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Hotel Franchise Termination: Preliminary Injunctions Protect Unlawful Trademark Use

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HOTEL FRANCHISE TERMINATION: PRELIMINARY INJUNCTIONS PROTECT UNLAWFUL TRADEMARK USE

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Abstract

Hotel franchise companies license the use of their trademarks, name, logo, and operating procedures to their franchisees in return for the ongoing payment of franchise fees. When a hotel owner fails to pay money owed for franchise fees or fails to adhere to the operational or other requirements, the hotel franchise company will be forced to terminate the franchise. The Lanham Act allows protection to a hotel company for the property rights that exist in their trademarks, logo, and name by allowing for the registration of those marks and by providing for the use of preliminary injunctions granted by federal courts to stop the unlawful use of valid trademarks. This paper explains how hotels can make use of such tools to protect their bottom line.

Introduction

A hotel franchise is a contractual agreement in which a hotel chain (franchiser) agrees to permit a hotel owner (franchisee) the use of the chain's name and logo (trademarks, service marks), operating procedures, advertising, and central reservations systems. The franchisee hotel operator agrees, in return, to pay a variety of ongoing franchise fees and to operate the hotel in accordance with the franchise agreement and operating manuals. These conditions usually require the franchisee to maintain certain standards of quality, service, cleanliness, staffing, and operations that are spelled out in great detail in the franchise agreement and operating manuals. The franchise name, logo, trademarks, and service marks represent property belonging to the chain and are licensed for use to the hotel owner, so long as the franchise agreement is valid. The benefits to both parties are clear. The franchiser receives the income from the initial and ongoing fees, while also being able to have additional exposure for its name and product from the franchised hotel. The hotel owner benefits from increased room sales resulting from the brand and name recognition, the central reservation system, the brand advertising, and the use of the chain operating procedures. A variety of technical and operating services are also usually provided (for a fee) to the hotel owner.

Rushmore, Ciraldo, and Tarras (1997) state that one of the major disadvantages of franchising to the franchising company is the loss of operational control. The loss of operational control can lead to lower levels of quality and a diminution of the value of the brand name and the trademarks.

> Franchise chains attempt to exert operational control by periodically inspecting each property to see that the facilities are well maintained and the hotel is operating at the prescribed standards... The ultimate penalty franchisers can wield in order to enforce their various regulations and standards is the termination of the franchise.

In the United States, the Lanham Act (15 USCS Sections 1051–1130) provides owners of trademarks certain property rights. The law describes the ownership rights and the remedies available for the unlawful use of a registered trademark. The Lanham Act provides for damages and/or injunctive relief to the owner for the unlawful use of a trademark by another. Since the trademark is a property right, the owner has the ability to license its use to others. The franchise agreement is the legal document that provides the hotel owner with the right to the use of the trademark so long as the franchise contract is in full force and effect. A violation and subsequent termination of the franchise agreement may give the hotel chain certain rights to damages and injunctive relief.

This paper will study and analyze the use of trademarks after the end of a franchise agreement by attempting to answer the following questions: Does the franchisee have the right to continue to use the trademarks, name, logo, and service marks at the end of the franchise agreement? Under what circumstances can the hotel chain prevent the hotel owner from the continued use of the trademarks? What standards must be met to obtain an injunction by a hotel chain to prevent the further use of the trademark? Do hotel chains make use of preliminary injunctions to protect their trademark property rights?

The Lanham Act

The intent of the Lanham Act (15 USCS §1127) is to provide owners of trademarks certain rights to prevent the unlawful use of such trademarks by others. Myers (2000) writes:

> The Lanham Act had two general purposes, according to the Senate Report: One is to protect the public so it may be confident that, in purchasing a product bearing a particular trade-mark which it favorably knows, it will get the product which it asks for and wants to get. Secondly, where the owner of a trademark has spent energy, time, and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats. This is the well-established rule of law protecting both the public and the trademark owner.

