADEMARK LICENSORS

There are a number of significant similarities between stockholders and licensors that make it particularly compelling to adopt a similar initial presumption of investor nonliability in the licensing context. First, trademark licensors, like corporate stockholders, are entities which invest "capital" in another entity for the primary purpose of realizing financial gain. While the stockholder invests money, the licensor invests the reputational, and hence economic value of his trade name or trademark. Second, in both situations, the future financial success of the enterprise de-

183. *See, e.g.*, Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F.2d 265, 267 (2d Cir. 1929) (L. Hand, J.) (permitting veil piercing where shareholder participates in transaction that gives rise to plaintiff's claim).

> In order to prevent the "direct participation" theory of [vicarious] liability from extinguishing the general rule of parent corporation immunity from the obligations of a subsidiary, that theory must be carefully limited to situations in which the parent corporation's control over particular transactions is exercised in disregard of the separate corporate [parapherualia] of the subsidiary.

Esmark, Inc. v. NLRB, 887 F.2d 739, 759 (7th Cir. 1989).

184. *See* FLETCHER, *supra* note 14, § 44.1 (discussing the "inadequate capitalization" piercing test).

pends in part on the investors' contribution of capital. Third, trademark licensors, like stockholders, typically agree to share in profits but not losses generated by the venture. Fourth, trademark licensors, like stockholders, are legally required to exercise some type of control over their "investees."[185] Finally, like stockholders, licensors can be either active or passive participants in the investment enterprise.

Corporate law has long recognized a presumption of limited liability for stockholders on the theory that such a rule will stimulate greater investment and thus contribute to the overall economic good of society. The same rationale argnably justifies a similar presumption in the licensing context. Indeed, the sheer volume of trademark licensing in the United States is evidence that such licensing stimulates the free flow of capital and economic growth, and is highly attractive as a form of investing. Like other investors, licensors are more likely to risk their "capital" if they know there is some way to limit their potential exposure to product liability suits, and if there are clear ground rules for determining when the normal presumption will be ignored.[186]

Even so, while the stockholder analogy is compelling, it is by no means a necessary foundation for the general position I advance here. Even if one does not fully accept the licensor-stockholder analogy, there are strong reasons to afford licensors an initial presumption of nonliability. As stated above, the law must start some place. It must presume either that licensors generally are subject to strict liability and create "exceptions" to the general rule, or start with the presumption that licensors generally are not subject to strict liability and develop legal "tests" for disregarding that general rule. Without some sort of general rule, all parties—licensors, licensees, plaintiffs, and the court system—are lost at sea.

Moreover, besides organizing the law in this area, such a presumption would recognize the important differences that exist between different classical, collateral, and promotional licensors. Classical licensors typically dictate standards and specifications for their products, whereas promotional and collateral licensors typically function as relatively passive investors. The proposed approach would account for these differences by

185. By statute, stockholders together elect corporate directors and establish their duties in the corporate bylaws. *See* FLETCHER, *supra* note 14, § 2.22. The Lanham Act itself requires licensors to exercise some form of control over the quality of the licensed goods. *See supra* Part II.D.

186. *See supra* note 177 and accompanying text. Moreover, the law must make a starting presumption that a licensor is or is not subject to strict liability. Indeed, it would appear that a presumption of nonliability already is inherent in the enterprise liability theory, since it imposes strict liability *only* on licensors who are "significantly involved" in their licensees' affairs.

affording all licensors an initial presumption of nonliability, but still allowing plaintiffs to rebut this presumption with proof that a particular licensor had engaged in activity that made it equitable to hold it strictly liable under one of the proposed tests.

Formalizing an initial presumption of licensor nonliability is consistent with the approach taken in many of the enterprise liability cases. Most courts have been reluctant to start with the presumption that all trademark licensors are strictly liable. In *Torres II*, for example, the Arizona Supreme Court strongly implied that a "mere licensor" would not be subject to strict liability.[187] Similarly, the recently released Restatement (Third) of Torts states that products liability generally attaches to licensors who substantially participate in their licensees' affairs, thus implying that such liability would not attach absent such participation.[188] Hence, to date the case law indicates that courts implicitly do start with a presumption that minimally involved licensors should not be subject to such liability.

Of course, an argument can be made that such a presumption is inconsistent with licensor's quality control obligations under the Lanham Act. Indeed, it seems odd to say that licensors have a legal duty to police their licensees for quality, but then to presume that licensors are basically passive investors and thus entitled to a presumption of nonliability. If such quality control is required to occur in every licensing arrangement, then arguably no licensor is entitled to such a presumption.

This argument is compelling and cannot be easily brushed aside. However, I do not think it fatal to my basic thesis for two reasons. First, the quality control requirement is highly indeterminate.[189] It has been soundly criticized, principally on the ground that it is based on a theory of trademarks and trademark licensing that applies, if at all, only in the classical licensing context. Classical licensors typically license their marks to licensees in connection with goods that the licensor previously manufactured itself under the same mark. In such circumstances, it might make sense to require the licensor to police its licensees' goods to ensure a uniform quality. However, even in that context, it is not at all clear what

187. *See Torres II*, 786 P.2d 939, 945 (Ariz. 1990) (en banc).

188. *See* RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 14 cmt. d (1997) ("Trademark licensors are liable for harm caused by defective products distributed under the licensor's trademark or logo when they participate substantially in the design, manufacture, or distribution of the licensee's products. In these circumstances they are treated as sellers of the products bearing their trademarks.").

189. *See supra* Part II.D.

"uniform quality" means, since manufacturers' own goods frequently are of an uneven quality.

If one moves away from the classical licensing context, the quality control requirement becomes even more unworkable. One cannot reasonably expect a collateral or promotional licensor to police its licensees' goods to determine whether they are of the same quality as other goods bearing the same mark, because the licensor has never manufactured other, similar goods under that mark. Thus, the licensor could not possibly develop meaningful standards to ensure uniform quality.

Whatever the quality control requirement means, no court has held that it means licensors must determine whether their licensee's products were manufactured, designed free from defects, were not unreasonably dangerous, or were labeled with appropriate warnings. Indeed, courts have held exactly the opposite. Almost every court to address this issue has recognized that the Lanham Act quality control requirement exists mainly to protect the trademark licensor's ownership rights in its mark and is not the basis for a tort duty.[190]

Finally, courts have not clearly indicated either the type or degree of control that a licensor must exercise to satisfy the Lanham Act requirement.[191] Some courts have required licensors to institute some type of formal, albeit minimal, quality control program, which includes inspecting the licensed goods. Other courts have been satisfied if the licensor merely retained the right to control the quality of the goods. Still others have permitted licensing where the licensor relied on a well-established licensee for quality control. Indeed, one court recently held that the quality control requirement does not apply at all to promotional licensors.[192]

In these uncertain waters, one cannot reasonably conclude that the quality control requirement in and of itself mandates that licensors be more than mere investors. Nor can one persuasively argne that such a requirement negates the applicability of the corporate law model or the initial presumption of investor limited liability.

