American Bar Association
33rd Annual Forum on Franchising

The Other IP:
Hot Topics in Trade Secrets, Copyrights and Patents

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October 13 – 15, 2010
The Hotel Del Coronado
San Diego, CA

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I. INTRODUCTION

Trademarks are often characterized – rightfully so – as the cornerstone of the franchise relationship and are featured as the key intellectual property right in the franchise agreement. They garner consumer recognition and loyalty and, with a successful marketing message and proper quality control, drive sales and profits for franchisor and franchisee alike. Other intellectual property rights – trade secrets, copyrights and even patents – also can and do play significant, though sometimes less visible, roles in franchise systems. Following a brief overview and comparison of various intellectual property rights, we explore these “other” intellectual property rights in more depth: what they are, how they relate to franchising, and some of the pitfalls that they may present for the franchise system.

Trademarks: Trademarks (and service marks) are any type of identifier or indicia (“any word, name, symbol, or device or any combination thereof . . .”2) that can be used to identify the source of products or services and distinguish them from those of others. The term “trademarks” has been used to encompass trademarks (including trade dress for product shapes and containers), service marks, collective membership marks and certification marks. In addition to traditional forms of trademarks such as words, letters, drawings, objects, and product shapes and containers, trademark protection on color,3 sound,4 and even scent5 has been upheld. There is no limit on the potential period of protection.

Trademarks are protected through a combination of the federal trademark statute, the Lanham Act,6 state statutes (so-called little Lanham Acts), and state judicial precedent that follows the Restatement of Torts. There are also criminal penalties for counterfeiting.7

Trademark rights can be acquired through use alone. Federal and state laws provide additional rights through a registration process. Trademarks can be enforced against anyone who uses the same or similar mark in a way that causes likelihood of confusion8 or deception9 or is likely to dilute the strength of the mark.9 There are also federal counterfeiting laws that

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3 United States Patent and Trademark Offices, Registration No. 7630773, American Life Assurance, duck quacking the word “AFLAC”.
6 18 U.S.C. §2320 (potential penalties up to $5,000,000 and 20 years imprisonment; See also, for example, Cal. Penal Code §350 (providing for monetary fines and imprisonment for various forms of trademark counterfeiting).
protect owners of federally registered marks from knock-offs that use identical or “substantially indistinguishable” marks.¹⁰

Franchisors are keenly aware of trademark rights as they feature prominently in franchise agreements, marketing and advertising guidelines, signage, promotional materials, and of course in franchise disclosure documents. Disputes arise over proper use, infringement by third parties, claims by others of infringement, and use by holdover franchisees. And time and money are invested in their registration both in the US and abroad.

These intellectual property rights have been – and undoubtedly will again be – addressed extensively by others so will not be addressed further below.

**Trade Secrets:** In contrast, trade secrets – the proprietor’s confidential bundle of nonpublic information that gives it a commercial advantage in the marketplace - are protected primarily by state statutory law (in the District of Columbia and forty-five states that have passed some version of the Uniform Trade Secrets Act¹¹) or through state judicial precedent that for years followed the Restatement of Torts § 757,¹² and now the Restatement (Third) of Unfair Competition §§ 39 - 45.¹³ Like trademarks, trade secrets have long played a significant role in franchising. They encompass facets of a franchise system’s operations, its recipes and ingredient lists, its suppliers and sometimes its customers, procedures in its operations manual, and contents of other proprietary materials. They are, as virtually every franchisee knows, contractually protected – often at great length – by nondisclosure and nonuse restrictions (often coupled with other restrictive covenants) – in franchise agreements.¹⁴ Like trademarks, trade secrets can be protected indefinitely - as long as confidentiality is maintained.

**Copyrights:** US copyright law¹⁵ provides for copyright protection on any “original works of authorship fixed in any tangible medium”¹⁶ for a specified period of time, against any unauthorized reproduction, distribution, public performance, public display or creation of derivative works. A key point is that copyright protects the expression of an idea rather than the idea itself. Moreover, unlike trademarks and trade secrets, copyrights have a long although finite duration.

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¹² Restatement of Torts § 757 (1939).


¹⁴ *See, for example, Carvel Corp. v. Eisenberg* 692 F.Supp. 182, 186 (S.D.N.Y.1988) (noting that courts have upheld restrictive covenants in franchise agreements, recognizing "a franchisor’s valid interest in its "know-how" and "trade secrets"); *Gold Messenger, Inc. v. McGuay* 937 P.2d 907 (Colo.App. 1997) (upholding preliminary injunction based on franchise agreement’s restrictive covenant whose purpose was to protect franchisor trade secrets).


¹⁶ *Id.* §102.
**Patents**: Federal patent laws\(^\text{17}\) grant inventors an exclusive right, which is embodied in the form of a patent. This allows the inventor to exclude all others, for a specified period of time, from making, using, selling and offering for sale any invention that is covered by the claims of the patent. This protection is granted by the federal government in exchange for making full disclosure of the invention and satisfaction of novelty and other requirements established by the patent laws. And, like a copyright, though much shorter in duration, a patent confers a finite period of protection.

II. **TRADE SECRETS**

A. **Origins of Trade Secrets and of Trade Secrets in Franchising**

The law of trade secrets has its origin in both common law and statutes.\(^\text{18}\) As expressed by the Massachusetts Supreme Court in an early, seminal trade secret decision:

Mr. Justice Story states the doctrine in the broadest terms, that “courts of equity will restrain a party from making a disclosure of secrets communicated to him in the course of a confidential employment; and it matters not, in such cases, whether the secrets be secrets of trade or secrets of title, or any other secrets of the party important to his interests.” 2 Story Eq. § 952. In this court, it is settled that a secret art is a legal subject of property; and that a bond for a conveyance of the exclusive right to it is not open to the objection of being in restraint of trade, but may be enforced by action at law, and requires the obligor not to divulge the secret to any other person.\(^\text{19}\)

A trade secret claim first appears in the franchise context in a 1954 Wisconsin Supreme Court decision. In *Culligan, Inc. v. Rheaume*\(^\text{20}\), plaintiff developed a specialized process to condition and soften water at customer premises. The system involved installing and servicing water treatment tanks at customer locations. Franchisees performed the services. The franchisor imparted trade secrets to a franchisee, Rheaume, who used the secrets to engage in competition to provide supplies to other franchisees. The court ruled "making use of trade secrets obtained by the defendants. . . under their franchise from plaintiff, in making sales to soft water operators located all over the United States, would constitute an act of unfair competition irrespective of whether or not such purchasers were franchised by plaintiff." An order for an accounting was upheld.\(^\text{21}\)


\(^{18}\) See, e.g., *Barnard Bakeshops, Inc. v. Dirig* 19 N.Y.S.2d 224, 228-229 (N.Y. Sup. Ct. 1940) (noting independently of an express contract, courts have enjoined disclosure of trade secrets imparted to employees, based on a duty and implied contract that an employee will not divulge confidential knowledge gained in course of employment).

\(^{19}\) *Peabody v. Norfolk* 98 Mass. 452, 459-460 (1868).

\(^{20}\) 67 N.W.2d 279 (Wisc. 1955).

\(^{21}\) Id. at 284.
Today trade secret law is largely statutory. The principal statute is the Uniform Trade Secrets Act. Forty-five states and the District of Columbia have adopted the Act.\textsuperscript{22} Five states, Massachusetts, New Jersey, New York, North Carolina and Texas, protect trade secrets under another statute or common law.

B. The Nature of Trade Secrets

Trade secrets comprise information that has commercial value. The information is not generally known to others and is not readily ascertainable by proper means. Thus, a trade secret is generally exclusive knowledge, having economic value, that was generated by efforts of a person or persons who have an interest in protecting its value.\textsuperscript{23}

The Uniform Trade Secrets Act defines "Trade Secrets" as: "information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."\textsuperscript{24}

The Uniform Trade Secret Act's reference to "proper means" refers to various ways information may be ascertained that are both acceptable in a legal or ethical sense, and inconsistent with secrecy. According to the Uniform Law Commissioners, proper means include discovery by independent invention; reverse engineering (starting with lawful acquisition of a product and working backward to find out how it was developed); discovery under license from the trade secret owner; observation of the item in public use or on public display; or obtaining the secret from published literature.\textsuperscript{25}


\textsuperscript{24} Uniform Trade Secrets Act, Sec. 1(4). A similar definition appears in a federal statute, the Espionage Act of 1996, which criminalizes theft of trade secrets related to products produced or placed in interstate commerce. 18 U.S.C. Sec. 1832(a). The Act defines trade secrets as "all forms and types of financial, business, scientific, technical, economic, or engineering information, including patterns, plans, compilations, program devices, formulas, designs, prototypes, methods, techniques, processes, procedures, programs, or codes, whether tangible or intangible, and whether or how stored, compiled, or memorialized physically, electronically, graphically, photographically, or in writing if— (A) the owner thereof has taken reasonable measures to keep such information secret; and (B) the information derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable through proper means by, the public." 18 U.S.C. Sec. 1839(3).

\textsuperscript{25} National Conference of Commissioners on Uniform State Laws, Comment on Uniform Trade Secrets Act with 1985 Amendments (1986).
C. **Trade Secrets in Franchise Systems**

"Information is the most valuable asset of many a business."\(^{26}\) Confidential information comprising trade secrets are important in most franchise systems. Typical aspects of a franchise system that the franchisor considers to consist of or include trade secrets include the following:

1. **Training Program**

To impart important information to franchisees about how to operate the franchised business, most franchisors provide an initial training program. A typical franchise training program consists of instruction in the history and values of the particular system, construction and decor of franchise premises, selection, hiring and management of personnel, advertising and marketing, sales and customer service procedures, opening and closing procedures, operating procedures, operation of equipment, buying and management of inventory and supplies, and accounting and reporting procedures. Other aspects of training are particular to the type of franchise. For a quick-service restaurant, training may include instruction and practice in food preparation, as well as operation of the point-of-sale (cash register) system. A real estate brokerage franchise may include training on recruiting of sales agents.

Historically, training has most often been provided in-person through a combination of classroom instruction and either simulated practice in a training facility, or in-field practice at an operating franchise location.\(^{27}\) Increasingly some aspects of training are being delivered remotely through instructional videos delivered in electronic media or accessed via the Internet.

In any one or more aspects of the operation, each franchisor may believe it holds a competitive advantage over others. The advantage may be in the manner and efficiency or contents of its training, or some other aspect. Most franchisors consider many and potentially almost all the contents of their training program to be confidential and trade secret.

2. **Confidential Franchise Operations Manual**

To impart, and aid the franchisee in adhering to the franchisor's system, to achieve uniformity system wide, the franchisor loans franchisees a written operations manual. Historically, manuals were provided in a printed-on-paper format, often in a bound notebook. Increasingly, operations manuals are provided via on-line access. Subjects and contents vary among systems in different industries, and vary by system. In a case involving a restaurant franchise, the court described the subjects covered by the franchisor's manual:

The franchisor is specifically given the power to promulgate a standard operational procedures manual which will be binding upon the franchisee covering the following subjects: training and supervision of franchisees and restaurant managers, quality

\(^{26}\) *Proimos v. Fair Automotive Repair, Inc.* 808 F.2d 1273, 1276 (8th Cir. 1987).

control, record keeping and account controls, administrative assistance, periodic inspections, appearance of the premises, hours of operation, merchandise sold, employees' appearance and demeanor, the personal standards in training, promotions, advertising and signs, preparations and service of food and beverages, and relations with suppliers.  

