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I. DEFINITION OF A TRADE MARK LICENSING AGREEMENT AND A FRANCHISE

A. A TRADE MARK LICENCE

1. IS THERE A DEFINITION OF A TRADE MARK AND, IF SOME, WHAT IS IT?

Industrial Property is ruled in Mexico principally through a statute known as the "Law For the Promotion and Protection of Industrial Property" (LPPIP), which was published in the Federal Government Gazette of June 27, 1991 and became effective as of June 28, 1991. Besides patents, said statute of Congress represents the legal instrument aimed to protecting trade marks, service marks, collective marks, commercial or trade names, slogans and appellations of origin. The foregoing are defined as follows by the LPPIP:

A. Marks (term comprising trade marks and service marks): "Understood as a mark is every visible sign that distinguishes products or services from others of their same kind or class in the market". (Article 88, LPPIP)

"The following signs may constitute a mark:

I. Visible, sufficiently distinctive names and figures, capable of identifying the products or services to which they are applied or attempted to be applied, against other products or services of their same kind or class;

II. Tridimensional forms;

III. Trade names and denominations or corporate names, provided they do not fall in the following article; and

IV. An individual's own name, provided there is no homonym already registered as a mark". (Article 89, LPPIP)

B. Collective marks: "Legally incorporated associations of producers, manufacturers, merchants or purveyors of services may apply for the registration of a collective mark to distinguish in the market the products or

services of their members from products or services of such persons who are not members of said associations". (Article 96, LPPIP)

C. Slogans: "Deemed to be slogans are the phrases or sentences whose purposes is to advertise to the public establishments or commercial, industrial or service businesses, products or services, to easily distinguish them from others of their kind". (Article 100, LPPIP)

D. Trade names: "The trade name of a company or industrial, commercial or service establishment, and the right to its exclusive use will be protected, without the need of a registration. The protection will cover the geographic zone of the actual clientele or the company or establishment to which the trade name is applied, and will extend throughout the entire country if there is a massive and constant dissemination thereof at the national level". (Article 105, LPPIP)

E. Appellation of origin: "Understood as an appellation of origin is the name of a geographic region of the country which is used to designate a product that originates there, and the quality or characteristics of which are due exclusively to the geographic medium, which includes natural and human factors". (Article 156, LPPIP)

2. IS THERE A DEFINITION OF A TRADE MARK LICENCE AND, IF SO, WHAT IS IT?

The Mexican LPPIP does not convey any particular definition of trade mark license, however, from the combination of some of the provisions in said statute a legally acceptable concept can be obtained:

- a) First of all, in accordance to the LPPIP, "the holder of the registration of a mark may grant, by means of an agreement, a license to one or more persons respecting all or some of the products or services to which the mark is applied..." (Article 136, LPPIP). Although not expressly mentioned by the LPPIP, the holder of a trade mark registration may license any rights arising therefrom, but most frequently the right for the use of the mark in the manufacture and commercialisation of a product or the rendering of a service. Also, due to the nature and scope of the exclusive rights in a trade mark registration, its owner is entitled to decide whether to grant the corresponding license on an exclusive or non-exclusive basis, with an additional right to sublicense and covering the entire Mexican Republic or a particular territory therein.
- b) Secondly, the LPPIP imposes an obligation of quality control by stating that

"the products that are sold or the services that are rendered by the user must be of the same quality as those manufactured or rendered by the holder of the mark..." (Article 139, LPPIP). Further comments in this regard can be found at 3 a) below.

c) The LPPIP further establishes that "the use of the mark by the user to whom a license, recorded with the Ministry, has been granted, will inure to the benefit of the owner of the mark". The present provision as the foregoing one is aimed to protecting uniformity of trademarks and the goodwill backing them. More detailed comments in this regard can be consulted at 3 b) below.

d) In order to achieve a quality and uniformity standard in the manufacture of products or the rendering of services under the licensed trade mark, it seems warranted that licensor shall have to disclose information and to provide training and technical assistance to licensee, pursuant to the procedures and techniques for the manufacture and commercialization of the products and the rendering of the services. Accordingly, it is commonly observed in complex trade mark license agreements that they include knowhow and confidentiality clauses in connection with the quality control and training programs by licensor.

e) Finally, as to consideration, it is frequently found that licensee pays a license fee in the form of a lump sum and/or a fee measured by the number of products sold or by gross sales.