One could argue that an initial presumption of licensor nonliability is unjustified given the fact that strict liability generally applies to "sellers," and all trademarks "help sell" the goods on which they appear. Since modern trademark theory is based on the notion that trademarks serve ad-

190. *See supra* note 162.

191. *See supra* Part II.D.

192. *See supra* note 61 and accompanying text.

vertising or "custom-creating" functions,[193] the law should initially presume that all trademark licensors are strictly liable because all trademark owners create and stimulate consumer demand for the trademarked goods.[194] Again, while this may present a compelling argument, it does not defeat my larger thesis that trademark licensors should be granted an initial presumption of nonliability.

First, courts and legislatures have not generally accepted such an approach, presumably because they can imagine circumstances in which it would seem inequitable to hold a noncontrolling, minimally involved, minimally profiting licensor strictly liable. This intuition seems particularly strong in the promotional licensing context where the licensor's name or mark appears on a product next to the name of the actual manufacturer. In these situations, the licensor's trademark undoubtedly stimulates consumer demand—if it did not, the licensee would not be willing to pay royalty fees to the licensor. But the licensee's own mark on the product also stimulates consumer demand. In the promotional licensing context, the licensor functions primarily as a promoter and does not appear to be a manufacturer. Such licensors are not compelling targets for strict liability because they rarely are in a position to ensure that the licensed goods are free of defects.

Second, the "consumer demand" test mentioned above would be quite broad if applied to entities other than licensors. A variety of entities "help sell" goods and "create consumer demand" for products, yet the law does not hold them strictly liable. Advertisers, promoters and most endorsers[195] are some of the more prominent examples. As broad as strict liability is, it has not yet expanded to encompass every entity or person that "helped sell" a defective product. Indeed, the class of persons potentially covered by such a rule would be highly indeterminate.[196] For these reasons, it probably is not prudent to extend strict liability to all trademark licensors merely on the theory that all trademarks stimulate consumer demand for the products on which the trademarks appear.

193. *See supra* Part II.A. *See also* MCCARTHY, *supra* note 22, § 3:12.

194. Indeed, this appears to be the basis for the courts' broad statements in both *Kasel* and *Connelly* suggesting that all trademark licensors are integral links in the enterprises that place goods into the stream of commerce. *See supra* note 105 and text accompanying notes 117 and 118.

195. By contrast, several courts have imposed strict liability on entities such as Good Housekeeping that officially certify the safety of goods. *See, e.g.*, Justin T. Beck, Hanberry v. Hearst Corp.*: Liability of Product Certifiers*, 5 U.S.F. L. REV. 137 (1970).

196. In other contexts, courts have rejected tort rules that do not sufficiently define the class of persons to which they apply. *See, e.g.*, Ossining Union Free Sch. Dist. v. Andersen, 539 N.E.2d 91 (N.Y. 1989) (discussing problem of imposing tort duties on defendants that may expose them to liability to a potentially limitless and indeterminate class of plaintiffs).

While I have concluded that, on balance, the law should start with an initial presumption that trademark licensors, like other investors, should be afforded an initial presumption of limited liability, it does necessarily follow that such a presumption should be strong in the licensing context as it is in the corporate law context. Indeed, given the likelihood that classical licensors, in particular, are likely to engage in conduct that would justify holding them vicariously liable under several of the tests discussed below, I would expect that the initial presumption of nonliability would be rather weak in the classical licensing context. But even in that context, it would nonetheless be a *starting* presumption, and as such, would frame the issues and distribute the burden of proof within a fairly clear framework. Below, I discuss the circumstances under which it may be appropriate to disregard this initial presumption.

C. TOWARD A COMPREHENSIVE SET OF "PIERCING" TESTS

I suggest that the initial presumption of licensor nonliability should be disregarded where there are strong equitable reasons for doing so. Specifically, as a starting place, I argue that the presumption should be disregarded if, at the time the defective product was produced, a licensor (1) was the "functional equivalent" of a manufacturer, as evidenced by the fact that the licensor established or approved design or manufacturing specifications, standards, or dictated the contents of product warnings for the licensee's defective goods; (2) controlled the particular activity, such as product design, that gave rise to the harm; (3) contracted with a licensee that it knew or should have known was not adequately insured against reasonably foreseeable product liability risks; (4) induced consumers to believe that the licensor manufactured the licensed goods or vouched for the safety of those goods; or (5) contracted with a foreign licensee that is not subject to personal jurisdiction in the state where the licensed goods were sold to the plaintiff.

Of course, these tests are not necessarily all encompassing. There may be other circumstances that would justify a finding that a licensor has abused the privilege of doing business in the licensing form. But these tests reflect many of the concerns that are latent in the enterprise liability cases, and they contain the platform for developing a more coherent theory of licensor liability law.[197] In the sections that follow, I discuss each of the

197. Furthermore, the proposed tests are generally consistent with the underlying purposes of strict liability. They are sufficiently flexible to enable courts to impose strict liability on licensors who function as manufacturers or who use licensing arrangements to improperly avoid liability for the benefit of themselves or their licensees. They also will enable licensors and licensees to determine *in*

proposed tests in turn. However, my principal focus is on the first two tests since they involve issues of licensor control and involvement, and thus are most relevant to my critique of the enterprise theory.

1. *Control-Based Piercing Theories*

In this section, I analyze the first two proposed tests together, since each test is based on licensor control. First, I discuss the core aspects of a manufacturer's role in an attempt to more clearly define what it means to be the functional equivalent of a manufacturer. Then I consider whether the control-based tests should require proof of actual control, the right to control, or mere involvement by a licensor.

a. *The "functional equivalent of a manufacturer"*: In some of the enterprise liability cases, courts have indicated that heavily involved licensors are particularly suitable candidates for strict liability because they are the functional equivalents of manufacturers.[198] This is a sensible approach to vicarious liability in the licensing context because as an equitable matter, licensors who are the functional equivalent of manufacturers should not be permitted to escape a manufacturer's liability through the simple maneuver of entering into a trademark license. However, to determine whether a particular licensor is the functional equivalent of a manufacturer, it is necessary to first identify the core elements of a manufacturer's role—at least insofar as that role concerns product safety. Unfortunately, few courts applying the enterprise theory have engaged in this fundamental definitional process.

A manufacturer's core functions in relation to product safety issues include: (1) establishing product design; (2) establishing manufacturing specifications; (3) establishing quality control standards; (4) establishing testing protocols; (5) determining manufacturing processes; (6) determining the contents of product labels and advertising; (7) determining the contents of the "safety warning;" and (8) setting warranty policy.[199]

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advance whether particular conduct is likely to subject a licensor to strict liability. This increased predictability should, in turn, enable licensors to purchase strict liability insurance only when they are likely to need it. Finally, the proposed tests are consistent with licensors' obligations under the Lanham Act, because that Act arguably does not require licensors to do any of the things that would trigger liability under the proposed tests.

198. *See, e.g., Torres II*, 786 P.2d 939, 945 (Ariz. 1990) (en banc).