Each franchisor's manual is unique (absent improper copying). Each franchisor seeks to impart the instructions and guidelines that form the salient parts of its system.

A franchisor's manual may result from a large investment of time and money. It may reflect years of experience and study. Its contents provide the franchisor a competitive advantage over others. Therefore the franchisor considers its manual to be a trade secret. Typically, the manual is referred to as the "Confidential Operations Manual" or a similar title that includes the word "confidential."

A provision of a License Agreement used in the McDonald's system illustrates the franchisor's view that the manual is confidential:

Manuals. Licensor shall provide Licensee with the business manuals prepared by McDonald's for use by licensees of McDonald's restaurants similar to the Restaurant to be operated by Licensee. The business manuals contain detailed information relating to operation of the Restaurant including (a) food formulas and specifications for designated food and beverage products; (b) methods of inventory control; (c) bookkeeping and accounting procedures; (d) business practices and policies; and (e) other management, advertising, and personnel policies. Licensee agrees to promptly adopt and use exclusively the formulas, methods and policies contained in the business manuals, now and as they may be modified by Licensor from time to time. Licensee acknowledges that McDonald's is the owner of all proprietary rights in and to the McDonald's System and that the information revealed in the business manuals, in their entirety, constitute confidential trade secrets .... Such manuals, as modified by Licensor from time to time, and the policies contained therein, are incorporated in this License by reference.  

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3. **Upcoming business and marketing plans and advertisements.**

   Many franchisors plan their marketing campaigns ahead, often several months or seasons in advance. Because marketing and advertising themes as well as specific promotions are highly competitive, franchisors consider this information to be a trade secret. Similarly, ventures with potential business partners, potential co-branding ventures and other future transactions may be valuable secrets prior to being publicly announced. One factor that makes them valuable and secret is that after being announced (or before, if a competitor becomes aware), a competitor may attempt to arrange a similar or parallel deal or activity, also for competitive purposes.

4. **Customer/contacts lists, particularly for route sales franchises.**

   As noted above, the law of trade secrets has its origins in the courts' recognition and willingness to protect, secrecy of customer lists. Some franchises involve development and use of customer lists, particularly lists of customers who have a particular need or high propensity to purchase the goods or services of the franchise. For example, an industrial maintenance and inspection franchise may provide inspection and maintenance services for industrial equipment. Customers may require regular inspections according to a schedule, such as monthly or on a calendar quarter basis. Information on the customer identities, particular equipment to be maintained, and the maintenance and inspection schedule could be particularly valuable to the franchise system that possesses it.

5. **Vendor/supplier lists.**

   A competitive advantage in some systems is their sourcing of equipment, products for sale, and other inventory or supplies. In these systems, identities of vendors and suppliers may be considered a valuable trade secret.

6. **Pricing information.**

   Usually retail prices are posted and thus are not secret. But information that goes into setting prices or formulas used to determine pricing may be secret.

   Though the franchisor considers these aspects of the franchise to be trade secrets, a franchisee or court may disagree. If the franchisor fails to keep the information secret, or if by nature it is not the kind of information that the law recognizes as trade secret, then a court will not sustain a franchisor's claim that the information is secret.

   In *Re/Max of America, Inc. v. Viehweg*, a franchisor of real estate brokerage offices hired an individual to sell franchises. The franchisor sent the salesperson to its management training course and furnished him with operations and training manuals. He became disenchanted, believing that information provided to him by the franchisor was false. After being terminated, he refused to return the documents provided to him during training. He

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planned to launch a consulting business that would benefit from information he obtained from the franchisor's materials. He contacted franchisees, accusing the franchisor of misconduct and made use and disclosure of information the franchisor had provided to him. In the franchisor's claim seeking the return of the training materials, the court stated:

It is well established that trade secrets include "any formula, process, pattern, device, or compilation of information which is used in one's business, and which gives him an advantage over competitors who do not know it or use it." However, it is also held in Missouri that sales aids and materials entrusted by an employer to an employee do not rise to the level of trade secrets where they do not appear unique to a particular employer. Minor adaptations of common business techniques to an employer's own particular needs do not raise such to the level of a protectable "trade secret." The Court finds that the materials given to the defendant at plaintiff's orientation and training seminar are not trade secrets within the meaning of Missouri law. The evidence supports a finding that the training materials were assembled and distributed in a fashion common to new employee orientation and much of the material itself was designed for presentation to the public and potential customers. The plaintiff's "100 percent commission" concept, though arguably unique, is not a trade secret. The concept itself as a product the plaintiff is attempting to market and one's publicly offered product can hardly be considered a trade secret. 31

D. Some Franchise Systems Whose Core Assets are Trade Secrets

While almost every franchise system possesses some trade secrets, in some franchise systems, the core licensed asset is a trade secret. Often this occurs in the context of beverage, food service and restaurant franchises, in which the core product is based on a secret recipe.

As an example, distribution of soft drinks involves franchising in which the main product (branded sodas) are characterized by secret recipes. Coca Cola is a prominent example. Its recipe is possibly the world's most valuable and best kept trade secret. 32 At Coca-Cola, measures to protect secrecy of the recipe for their namesake product are extensive:

The complete formula for Coca-Cola is one of the best-kept trade secrets in the world. Although most of the ingredients are public knowledge . . . the ingredient that gives Coca-Cola its distinctive taste is a secret combination of flavoring oils and ingredients known as "Merchandise 7X." The formula for Merchandise 7X has been tightly guarded since Coca-Cola was first invented and is known by

31 Id. at 625-626 ([internal citations omitted]).

32 Coca-Cola Bottling Co. of Shreveport, Inc. v. Coca-Cola Co. (D.Del. 1985) 107 F.R.D. 288 (noting "the complete formula for Coca-Cola is one of the best-kept trade secrets in the world.").
only two persons within The Coca-Cola Company. The only written record of the secret formula is kept in a security vault at the Trust Company Bank in Atlanta, Georgia, which can only be opened upon a resolution from the Company's Board of Directors.

* * *

It is the Company's policy that only two persons in the Company shall know the formula at any one time, and that only those persons may oversee the actual preparation of Merchandise 7X. The Company refuses to allow the identity of those persons to be disclosed or to allow those persons to fly on the same airplane at the same time.  

The recipe for another famous product, Kentucky Fried Chicken, is likewise the subject of extensive protection measures. The seasoning, its blending system and method of preparation are subject to trade secret protection:

To protect the secrecy of the composition of KFC Seasoning, KFC has designed a blending system for making the seasoning. With permission from KFC, one part of KFC Seasoning recipe is blended by [John W. Sexton Co.] and another part is blended by [Stange Co.]. Neither company has knowledge of the complete formulation of KFC Seasoning nor of the other's specific activities in the production of the other's part of the product. Both companies have entered into secrecy agreements with KFC, binding them to maintain the confidentiality of that portion of the KFC Seasoning formula to which each is privy. KFC's relationship with both Sexton and Stange has existed for more than 25 years. No other companies are licensed to blend KFC Seasoning.

After KFC Seasoning is blended by Sexton and Stange, it is then mixed together and sold directly by Stange to all KFC retail operators and to distributors acting on behalf of KFC retail operators.  

E. Trade Secrets May Sometimes Be Developed by Franchisees

In some systems, franchisees may develop information that is confidential and important to their success. Often this includes information on customers and their buying preferences. For example, a pizza delivery franchisee may develop information on regular customers, where they live, when they like to order, and what kinds of pizza and toppings they prefer. A dry cleaning franchisee may obtain equivalent information on customers. A hotel franchisee may develop information on repeat customers, their occupations, and room and amenity preferences. A franchisee may consider data on prices charged, discounts given, customers' usages of discount coupons, results of particular advertisements and promotions, successful

33 Id. at 289.
34 KFC Corp. v. Marion-Kay Co. 620 F.Supp 1160 (D. Ind. 1985).
35 Id. at 1163.
up-sell efforts, sales trends, and numerous other information categories to be confidential, trade secrets of the franchised business.

In *Camp Creek Hospitality Inns v. Sheraton Franchise Corporation*, a hotel franchisee contracted to participate in the franchisor's nationwide reservation system. This enabled the franchisor's telephone agents to take reservations for the franchised hotel. Meanwhile, the franchisee acquired another hotel in the same vicinity, which competed with the franchisee. The franchisee claimed the manager of the franchisor-owned hotel improperly came into possession of confidential information on the franchisee's occupancy levels, average daily rates, rate levels, discounting policies, long term contracts, marketing plans, and operating expenses, and that the franchisor-owned hotel used this information to compete against the franchisee for customers. An appellate court noted that the franchisee provided this information pursuant to a mutual understanding that it would be kept confidential, and that even if the franchisee could not prove damages from the franchisor's use of the information, the Uniform Trade Secrets Act allows a reasonable royalty for use of such information, and also allows injunctive relief. Accordingly, a decision by a lower court that dismissed a trade secrets misappropriation claim was reversed.

F. Some Methods for Protecting Trade Secrets in a Franchise System

The Uniform Trade Secrets Act definition of a trade secret requires that the information claimed to be secret "is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." There are any number of steps a franchisor can take to protect information that the franchisor wishes to claim is secret. Often the particular methods are specific to the type of information to be protected. As the Coca-Cola and Kentucky Fried Chicken cases show, the steps to maintain secrecy are important. At Coca-Cola the recipes are kept secret by locking them in a safe that almost no one has access to. At Kentucky Fried Chicken, the spice mix is divided in two, with only a portion of the mix made by each of two suppliers, and then the two parts are mixed.

Among innumerable possibilities for protecting trade secrets, here are several that are often useful in franchise systems:

1. Limiting disclosure so that secret information is provided only to those who need to know that information in order to perform obligations they are required to perform. As examples, franchisees who sell Kentucky Fried Chicken have no need to know the details of the spice mix, but they do need to know how to cook the chicken at their restaurants. Distributors of Coca-Cola products may have no need to know the product recipe. Therefore these categories of information are held as secret by the franchisors, and are not provided to anyone except those who need to know the information.

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36 139 F.3d 1396 (11th Cir. 1998).
In systems in which the franchise operations manual is confidential, it is essential
to share contents of the manual with franchise owners, and with franchisor personnel who are
responsible to administer and secure franchisee compliance with the manual. But some
franchisor personnel may have no need to have access to the manual. Likewise most suppliers
have no need for access to the manual. The manual is not made available to those persons.

2. As to those who need to have access to confidential information to
perform their roles, they should be provided only that portion of the information that they need to
know. For example, an equipment supplier to franchise system may have a need to review how
their equipment is presented in the "Equipment" section of the operations manual. However,
there is no need for the supplier to review other portions of the operations manual. Therefore
the equipment supplier should be provided, for review and comment, only the portion of the
manual that pertains to equipment which that supplier provides to the system.

3. Printed materials that are confidential, regardless of their form, should be
labeled "confidential." Manuals can have a confidentiality notice on their cover, title page and in
headers and footers on each page. On-line materials can be made accessible only after the
visitor reads a user screen that gives notice that the materials are confidential. CD-roms, floppy
discs, video cassettes and other media can be labeled "confidential" on the media itself, in
addition to any confidentiality notices placed in the content contained in the media.

Conversely, part of a labeling program should include assessing which materials
are and are not confidential, and not placing a "confidential" label on materials that are not
confidential. Overusing such labels can result in diluting their credibility, and effectiveness.
This is because it soon becomes apparent that non-confidential labels have been mislabeled as
confidential. As a result, personnel and others may tend to ignore or disregard the label.