From the above, and based on the principles and provisions of the LPPIP, a trademark license could be reputed as a form of business, represented in a contract, in which licensor will grant to licensee the right for using his trademark in connection with the products manufactured and commercialized or the services rendered by said licensee, under an exclusive or non-exclusive basis, with the option of an additional right to sublicense and for the Mexican territory or a part of it. In other words, a trade mark license agreement allows licensee sharing a portion of the goodwill associated with the licensed trade or service mark, in exchange for a consideration that is commensurate with such goodwill. Accordingly, licensor will be interested in expanding his operation or business by letting third parties using his trademark in return of a royalty. Licensee will only be interested in paying for the value of a trademark or service mark carrying sales and increasing profits. In addition to the particular interest of licensor and licensee, the LPPIP protects the legal interest of that non-measurable entity being the consumer public from any form attempting against uniformity of a licensed trade mark. In fact, this justifies in a very important manner the LPPIP's policy of combating the so-called naked licenses, by promoting quality control

provisions, which are mandatory according to the Law itself.

Lastly, the Mexican doctrine has provided various definitions of trade mark license, deserving special mention the one made by Dr. David Rangel - Medina in the "Revista Mexicana de la Propiedad Industrial y Artística "(La Licencia de Explotación de Marcas en el Derecho Mexicano, number 4, July - December 1964, at p. 279):

"The condition of authorized user arises from an agreement entered into by the owner of the trade mark and an individual or legal entity who agrees employing the same manufacturing procedures and technical formulas, in order that those products by the registration owner and those of the user are equivalent. The exchange to complying with said substantial obligations, said person shares the exploitation of the trademark. The document in which the agreement is written is known as license for exploitation of the trade mark".

3. ARE THERE SPECIFIC PROVISIONS CONCERNING A TRADE MARK LICENCE AND WHAT ARE THOSE PROVISIONS?

Following are comments to provisions in the LPPIP regulating trade mark licenses as well as to clauses usually contained in these kind of agreements and compatible with the LPPIP, although not necessarily included in the statute in an express manner:

a) Quality Control: Article 139 of the LPPIP - referred to at 2 b) -, does not particularly point out who bears the quality control obligation referred to above. However, it can be obtained therefrom that, on the one hand, licensee shall have to manufacture its products or render its services following the standards and guide-lines dictated by licensor in order to at least achieve the same level of quality as to the products or services of this latter party. On the other hand, licensor is bound to keep control of licensee's products or services quality standards, which not only has to be considered as a right, but as well as a commitment on its behalf for monitoring, testing and approving licensee's products or services. Considering that one of the main objectives of the LPPIP is that trade marks remain as instruments for standardizing quality in a uniform manner in the benefit of consumers, we have to understand the quality control provision as broad as possible and as a result, the authority of licensor to control quality of licensee's products or services going beyond the simple approval of the products or services themselves, but also of the manufacturing or

production techniques and procedures.

As to enforcement of the quality control provision, Mexican law would most likely support termination of trade mark license agreements on the basis of breach of quality control clauses. However, it remains to be seen what actions could be taken if the license agreement does not convey a quality control clause. Perhaps, the Trademark Office would be entitled to refuse recordal of the agreement for contradicting the public interest; also, although never explored or tested before in Mexico, there should be the possibility that the members of the general public file consumer class actions against the parties' failure in taking adequate measures for procuring uniformity of the licensed trade mark.

b) Recording System: The LPPIP has introduced an assignment and license recording system, having similarities with the Anglo-Saxon registered user system. In keeping with this, article 136 of the LPPIP states that "the license shall be recorded with the Ministry in order for it to be enforceable against third parties". In addition, article 141 of the LPPIP establishes that "the use of the mark by the user to whom a license, recorded with the Ministry (Trademark Office), has been granted, will be deemed to be used by the holder of the mark".