199. To be sure, manufacturers may participate in the safety assurance process in other vital ways, but the enumerated functions represent the core aspects of a manufacturer's safety assurance role. Indeed, a number of states by statute have limited the application of strict liability to retail suppliers based on statutorily enumerated tests. One of those tests is whether the supplier furnished the manufacturer with the design or manufacturing specifications or formulas that were used to produce

Although courts have focused on many of these factors, they have not identified any one factor as more important than the others. But a close analysis of the cases reveals that in most of the cases where strict liability was imposed, there was a finding, or at least a genuine factual dispute, that the licensor provided its licensee with specifications or standards for manufacturing the goods.[200] Conversely, in a case where liability was alleged but not imposed under the enterprise theory, the licensor did not provide its licensees with specifications for manufacturiug the product.[201] Accordingly, it appears that courts view this particular factor as especially significant.

This makes sense since most product defects are likely to be related to design or manufacturing specifications, manufacturing methods, or quality control standards. When, as is often the case, the cause of a particular product defect is unclear, it is reasonable to apply vicarious liability to the entity that is generally responsible for the development of the product. The list of eight items identified above thus provides a useful initial test for determining whether a particular licensor is the functional equivalent of a manufacturer.

b. *"Control" vs. "Involvement"*: Courts have not clearly indicated whether the enterprise liability theory requires proof of a licensor's actual control, right to control, significant involvement, or mere participation in the licensee's operations. This is no small problem as vicarious liability normally requires a showing of actual control. Mere involvement or participation is rarely, if ever, grounds for such liability.

Unfortunately, courts have fudged this issue in the enterprise liability cases. In some of these cases, courts have cited to the licensor's actual control. In other cases, they have cited to the licensor's right to control or refer to the right to control as if it were tantamount to actual control. At other times, they purport to rely on evidence of "significant involvement" or "participatory connection." This ambiguity is unnecessary.

A measure of clarity can be achieved by focusing on various types of involvement in the context of a particular aspect of the manufacturing process. For example, I have said that, for present purposes, the essential elements of a manufacturer's role are establishing product specifications,

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the product. *See, e.g.*, OHIO REV. CODE ANN. § 2307.78 (Anderson 1995) (imposing a manufacturer's product liability on a supplier who "created or furnished a manufacturer with the design or formulation that was used to produce, create, make, construct, assemble, or rebuild that product or a component of that product").

200. *See supra* Part III.

201. *See* discussion of *Burkert v. Perol Plus of Naugatuck, Inc.*, *supra* Part III.A.5.

standards or warnings, and that these elements collectively should be the most important factor in determining a licensor's strict liability.

A licensor's involvement in these core areas may fit into one of the following four categories: (1) the licensor merely suggests or advises that certain specifications be adopted, but there is no expectation that the specification will be used, and, in fact, they are not used; (2) the licensor knows, or reasonably can foresee, that the licensee relies on the licensor to provide accurate and safe specifications, and the licensee does, in fact, so rely; (3) the licensor contractually retains the right to dictate specifications and standards but does not actually do so; and (4) the licensor retains the right to dictate standards or specifications and does so.

The critical question is whether these distinctions should make a difference in determining whether a licensor is held strictly liable. I contend that they should. Specifically, I propose that strict liability should attach only when the licensor is involved in core manufacturing functions and its involvement fits into categories two or four, and in some instances, category three listed above. I argue that in all cases, the bottom line should be whether there was an understanding between the licensor and licensee—either tacit or express—that the licensor would provide specifications, standards, or warnings for the licensed goods and that it, in fact, does so. When this test is met, it is reasonable to say that the licensor is indeed the functional equivalent of a manufacturer. In the sections that follow, I consider each type of licensor involvement in turn.

i. *Advice, consultation, and assistance*: Mere involvement or participation of the type described in category one is insufficient to justify imposing strict liability on trademark licensors. First, involvement or participation—in the form of advice, suggestions, or assistance that is not adopted—is rarely the basis for vicarions liability. Indeed, if such involvement were sufficient to create vicarious and strict liability, all sorts of entities would be vicariously and strictly liable for defective products produced by others. Independent design firms, outside consultants, in-house employees, and even attorneys provide advice and assistance to manufacturers. Indeed, many of these entities profit from the provision of such advice or assistance, yet the law does not make them liable for product defects on this basis alone. There is no sound reason why trademark licensors, who also merely provide advice, suggestions, or assistance that is not accepted or followed, should be treated differently.[202]

202. Indeed, we generally recognize that the provision of advice and suggestions is a positive thing and should be encouraged. A rule of law that imposes vicarious liability on trademark licensors

ii. *Involvement that induces foreseeable reliance*: Licensors, who know their licensees are relying on them to perform core manufacturing functions, should be subject to strict liability under the functional equivalence test.[203] If a licensor provides its licensee with product specifications knowing they will be used, it would be absurd to find that the licensor was not the functional equivalent of a manufacturer merely because it did not dictate that the specifications be followed. Thus, the bottom-line test should be whether there is an understanding, either express or tacit, that the licensee will follow the licensor's specifications and standards, and that the licensor in fact does so.

iii. *The right to control*: A compelling argument can be made that it is incongruent to hold that a licensor, who has the right to control product specifications and standards or other aspects of the manufacturing or design process, should *not* be subject to strict liability, but that a retail seller, who generally has no such right, should be subject to strict liability.[204] Indeed, if a licensor has the right to control the quality of its licensees' products, it arguably is in a position to ensure that the licensed goods are safe, or at least that they contain sufficient warnings. One of the fundamental purposes of strict liability is to shift the cost of insuring against product accidents to entities that are best situated to ensure that they do not happen in the first place.

However, premising a licensor's strict liability on the mere right to control product quality is problematical for several reasons. First, vicarious liability rarely turns on the mere "right to control" in a general sense.[205] To the contrary, courts generally require a showing that the al-

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based merely on vague notions of "involvement" would likely create perverse incentives for licensors to remain totally uninvolved in their licensee's affairs—even if their advice or assistance would maximize operational efficiency and product safety. It does not make sense for the law to penalize or discourage wholly beneficial involvement through the threat of strict liability.

203. Such involvement may be grounds for imposing negligence liability on licensors under section 324A of the Restatement (Second) of Torts. That provision imposes *direct* negligence liability on entities in circumstances that closely parallel the conduct described in the second category. Under section 324A, an actor is liable to third parties if the actor negligently provides advice or assistance to a second party and can reasonably foresee that the second or third party is detrimentally relying on the first party for the provision of such services. *See* RESTATEMENT (SECOND) OF TORTS § 324A (1965).

204. This position is advanced in a student note on the *Connelly* case:

> It would be incongruous to hold a defendant, such as a retailer or a distributor, liable for an injury caused by a defective product the quality of which was beyond his ability to control, and to exculpate a trademark licensor who has a legal obligation to directly control the nature and quality of the product during [the] manufacture.

See Mary Stanley Silverberg, Note, *Products Liability: Imposing Strict Products Liability on the Trademark Licensor* — Conelly v. Uniroyal, Inc., 5 U. DAYTON L. REV. 408, 423 (1980).

205. *See, e.g.*, Maki v. Copper Range Co., 328 N.W.2d 430 (Mich. Ct. App. 1982) (refusing to apply "retained control" concept to hold stockholder vicariously liable for torts of corporation).

leged principal controls the "method and manner" of the alleged agent's work.[206] There is no valid reason to adopt a different approach in the licensing context.