4. The franchisor's computer system that houses trade secret information
can include features to restrict access, such as permitting access only to individuals who are on
a pre-programmed list of authorized users, and also password protection. A goal of this
approach is to prevent both intentional and inadvertent access by persons who are not
authorized or do not need to access confidential information.

5. Franchisor employees and franchisees can be counseled at the start, and
during, and at the end of their business relationship, about categories of information the
franchisor considers secret, and restrictions and procedures that should be adhered to in order
to protect the secrets. It is a good idea to mention trade secret protection periodically in
newsletters and other regular communications as a method to refresh people's attention to the
importance of protecting the system's secrets.

6. The franchisor can enter into confidentiality agreements, or include
confidentiality provisions in agreements to be entered into with franchisees, employees,
consultants, suppliers, vendors and others. These provisions are a common part of most
franchise agreements. They can also be included in the company's operations manual,
employee manual, and other forms of agreements. In these provisions the other party
acknowledges they will or may receive trade secret information of the franchisor, and they agree
to protect the confidentiality of that information.
7. At the time of termination or nonrenewal of a franchise, the franchisor should follow through on retrieving and having the franchisee return all embodiments of the franchisor's confidential information and trade secrets.

8. Confidential information should be kept in locked or restricted access cabinets. Sometimes, an office's floor layout and positioning of staff are designed to guard the location of trade secrets, and prevent unauthorized persons from wandering into areas where confidential information is present. Some franchisors locate their offices in secure premises, monitored by cameras and guarded by security personnel, to further control unauthorized access. Visitors may be required to wear clearly identifiable "Visitor" badges, so that company personnel can see they are visitors, and act appropriately to shield confidential information from disclosure. In some research and development departments, bright red flags or cones are displayed at desks of individuals while they work trade secret information. The flags or cones are a signal to others to stay away because confidential information is visible.

9. Some franchisors remind franchisees, personnel and others of the substantive importance to the organization and their own livelihoods, of the trade secrets and their protection. The trade secrets, though not visible or tangible, are property, which provide the organization various competitive advantages. Disclosure is tantamount to giving property away, and providing the same advantage to others. Franchisees and personnel who recognize the value of the secrets to the organization, are more likely to collaborate in helping to protect them.

10. Another important step that a franchise system can implement is to adopt a policy that affirmatively respects the trade secrets of others. Asking incoming employees to execute and acknowledgement that they will not disclose a former employer's trade secrets is one method of implementing such a policy. This approach leads people who are associated with the franchise system to require reciprocal respect for the franchisor's own secrets. Conversely, where a franchise system (or any company) does not respect the trade secrets of others, members of the system will inevitably have doubts whether they or others are really required to protect the franchisor's own secrets. If personnel are permitted to bring and use the trade secrets of others, personnel will doubt that the franchisor's own secrets can be protected against use in other systems. Applying this policy provides a palpable demonstration to personnel as to how trade secret rights may be respected.

11. There is no limit to the precautions that may be taken to protect confidentiality and secrecy of trade secrets. No matter how many protective measures are identified, it would always be possible to think of an additional protection that could be implemented. Thus, the law does not require a trade secret owner to take every possible step. Rather, the Uniform Trade Secrets Act requires a trade secret owner to make "efforts that are reasonable under the circumstances" to maintain secrecy.\(^\text{49}\)

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\(^{49}\) Uniform Trade Secrets Act, Sec. 1(4).
G. Some Recent Noteworthy Trade Secret Decisions

Typically the contours of trade secret disputes (and disputes over other intellectual property) in franchise relationships involve the issues of continued use of the information after expiration or termination of the franchise. During the franchise term, the franchisor expects the franchisee to have possession and make use of the information. After the franchise agreement expires or terminates, the franchisor typically wants the franchisee to stop operating in competition. Sometimes the franchisee seeks to remain in a similar business, or to become affiliated with someone in a similar business.

A particularly hot topic is the issue of using restrictive covenants to protect trade secrets, and conversely, the invocation of trade secrets as a basis to enforce restrictive covenants. A method used to protect secrets is to require franchisees, suppliers, consultants, distributors, personnel and others whom a company deals with, to agree not to work for, provide services to, distribute products of, or otherwise engage with a competitor, or engage in activities that compete with the franchisor. These restrictions are referred to as provisions for exclusive dealing, restrictive covenants or noncompetition agreements. But enforcement of restrictive covenants is disfavored, because they restrict free competition. Sometimes the existence of a trade secret is claimed, as reasons why a court should enforce a restrictive covenant.

When a restrictive covenant’s purpose is to protect trade secrets, sometimes a premise is that the franchisee, supplier, consultant, distributor, dealer, employee or other person who was exposed to the franchisor’s secrets, is unable to avoid using them. Such use is viewed as inevitable.\(^{41}\) Another premise is that working for or assisting a competitor or engaging in competition creates unavoidable incentive, and temptation, to disclose company secrets to the competitor, or use the secrets for the competitor’s benefit.

Generally, the law disfavors enforcement of restrictive covenants as conflicting with public policy that encourages free competition. But they may be enforceable if reasonably needed to protect legitimate business interests of the protected party, such as trade secrets, and are reasonably limited in time, geographic scope and scope of restricted activity. In some states, a court that finds a restrictive covenant to be overbroad, has authority to "blue pencil" the restriction, which means reducing its scope to what the court views as reasonable, and enforcing the restriction as reduced.

Courts scrutinize these provisions in the context of distribution, dealer and franchise agreements, and may refuse to enforce unreasonable restrictions, but are willing to enforce those they view as being reasonable. Courts examine covenants not to compete and enforce or refuse to enforce them without regard to whether they are in term or post-term covenants.

\(^{41}\) See, e.g., *Pepsico, Inc. v. Redmond* 54 F.3d 1262 (7th Cir. 1995). See also, *Jackson Hewitt, Inc. v. JSE Business Development Group* 2009 WL 5205983 at *3 (D.N.J. 2009) (irreparable harm flows from defendants' failure to return all client files and defendants' potential use-or inevitable disclosure-of information contained therein).
In Naturalawn of America, inc. v. West Group, LLC, a franchisor of landscape and organic lawn care services sought an injunction against a former franchisee, for using trade secrets and engaging in competition after the Franchise Agreement ended. The former franchisee was operating a lawn care business in competition with the franchisor. The court found the franchisor’s specially designed computer software was a trade secret. “Although the software is publicly available in its basic form, the specific software at issue here is customized, enhanced, and unique to NLA’s franchise.”

The franchisor’s customer list was also secret. “[T]he identity of NLA’s customer is not widely known outside NLA and that the lists of those customers are well known among NLA employees and franchisees.” The customer lists had been developed over time and required effort and money to establish. The lists and how they were maintained were carefully guarded. The Franchise Agreements provided for their return on termination of the franchise. The court found this data was important because the customer list would be valuable to a former franchisee that sought to become a competitor. A preliminary injunction was granted against the franchisee using or disclosing the franchisor’s trade secrets, and against competing with the franchisor in breach of the Franchise Agreement.

In Precision Franchising LLC v. Yim, plaintiff was the franchisor of automotive care businesses. Defendants operated a Precision Tune Auto Care franchise. The court found that the franchisor provided its franchisee trade secrets to use, including manuals, software and training. The franchisor claimed that on termination of the franchise, the franchisee failed to return the software. The franchise agreement required the franchisee, on termination, to stop using and return to the franchisor all proprietary information and trade secrets, including software, provided by the franchisor. The franchisee failed to appear and was therefore in default. The court therefore deemed the franchisor’s allegations to be admitted, and granted the franchisor an order of specific performance, requiring the franchisee to return the software, and other materials comprising trade secrets.

In Papa John’s International, Inc. v. Rezko, a franchisor of pizza restaurants sued a former franchisee for continuing to use trademarks, trade secrets and copyrights after termination of the franchises. The defendants moved to dismiss the complaint on the grounds that it did not state the claims with enough specificity. The district court noted that the trade secret misappropriation allegations were vague and conclusory. The claim alleged that “[t]he ‘Papa John’s System’ includes information, formulae, patterns, compilations, programs, data, devices, methods, techniques and processes that derive independent economic value from not

\[43\] Id., 484 F.Supp.2d at 399.
\[44\] Id., 484 F.Supp.2d 404.
\[46\] Id at *3.
\[47\] Id at *5.
being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from their disclosure or use.” The claim also alleged that Papa John’s undertook reasonable efforts under the circumstances to maintain secrecy of the trade secrets.

The court ruled that the plaintiff must show concrete secrets but need not allege details of the secrets as that would result in their public disclosure. The court ruled that the claim was sufficiently stated, but encouraged the franchisor to amend the complaint to allege more specifically what secrets were misappropriated.

A particularly interesting analysis of whether information was a trade secret appears in the Ohio court of appeals opinion in Mack Trucks, inc. v. Motor Vehicle Dealers Board.\textsuperscript{49} A truck manufacturer terminated a franchised dealer on various grounds, including that the dealer sold confidential trade secret information a competing manufacturer of truck parts. The franchisee protested the termination to the state’s Motor Vehicle Board, which found that the shared information was not a trade secret and that the franchisee was not required to keep the information confidential. The franchisor appealed to a trial court which affirmed the Board’s decision.

The information was a parts assembly database containing specifications for one million different vehicles. The database showed which parts were on each vehicle and how the parts uniquely fit together, in view of each Mack truck being custom built. The database explained which parts were updated or replaced with newer parts.

The appellate court reversed, agreeing with the franchisor that the parts data was a trade secret and the franchised dealer violated a confidentiality obligation in providing the information to a competitor. The appellate court’s opinion discussed the definition of a trade secret, and listed various factors to be considered in deciding if a trade secret is present:

(1) the extent to which the information is known outside the business;

(2) the extent to which it is known to those inside the business,

(3) precautions taken by the holder of the trade secret to guard the secrecy of the information;

(4) savings effected and value to the holder in having the information withheld from competitors;

(5) the amount of effort or money expended in obtaining and developing the information; and

(6) the amount of time and expense it would take for others to acquire and duplicate.

\textsuperscript{49} 2006 WL 1495122 (Oh. App. 2006).
The court found that the information satisfied the requirements to be a trade secret, stating:

MACSPEC 2001 is a computer program that derives independent economic value from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use. The MACSPEC 2001 system contains specifications of nearly every Mack vehicle. Every Mack vehicle is custom produced to the individual customer's specifications; thus, without knowing which parts are used and how the parts fit together in any particular custom vehicle [the competing parts maker] would be unable to determine which parts are necessary to repair a Mack owner's vehicle. The economic value of the MACSPEC 2001 system is patently derived from a competitor's difficulty in servicing a customer's Mack vehicle without the system, while a Mack dealer with the MACSPEC 2001 would be able to determine the necessary parts and how they fit together instantly via access to the assembly record for the customer's particular vehicle.\(^{50}\)

Regarding cost and value of the program, the court stated:

[Mack's manager of publications] said the system cost $34 million to develop and would be extremely valuable to a competitor. [An operations manager at an authorized Mack dealer] agreed that dissemination of the MACSPEC 2001 program to non-authorized service dealers would be harmful to Mack and its dealers. [Mack's senior vice-president of sales] testified that divulging the MACSPEC system to a competitor would cause significant and possibly irreparable economic harm to Mack. Toledo Mack's parts manager . . . admitted that having access to the information contained in the MACSPEC 2001 system would help [the competitor] compete with Mack.\(^{51}\)

The decision, though unpublished, is particularly interesting and illuminating as to the existence of a trade secret, and as to evidence and argument made on either side of the dispute, apparent from the contrasting analyses between the court of appeals and the Motor Vehicle Board.