Trademarks may be registered (becoming "registered marks") in the U.S. Patent and Trademark Office and thereafter provide additional ownership rights to the owner. The term "mark" includes any trademark, service mark, collective mark, or certification mark. The term "trademark" includes any "word, name, symbol, or device, or any combination thereof...to identify and distinguish his or her goods, including a unique product, from those manufactured or sold by others and to indicate the source of the goods, even if that source is unknown." The term "service mark" means any word, name, symbol, or device, or any combination thereof to identify and distinguish the services of one person, including a unique service, from the services of others and to indicate the source of the services, even if that source is unknown. (15 USCS §1127)

The types of use of another's trademark that violate the ownership rights of the owner are clearly detailed in section 1114 of the Act:

> Any person who shall, without the consent of the registrant—
> (a) use in commerce any reproduction, counterfeit, copy, or colorable imitation of a

> registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive...shall be liable in a civil action by the registrant for the remedies hereinafter provided.

The relief via injunctive remedies available to the owner for the unlawful use of the owner's trademarks are also clearly detailed in Section 1116 of the Act:

> The several courts vested with jurisdiction of civil actions arising under this Act shall have power to grant injunctions, according to the principles of equity and upon such terms as the court may deem reasonable, to prevent the violation of any right of the registrant of a mark registered in the Patent and Trademark Office.

An injunction is an order by the court to stop certain activities that one of the parties is engaged in. A preliminary injunction is an order issued by the court soon after the case is first filed and before the case is heard and decided on the merits.

When a person or company registers a mark with the Patent and Trademark Office, the Lanham Act provides significant additional ownership rights and protections in court proceedings. By the registration of the mark and the continuous use of the mark for five years, the Lanham Act provides that the validity of the mark cannot be contested in court as part of a hearing for an injunction. To the extent that the right to use the registered mark has become incontestable, the registration shall be conclusive evidence of the validity of the registered mark and of the registration of the mark, of the registrant's ownership of the mark, and of the registrant's exclusive right to use the registered mark in commerce.

When the Franchise Agreement Ends

In many cases, hotel franchise agreements end when the contract's term expires, and is not renewed by the parties. Clearly, the rights to use the trademark end upon the expiration of the franchise agreement, and the franchiser may obtain injunctive relief if the hotel owner continues the use of the trademark. When the franchise agreement is terminated for cause by the hotel chain, the hotel chain usually will seek an injunction in a state or federal court to prevent the continued use of its trademarks, name, and logo.

Traditionally, courts separated claims of unauthorized trademark use from those relating to breach of franchise agreement. Thus, if the franchise agreement rightfully or wrongfully was terminated, the termination itself was considered a revocation of the consent necessary to continue use of the marks and thus authorized a claim under the Lanham Act for unauthorized trademark use. This did not mean that the franchisee was left without relief; only that relief was limited to the recovery of monetary damages. (Barkoff, 2001)

In the case of *Hall v. Burger King Corp*, 912 F Supp. 1509 (S.D. Fla. 1992), the plaintiff Hall stopped paying monthly royalties, advertising fees, and sales promotion contributions. After receiving a Notice of Default from Burger King, Hall failed to make any additional payments. Her franchise agreement and her right to use the Burger King

trademarks were terminated by Burger King. After the termination, Hall continued to operate her restaurant as a Burger King restaurant and continued to use the Burger King name and trademarks. Burger King sought a preliminary injunction, asking the court to immediately stop Hall from using the trademarks and holding the business out as an authorized Burger King restaurant. Hall claimed that she had a series of complaints or disputes with Burger King, and was holding back her payments, claiming that the franchise termination was wrongful. In issuing the preliminary injunction to Burger King, the court stated:

> While Hall does not dispute that her present use of the BKC Marks is without BKC's license or consent, she does contend that her franchise was wrongfully terminated since her alleged damage claims against BKC exceed the total of unpaid royalties and advertising contributions she refused to pay. As a matter of law, however, a terminated franchisee's remedy for wrongful termination is an action for money damages, and not the continued unauthorized use of its franchiser's trademarks. Thus, while a terminated franchisee may seek money damages for any injuries resulting from the alleged wrongful termination of its franchise, it may not continue to use the franchiser's trademarks without authority in violation of law.