Second, states increasingly are moving away from holding retail sellers and wholesalers strictly liable. In fact, some states by statute completely exempt nonmanufacturers from strict liability.[207] Other states have enacted statutes providing that such sellers will be subject to strict liability only if the manufacturer of the defective goods is unavailable or insolvent.[208] Accordingly, the fact that retail sellers generally are subject to strict liability, even absent a right to control product quality, should not be dispositive.

Third, nonmanufacturing sellers are subject to strict liability under section 402A because they are engaged in the *actual physical exchange* of products in the marketplace and thereby implicitly warrant the safety of those goods.[209] This is not usually the case with trademark licensors. The absence of involvement in the actual physical exchange of goods, at any stage in the distribution process, distinguishes licensors from *all other entities*—such as retailers, wholesalers, jobbers, and lessors—to which strict liability normally applies. Given that one of the underlying rationales of strict liability is the notion that those engaged in the physical transfer of goods implicitly warrant their safety to other entities in the chain of distribution and ultimately to the consumer, this distinction may explain why

206. *See, e.g.*, Drexel v. Union Prescription Ctr., Inc., 428 F. Supp. 663, 666 (E.D. Pa. 1977) (holding that a plaintiff must demonstrate not only that the principal has the right to control the results of its agent's work, "but also the very manner in which the work is to be done"), *rev'd on other grounds*, 582 F.2d 781 (3d Cir. 1978); McLaughlin v. Chicken Delight, Inc., 321 A.2d 456, 459 (Conn. 1973) (finding that actual agency requires a showing that the licensor has "the right to direct and control the performance of the work by the agent"); Arthur Murray, Inc. v. Smith, 183 S.E.2d 66 (Ga. Ct. App. 1971) (holding no actual agency where licensor/franchisor did not have the right to control the "day-to-day operation" of the licensee's business). *See also* Oberlin v. Marlin Am. Corp., 596 F.2d 1322, 1327 (7th Cir. 1979) (determining that the Lanham Act quality control requirement does not "give a licensor control over day-to-day operations of a licensee beyond that necessary to ensure uniform quality of the product or service in question" and thus "does not . . . saddle the licensor with the responsibilities under State law of a principal for his agent"); Smith v. Cities Serv. Oil Co., 346 F.2d 349 (7th Cir. 1965); Coe v. Esau, 377 P.2d 815 (Okla. 1963); Murphy v. Holiday Inns, Inc., 219 S.E.2d 874 (Va. 1975).

207. *See, e.g.*, GA. CODE ANN. § 51-11-1 (Supp. 1996); NEB. REV. STAT. § 25-21,181 (1995); S.D. CODIFIED LAWS § 20-9-9 (Michie 1995).

208. *See, e.g.*, DEL. CODE ANN. tit. 18, § 7001 (1989); IDAHO CODE § [6-1407] 6-1307 (1990); 735 ILL. COMP. STAT. ANN. 5/2-621(a)-(c) (West 1993 & Supp. 1996); KAN. STAT. ANN. § 60-3306 (Supp. 1994); KY. REV. STAT. ANN. § 411.340 (Michie 1992); MD. CODE ANN., CTS. & JUD. PROC. § 5-311 (1995); MINN. STAT. ANN. § 544.41 (West 1988); MO. REV. STAT. § 537.762 (1988); N.C. GEN. STAT. § 99B-2 (1989); N.D. CENT. CODE § 28-01.1-06.1 (1991); TENN. CODE ANN. § 29-28-106 (Supp. 1997); WASH. REV. CODE ANN. § 7.72.040 (West 1991).

209. *See, e.g.*, RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 1 cmt. a (1997).

several courts and the authors of the Restatement (Third) of Torts have been reluctant to impose strict liability on the "mere licensor."

Fourth, it is not at all clear what the right to control means in this context.[210] If the right to control the quality of the licensed goods is boilerplate language inserted to satisfy the Lanham Act, it may mean very little. However, if the contractual right to control goes beyond the Lanham Act, it may be more significant. For example, contractual language of this sort might be quite relevant if the licensor retains the right to control product safety, to dictate specifications, and to dictate the contents of product warnings. In these circumstances, it might be reasonable to find that the licensor is the functional equivalent of a manufacturer based on such contractual language. I suspect, however, that such language is rare.

Fifth, if the mere right to control product quality was sufficient to justify imposing strict liability on trademark licensors, such liability would attach to nearly *all* licensors, since virtually all licensing agreements grant such rights to licensors.[211] Indeed, these clauses are inserted into trademark agreements even though both parties understand that the licensor has no intention of exercising any quality control rights whatsoever. Many licensors will risk a finding of abandonment by not exercising such a right. But few are so foolhardy as to not reserve such a right in the licensing contract. Accordingly, unless courts and legislatures are prepared to apply strict liability to all trademark licensors, the mere "right to control" cannot be a sufficient test.[212]

iv. *Actual control of specifications and standards*: Vicarious liability normally follows actual control. With the exceptions noted above, there does not seem to be any reason for departing from this fundamental principle in the trademark licensing context. Even so, the control-based tests employed here, like those employed in the shareholder context, should be sufficiently flexible to capture controlling investors—even in the absence of proof of an agency relationship. Accordingly, the challenge in the licensing context is to identify a sphere of control that captures

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210. *See supra* Part II.D.

211. *See supra* Part II.D.

212. *See, e.g.*, Maki v. Copper Range Co., 328 N.W.2d 430, 432 (Mich. Ct. App. 1982) (rejecting a "right to control" test in the corporate veil piercing context on the ground that such a right is *i* in the shareholder/corporation relationship; such a test thus would render the protection of the veil nugatory). To the extent licensors are entitled to a similar presumption of nonliability, a "right to control" test would similarly negate that presumption. Indeed, if the right to control were enough, there would be no such thing as a "mere licensor," as contemplated by the Arizona Supreme Court in *Torres II*. To the contrary, by definition, all licensors would be "substantial participants" in their licensees' affairs and thus subject to strict liability.

licensors who are the "functional equivalent of manufacturers," that does not require the type of day-to-day control required to find an agency relationship, and that gives appropriate weight to Lanham Act control.[213] As I show below, corporate law may again provide a useful framework for devising a test that satisfies these criteria.

Under corporate law as it exists in some states, veil piercing is permitted if a shareholder exercises control in one of two ways. First, the corporate form will be disregarded if the shareholder totally dominates and controls the corporation such that, as a practical matter, the corporation has no independent existence separate and apart from the shareholder. I call this "generic piercing." Second, in many jurisdictions, veil piercing is permitted if the shareholder controls the corporation with respect to the particular activity, or area of activities, which gave rise to the cause of action.[214] I call this "transaction-specific" piercing.