An issue in trade secret jurisprudence today is the question of inevitable disclosure. That is, whether a claim of trade secret misappropriation may be established by proving that a defendant's actions will inevitably or unavoidably lead him or her to rely on or use the plaintiff's trade secrets.

\textit{PepsiCo v. Redmond}\(^\text{52}\) is a seminal decision. A longtime PepsiCo general manager was hired away by a competing beverage manufacturer. He had been privy to PepsiCo's highly

\(^{50}\) 2006 WL 1495122 at *6

\(^{51}\) 2006 WL 1495122 at *6

\(^{52}\) PepsiCo, Inc. v. Redmond, 54 F.3d 1262 (7th Cir. 1995).
confidential strategic plans containing financial goals, strategies for manufacturing, production, marketing, packaging and distribution, promotional events calendars, growth expectations, "attack plans" for specific markets and Pepsico's architecture for pricing products in the marketplace. Pepsico argued that he would "inevitably disclose that information" to his new employer. The court ruled that "unless Redmond possessed an uncanny ability to compartmentalize information, he would necessarily be making decisions about products at his new employer "by relying on his knowledge of [Pepsico] trade secrets." On this basis the 7th Circuit Court of Appeals affirmed an injunction against the individual assuming his duties at the new employer.\(^{53}\)

The "inevitable disclosure" doctrine has not been accepted in every jurisdiction. Some courts have expressly rejected the doctrine.\(^{54}\) A U.S. District Court in Missouri rejected application of the doctrine, noting that it should be applied rarely, and that exposure to trade secrets does not create an automatic inference of inevitable disclosure. Rather, applying the theory requires proof of facts indicating the nature of the secrets at issue and the nature of the relationships justify an inference that the person cannot help but consider secret information.\(^{55}\)

The doctrine has, however, been applied in the context of franchising. In *Jackson Hewitt, Inc. v. JSE Business Development*,\(^{56}\) the franchisor sued to enforce a post-termination obligation, including a two-year post term noncompetition restriction. The court found the former franchisee, by retaining client files after termination, posed a threat of irreparable harm, based on a likelihood of inevitable disclosure of the information.\(^{57}\)

H. **Franchise Pre-Sale Disclosure Issues.**

Trade secrets are a subject of pre-sale disclosure requirements under the Franchise Disclosure Document ("FDD"). Most franchisors treat their operating manuals as confidential trade secrets. But Item 11 of the FDD requires the franchisor to disclose the operating manual table of contents, the number of pages devoted to each subject and the total number of pages in the manual. The franchisor may omit this disclosure by offering the prospective franchisee the opportunity to view the manual before buying the franchise. But letting a prospective franchisee view the manual without an obligation of confidentiality, could waive trade secret status. Therefore, a franchisor will typically either require the prospective franchisee to enter into a

\(^{53}\) *Id.*, 54 F.3d at 1269, 1271.


\(^{56}\) 2009 WL 5205983 (D.N.J. 2009).

\(^{57}\) *Id*. Also, passing reference was made to the ability to prove misappropriation based on inevitable disclosure in another franchise termination decision, *American Express Financial Advisors v. Yantis*, 358 F.Supp.2d 818, 833 (N.D. Iowa 2005).
confidentiality agreement before viewing the manual, or will make disclosure of only the manual table of contents (in the FDD) before the prospective franchisee enters into a franchise agreement with its confidentiality restrictions.

FDD Item 14 provides for disclosure whether the franchisor owns rights in, or licenses to patents or copyrights that are material to the franchise. The FDD instructions also call for disclosure if the franchisor claims proprietary rights in confidential information or trade secrets, requiring a description of the general terms of the proprietary information communicated to the franchisee and terms for use by the franchisee. To permit the franchisor to protect confidentiality, only a description of the general nature of the proprietary information is required, such as whether a formula or recipe is considered to be a trade secret.

In FDD Item 17, a franchisor must identify, by section number, any in-term or post-term noncompetition covenant in the Franchise Agreement. The Item 17 table also requires the franchisor to provide a summary of the provision. Some franchisors elect to mention in the summary that the noncompetition restriction's purpose, or among its purposes, is to protect trade secrets of the franchisor.

The required disclosure about trade secrets may, on occasion, become a liability to the franchisor. In Morris v. International Yogurt Co., the franchise agreement said the yogurt mix was unique and its formulated manufacturing process was a trade secret. The disclosure document (at the time, called a Uniform Franchise Offering Circular or UFOC) said "the yogurt mix used in the preparation of 'The Yogurt Stand' frozen yogurt is considered a unique and special formula." The Washington supreme court considered these statements important in agreeing with a franchisee claim of material nondisclosure by the franchisor. The franchisor had not revealed that the manufacturer also sold the mix to other customers.

The court noted that "neither the franchise agreement nor the offering circular stated that the mix was available to anyone other than IYC and its franchisees." The court found that the proprietary nature of the yogurt mix was a significant factor to potential franchisees, and therefore the franchisor's failure to disclose the availability of the yogurt mix to nonfranchisees was an omission of material fact. In deciding whether to buy the franchise, a reasonable person "would have considered it important that the same yogurt mix was available to persons not purchasing the franchise. The fact that an essential component of the franchise's major product is unique and considered a trade secret is of far less value to the potential franchisee if that ingredient is generally available to all persons whether or not they have purchased the franchise."

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58 Before entering into any agreement with a prospective franchisee, including a confidentiality agreement, the franchisor must provide required disclosures and allow the applicable cooling off period to elapse.


60 Id. at 34.

61 Id.

62 Id. at 40.
In other words, the existence and general nature of trade secrets, disclosed in the FDD, may be a material fact to prospective franchisees. This disclosure may result in an additional obligation by the franchisor to also disclose other material facts concerning the trade secrets, such as whether the secrets (or the products in which they are embodied) are available to others.

I. **Trade Secret Audits**

Franchisors (and in some instances, franchisees) who possess trade secrets may determine that they have sufficient value to be worth identifying, inventorying, and evaluating the level and effectiveness of the company's protection measures. These steps may be taken on an ongoing basis. Or they may be conducted in a trade secret audit.

A rancher might categorize and count their cattle, and inspect corrals and fences to assure chattel stay on the ranch and are safe against escape, attack and theft. The rancher would repair broken and decaying railings and posts. Likewise, a product manufacturer may count inventory and inspect security at its warehouse and along its distribution and delivery system. Trade secrets, in contrast, are intangible. They can neither be counted, nor corralled the same as tangible properties. But they can be inventoried. And measures taken to protect trade secrets against unintended disclosure and theft can be inspected, repaired, modified and supplemented.

In a franchise system, typical trade secret elements include any one or more of the operations manual, operating procedures, product recipes, sources of supply, customer data, upcoming (unannounced) marketing initiatives, and new products and services in development. In almost every company there is additional information that provides the organization a competitive advantage, that the company considers secret and takes reasonable steps to protect. At one company this may include compensation terms of a key employee. At another company, the secret may be special pricing and other terms offered to select customers. Elsewhere, secret negotiations may be ongoing for a possible acquisition. Or the drafting may have begun of an application for a new patent. There are also negative trade secrets, like a product formula that does not work, poor results of a discontinued product line, or a new line of service that was analyzed and rejected.

A basic trade secret audit begins with making an inventory of the organization's valuable, confidential information. The inventory is in essence a list, identifying categories of information that meet the law's definition of a trade secret. In the process of making this list, the company may identify information categories that had not previously been recognized as having value as trade secrets.

The next phase of a basic audit is to identify measures that the company takes to protect confidentiality of its secrets. Some measures may be so routine as to never have required special attention (locking the business premises each day; using passwords and firewalls to block unauthorized access to the company's computers; politely reminding personnel not to discuss confidential information with third parties). Other measures may have been carefully adopted for the protection of secrets (encoding sensitive computerized data, placing confidentiality notices on the cover page of confidential manuals and confidential reports, prohibiting photocopying of sensitive data).
A third phase of a basic audit is to assess effectiveness of measures being taken to protect company secrets. This includes both past effectiveness and how likely the methods are to be successful in the future. This step may include assessment of personnel's willingness to protect company information, issues regarding employee mobility, risks of accidental or inadvertent disclosures involving personnel, suppliers, customers and malevolent third parties (like computer hackers), and the level of aggressiveness of competitors who might seek to acquire the company's information.

A further phase of a basic audit is evaluating protection measures for their reasonableness. Reasonableness may be based on any number of factors: effectiveness at protecting the secret, cost of the measure and cost-justification compared to the value of the secret, cost compared to other available measures, practicality of implementing the measure, are examples.

Based on effectiveness and reasonableness, a company may decide whether any existing protection measures could be abandoned or modified, corrective steps that should be taken, and whether new or additional measures should be implemented.

J. Protection of Trade Secrets When Suppliers Provide Proprietary Products

When proprietary products with trade secret ingredients or secret recipes are involved, franchisors typically seek to be alert to protect the confidentiality of that information. Most often this is accomplished by some combination of: (i) selecting manufacturers and suppliers who can be relied on to respect confidentiality, and protect confidential information; (ii) entering into written agreements with such manufacturers, requiring them to protect the secrecy of recipes and processes used to manufacture products for the franchisor's system; and (iii) ongoing policing and monitoring to assure that products which are supposed to be restricted to only the franchisor's supply chain, are not diverted elsewhere.

K. Post-Termination Protection

Another step in protecting secrets is to require suppliers, franchisees, employees and others with whom the company deals, to agree not to work for, provide services to, or distribute products of, a competitor, or engage in activities that compete with the franchisor. During the term of the franchise agreement or other business relationship, these provisions may be referred to as "exclusive dealing" clauses. Provisions that take effect on expiration or termination, are more likely to be referred to as post-term restrictive covenants, or noncompetition agreements.

Historically, the law disfavored enforcement of restrictive covenants as conflicting with public policy that encourages free competition. But this disfavor is not universal. In some jurisdictions, "the disfavor with which common law courts once looked upon non-competition clauses as unreasonable restraints on trade and against public policy has given way to a willing

63 See e.g., Interim Health Care of Northern Illinois v. Interim Health Care, Inc., 225 F.3d 876, 879 (7th Cir. 2000) ("because Illinois courts favor competition and frown on restraints on trade, we must strictly construe noncompetition agreements against the party seeking restriction.") (internal punctuation omitted).
acceptance of covenants not to compete where agreements are voluntary and reasonable. While the law frowns upon unreasonable restrictions, it favors the enforcement of contracts intended to protect legitimate interests, for it is as much a matter of public concern to see that valid covenants are observed as it is to frustrate oppressive ones. Thus, restrictive covenants may be enforceable when reasonably needed to protect legitimate business interests of the franchisor, such as protecting trade secrets, and are reasonably limited in time, geographic scope and scope of restricted activity. In some states, a court that finds a restrictive covenant to be overbroad, has authority to "blue pencil" the restriction, which means reducing its scope to what the court views as reasonable, and enforcing the restriction as reduced.

California law on enforceability of restrictive covenants to protect trade secrets, warrants particular attention. California has a general rule that prohibits enforcement of restrictive covenants. A California statute provides that, subject to certain exceptions stated in the statute, "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind, is to that extent void." For many years California courts recognized a judicially created exception to this rule, where a restrictive covenant's purpose was to protect trade secrets. Recent California decisions have raised significant doubt whether the trade secret exception still exists, however.