As in some Anglo-Saxon jurisdictions, the idea surrounding the requirement of the LPPIP for recording license agreements, in order for a trade mark's use made by a licensee to inure in the benefit of licensor and owner of the registration, arises from the principle of uniformity in the quality of the products manufactured or services rendered under the licensed trade mark. Thus, in those cases licensee's use of licensor's trade mark will be made as if it was made by licensor himself. The recordal requirements have the intention that the Trademark Office is able to trace, from the official records themselves, if steps have been taken for imposing quality control provisions as to uses of the trade mark made by any authorized user. However, as in practice a single license recordal has been considered as sufficient ground in order for licensee's use of the trade mark to inure in the benefit of licensor, it is unclear whether in case of multiple users of said trade mark, the lack of recordation of any of them would produce abandonment of rights and the availability of sanctions against licensor for non-compliance with *the* afore-mentioned quality control legal provisions. In accordance with the LPPIP, license recordals have no longer the purpose of producing legal effects, prior to strong scrutiny and approval measures as it used to be with the former Technology Transfer Law (LTT). Nowadays,

recordations are not mandatory but are anyway recommended in order that they produce effects against third parties and the Trademark Office has now the authority to refuse and reject recordations of licenses and assignments in case of public interest, as well when the applicability of the LPPIP is expressly excluded from the respective agreement, without detriment to the fact that the parties may submit any dispute or controversy to international arbitration.

c) Cancellation of a license's recordation: Pursuant cancellation of the recordal of a trade mark license agreement, article 138 of the LPPIP establishes the following:

Cancellation of the recordation of a license will be available in the following cases:

"I. When jointly requested by the holder of the mark and the user to whom the license was granted;

"II. As a result of the nullity, lapsing or cancellation of the registration of the mark; and

"III. By a court order". (Article 138, LPPIP)

The foregoing provision is directed to protecting licensee's interest in keeping with the licensing relationship, in those cases when licensor unilaterally terminates the agreement without licensee's will concurring as to that end. Thus, for instance, if licensee should not accept or recognize the termination of the license or rescission of the same, notwithstanding the fact that the license has terminated or can be rescinded in accordance with the terms agreed upon by the parties, licensor will have to resort to a Court of Law seeking for the corresponding judgment, so the provisions of the Commerce Code, Civil Code, Codes of Procedures and the LPPIP would be applicable.

d) Legal Actions: The last specific provision governing trade mark license agreements is article 140 of the LPPIP, which states that "the user to whom a license has been granted and who is recorded with the Trade mark Office, will be entitled to exercise legal actions to impede the counterfeiting, imitation or illegal use of the mark, as he himself was the holder, unless otherwise agreed upon".

It is important to take into account that no additional legal restrictions or obligations are imposed by the LPPIP, besides the ones that we have referred to above. As the LTT was abolished as a result of the implementation of the LPPIP, it is now the will of the contracting parties that rules trade mark license agreements, in general terms. However, restrictions can sometimes be found in laws and other provisions regulating specific subjects, such as tax law - that for

example, would consider a disproportional and unreasonable royalty as only partially deductible-, or antitrust law - in this regard please refer to comments in the corresponding chapter below-.

4. ARE THERE PROVISIONS CONCERNING COLLECTIVE OR CERTIFICATION MARKS, AND, IF SO, IS THERE ANY OBLIGATION IMPOSED BY REGULATIONS ON THE USERS OF SUCH A COLLECTIVE OR CERTIFICATION MARK?

The Trademark Laws in Mexico does not recognize protection for certification marks; however, as to collective marks, the following provisions are found: "Legally incorporated associations of producers, manufacturers, merchants or purveyors of services may apply for the registration of a collective mark to distinguish in the market the products or services of their members from products or services of such persons who are not members of said associations". (Article 96)

"Together with the application for the collective mark, it will be necessary to submit a list of the associates and the rules for use of the mark. Once the registration of the collective mark has been obtained, the association shall notify the Ministry of any changes that occur in the list of associates". (Article 97)

"The collective mark may not be transferred to third parties, and its use is reserved to the members of the association. Collective marks will be governed, in absence of a special provision, by the provisions of this law relating to marks. (Article 98)

B. A FRANCHISING AGREEMENT

1. DOES DOMESTIC LAW INCLUDE PROVISIONS WHICH ARE SPECIFIC TO A FRANCHISE, AND IF SO, WHAT ARE THEY?

IN THIS CASE, WHAT DEFINITIONS ARE LAID DOWN BY THE LAW? IF THERE ARE NO LEGAL DEFINITIONS, WHAT ARE THE DEFINITIONS WHICH ARE ADMITTED BY CASE LAW, OF IT THERE ARE NONE, WHAT DEFINITIONS COULD BE SUGGESTED?