This same general approach might be applied in the licensing context. Under such an approach, licensors would be subject to strict liability if they either generally control the operations of the manufacturer, or control the particular aspect of the manufacturing operation that gave rise to the

213. "Vicarious liability" in this context means that if a licensor provides its licensees with faulty specifications and standards for manufacturing the licensed goods, the licensor will likely be held directly liable under seetion 324A of the Restatement (Second) of Torts if the specifications caused the product defect. By contrast, vicarious liability applies when such a causal connection cannot be established. I propose that in the latter circumstances, courts determine a licensor's strict liability based on certain principles borrowed from corporate veil piercing law.

214. In the corporate law context, a number of courts have permitted a form of veil piercing when a shareholder "directly participates" in the transaction that gave rise to plaintiff's claim. For the most part, these courts have not required proof of a direct causal connection between the plaintiff's injury and the shareholder's participation. Rather, piercing has bcen permitted if the shareholder controlled the area of corporate decisionmaking that gave rise to the harm. *See, e.g.*, Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F.2d 265, 267 (2d Cir. 1929) (L. Hand, J.) (discussing the transaction-specific theory of shareholder, control-based liability). *See also* Esmark, Inc. v. NLRB, 887 F.2d 739, 759 (7th Cir. 1989) (suggesting that the "direct participation" theory be limited to situations where "the parent corporation's control over particular transactions is exercised in disregard of the separate corporate [paraphernalia] of the subsidiary"). A similar piercing theory might be used in the licensing context. That is, even if a plaintiff could not show that a particular licensor extensively controlled all aspects of its licensees' operations, such that the licensor generally was the "functional equivalent of a manufacturer," it might still be appropriate to impose vicarious liability on a licensor who "controls" the particular aspect of the licensee's operation that gave rise to the product defect. For example, under this piereing test, a plaintiff asserting a design defect claim would only have to show that the manufacturer dictated the design specifications for the product. Similarly, in a manufacturing defect case, plaintiff would only have to show that the licensor dictated manufacturing specifications or standards. In this way, a "transaction-specific" piercing test would allow plaintiffs to prevail against licensors who were in fact in a position to eliminate the unsafe character of the product, even though their involvement did not rise to the level where they can be characterized as the "functional equivalent" of a manufacturer.

product defect. Under either prong of this test, plaintiffs would not be required to show a causal connection between the licensor's control and the product defect or their injuries.

By "control," I do not mean close or even constant supervision over day-to-day operations of the licensee. Rather, I mean only that there is an understanding between the parties that the licensor will dictate either major policy regarding standards or specifications for manufacturing, designing, or selling the goods, or dictate the contents of product warnings. The proposed test would capture the licensor who exercises such control at the time the licensing arrangement is established, or the licensor who subsequently *approves* specifications, standards, or warnings that are proposed by the licensee. In either case, the licensor would be "controlling" the licensee under the test proposed here.

This approach would achieve many desirable goals and avoid many of the problems that characterize current law. First, it would ensure that vicarious liability follows control and not mere "involvement." As stated above, there are sound policy reasons to refrain from penalizing licensors who merely give beneficial advice or assistance to their licensees—especially if there is no expectation that such advice will be followed and if it, in fact, is not followed.[215]

Second, by requiring actual control of the sort proposed here, and not merely the general "right to control," licensors will not be unduly penalized merely because they retain contractual control rights to satisfy the Lanham Act. Similarly, by allowing liability to attach only if the licensor's actual control is either pervasive (generic piercing) or defect-specific (transaction-specific piercing), courts will avoid penalizing licensors who exercise pro forma "quality control" solely to satisfy perceived Lanham Act requirements. Courts generally have not interpreted the Lanham Act to require licensors to dictate product specifications, standards, or warnings. Accordingly, licensors who do not exercise control beyond their Lanham Act duties should not be held vicariously and strictly liable under the tests proposed here.

Third, these tests should ensure that strict liability is applied to all trademark licensors who truly are the "functional equivalent" of manufacturers. Where there is an understanding between a licensor and its licensee that the former will dictate product specifications and standards, monitor the production process, perform safety testing, or dictate the content of warnings, the licensor truly is the functional equivalent of manufacturer, at

215. *See supra* Part V.C.1.b.i.

least for product safety purposes, and should not be permitted to escape strict liability simply by entering into a licensing arrangement.

Fourth, the proposed tests should be relatively straightforward to administer. In other areas of the law, courts frequently determine whether one party controls another and, if so, in what respects. Courts should have relatively little difficulty assessing whether a licensor has dictated product standards, specifications, or warnings such that it has become the functional equivalent of a manufacturer. By contrast, the current tests, which rely on vague concepts like "participatory connection" and "significant involvement," are highly indeterminate and are more difficult for courts to administer.[216]

Fifth, the proposed tests are consistent with other forms of vicarious liability. Vicarious liability is rarely, if ever, imposed on the basis of mere participation or involvement. Rather, such liability normally follows control. There is no reason to take a different approach in the licensing context.

Sixth, the tests proposed here are much more determinate than the "significant involvement" or "participatory connection" tests used in the enterprise liability cases. They should thus enable licensors and licensees to structure their relationships and adjust their behavior so as to apportion the risk of strict liability more predictably.

Finally, the proposed tests appear to be consistent with our basic intuition that classical licensors are more appropriate candidates for strict liability than collateral or promotional licensors. Classical licensors would likely be subject to strict liability under the proposed tests because they

216. In this connection, it is worth considering how such a test would be applied where, as is often the case, the licensor is also a stockholder in its licensee. Generally, shareholders are not liable for the debts of the corporation in which they own stock, unless there exists a recognized basis for piercing the corporate veil. In many states, veil piercing may not be permitted merely based on a showing of "control." Rather, plaintiffs frequently must show that the corporate form was abused or misused in some form or fashion, or show that corporate formalities such as separate bank accounts and corporate records were disregarded. *See* FLETCHER, *supra* note 14, §§ 41-43. Thus, in these jurisdictions, if a shareholder/licensor exercises substantial control, observes all corporate formalities, and does not abuse the corporate form by stripping corporate assets or the like, it generally will not be subject to liability under veil piercing rules. It will, however, be subject to liability under the test proposed here if the nature and extent of its control makes it the functional equivalent of a manufacturer. The normal veil piercing tests and the test proposed here are not contradictory. Indeed, if a shareholder is also a trademark licensor and exercises control such that it is the functional equivalent of a manufacturer, it will forfeit the protection of the corporate veil. However, it will have done so not as a result of corporate law principles, but rather as a result of vicarious liability principles designed especially for applying strict liability in the licensing context. The corporate veil, after all, does not immunize shareholders from liability based on their own actions.

typically dictate the specifications and standards for manufacturing the licensed goods. They do so because they developed recognition for the trademark in the relevant market and conceived of the goods themselves, are more knowledgeable about the product and the market than the licensee, and are equipped to establish and maintain such control. The classical licensor maintains active and pervasive quality control, not primarily to fulfill the Lanham Act, but because such an arrangement makes good business sense for both parties. In these circumstances, it is especially appropriate to expose the licensor to strict liability for its licensees' goods.