In Edwards v. Arthur Anderson the California Supreme Court ruled that Section 16600 prohibits employee noncompetition agreements unless the agreement falls within a specific statutory exception. In a footnote, the Edwards court said: "We do not here address the applicability of the so-called trade secret exception to section 16600." While the California supreme court did not expressly rule on the question, an intermediate appellate court has stated

64 Reynolds and Reynolds Co. v. Tart, 955 F.Supp. 547, 552 (W.D.N.C. 1997) (internal citation and punctuation omitted).

65 See, e.g., Medi-Weightloss Franchising USA, LLC v. Sadek, 2010 WL 1837767 (M.D.Fla. 2010) (party seeking to enforce restrictive covenant must plead and prove legitimate business interests justifying the restrictive covenant and that the restriction is reasonably necessary to protect such interests; legitimate interests include trade secrets); National Reprographics, Inc. v. Strom 621 F.Supp.2d 204, 222-223 (to be enforced, restrictive covenant must be reasonably necessary to protect legitimate business interests, but covenant will not be enforced beyond geographic area and time period needed to protect such interest).


68 See Dowell v. Biosense Webster, Inc., 179 Cal.App.4th 564, 575-576 (citing prior decisions claimed to have established a judicially created trade secret exception to Business & Professions Code Sec. 16600).


70 44 Cal.4th at 946.
that "we doubt the continued viability of the common law trade secret exception to covenants not to compete."\textsuperscript{71}

Franchisors can be expected to continue to require confidentiality and restrictive covenants from manufacturers in their supply chain. Because the enforceability of such covenants varies widely between different states, franchisors may wish to factor into the process of selecting suppliers, the choice of law that may govern the parties' relationship, both during the term of the agreement, and afterward.

III. COPYRIGHTS

A. What is a Copyright?

Unlike trade secret and trademark law, where all or at least some of the rights afforded the owner derive from state law, copyright is almost entirely a product of federal law. Copyright is one of the two forms of intellectual property rights contemplated by the U.S. Constitution.\textsuperscript{72} With limited exception, federal copyright law will preempt in the event of a conflict with other laws.

Under the 1976 Copyright Act (the "Copyright Act"), copyright protection is available for "original works of authorship fixed in any tangible medium of expression."\textsuperscript{73} The owner of a copyright has the exclusive right to: (1) reproduce the work and copy it; (2) prepare derivative works based upon the copyrighted work; (3) distribute copies of the work to the public; and (4) for certain kinds of works, publicly display the copyrighted works.\textsuperscript{74} These rights apply equally to digital and analog works.

For the purposes of copyright law, a work is original if it is the author's own independent work. The degree of originality required is minimal, and copyright protection does not depend on the artistic or intellectual merit of the work. All the rights described above are collectively referred to as "copyright" and belong exclusively to the author of the work as soon as the form of expression is "fixed" in a tangible form (e.g., as soon as an idea is written down or a photograph is taken).

It is important to understand that copyright ownership and ownership of the material object in which the copyright is embodied are not the same. To put it another way, the owner of the physical object, for example, a John Grisham novel, has the right to do what he or she wishes with the tangible material comprising the novel. But as to the expression contained in the novel, he or she generally cannot exercise the exclusive rights of copyright ownership -- e.g., make copies of or make derivative works from the Grisham novel -- without the express

\textsuperscript{71} Dowell v. Biosense Webster, Inc., 179 Cal. App.4th 564, 577.

\textsuperscript{72} Constitution Article I, Section 8: "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."

\textsuperscript{73} 17 U.S.C. § 102.

\textsuperscript{74} 17 U.S.C. § 106.
authorization of the copyright owner. Another important caveat regarding copyright law is that copyright protects against *copying* but not—as is the case with patents—against *independent creation*; if someone independently creates the same work (as unlikely as that might be), copyright law provides no remedy.

B. **What Is and Is Not Protected by Copyright**

1. **Types of Works Protected**

Over the years, Congress and the courts have extended copyright protection to a wide range of creative works. The current copyright law identifies the following categories of protected subject matter:

- literary works (e.g., franchise system operations manuals, advertisements, menus, scripts, promotional materials, software)\(^{75}\);
- musical works (e.g., advertising jingles);
- architectural works (e.g., the distinctive shape of a franchise system’s prototypical building or façade);
- dramatic works (e.g., plays);
- pantomimes and choreographic works;
- pictorial, graphic and sculptural works (e.g., photos used in a franchise system’s advertisements, artwork displayed in franchisee locations, graphics displayed on social media websites, signage\(^{76}\));
- motion pictures and other audiovisual works (e.g., television commercials and videos for franchise systems);
- sound recordings (e.g., songs and/or music recorded as background for a franchise system’s radio advertisements; music played on franchisee locations for the benefit of customers); and
- vessel hull designs.

Although many franchisors have few registered copyrights, a franchisor that asserts that it does not own any material copyrights may be surprised to find that an audit of its intellectual property rights would reveal numerous copyrights that in fact may be viewed as material to its system (e.g., operations manuals, menus, advertising materials, commercials, graphic art, and more).

In addition to the foregoing, copyright law also recognizes two special categories of works that are comprised of pre-existing materials—derivative works and compilations. A derivative work is a work based on one or more pre-existing works in which the underlying work

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75 Note that copyright protection would arguably be available for a franchisor’s legal documents and franchise disclosure document as literary works. Some such documents bear copyright notices, reflecting that the franchisor or sometimes their legal counsel, claim copyright ownership in their contents. Such protection could potentially be “thin,” in particular where a court finds there are only a limited number of ways to express particular legal provisions.

76 For an example of a dispute involving copyrights in a franchise program’s signage, see *Thomsen v. Famous Dave’s of America, Inc.*, 606 F.3d 905 (8th Cir. 2010).
is "recast, transformed or adapted." For instance, when a print advertisement featuring a photograph and associated text is updated or modified for use in a new advertising campaign, a separate derivative work may be created. A compilation, on the other hand, is a work "formed by the collection and assembling of pre-existing material or of data that are selected, coordinated, or arranged in such a way that the resulting work as a whole constitutes an original work of authorship." For example, an Internet web site comprised of pre-existing elements drawn from a company's already-developed marketing and promotional materials (including text, images, video clips etc.) qualifies as a compilation.

There are two important considerations of which authors must remain mindful for derivative works and compilations. First, copyright in the derivative work extends only to the new and original material added by the second author. Under this rule, for example, a musician who creates a new arrangement of an old favorite no longer protected by copyright (i.e., in the public domain) will obtain rights only in the new and original aspects he adds to the old song (and not in the pre-existing material). Second, copyright in a compilation is limited to the compilation author's original expression (i.e., the selection and arrangement of the pre-existing elements); the compilation author does not obtain rights in the underlying elements themselves.

2. Public Domain and Other Exclusions from Protection

The public domain is a repository of works that for various reasons are not protected by copyright. A work that is in the public domain may be freely used by anyone for almost any purpose without permission. Works may enter the public domain for a variety of reasons: for example, the copyright may have expired. Once a work enters the public domain, it can never regain copyright status.

Certain other works are categorically excluded from copyright protection from the moment of creation. For instance, words and short phrases such as names, titles, and slogans generally are not eligible for copyright protection. Moreover, the Copyright Act explicitly provides that copyright protection does not extend to "any work of the United States Government." It is also important to recognize that, although the Copyright Act bars copyright protection for works of the federal government, this statutory prohibition does not apply to works of state governments and their political subdivisions. Practically speaking, although public policy probably prevents state and local governments from claiming copyright in the texts of statutes, ordinances, and similar official public documents, other state and local publications, such as those containing historical, technical, educational, or other proprietary informational material, may be subject to copyright protection.

3. First Sale Doctrine – Exception to Exclusive Right of Distribution

Although a copyright owner generally has the exclusive right to distribute copies of his/her work to the public, the lawful possessor of a particular copy of that work has the right to further distribute that work without the copyright owner's consent. A classic example is the purchase of a book – the owner of the copy of the book has the right to resell that copy or give it

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to whomever he/she wishes without violating the copyright owner’s distribution right. Moreover, applying the first sale doctrine in the digital environment (particularly for “born digital” works) and consideration of possible expansion to the “digital first sale” doctrine can, however, be challenging.  

C. When a Work Becomes “Copyrighted”

One of the most misunderstood aspects of copyright is the way to secure protection. Unlike a patent, there is no requirement of an application or examination. Instead, under current copyright law, copyright protection begins at the moment that an original work of authorship is fixed in a tangible medium of expression.  

1. The Fixation Requirement

A work becomes “fixed” for copyright purposes when its “embodiment in a copy . . . , by or under the authority of the author, is sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration.” The lack of significant permanence of the copy made is not necessarily dispositive on the issue of fixation. For example, courts addressing this issue in the digital environment have held that information stored in a computer’s random access memory is sufficiently permanent to satisfy the fixation requirement.

The manner and medium of fixation are virtually unlimited. For instance, a musician may use a tape recorder to capture creative expression, while a novelist uses a computer and word processing software. Congress anticipated that the technology used to capture creative expression would continually change and evolve. Accordingly, the copyright law states that a fixation may be in any tangible medium “now known or later developed, and from which the work can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device.”

2. The “Originality Requirement”

The standard for what constitutes an original work of authorship is not rigorous and requires only a minimal level of creative spark. As the Supreme Court recently explained: “Original, as the term is used in copyright, means only that the work was independently created by the author (as opposed to copied from other works), and that it possess at least some

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79 Securing copyright protection in the U.S. has changed in the last several decades. Before January 1, 1978, works published in the U.S. needed to have proper notice of copyright as a condition of protection. The failure to include such a notice usually meant the work entered the public domain. In 1989, Congress eliminated the notice requirement as a condition for obtaining copyright protection.

minimal degree of creativity."\textsuperscript{81} To meet this standard, a work need not be novel, ingenious or even have artistic or aesthetic merit; it need only have a minimal level of creative spark.

3. \textbf{Copyright Registration}

Under current copyright law, a work does not have to be registered with the U.S. Copyright Office to be protected, but there are a number of significant benefits in doing so. First, registration establishes a public record of the copyright claim. Second, for U.S. entities, registration is generally required before the copyright owner can bring an infringement action in court.\textsuperscript{82} Further, if registration occurs before or within five years of first publication, the registration will constitute prima facie evidence of the validity of the copyright and of the facts stated in the registration certificate.\textsuperscript{83} Additionally, if a work is registered within three months after first publication, or prior to an infringement of the work, the enhanced remedies of statutory damages and attorneys’ fees will be available to the copyright owner in a successful infringement suit.\textsuperscript{84}

Registration can be accomplished on-line at the U.S. Copyright Office website\textsuperscript{85} or via paper application, though the Copyright Office prefers and provides modest application fee discounts as an incentive to use the electronic filing system where available.\textsuperscript{86}

Franchisors are typically reluctant to seek to register the copyright in any materials that embody trade secrets (\textit{e.g.}, operations manuals) as submitting an application for copyright registration normally makes public a copy of the material in which the copyright rights are claimed as the application process requires the submission of one or two “deposit copies” of the work. These deposit copies are available for public inspection on-site at the Copyright Office. The Copyright Office does, however, provide a process for asserting that some of the material in the copyrighted work is also subject to trade secret protection and offers several alternative options for redacting the deposit copy materials. Whether these provide adequate protections


\textsuperscript{82} In some jurisdictions, a pending application for registration may be sufficient. (A registration is not needed where the owner has sought copyright registration but was denied registration by the Copyright Office.) Foreign copyright owners do not need to have a registration to sue for infringement in the US. Where a registration is needed on an expedited basis, the Copyright Office provides a vehicle for reducing the typical registration issuance period of 4 to 24 months (as of May 2010) to approximately two weeks for a fee of $760 (as of May 2010).