Some federal courts have started to take the position that disputes relating to the franchise agreement may prevent the franchiser from terminating the agreement and obtaining a preliminary injunction preventing further use of the trademarks and name. The court in the *S&R Corp v. Jiffy Lube Int'l,* U.S Court of Appeals for the Third Circuit, 968 F.2d 371 (1992)found that the court must first determine that the franchisers had "sufficient facts indicating that its termination was proper." This trend has continued and other federal courts now require the franchiser to show as part of meeting the standard of being able to show that it will "probably succeed on the merits" (infra), that the termination by the franchiser was not a wrongful termination. In *McDonald's v. Robertson,* 147 F.3d 1301 (1998), the court stated:

> We find that the Lanham Act's requirement that a franchiser demonstrate that unauthorized trademark use occurred to prevail on the merits of a trademark infringement claim against a franchisee necessitates some type of showing that the franchiser properly terminated the contract purporting to authorize the trademarks' use, thus resulting in the unauthorized use of trademarks by the former franchisee.

Right to an Injunction

Coldwell, Blakeway, Husted, and Vincent (2001) state:

> Termination does not necessarily mark the end of the franchiser/franchisee relationship. Often an involuntarily terminated franchisee may refuse to remove signage, promotional materials, or other items, which identify the franchisee with the franchise system. Injunctions are an important remedy to help prevent public confusion and dilution of the franchiser's marks. The Lanham Act provides the federal statutory foundation for injunctions against terminated franchisees.

The standards necessary to obtain a preliminary injunction in the U.S. federal courts, while varying slightly from one federal district to another, are all similar. In the case of *Pappan v. Hardees Food Systems Inc.,* 143 F. 3d. 800 (1998), a U.S. Court of Appeals for the Third Circuit ruled:

When ruling on a motion for preliminary injunctive relief, a district court must consider four factors: (1) the likelihood that plaintiff will prevail on the merits at final hearing; (2) the extent to which plaintiff is being irreparably harmed by the conduct complained of; (3) the extent to which defendant will suffer irreparable harm if the preliminary injunction is issued; and (4) the public interest.

Recent Hotel Cases Involving Franchise Terminations and Preliminary Injunctions

Ramada Franchise Systems, Inc. v. Jacobcart (2001)

Ramada licenses franchisees to operate hotels and motels under the Ramada trademark. It provides franchisees with access to its central reservation system, advertising, and the right to use the Ramada name and logo. The defendants entered into a franchise agreement in September 1999 to operate a Ramada hotel. The defendant failed to comply with contractual obligations as a franchisee and Ramada gave it numerous notices to pay the fees due and to improve the facilities in accordance with its operating manuals. When the defendant failed to comply, Ramada terminated the franchise agreement, and ordered the defendant to stop all use of the Ramada name and trademark. The defendant continued to rent rooms as a Ramada Inn. Ramada filed suit and requested a preliminary injunction.

The court required Ramada to prove four items in order to receive the injunction:

(1) A substantial likelihood that it will prevail on the merits; the court determined that Ramada had registered its trademark name and logo in the patent and trademark office:

> Registration confers certain rights on Ramada. 15 U.S.C. § 1115 (the Lanham Act) (a) provides: Any registration . . . shall be admissible in evidence and shall be prima facie evidence of the validity of the registered mark and of the registration of the mark, of the registrant's ownership of the mark, and of the registrant's exclusive right to use the registered mark in commerce on or in connection with the goods or services.

The act of validly registering and using the trademark convinced the court of the likelihood of Ramada prevailing.

(2) A substantial threat that it will suffer irreparable injury if the injunction is not granted; The court found:

> Ramada has also established a substantial threat that it will suffer irreparable injury if the injunction is not granted. In a trademark infringement case, "a substantial likelihood of confusion constitutes irreparable injury." The likelihood of confusion is obvious when a defendant holds itself out as a franchisee.

(3) That the threatened injury to it outweighs the threatened harm the injunction may do to defendants; The court found that:

> Although defendants will suffer some amount of harm if a preliminary injunction is issued, courts usually hold that when defendants improperly use a plaintiff's trademark, the

> threatened harm to the plaintiff outweighs the threatened harm to the defendants. Ramada will suffer substantial harm because it cannot control its own reputation and good will.

(4) That granting the preliminary injunction will not disserve the public interest; with no discussion the court found that:

> The entry of a preliminary injunction will not disserve the public interest, which promotes the protection of valuable trademarks and service marks in a capital-based economy that rewards success through competition.

The court issued the preliminary injunction enjoining the defendant from using any of the Ramada trademarks, names, and logos and enjoined it from holding itself out as a Ramada Inn. *Ramada Franchise Systems, Inc v. Jacobcart* (2001) United States District Court for the District Texas, Dallas Division.