In contrast, collateral licensors would less likely be held liable under the proposed tests. This, too, makes sense. Ordinarily, collateral licensors know less about the licensed goods than do their licensees. The collateral licensor generally is not capable of dictating specifications, testing for safety, or determining the contents of product warnings. As a result, collateral licensors frequently defer to the licensee's expertise in these areas—again, not because of the Lanham Act, but because such deference makes sense in these arrangements. To be sure, the collateral licensor will retain quality control rights and may even institute a pro forma quality control program. But the collateral licensor is rarely the functional equivalent of a manufacturer.

Strict liability is even less likely to attach to promotional licensors under the proposed control-based piercing tests. Promotional licensors typically license their marks to an established manufacturer of a product that already bears that manufacturer's name. Promotional licensors are rarely knowledgeable about manufacturing or designing the licensed goods. Consequently, promotional licensors, like collateral licensors, generally would not be subject to liability under the "functional equivalence" test articulated here.

2. *Undercapitalization or Asset Stripping*

If licensors are to be afforded the same initial presumption of nonliability as corporate investors, then it seems appropriate to burden them with the same duties that encumber such investors. Specifically, corporate investors have a duty to form corporations that have enough capital to meet reasonably foreseeable financial obligations.[217] If they fail to do this, or if they strip the company of assets after it is formed, they are subject to

217. *See generally* FLETCHER, *supra* note 14, § 44.1.

vicarious liability under traditional veil piercing law.[218] Although corporations exist primarily to limit investors' liability, the rationale behind this rule proposes that investors should not be permitted to manipulate the system so as to abuse the corporate form. Corporate investors thus have a basic duty to form adequately capitalized corporations and to refrain from taking excessive dividends.[219]

With some variations, a similar approach could be adopted in the licensing context. It seems consistent with the underlying rationales of strict liability to say that trademark licensors should not be permitted to knowingly license their names or marks to inadequately capitalized companies, to systematically profit from those companies, and then to escape liability if their licensees go bankrupt. The critical issue here, as in the shareholder context, is whether the adequacy of capitalization should be measured at the time of the lawsuit or sometime in advance of that date.[220] It would not be too burdensome to impose a continuing duty on trademark licensors to ensure that their licensees have sufficient assets or insurance to cover reasonably foreseeable product liability risks. If a potential licensee does not have such assets or insurance, the licensor should either choose a different licensee or purchase its own strict liability insurance.

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218. *See, e.g.*, Nilsson v. Louisiana Hydrolec, 854 F.2d 1538, 1543 (9th Cir. 1988) (holding that a corporation with no assets was grossly undercapitalized); United States v. Ira S. Bushey & Sons, 363 F. Supp. 110, 112 (D. Vt. 1973) (noting that all profits or surplus from subsidiary were remitted to parent on a regular basis), *aff'd*, 487 F.2d 1393 (2d Cir. 1973); Gentry v. Credit Plan Corp., 528 S.W.2d 571, 574 (Tex. 1975) (finding subsidiary undercapitalized when it had a "deficit in retained earnings of $118,794.00").

219. *See, e.g.*, United States v. Reserve Mining Co., 380 F. Supp. 11, 16 (D. Minn. 1974) (holding that veil piercing is warranted where subsidiary is "run in such a manner as to pass all its profits to the parents"). *See also* Galligher v. Reconco Builders, Inc., 415 N.E.2d 560, 564 (Ill. App. Ct. 1980) ("[i]f the capital is illusory or trifling compared with the business to be done and the risk of loss, this is a ground for denying the separate entity privilege") (quoting HENRY W. BALLANTINE, BALLANTINE ON CORPORATIONS 302-03 (rev. ed. 1946)).

220. In the shareholder context, the adequacy of capitalization is judged either at the time the corporation is formed or at the time of the alleged wrong. *See, e.g.*, Stephens v. American Home Assurance Co., 811 F. Supp. 937, 953 (S.D.N.Y. 1993) ("[A] corporation that commences business with adequate capital and subsequently suffers insolvency is not undercapitalized as the term is used in a 'piercing the corporate veil' question."), *vacated on other grounds sub nom.* Stephens v. National Distillers and Chem. Corp., 70 F.3d 10 (2d Cir. 1995). *See also* Laborers Clean-Up Contract Admin. Trust Fund v. Uriarte Clean-Up Serv., Inc., 736 F.2d 516, 524 (9th Cir. 1984) ("Adequate capitalization means 'capital reasonably regarded as adequate to enable [the corporation] to operate its business and pay its debts as they mature.'") (alteration in the original) (citing NORMAN D. LATTIN, LATTIN ON CORPORATIONS § 15(a), at 77 (2d ed. 1971)); Comment, *Alternative Methods of Piercing the Corporate Veil in Contract and Tort Cases*, 48 B.U. L. REV. 123, 139 (1968) (quoting Walkovsky v. Carlton, 233 N.E.2d 6, 14 (1966) (Keating, J., dissenting) (finding that the test is whether the corporation, at the time of formation or of the alleged wrong, has "'capital insufficient to meet liabilities which are certain to arise in the ordinary course of the corporation's business'")).

3. *Inducing Consumer Reliance*

In the corporate context, shareholders may be held vicariously liable for the torts of their corporations if they "hold themselves out" as guarantors of the corporation's debts or lead third parties to believe that they are dealing with the shareholders as individuals rather than as a corporation.[221] An analogous principle might be employed in the licensing context. Indeed, several courts have imposed strict liability on trademark licensors under the "apparent manufacturer" doctrine as set forth in section 400 of the Restatement (Second) of Torts. A thorough review of those cases, and of that doctrine, is beyond the scope of this Article.[222] However, a brief discussion of the apparent manufacturer is provided below. Section 400 of the Restatement (Second) of Torts provides that, "[o]ne who puts out as his own product a chattel manufactured by another is subject to the same liability as though he were a manufacturer."[223]

The official comments to section 400 state that the doctrine applies in two types of cases: (1) where the trademark owner appears to be the actual manufacturer of the product, and (2) where the product appears to have been made for the trademark owner and its reputation is an assurance to the user of the quality of the product.[224] Despite this broad language, most courts have taken the position that the doctrine applies only to house-branding retail sellers and does not apply to a trademark licensor who neither distributes nor sells the trademarked goods.[225] Recoguizing this fact,

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221. *See* Hillsborough Holdings Corp. v. Celotex Corp. (*In re* Hillshorough Holdings Corp.), 166 B.R. 461, 469-70 (Bankr. M.D. Fla. 1994).

> For example, if the shareholder[] entered into business relationships as an individual and not as a corporation, especially if the shareholder ignored the formalities required by law, *or held himself out to the marketplace as an individual*, no doubt the shareholder will not be permitted to hide behind the corporate shield. The corporate veil may be pierced for no other reason than that the shareholders are bound by their conduct and are estoppe[d] to hide behind the corporate veil.

Id. (emphasis added).

222. I address the apparent manufacturer doctrine and consumer reliance theories generally in a separate article. *See* Franklyn, *supra* note 4.

223. RESTATEMENT (SECOND) OF TORTS § 400 (1965).

224. *See id.* cmt. d.