\textsuperscript{83} 17 U.S.C. § 410(c).

\textsuperscript{84} 17 U.S.C. § 412.

\textsuperscript{85} See \url{www.copyright.gov}; see in particular the “Electronic Copyright Office (eCO)” site at https://eco.copyright.gov/eService_enu/start.swf?SWECmd=GotoView&sn=fSSACZ90CsdHn8lfAPFguzKLGE9WSXJOcxlKHzdLgZSk&SWEView=HomePage+View+%28eService%29&SWEHo=eco.copyright.gov&SWETS=1276123900.

\textsuperscript{86} As of August 1, 2009, the fee for filing an application for copyright registration electronically is $35; the fee for using a paper version of an on-line form with a Copyright Office barcode is $50; and the fee for a paper filing using the prior individual application forms is $65. See \url{http://www.copyright.gov/docs/fees.html}. 
to safeguard the trade secret status of important works such as operations manuals remains subject to debate.

Another benefit of copyright registration is that a copyright owner may record a registered copyright with the U.S. Customs Department. In practical terms, this is most relevant to copyrights embodied in consumer goods (e.g., software, music recordings, DVDs, toys, and the like) and may not provide notable benefits to most franchise systems. That being said, given the relatively low costs associated with seeking copyright registration(s) and recording them with the US Customs Department, franchise systems that sell or give away goods that are easily counterfeited may wish to proceed accordingly as these measures could help to stop or at least slow the importation of counterfeit goods.

4. **Benefits of Copyright Notice and the Form of Notice**

Though copyright notice is not required for works created after March 1, 1989, copyright law maintains potentially important incentives for copyright owners to display copyright notice on copyrightable works. First, it identifies the author and provides the date of publication. Second, it provides warning to potential unauthorized users that the copyright owner is aware of its rights and deprives an alleged infringer of the “innocent infringement” defense, which would otherwise be available to reduce a damage recovery.

D. **Copyright Ownership**

1. **Work Made For Hire Doctrine**

When one party authors a work for another party, “work made for hire” principles may serve to establish which party obtains the copyright in the work. This circumstance is common in franchising, where a franchisor may hire others to create or assist in creating such materials as operations manuals, franchise announcements, marketing announcements, advertising art, commercial art, marketing materials and other system related materials. These multi-party arrangements generally can be divided into three categories.

The first category includes works prepared by an employee within the scope of his or her employment.\(^{87}\) In these cases, the copyright in the work belongs to the employer at the outset as if the employer wrote or otherwise authored the work. For example, if a franchisor has its employees create its operations manual, the copyright in that manual is owned by the franchisor as soon as they create the manual.

The second category of works made for hire includes works that fall within one of the nine classes of “specially ordered or commissioned works” specified in the Copyright Act.\(^{88}\) If a commissioned work falls within one of these nine classes of works\(^{89}\), and both parties agree in


\(^{88}\) Id.

\(^{89}\) A work specially ordered or commissioned for use as a contribution to a collective work, as a part of a motion picture or other audiovisual work, as a translation, as a supplementary work, as a compilation, as an instructional text,
writing that the work shall be considered a work made for hire, then the commissioning party is considered the author for copyright purposes. In the absence of a written and signed agreement designating the work a work made for hire, however, the copyright otherwise belongs to the independent contractor.

The third category includes works authored by independent contractors that do not fall within one of the nine special classes of works. The copyright in these works belongs to the independent contractor, not the party on whose behalf the work was prepared (despite the fact that the commissioning party paid for the creation services), although the independent contractor may thereafter assign his or her rights to the commissioning party. For example, if a franchisor engages a photographer to take photos for a promotional campaign (or brochure or its website), absent an assignment from the photographer, the franchisor will not own the copyright in the photos and may therefore may not have the unfettered right to use the photos outside the original intended use.

Some franchisors include copyright assignment provisions (sometimes subsumed within an “innovations” clause) in their franchise agreements to ensure that the copyright in works that franchisees create (as well as derivative works that improve on the original) that relate to the franchise system are transferred to the franchisor automatically. Alternatively, a franchisor could include a provision giving it a non-terminable, transferable license to use such works. In the absence of any pertinent provision, upon termination or expiration of the franchise agreement there may be uncertainty as to whether either the franchisor or franchisee may use the work in question (though use by the franchisee thereafter may trigger other concerns such as trademark infringement, trade dress infringement, and violations of restrictive covenants).

Franchisors and franchisees alike that operate in California should be aware of a peculiar law that seems to automatically convert independent contractors in California into employees. This is triggered where a contractor executes a work for hire agreement intended to initially vest the copyright in the commissioning party. Typical language used in an independent contractor agreement to deal with copyright ownership issues might yield unexpected results from an employment law perspective in California. This issue should be taken into account when preparing or reviewing any independent contractor agreements (where the contractor is in California). In those cases, it may be preferable to use simple copyright assignment language rather than “work for hire” language, even though this approach would provide the contractor with the right to reclaim the copyright in the work 35 years later. Otherwise, California law may bestow on a contractor whatever statutory rights an employee possesses.

as a test, as answer material for a test, or as an atlas. Id.

90 Id.

91 California Labor Code Section 3351.5 (c) states that “Employee includes”... "Any person while engaged by contract for the creation of a specially ordered or commissioned work of authorship in which the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire, as defined in Section 101 of Title 17 of the United States Code, and the ordering or commissioning party obtains ownership of all the rights comprised in the copyright in the work."

2. **Joint Ownership**

In the corporate franchise setting, creative activity is likely to occur through the efforts of several employees working together and/or with independent contractors. In such instances, copyright law may recognize more than one author for a particular work. The broad rule governing joint authorship is that if an author creates a work with the intention that his or her expression be merged into inseparable or interdependent parts of a separate whole, then the resulting work will be considered a "joint work." Each author of a joint work has a claim to the entire work and is entitled to the benefits of ownership in that work. Though there is no requirement that the respective contributions of each author be equal in either quality or quantity, courts generally require that a contribution be copyrightable on its own to merit joint authorship status.

Joint ownership (as opposed to full ownership obtained by an employer under the work made for hire doctrine, for example) could significantly impede a franchisor’s ability to capitalize on the copyright. In the absence of an agreement to the contrary, the joint owners share equally in the ownership of the copyrighted work. Accordingly, each joint owner is entitled to take numerous unilateral actions concerning the work -- even actions that could seriously jeopardize the ability of the other joint owners to exploit their rights in the work. For instance, a joint owner may assign his or her interest in the work without obtaining the consent of the other joint owner(s).

E. **Transfer of Ownership**

Like tangible property, such as a piece of equipment or real estate, copyright interests may be transferred to third parties. The grant of a right on a non-exclusive basis (e.g., a non-exclusive license granting a third party the right to make a limited number of copies of a work) is not required to be in writing. As such, such a transfer can be made through an oral agreement or it can be implied through the conduct of the parties.

In contrast, the transfer of one or more of the rights of a copyright owner to a third party on an exclusive basis (e.g., an exclusive license to publish a novel in a paperback version), or the complete assignment of all copyright interests, require a writing signed by the owner of the right(s) conveyed. The holder of an exclusive license is entitled to all the protection and remedies of the original owner, including the right to bring a copyright infringement suit against any third parties that infringe the particular right(s) granted. A transfer or assignment of these exclusive rights may not be absolute because the Copyright Act includes a provision that permits a transferee (or his or her heirs) to revoke a prior assignment or license approximately 35 years after the original grant was made.\(^9\)

Like other forms of property, copyrights may also serve as collateral for loans and other obligations. Security interests, mortgages, and collateral assignments of copyrights may all serve as vehicle to document the role that copyrights (or contract rights pertaining to copyrights) play when serving as security for a loan. From the lender's perspective, precisely how and where to perfect a security interest in a copyright depends on whether the copyright is

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registered and whether the right is exclusive or nonexclusive, the domicile of the copyright rights holder and other factors.

F. Copyright Duration

Copyright does not last indefinitely and over the years Congress has modified the term of copyright five times. Although the law at any one time has been fairly simple, the cumulative effect of all these changes has made the deceptively simple question of "how long does copyright last?" somewhat complicated to answer. In view of the lifespan of most manuals, advertising art, and other creative work used in a franchise setting, and the practical realities of the business world, which require updating and change from time to time, the extensive length of copyright protection often means copyright rights will outlast the useful life of many creative works used in the franchise system.

1. Works Created On or After January 1, 1978

For works created on or after January 1, 1978, copyright protection begins with the creation of the work and lasts for the life of the author plus 70 years. Copyrights in works of joint authorship (other than works made for hire) last until the end of the year of the 70th anniversary of the last surviving author's death. Anonymous or pseudonymous works (if the name of the author is not revealed) and works made for hire are protected for 95 years from the date of first publication, or 120 years from the date of creation, whichever is shorter.

2. Unpublished Works Created Before January 1, 1978

For works created before January 1, 1978, but never published or registered as unpublished works with the Copyright Office before that date, the same duration rules discussed above generally apply.

3. Works Created and Published Before January 1, 1978

The rules for determining the copyright term for works created and published before January 1, 1978, are complex. The copyright term for these works is not measured by the life of the author. Instead, the term for these works lasts for a fixed period beginning on the date of publication or registration (for unpublished works) and extending anywhere from a minimum of 28 to a maximum of 95 years, depending on the circumstances.

G. Copyright Infringement

1. Elements of Copyright Infringement and Who Can Be Sued

To bring a successful copyright infringement claim, the copyright owner must show (1) ownership of a valid copyright, and (2) that the defendant copied the protected work. The plaintiff may prove that the defendant copied the work either through direct evidence or by showing that the defendant (1) had access to the protected work and (2) a substantial similarity exists between the protected work and the allegedly infringing work. As noted above, copyright law protects against copying but not against independent creation. Consequently, there is no infringement if someone merely independently creates the same or a substantially similar work (as unlikely as that might be).
Any violation of the exclusive rights of the copyright owner (e.g., the right to reproduce or distribute the work, or prepare derivative works based on the original) is considered an infringement. These rights may be infringed “directly” by doing an act (whether intentional or unintentional) with respect to a copyrighted work without permission of the copyright owner. One may also infringe another’s rights “indirectly” by causing, inducing, or materially assisting in an infringing act with knowledge of or reason to believe it is infringing (i.e., “contributory infringement”) or by being in a position to supervise or control the infringing activity and gaining a benefit from it (i.e., “vicarious infringement”).

A copyright infringement, or the infringement of other intellectual property rights for that matter, is a tort for which personal liability may attach. As such, a franchisor’s or franchisee’s corporate officers, directors, and employees are not necessarily immune from personal liability for infringing acts that are committed while they are discharging their duties to the corporation and/or within the scope of their employment. Though officers, directors, and senior managers are not necessarily strictly liable for all acts of their subordinates, they may be held to account for acts which they had a material role in directing.

2. Remedies for Copyright Infringement

The Copyright Act provides two types of monetary relief: actual damages and statutory damages. Actual damages include damages suffered as the result of the infringement (e.g., lost profits, injury to market value of work) and profits made by the defendant attributable to the infringement. As an alternative to actual damages, which may be difficult to prove in certain circumstances, the Copyright Act permits plaintiffs to recover statutory damages, provided the plaintiff registered its copyright before the infringing conduct began or within three months of first publication of the work.