Country Inns & Suites by Carlson, Inc v. Two H.O Partnership (2001)

Carlson owns the trademarks, service marks, and trade dress for Country Inns and Suites, a nationwide chain of franchised hotels. Carlson licenses others to use the Country Inn marks. Carlson had duly registered all of its trademarks. In 1992, Carlson and the defendants entered into a franchise agreement under which the defendants would operate a Country Inn and Suites in Two Harbors, Minnesota. The defendants agreed to operate the hotel in accordance with the Carlson operating manual and to make any changes that Carlson might require in the future.

Carlson gave all of its franchisees notice in July 1997 (to be effective in 1998) that it would change the operating manual to require that the hotels provide a full-size ironing board in each room. Carlson performed five inspections during 1999 and 2000 and each time discovered that the plaintiff had not installed the new ironing boards. Carlson notified the defendants that Carlson would terminate the franchise unless the ironing boards were installed. The defendants informed Carlson that they would not be installing the ironing boards, which led Carlson to terminate the franchise. The defendants continued to use the Carlson signage after the franchise had been terminated and after the termination of their license to use the trademarks of Country Inn and Suites. Carlson filed suit and requested a preliminary injunction that would force the defendants to remove the Country Inn sign. The court required Carlson to demonstrate four items in order to receive the injunction:

(1) It will probably succeed on the merits. The court followed previous cases and relied upon the fact that the marks had been properly registered. The court stated that "Registration makes the marks incontestable, and gives Carlson the exclusive right to use the CIS marks in commerce." More importantly, registration allows Carlson to "rely on incontestability to enjoin infringement and [prevents] such an action [from being] defended on the grounds that the mark is merely descriptive.

(2) It will suffer irreparable harm absent the injunction. The court stated that "Because a trademark represents intangible assets such as reputation and goodwill, the Court may presume irreparable harm if Carlson demonstrates a likelihood of confusion between its CIS marks and defendants' signs."

(3) The balance of harms favors the moving party. The defendants argued that forced to remove the three signs in question would be a financial hardship. The court stated, "The Court determines that damage to Carlson's intellectual property outweighs any financial burden that defendants would incur by altering the three signs at issue here."

(4) The public interest favors granting the injunction. The court states that, "Federal trademark law is premised on the concept that protecting intellectual property and prevening consumer deception is in the public interest."

The court granted the preliminary injunction to Carlson and ordered that the defendant immediately refrain from using any of the Carlson trademarks and ordered the signs be removed within 30 days. *Country Inns & Suites by Carlson, Inc v. Two H.O Partnership, et al.*, United States District Court for the District of Minnesota, 2001 U.S. Dist. LEXIS 20186.

Conclusion

Hotel franchise companies license the use of their trademarks, name, logo, and operating procedures to their franchisees in return for the ongoing payment of franchise fees. When a hotel owner fails to pay money owed for franchise fees or fails to adhere to the operational or other requirements, the hotel franchise company will be forced to terminate the franchise. A valid termination automatically removes the right of the franchisee to use the franchise trademarks, name, and logo. When the hotel owner (franchisee) continues to use the trademarks, name, and logo and/or continues to hold himself or herself out as a valid licensed, franchisee, the property rights and customer goodwill of the franchise company are at risk.

The Lanham Act allows protection to a company for the property rights that exist in their trademarks, logo, and name. The Act allows for the registration of those marks in the U.S. Patent and Trademark Office. In addition, the Act provides for the granting of preliminary injunctions in federal court to prevent the unlawful use of valid trademarks. A series of court cases and some recent cases involving hotel franchise companies show the importance of trademark registration, as the registration makes the existence of the trademark incontestable. The courts continue to uphold the right of the hotel franchise company to protect its property rights in its name, logo, and trademarks by providing for the granting of a preliminary injunction. The preliminary injunction can be sought and obtained immediately after the termination of the franchise, and without litigating all of the issues that may be present. The injunction can be obtained at the initiation of the suit, with the complete trial on all of the other issues to be conducted at some later time. The use of the preliminary injunction is effective in allowing the hotel franchiser to protect its property rights granted to it under the federal trademark legislation.

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