The LPPIP provides the following as a legal definition for a franchise:

"A franchise will exist when, with the license of a mark, technical knowledge is transmitted or technical assistance is provided, allowing the person to whom it is granted to produce or sell products or render services uniformly and with the operational, commercial and administrative methods established by the holder of the mark, for the purpose of preserving the quality, prestige and image of the products or services distinguished by the mark.

"Whoever grants a franchise shall provide to the person to whom it is intended to be granted, prior to the execution of the respective agreement, information about the status of his business, in the terms established in the Regulations of this Law.

"The provisions contained in this chapter will apply to the recordation of a franchise". (Article 142, LPPIP)

2. DOES LEGISLATION INCLUDE PARTICULAR RULES AS REGARDS A FRANCHISE, ESPECIALLY IN RELATION TO TERRITORIAL RESTRICTIONS, AN OBLIGATION TO REGISTER THE AGREEMENT, PROTECTION FOR THE FRANCHISED PARTIES IN THE EVENT OF EXPIRATION OF THE AGREEMENT, AND RESPONSIBILITY FOR THE FACT OF THE PRODUCT. IN THE ABSENCE OF A LEGISLATIVE PROVISION, ARE THERE RULES WHICH HAVE BEEN LAID DOWN BY CASE LAW OR DOCTRINE?

Mexican law has recognized franchise and trade mark licenses as two different forms of doing business and accordingly, as two different forms of agreement, which despite some similarities, are independently conceived and governed. The basic similarity arises from the fact that in both it is a trademark that constitutes the core of the business. A second similarity arises from the fact that the two forms of agreements share the same historical root. However, they both developed afterwards taking different directions and aimed to resolve essentially different situations.

In line with the above, trade mark licenses are found in every franchise

agreement but not every trade mark license will necessarily be forming part of a franchising agreement. Also, quality control provisions and even know-how and confidentiality clauses can be found in both type of agreements, which can be understood precisely from the fact that the trade mark represents the ground on which both forms of agreements rely.

The first forms of franchising that appeared in Mexico can be found back during the decades of the 50's and 60's, and are now identified by the experts as "franchises of the first generation". The most suitable example can be found in the automobile distribution business and further in the soft drink bottling and distribution industry. However, as the franchising business has been developing in Mexico, it is now virtually impossible referring to such "first generation" franchises as real franchises, if they only represent basic forms for distributing products by dividing territories.

The term "franchising" remained associated with the division of a market into various fragmented territories until the last decade, when a modern concept of franchise known as "business format" became effective as a result of the changes in Mexico's protectionist policies of the 70's and 80's. Essentially a franchise is still a form for producing and distributing goods or rendering services, but presently based on a "system", comprising a complete marketing, operation, commercial and administrative strategy or method established by the owner of the mark and that is planned to be disclosed to third parties, whose work and investment will contribute to a business expansion that otherwise would not have been reached by franchisor. Therefore, as the use of the trademark will be permitted to a multiplicity of parties, which requires strict uniformity standards, it is of utmost importance that they all follow the same instructions and comply with the same rules in the production and distribution of the products or the rendering of the services.

The relationship between franchisor and franchisee has become in Mexico one of a close participation, in which franchisor is constantly assisting franchisee in accomplishing the purposes of the franchise and in which franchisee works for implementing franchisor's ideas and indications. This type of business requires franchisee to be acquainted with how the "system" works and franchisor to exercise tight quality control measures. In Mexico it is a common practice that only information related to the franchise shall be contained in manuals that are handed to the franchisees as part of the deal.

Being a "system" integrated by a diversity of elements, a franchised business can include not only trademarks but patents, copyrights and other intellectual

property rights as well, which are normally licensed as part of the franchise agreement. The territory of the franchise constitutes a very important element in this type of business frequently divided according to demographic distribution and market needs. The only restrictions that are imposed in a franchise agreement are those established by franchisor as there are none imposed by the LPPIP; in any event, it has to be borne in mind that due to the nature of the franchise itself a plurality of users of the trademark will be strategically distributed along the Mexican territory, attending to the demographic and market criteria explained above.