A court has wide discretion in imposing statutory damages, which may range from $750 to $30,000 for each work infringed (but may go as high as $150,000 if the infringement is willful). If the infringer shows it was not aware and had no reason to believe that its acts constituted copyright infringement (so-called “innocent” infringement), the court may reduce the award to not less than $200 per infringed work. Importantly, reproducing ten different works, one hundred times each, would constitute ten (not one thousand) separate acts of infringement for which statutory damages would be available.

In addition to actual or statutory damages, costs and attorneys’ fees may be awarded to a prevailing party that had registered its copyright prior to the commencement of the infringing conduct. Further, a plaintiff may be entitled to temporary or permanent injunctive relief against

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95 See 17 U.S.C. § 504(b).
96 See 17 U.S.C. § 504(c).
97 Id.
a defendant’s infringing conduct. The copyright law also includes criminal sanctions for certain counterfeiting activities.

H. Fair Use as a Limitation on Copyright Owners’ Exclusive Rights

Although the rights granted to copyright owners under the copyright law are broad and inclusive, there are limits. Courts have long recognized that certain uses, although technically infringements, should otherwise be protected as “fair uses.” The current copyright statute codifies this judicially established notion by providing, in relevant part, that “the fair use of a copyrighted work, including such use by reproduction in copies . . . for the purposes such as criticism, comment, news reporting, teaching . . . , scholarship, or research” is not an infringement.

Courts have not limited the fair use doctrine, however, to these listed purposes. Rather, courts look to the facts of each particular case and weigh four factors, discussed briefly below, to determine whether the particular challenged activities constitute a “fair use” or an infringement. The Supreme Court in 1994 stated that no one factor is dispositive and that all four factors must be weighed together.

1. Purpose and Character of Use

The first “fair use” factor is the “purpose and character of the use,” including whether such use is of a commercial nature or for non-profit educational purposes. The test focuses on the use, not on the user -- a commercial user can make “non-profit educational” use of material, just as a “non-profit educational” institution can make “commercial” uses. For instance, Rev. Jerry Falwell’s religious organization, Moral Majority, Inc., conceded that it used portions of Hustler magazine in part for fundraising (i.e., commercial) purposes, raising nearly one million dollars. In this case, however, balancing the factors of the test, the Ninth Circuit affirmed in favor of the religious organization, observing that, even assuming such use was for a purely commercial purpose, defendants’ use was “fair” because they had not used more than was reasonably necessary “to rebut the personal attack upon Falwell and make a political comment about pornography to comment on the magazine’s parody”; and because such use “could not have diminished any potential sales, interfered with the marketability of the parody or fulfilled the demand for the original work.”

In addition to examining the “commercial” nature of the use, courts also focus on whether the use of a protected work is a “transformative use.” If the use “adds something new” to the work, transforming “raw material” into “new information, new aesthetics, new insights, or understandings,” the balance shifts in favor of the defendant on this factor.

2. **Nature of the Copyrighted Work**

The more "creative" the work, the greater the scope of copyright protection. Courts are, therefore, more likely to apply the fair use defense to factual works, in part in an effort to avoid impeding the free flow of information and ideas. Consequently, reproducing an article from a web page, for example, that principally reports the facts of an industry event may more likely fall within the fair use defense than would reproducing a piece providing more analysis, speculation, and creativity.

3. **Amount and Substantiality of the Work Taken**

The third factor is the "amount and substantiality of the portion used in relation to the copyrighted work as a whole." For example, reproducing an entire newsletter or newspaper is qualitatively different from copying a single page. Likewise, reproducing a single page from a web site is different from copying the entire site.

The significance of these differences on the fair use analysis is not uniformly predictable. Indeed, the wholesale copying of some 86,000 articles in one year was found to be "fair use" when done by a medical library. On the other hand, the copying of eight articles for personal (but work-related) use by a Texaco scientist was found not to constitute fair use. Indeed, the Supreme Court has found that copying only approximately 400 words from President Ford’s memoirs did not constitute fair use, given the significance of the passage taken.

4. **Effect on the Potential Market**

The final fair use factor is "the effect of the use upon the potential market for or value of the copyrighted work." For instance, the systematic copying on a cover-to-cover basis of a newsletter that is available through subscription arguably deprives the publisher of a predictable subscription revenue stream. In the Texaco decision mentioned above, the court found that the photocopying of eight articles by a Texaco scientist did not constitute a "fair use" by relying heavily on the fact that a license covering the copying activity was readily and inexpensively available. An adverse decision for the publishers in that case, permitting copying under the fair use doctrine and not requiring such a license, would have substantially and adversely affected the market value of the publishers’ copyrights by depriving them of potential royalties.

I. **Examples of franchise programs that rely particularly on copyrights**

Some franchise programs rely to a significant degree on intellectual property comprised of copyrights. Currently, Jack in the Box, Inc. conducts a prominent advertising campaign making use of a distinctive character known as "Jack." The content of the commercials and

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imagery are likely protected by copyright. In another example, a franchisor of residential building companies invested significant sums to create and develop architectural designs. The franchisor's policy was "to claim promptly and to enforce consistently (indeed doggedly) copyrights for each protected architectural design."\textsuperscript{107} The franchisor and franchisee jointly sued and were awarded damages against a homeowner, builder and drafter for infringement of an architectural design.\textsuperscript{108}

J. Methods for Protecting Copyrights in Franchise Systems

Franchise systems use and rely on copyrighted material on a daily basis – in advertisements, training, sales, operations of franchised and corporate locations, and many other ways. Franchisors and franchisees alike should be careful to protect important materials subject to copyright. In addition to displaying a copyright notice on materials, they should consider which materials might warrant the added benefits of copyright registration. Moreover, there may be ways to enhance the protection through contract provisions (e.g., imposing limitations on the reproduction and use of materials that may be reproduced from a franchise system's external website; using password protections and copy-protections in system intranet sites).

In addition to copyright notice and registration, a number of commercially available computer system tools can further help secure copyrighted materials distributed over the Internet. Because of the variety of hardware and software used to access the Internet, electronic documents (particularly those that include graphic elements) may not retain the form you intend them to when accessed by others. Furthermore, third parties who access these materials may be able to manipulate them so as to re-transmit them in altered form. To avoid such results, there are increasingly available technological protection measures designed to ensure that proprietary material is not misused by third parties. These measures include using a digital watermark (formed by switching particular bits in a digital image); digital fingerprints; encryption; or software restricting access to authorized users, monitoring the number of users, or the nature of use.

Of course, even the most sophisticated technological measures are vulnerable to tampering. Congress recognized and attempted to address this concern in a recent amendment to the copyright statute known as The Digital Millennium Copyright Act ("DMCA").\textsuperscript{109} Among its provisions, the DMCA provides special protection against conduct that circumvents technological measures (such as encryption) controlling access to a copyrighted work.

The DMCA also includes provisions designed to insure the integrity of copyright management information ("CMI").\textsuperscript{110} CMI includes a broad range of information such as information that identifies the copyrighted work (e.g., title, author, and/or copyright owner); terms and conditions of use; and certain identifying numbers or symbols that accompany the above

\textsuperscript{107} Arthur Rutenberg Homes, Inc. v. Maloney, 891 F.Supp. 1560, 1562 (M.D.Fla. 1995).
\textsuperscript{108} Id. at 1568-1569.
\textsuperscript{109} 17 U.S.C. §§ 1201 - 1205.
\textsuperscript{110} 17 U.S.C. § 1202.
information. The law now prohibits the distribution of false CMI, the intentional removal or alteration of such information, and the distribution or importation of copies of works with the knowledge that CMI has been removed or altered.

Given the potential for personal liability for copyright infringement, franchisors and franchisees should take significant steps to ensure that their own activities do not infringe these rights. Indeed, failure to respect the copyrights of third parties may subject both the corporation, as well as the individuals responsible for the infringement, to significant civil and, in some cases, criminal penalties. With the fundamentals of copyright law outlined above in mind, the following section highlights some of the circumstances under which copyright problems and potential infringement liability exposure for franchisors and franchisees may most frequently arise. In addition to identifying the nature of the particular problem and risks it may pose, we offer the following suggestions, which include certain broad strategies, designed to reduce these potential risks.

1. **Photocopying Newsletters, Periodicals, and Other Written Materials**

Corporations often receive one copy of a newsletter or journal. The publication may reside in centralized location or be circulated throughout the office. Frequently, a publication may contain materials relevant to many employees. Simply photocopying the publication or a portion of it may appear, at first, to be an efficient way to disseminate it among a number of employees. However, copying periodicals, even for limited internal distribution, can lead to substantial corporate and personal liability under the copyright law.

Although the fair use defense to copyright infringement liability may be available to shield the copying and distribution of protected material under certain circumstances, the Supreme Court has made clear that the fair use doctrine will not be liberally applied in this context. Accordingly, the only sure method to avoid the risk of copyright liability is to either (1) purchase enough subscriptions of the publication to ensure that all who need to see it do, (2) circulate the original newsletter, periodical, or other written material among the interested individuals, or (3) seek a license to copy the materials either directly from the copyright owner or from the Copyright Clearance Center ("CCC"). However, some publications are not covered by CCC licenses and cover-to-cover copying is not permitted. As such, employees of a franchisor of franchisee that holds a CCC license should always confirm in advance whether a proposed distribution is covered by the CCC license, and should not assume that a given publication is covered by the CCC blanket license.

In the absence of a CCC license (and in some cases, even with one in place), the following practices should be followed in order to lessen the risk of liability for copyright infringement:

- Avoid cover-to-cover photocopying, particularly for the purpose of enhancing an “office library.”
- Copy only relevant portions of articles or pages containing specifically needed information.

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111 See [http://www.copyright.com](http://www.copyright.com).
• Copy only at times when research warrants use of photocopies and make these copies only at the moment when the need for them arises.
• When redistributing photocopied materials, limit copied material to data that is strictly factual in nature, such as charts, graphs, and tables.

2. **Posting Copyrighted Materials to or Downloading Copyrighted Material from the Internet**

A widely held misconception is that all materials posted on the Internet may be copied, downloaded, distributed, and modified without limitation. The rights of copyright owners (and restrictions on users) apply equally to the digital context as to the analog world. Failure to understand this fundamental point can lead to significant risk of corporate and individual liability.

In the dynamic world of the Internet, activities that violate copyright and those that do not are still evolving. Virtually every transmission of a copyrighted work across the Internet involves some form of copying (thereby potentially infringing at some stage one of the copyright owner’s exclusive rights, unless there was permission for the action, for example in a website’s terms and conditions policies) because the very act of storing information to or in a computer’s memory or printing that information constitutes making a copy.

Despite the fact that the activities described above may be technical violations of the copyright law, some take the view that (absent an on-line agreement prohibiting it) some limited copying and distribution may be permitted by either the fair use doctrine or through an implied license. (If this were not so, Internet users could not legally view any protected web page even in the first instance.) In light of ambiguities of the legality of copying material from Internet sources, prudence suggests that franchisors and franchisees should take steps to limit their risk exposure through the following practices

• Avoid routine downloading or printing any web site in its entirety (other than one’s own).
• Download or print only relevant portions of articles or pages containing specifically needed information.
• Keep in mind that any copying or distributing of material downloaded from or printed off the Internet presents the same issues as does making copies of newsletters, periodicals, and other written materials (as discussed in the preceding section).

3. **Unauthorized Use of Computer Software**

Computer software, instructions, and manuals are subject to copyright protection and may be subject to contractual restrictions designed to safeguard the software manufacturer’s investment in creating the software. Risk of copyright infringement and contract liability may arise under a number of scenarios, including when an employee copies software borrowed from a third party and loads the software onto a workplace computer, or when an employee copies software licensed to the employer for its own personal use or for further distribution in violation of the terms of the employer’s agreement with the software manufacturer. In addition to potential legal liability, use of unauthorized software can also expose computer hardware and software to harmful computer viruses.