225. *See, e.g.*, Yoder v. Honeywell, Inc., 104 F.3d 1215, 1222-24 (10th Cir. 1997); *Torres I*, 867 F.2d 1234, 1236 (9th Cir. 1989) ("The cases which apply the apparent manufacturer doctrine demonstrate that section 400 applies only where a retailer or distributor has held itself out to the public as the manufacturer of a product."); Affiliated FM Ins. v. Trane, 831 F.2d 153, 155 (7th Cir. 1987) (holding section 400 inapplicable to parent corporation licensor because defective product was "put out" by parent's subsidiary); Nelson v. International Paint Co., 734 F.2d 1084, 1088 (5th Cir. 1984) (finding that under Texas law, section 400 does not apply to a trademark licensor who does not manufacture or market the defective product); *In re* TMJ Implants Prod. Liab. Litig., 880 F. Supp. 1311, 1321-22 (D. Minn. 1995); Harmon v. National Automotive Parts Ass'n, 720 F. Supp. 79, 81 (N.D. Miss. 1989)

the authors of the recently released Restatement (Third) of Torts take a similar position in their restatement of the prevailing law.[226]

This position may reflect the historical origins of the doctrine,[227] but it is inconsistent with the doctrine's underlying purpose and logic. The doctrine is premised on the simple notion that one who holds himself out as a manufacturer should be estopped from denying that one is in fact a manufacturer.[228] Although this rationale was first articulated as a means of imposing a manufacturer's liability on "house-labeling" sellers, it applies with equal force to trademark licensors.[229] Hence, if a plaintiff can prove (1) that a trademark licensor, by placing its name on a product, induces consumers to believe that the trademark licensor made the product or vouches for its safety, and (2) that plaintiff purchased a defective product in reliance on such a belief, it would seem that the licensor should be estopped from denying that it manufactured the goods. In such circumstances, if the actual manufacturer would have been subject to strict liability, the same standard of liability should be applied to the licensor.

(applying Mississippi law to find that the "comments to § 400 . . . suggest that it does not apply to one who is not a seller or distributor of a product").

226. *See* RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 14 cmt. d (1997).

> The rule stated in this section does not, in its terms, apply to the owner of a trademark who licenses a manufacturer to place the licensor's trademark or logo on the manufacturer's product and distributes it as though manufactured by the licensor. In such a case, the licensor does not "sell or distribute as its own a product manufactured by another." Thus, the manufacturer may be liable [under the sections of this Restatement that apply to manufacturer liability], but the licensor, who does not sell or otherwise distribute products, is not liable under this Section of this Restatement.

Id.

227. *See, e.g.*, Hebel v. Sherman Equip. Co., 442 N.E.2d 199, 201 (Ill. 1982) (noting that section 400 was a pre-402A means of applying a manufacturer's liability to "house branding" retail sellers).

228. *See id.* at 201.

> [The] primary rationale for imposing liability on the apparent manufacturer of a defective product is that it has induced the purchasing public to believe that it is the actual manufacturer, and to act on this belief—that is, to purchase the product in reliance on the apparent manufacturer's reputation and skill in making it.

Id.

229. *See, e.g.*, Brandimarti v. Caterpiller Tractor Co., 527 A.2d 134 (Pa. Super. Ct. 1987). Caterpiller, a licensor/parent corporation, was held strictly liable under the apparent manufacturer doctrine for personal injuries caused by a defective forklift manufactured by Towmotor, Caterpiller's wholly owned subsidiary. The forklift bore the Caterpiller name and Caterpiller "could expect others to purchase the product in reliance on the skill and reputation associated" with that name. No evidence that the licensor was involved with, exerted control over, or in any way distributed or marketed the defective product was presented. *See id. See also* Connelly v. Uniroyal, Inc., 389 N.E.2d 155, 162-63 (Ill. 1979) (holding that societal purposes underlying the imposition of strict liability on one who holds himself out as a manufacturer mandate application of the doctrine to a trademark licensor, particularly where the product bears no indication that it was manufactured by any other entity; the fact that the licensor was not a link in the chain of distribution was wholly irrelevant).

To be sure, this doctrine should only apply when the licensor's name or mark induced consumer reliance in this manner. If so limited, the doctrine would apply in many classical licensing situations where the licensor's trademarks are the only marks on the goods. But the doctrine probably should not apply in most collateral and promotional licensing situations, where the identity of the actual manufacturer is disclosed on the products and consumers purchase the goods primarily in reliance on the reputation of the actual manufacturer.[230] In such circumstances, plaintiffs will be hard-pressed to prove that they purchased the trademarked goods because they believed the licensor either made them or vouched for their safety.

4. *Contracting with Unavailable or Foreign Licensees*

In this section, I discuss the significance of the fact that in many of the enterprise liability cases, the licensee at issue was outside the personal jurisdiction of the court or not subject to strict liability in its country of origin.[231] First, I argue that this factor should be formalized as an independent piercing test, such that licensors waive the presumption of limited liability if they contract with foreign licensees who are not subject to personal jurisdiction in states where the goods are sold. I then consider whether courts or legislatures should enact "safe harbor" statutes for licensors, which would exempt licensors from strict liability if the actual manufacturer, wholesaler, or retailer of the defective goods is solvent and is subject to the personal jurisdiction of the forum court.

a. *Unavailable or foreign licensees*: It seems consistent with the underlying purposes of strict liability to require licensors to contract with licensees who will be subject to the personal jurisdiction of the courts in

230. *But see* RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 14 cmt. c (stating that the doctrine should apply even when the identity of the actual manufacturer is disclosed on the goods, because even in that situation consumers purchase the goods in part because of their reliance on the reputation of the trademark owner). It is highly questionable whether this is an accurate restatement of the existing case law, even in the context of the application of the apparent manufacturer doctrine to "house branding" sellers. Indeed, the authors of the Restatement (Second) of Torts took the opposite position:

> [W]here the real manufacturer or packer is clearly and accurately identified on the label or other markings on the goods, and it is also clearly stated that another who is also named [*i.e.*, the house branding seller] has nothing to do with the goods except to distribute or sell them, the latter does not put out such goods as his own [and thus is not liable under this Section of the Restatement].

RESTATEMENT (SECOND) OF TORTS § 400 cmt. d (1965).

231. *See* discussion *supra* Part III.

which the licensed goods are sold.[232] The penalty for failing to meet this requirement should be a loss of the presumption of limited licensor liability.

Indeed, in several of the enterprise liability cases, courts seemed troubled by the fact that the manufacturer/licensees were uuavailable as defendants.[233] Thus, if the trademark licensors in those cases were not subject to strict liability, the plaintiffs might have been forced to litigate in foreign countries which did not recognize the doctrine of strict liability. This, in turn, would impede the interest of the forum state where the plaintiff purchased the defective goods in applying its own strict liability law to the benefit of forum residents. In these circumstances, courts have reached out to impose strict liability on trademark licensors.