As to consideration in a franchise agreement, a royalty is not only justified because of the licensing of trade marks and other intellectual property rights, but also in connection with the range of services that franchisor renders to its franchisees and the investment made by licensor in the development of the "system" and programs surrounding it, including publicity and marketing strategies. In addition, it is common in Mexico that licensor charges a so-called "franchise fee" which is paid at the time that the agreement is executed and which has the purpose of reimbursing the expenses in which franchisor incurred for preparing the execution of the business arrangement.

Under Mexican LPPIP, franchisors are required to provide to a potential franchisee, information about the status of his business, in the terms established in the regulations of the LPPIP. Although no regulations have been published so far, it is expected that the obligation in behalf of franchisor for disclosing its business and financial information to the prospective franchisee - "offering" as it is known - will not exceed the scope that is actually required in other countries.

Finally, the LPPIP states that the recordal provisions that were previously discussed for the case of trade mark licenses shall be applied to franchise agreements as well.

III. LINE OF DEMARCATION BETWEEN TRADEMARK LICENSING AND FRANCHISING AGREEMENTS

1. What are the essential element of a trademark licensing agreement and a franchising agreement?

A) An obligation on the part of the franchiser to give the franchised party all financial and other information relating to this activity, which may be decisive in

terms of inducing a new franchised party to sign the agreement.

B) Transfer of the technical and commercial know-how. In this the determining element in the franchising agreement?

C) Quality control in respect of the products or services.

Does such quality control also exist in regard to a trade mark licensing agreement, and is it then exercised at a different level, in relation to a franchising agreement?

While discussing the elements of trade mark licenses and franchising agreements, it was mentioned that although they both share characteristics in common and are strongly framed on trademarks, they actually represent two different forms of doing business directed to resolve different problems.

Notwithstanding the foregoing, and in case of a vis-a-vis analysis of the two forms of agreement the following dividing lines can be drawn:

- a) The LPPIP requires franchised to disclose information about his or her business to franchisee, which this is not an obligation imposed by the LPPIP in case of licenses;
- b) As to transfer of information, it is frequently found in franchise agreements, but also in most type of license agreements, depending on its complexity level;
- c) Quality control provisions are equally required by the LPPIP in both types of agreements. However, franchises deserve a special attention as to quality control in general terms, considering that it will be normally a large number of franchisees that will make use of the franchised trade mark. However, a franchise will never be granted on exclusivity as it is frequently the case of trade mark licenses;
- d) Licensor shall not provide ancillary services to licensee and shall not make licensee participate in any kind of marketing, administrative or operative plan or strategy, which is essential in any franchise agreement.
- e) As a difference from a franchise agreement, the licensor may condition the licensee to meeting minimum sales quotas or other performance criteria during each year of the license agreement. Some trade mark license agreements provide that failure to meet minimum sales quotas or make minimum royalty payments will result in loss of exclusive use of the mark, while others provide that the failure to meet such quotas gives the licensor the right to terminate the license.

2. Independently of a franchising agreement, the proprietor of a trade mark may be induced to grant enjoyment thereof to a number of licensees

On the other hand, some countries make provision for a collective or

certification trade mark.

Regulations in respect of use often include obligations on the part of the users of such a collective or certification mark, with the possibility of monitoring. The owner of a trade mark registration has the right to decide whether to grant licenses his trade mark or not and there is no obligation set by the LPPIP on his behalf for doing it. However, in case of franchises, their objectives will be fulfilled only if a trade mark is licensed as it is this element the core of the agreement.

The LPPIP does not provide whether a trade mark, a service mark or a collective mark are to be the subject of a franchise agreement; it should be possible to have any of the three as no restrictions are imposed by the LPPIP. However, a collective mark requires an association to be the owner of the registration, which would be difficult in case of a franchise agreement. In keeping with this idea, use requirements could have very different purposes in both cases.

III. Anti-trust rules

A trade mark licensing agreement and a franchising agreement may fall foul of antitrust rules.

Before fully addressing the present question, the rules of unfair trade practices in commerce deserve some previous comment. Formerly, restrictive practices and limitations were expressly prohibited and controlled in most intellectual property licensing and technology transfer agreements. This was governed by the so-called Technology Transfer Law, which was however repealed in June 1991, at the same time that the new Law for the Promotion and Protection of Industrial Property (LPPIP) was implemented. Among other provisions, the LTT prohibited tying arrangements, confidentiality covenants beyond the expiration date of agreements, and limitations in general that could attempt against the strict technology transfer policies of former governments.