This approach seems sensible, given that one of the main purposes of strict liability law is to provide injured consumers with adequate compensation. However, it would seem better to articulate this test as a separate ground for imposiug strict liability on trademark licensors, instead of resorting to broad and indeterminate concepts like the "significant involvement" test articulated in *Kasel* or the "participatory conuection" test used in *Torres.* If the test were articulated iu such explicit terms, trademark licensors would be on notice that they should either contract with American licensees, require their foreign licensees to waive any objectious they might have to personal jurisdiction iu the United States, or purchase their own strict liability insurance.

b. *A proposed "safe harbor" rule*: Conversely, it might be desirable to enact laws stating that trademark licensors shall not be required to defend against a strict liability claim if the manufacturer, wholesaler, or retailer is subject to service of process and able to satisfy a likely judgment against it. Several states have adopted similar rnles for nonmanufacturing sellers such as wholesalers and retailers.[234] Generally, these statutes state that nonmanufacturing sellers are not subject to strict liability unless the manufacturer of the defective goods is unable to satisfy a likely judgment or is outside the jurisdiction of the court.[235] If plaintiffs cannot establish

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232. A similar rule has been applied to retail suppliers by statute. *See, e.g.*, OHIO REV. CODE ANN. § 2307.78 (Anderson 1995) (stating that a supplier is subject to compensatory damages based on a product liability claim only if the claimant establishes, by a preponderance of the evidence, inter alia, that "the manufacturer of that product is not subject to judicial process in this state").

233. *See id.*

234. *See supra* note 208 and accompanying text.

235. *See* sources cited *supra* note 208.

one of these requirements at the onset of the case, the nonmanufacturing seller is entitled to dismissal from the action.[236]

There are a number of compelling reasons to enact similar "safe harbor" statutes for licensors. First, in all cases where a manufacturer or other entity in the chain of distribution is solvent and subject to jurisdiction, there is no reason to make yet another entity spend legal fees to defend against strict liability claims that are duplicative of claims against these other entities.

Second, such a rule would not interfere with the general goal of strict liability law that plaintiffs should be compensated for injuries that are caused by defective goods. This is so because under the proposed rule, licensors would be immune from strict liability claims only if other entities were not available to compensate the plaintiffs. Hence, the proposed rule would minimize legal and insurance costs while at the same time ensnring adequate compensation.

Third, the proposed rule would make this area of the law far more predictable than it is today. By choosing well-capitalized licensees and requiring them to waive any objections to personal jurisdiction throughout the United States, licensors could better ascertain their exposure to strict liability claims and the necessity of purchasing 402A insurance.

Finally, if reducing legal fees and insurance costs are sufficiently strong interests to justify such a rule for wholesalers and retailers, then these interests should also support the adoption of a similar rule for trademark licensors.

Against these potential benefits, legislatures must weigh the potential downsides to adopting such a statute. First, a statute of this type may place an intolerable burden on plaintiffs. Given the fact that the licensed goods may be labeled with only the licensor's name or mark, plaintiffs may have considerable difficulty identifying the actual manufacturer—let alone proving that the manufacturer is solvent and subject to the court's jurisdiction. However, shifting the burden of proof on these issues to the licensor would substantially lessen this risk. That is, the proposed rule could be modified to state that a licensor will remain subject to a strict liability claim unless *it* proves that the actual manufacturer is solvent and within the court's jurisdiction.

Second, if the actual manufacturer declares bankruptcy, or otherwise becomes unable to satisfy a likely judgment after the licensor has been

236. *See* sources cited *supra* note 208.

dismissed, there is a risk that a meritorious plaintiff would go uncompensated. However, legislatures have been willing to take this risk with respect to retailers and wholesalers, given the cost-savings such an approach might achieve. With licensors, there are even more compelling reasons to take such a risk, given that they would only be relieved of strict liability if *the manufacturer, wholesaler and retailer* were *each* unable to satisfy a likely judgment or outside the jurisdiction of the court.[237]

Third, one may argue that the proposed statute would unduly "shield" licensors from liability even when they were more responsible for the defective goods than their licensees. If a licensor completely controls its licensee, requires it to follow the licensor's design and manufacturing specifications, and otherwise dictates safety policies regarding the product, it would seem unreasonable to allow it to escape strict liability merely because the manufacturer is subject to the court's jurisdiction and solvent. Indeed, the possibility of such extensive involvement distinguishes licensors from retailers or wholesalers and thus may call for a different approach in the licensing context. Nevertheless, extending the protection of these statutes to licensors may be defensible even when the licensor has exercised such control. Strict liability is a departure from the normal tort rule that liability follows fault. One of the primary justifications for this departure is that strict liability is a form of product-accident insurance and that manufacturers are more able than consumers to shoulder the costs of such insurance. Accordingly, if a manufacturer is capable of paying a likely judgment and is legally obligated to do so, it arguably should not matter that another entity exercised "control" over the manufacturer. Indeed, a compelling argument can be made that it is not economically efficient for society to require additional parties to defend against strict liability claims if the manufacturer is capable of satisfying such claims.[238]

237. Allowing plaintiffs to add licensors as defendants in such situations might solve this problem. However, depending on the status of the case, this solution may create as many problems as it solves. For example, if the manufacturer becomes insolvent while the case is on appeal, it would be procedurally impracticable, if allowable at all, for the plaintiff to add the licensor. Courts would then have to deal with thorny issues such as whether the jury's findings against the manufacturer applied collaterally to the licensor. If they did not, the plaintiff would have to start all over against the licensor—hardly a situation that lends to reduced legal costs. In this scenario, the rule could not serve its stated purposes.

238. Strict liability represents society's collective decision that the economic costs of strict liability insurance—in the form of increased prices and decreased monies available for investment—are worth the benefit of securing compensation for potential product injuries. As the costs of such insurance are substantially and unnecessarily increased, the wisdom of this decision becomes doubtful. *See supra* note 150.

VI. CONCLUSION

In this Article, I have argued that the application of the enterprise liability theory of strict liability to trademark licensors has been uneven at best and entirely ad hoc at worst. I have argued that the indeterminacy of the law in this area is neither necessary nor desirable. A more coherent theory of licensor liability can be constructed by borrowing the basic analytical framework from corporate veil piercing law. Such a framework would include an initial presumption of licensor nonliability, coupled with a collection of clear, yet flexible "piercing" tests. As a starting place, I have suggested that this initial presumption should be discarded based on proof that a particular trademark licensor: (1) operated as the functional equivalent of a manufacturer; (2) controlled the area of its licensee's operations that gave rise to the plaintiff's injury; (3) knowingly or recklessly contracted with a licensee who could not meet reasonably foreseeable product liability risks; (4) "held itself out" as an entity that made or vouched for the safety of the licensed goods; or (5) contracted with a foreigu licensee who is not subject to personal jurisdiction in the states where the licensed goods are sold.

The proposed tests are based on a coherent theory of vicarious liability and are consistent with the underlying purposes of strict liability generally. They are sufficiently flexible to enable courts to impose strict liability on licensors who are the functional equivalents of manufacturers, or who use licensing arrangements in an improper attempt to escape tort liability. They also offer a greater degree of certainty that minimally involved licensors who contract with sufficiently capitalized and jurisdictionally available licensees will not be held strictly liable nor forced to shoulder the costs of 402A insurance. In an era when such insurance has become increasingly expensive, this is a desirable goal, especially where other entities in the chain of distribution already insure against the same risks.