After the LTT was repealed, the old principle stating that the intention and will of the contracting parties shall rule the legal relationships between them was incorporated as the governing rule in intellectual property licenses and assignments.

Notwithstanding the foregoing, on December 24, 1992, a new law entitled "Federal Law of Economic Competition" (FLEC), was published in the Federal Official Gazette, in force as of June 24, 1993, with the aim of ensuring free competition by preventing and eliminating monopolies, monopolies practices and any restriction to the efficient functionality of every market of goods and services.

The FLEC objectives are avoiding monopolies and monopolistic practices, including trusts and cartels; in fact, the provisions of such statute are so broad that comprise unfair trade and restrictive practices in commerce - including all type of agreements-, if they are directed to diminish, distort, impede or block competition in the production, processing, distribution and commercialization of goods and services.

The statute has set a distinction between the so-called "absolute practices" and "relative practices". The first category prohibits and sanctions any act that attempts against free competition under any angle and the latter relates to practices requiring a more detailed and exhaustive analysis for ensuring that they attempt or distort free competition. Such distinction has thus the purpose of establishing different levels in the application of the rules and sometimes of the FLEC.

With regard to "relative monopolistic practices", the FLEC further establishes that in order to determine whether it has been infringed, it must be shown that the licensor has "substantial power" over the "relevant market" and that the violations upon the law are made respecting the goods or services of the corresponding "relevant market".

The FLEC understands that in order to determine the meaning of "relevant market", the possibilities of substituting the good or service by third parties, should be considered in addition to the costs of the good itself, of its raw materials, components and substitutes in other regions or foreign countries and the government restrictions imposed on them. Also, the FLEC understands as "substantial power" over a market, the fact that a particular entity has power to fix prices unilaterally or to restrict the supply of the good in "relevant market", without an opportunity for competitors to contra rest said power.

As it can be appreciated the provisions of the FLEC are so broad that could be extensively applied to restrictive practices in a license or franchise agreement. However, it seems that application of these rules will be more justified in case that the particular goods are considered as non staple. Accordingly, we believe the more possibilities customers have to find the same or substitute products in the market from third parties competing against licensor, the more likelihood will exist that the authorities in charge of governing this law will apply the sanctions and remedies offered by such law. Such sanctions represent administrative fines and orders of suspension, correction and suppression of the infringing practice.

In conclusion, after the LTT was repealed there was no doubt that most

restrictive practices in licensing agreements were seemed to be considered legal, as long as the contracting parties agreed upon in that direction. However, after the implementation of the FLEC restrictive and monopolic practices could be pursued again, in those cases in which a "relevant market" is undertaken by a single entity representing a "substantial power". It has to be realized that this law would most likely not cover ordinary situations, but rather situations in which there is a real or monopolic practice.

Summary

Mexican law has recognized franchise and trade mark licenses as two different forms of doing business and accordingly, as two different forms of agreement, which despite some similarities, are independently conceived and governed. The basic similarity arises from the fact that in both it is a trademark that constitutes the core of the business. A second similarity arises from the fact that the two forms of agreements share the same historical root. However, they both developed afterwards taking different directions and aimed to resolve essentially different situations.

In line with the above, trade mark licenses are found in every franchise agreement but not every trade mark license will necessarily be forming part of a franchising agreement. Also, quality control provisions and even know-how and confidentiality clauses can be found in both type of agreements, which can be understood precisely from the fact that the trade mark represents the ground on which both forms of agreements rely.

Franchise agreements have evolved in Mexico from the "first generation" franchises, which were closer to distribution agreements to franchises of "business format, which have become real "systems", comprising a complete marketing, operation, commercial and administrative strategy. Therefore, the franchise will be surrounded by very complex legal and business requirements, which in most cases differ from those observed in license agreements.

On the other hand, trade mark license agreements in Mexico have also matured through the passing of time and its complexity has also increased, however, in most cases the relationship between a licensor and a licensee shall be not as close as franchisor's and franchisee's, considering that besides technical assistance and training, licensor will normally not provide ancillary services and the operation, administration and marketing policies of licensee's company will be set up by this latter party.