Franchise system entities can limit exposure in this area by engaging in appropriate conduct, which may include doing the following only with requisite approval:
Loading any outside software on workplace computers.
Copying or distributing – for personal use – software acquired by the employer.
Copying or distributing additional copies of software for business use.
Copying software manuals.

4. Infringement of Copyright in Architectural Plans

In franchise systems where uniformity of franchisee site appearance is accomplished through use of franchisor-supplied prototypical building plans, the franchisor should be careful to either acquire ownership of the copyright in those plans or at least a clear license authorizing the franchisor, its franchisees, and their local architects to adapt those plans to accommodate local site issues (e.g., elevation, footprint, and/or local zoning ordinances). If it does not, the local architect who adapts original architectural plans to the particular circumstances of the local site (whether for a franchisor corporate location or for a franchisee site) may result in infringement of the copyright owned by the original architect in the underlying plans for the prototypical building design.

K. FDD Disclosure Issues

Item 14 of franchise disclosure documents ("Patents, Copyrights and Proprietary Information") requires disclosure of information relating to copyright material to the franchise.\textsuperscript{112} Although many franchisors note in response to Item 14 disclosure requirements\textsuperscript{113} that they claim copyright rights in their operations manuals (but have not registered them), the authors have seen few if any disclosures regarding other material copyrights. Whether this is a reflection of oversight, an under appreciation of copyright principles, or an accurate belief that there are no copyrights (other than in manuals) material to the system, is unclear.

Some franchise systems may rely on one or more of the following that may, depending on the circumstances, arguably be material to the system. For example, if the franchise system requires franchisees to play music at their location for the benefit of customers, a copyright license is likely required to avoid liability for infringement. Similarly, agreements with satellite and cable television providers to permit use of television programming at system sites would require some sort of license that relies on copyrights. Likewise, chains that depend on computerized reservation systems may be covered by software licenses in which the essential licensed right is the copyright in the software that drives the reservation system.

L. Actions at Time of Termination/Nonrenewal of Franchises

The typical franchise agreement provisions covering the obligations of a franchisee upon termination or expiration of the franchise agreement likely – at least indirectly – cover many of the steps that franchisors should consider imposing with respect to copyright issues. If not, franchisors may want to consider adding provisions specific to copyright, including but not limited to:

\textsuperscript{112} 16 C.F.R. § 436.5.
\textsuperscript{113} See Appendix A for excerpts from Item 14 as it relates to copyrights.
refrain from copying any franchisor material covered by copyright
refrain from reproducing any franchisor material covered by copyright
refrain from distributing any franchisor material covered by copyright
refrain from revising any franchisor material covered by copyright
refrain from publicly displaying any franchisor material covered by copyright
refrain from seeking to register the copyright in any franchisor material covered by copyright
assign to franchisor all rights in any derivative works created by franchisee as a result of the franchise relationship
indemnify franchisor from liability for any continued use of third party copyright-protected material (e.g., software, music, audiovisual works, art work, etc. used pursuant to license or sublicense that was tied to the franchise agreement

To limit liability for copyright violations, beyond the requirements of typical end of relationship provisions regarding de-identification and restrictive covenants, franchisees exiting a system may want to ensure that they have deleted proprietary software from their computers, returned and/or deleted franchisor supplied materials from their computers and hard files, and taken other steps to ensure that they do not improperly use copyrighted materials licensed or sublicensed by the franchisor.

IV. PATENTS

A. What is a Patent?

Patents are a constitutionally created form of intellectual property, governed by federal statute. A patent gives the patent owner the exclusive right to exclude others from making, using, selling, and offering for sale the patented invention. During the life of the patent, the owner has the complete right to determine who, if anyone, has the right to make, use, sell, or offer for sale the patented invention in the U.S. The patent may be sold outright by assigning all the rights to it, or licensed on an exclusive or nonexclusive basis. Further, once a patent has been issued, and as long as the patent is deemed valid and enforceable, the patent owner is protected against any independent discovery or reverse engineering of the patented invention. Patent rights are enforceable in the federal courts.

B. Types of Patents

There are three general categories of patents: utility patents, design patents, and plant patents. Certain fundamental differences exist between each of these types and not all inventions and discoveries are subject to their protection.

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114 To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries. Article I, Section 8, US Constitution. (emphasis added).
115 35 U.S.C. § 1 et seq.
Utility patents may be granted for "any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof." As technology has progressed, questions have arisen as to what subject matter is entitled to patent protection. In 1980, for example, the U.S. Supreme Court first ruled that man-made organisms could be patented, and on April 12, 1988, the U.S. Patent andTrademark Office issued its first patent for an animal to Harvard University for its transgenetic mouse (a mouse with a humanly inserted gene that makes it more susceptible to cancer). Likewise, the patentability of computer software has been the subject of several Supreme Court and numerous other federal appellate courts decisions. Patentability of business methods has also been widely debated and addressed in a recent Supreme Court decision, discussed further below.

On the other hand, courts have ruled that a mere arrangement of printed matter, a naturally existing article, an abstract method, and a mere scientific principle have all been considered unpatentable subject matter. While these examples are by no means exhaustive, they illustrate some fundamental limitations on the types of inventions which the U.S. patent law was intended to protect.

Design patents cover new, original, and ornamental design for an "article of manufacture." Design patents are granted for a term of fourteen years from the date of grant and generally have a low cost of acquisition. It is also relatively easy to enforce design patents against infringers which can make them a cost effective way to protect a product where appearance plays a significant role. Typical articles of manufacture for which design patents are sought include household articles, furnishings, weaving, lamps, packages and containers, games and toys, and jewelry. A computer icon display may also be the subject of a design patent. These patents may be used by a franchisor to attempt to protect aesthetic features of its franchise system trade dress.

Whoever invents or discovers and asexually reproduces a distinct and new variety of plant, including cultivated spores, mutants, hybrids, and newly found seedlings, other than a tuber propagated plant or a plant found in an uncultivated state, may obtain a plant patent. In general, plant patents are not very common and apparently yet an untapped tool in franchising; accordingly, we do not address them further here.

C. Patent Application Issues

1. The Application

The process of obtaining a patent in the United States is initiated by filing an application with the U.S. Patent and Trademark Office ("PTO"). A patent application includes a specification, at least one claim, one or more drawings (if appropriate), an inventor’s oath or declaration, and a filing fee. Each of these must be filed in conformity with various statutory requirements and with rules established by the PTO.

The specification is a written description of the invention detailing how to make and use the invention and describing the "best mode" that the inventor knows of practicing the invention. The claims define the subject matter that the inventor is trying to patent and are therefore analogous in a sense to the description of land defining the property rights in a deed to a parcel real estate. The oath or declaration specifies, among other things, that the applicant is the original inventor. The application must be made by the inventor with the papers verified and signed by the inventor. If the inventor is deceased or under some legal incapacity, a legal representative of the inventor may make application for a patent if certain requirements are satisfied.

The patent laws and PTO rules also provide for a simplified "provisional" application. A provisional application must include a specification, at least one drawing, a filing fee, but need not include claims, or declaration. A provisional application can serve as the basis for a later regular application, which is given the benefit of the provisional application’s filing date if filed within one year. A provisional application is not examined and cannot mature into a patent.

Patent applications are confidential when filed and cannot be accessed publicly so they should be treated as trade secrets until disclosed. Unless earlier withdrawn, however, applications that have been pending for 18 months are published by the PTO and thus become public at that time. (One can request non-publication of a US patent application so long as it is not filed in other countries.\textsuperscript{119})

2. Patentability Searches

To determine the likelihood of obtaining a patent, many applicants will have a patentability search conducted in the records of the PTO and other publications to attempt to locate similar patents already issued to others and disclosures or discoveries of similar inventions by others. By studying the results of such a search, counsel can provide an opinion on the likelihood of obtaining patent protection for an invention before going through the

expense of preparing and filing a patent application. Also, knowledge of prior art may enable
counsel to prepare a better, more persuasive patent application. In addition, a patentability
search may turn up unexpired patents which could be infringed by the manufacture, use, or sale
of an invention. However, a patentability search is somewhat different from a "clearance"
search which has a different focus and entails a different analysis.

It should be noted that patent grants a patent holder the right to prevent others from
making, using, selling, or offering for sale the invention. It does not, however, give the patent
holder the affirmative right to make, use, sell, or offer for sale the invention. Thus, even if an
invention is patented, there may be some aspect of the making, using, selling, or offering for
sale of the invention that would infringe another's patent. Under this scenario, the patent owner
must either wait until the other patent expires or obtain a license from the owner of the other
patent.

3. The Examination Process

After the patent application is filed, it will be examined by a PTO examiner having
expertise in the technical area of the invention. The examiner will study the application and
search (1) all relevant prior U.S. patents in the PTO, (2) patents of foreign countries, and (3)
publications to determine if the invention is both novel\textsuperscript{120} and nonobvious. An invention is
considered novel if, for example, it has not previously been described in a publication (such as a
patent), offered for sale, put in public use, or made the subject of an earlier application by a third
party. An invention is considered nonobvious if the differences between the subject matter of
the invention sought to be patented and the prior publication would not have been obvious to a
person skilled in the art to which the subject matter of the invention pertains. The examiner will
then reach an initial decision as to the patentability of the invention as claimed and also as to
various formal matters. The examiner then communicates the decision to the applicant or the
applicant's representative in writing.

Often the examiner will object to certain portions of the application or will reject some or
all of the claims. If this occurs, the applicant may ask for reconsideration with or without
amending the application or claims. The examiner will then re-examine and reconsider the
application and again communicate the result to the applicant in writing. In some cases, further
reconsideration of the application may be given by the examiner. If the examiner's final decision
is adverse, the applicant may appeal the decision to the PTO Board of Patent Appeals &

\textsuperscript{120} 35 U.S.C. §§ 102 and 182. Even if an invention is novel, the U.S. patent law specifically precludes patent
protection for the invention "if the differences between the subject matter sought to be patented and the prior art are
such that the subject matter as a whole would have been obvious at the time the invention was made to a person
having ordinary skill in the art to which said subject matter pertains." 35 U.S.C. § 103. The law basically prohibits the
patenting of an invention that is merely an obvious addition to or alteration of something already in existence or
already known. The meaning of this section is, of course, susceptible to subjective interpretation, and a large body
of case law exists on this issue.
Interferences, then to the U.S. Court of Appeals for the Federal Circuit, and finally to the U.S. Supreme Court. Alternatively, the applicant can file a civil action against the Commissioner of Patents and Trademarks in the U.S. District Court for the District of Columbia and then appeal to the Federal Circuit.

If the examiner ultimately allows the application, the applicant is sent a Notice of Allowance. The applicant must then pay a governmental issue fee to have the final patent issued and printed. In addition, once the patent is formally granted, periodic maintenance fees must be paid to keep the patent alive during its full term. Maintenance fees are due 4, 8, and 12 years after issue. After a United States utility patent is granted, it remains in force for a period of 20 years from the date of filing the patent application. For a patent in force on June 8, 1995, or that results from an application filed before June 8, 1995, the grant is for a period of 17 years from the date the patent issued or 20 years from the date of filing the patent application, whichever is greater. The 20-year time period is measured from the filing date of the earliest dated U.S. application to which the patent refers. The patent term can be extended up to 5 years in certain instances. Design patents have a term of 14 years from the date of issuance.

As patent rights are a creature solely of federal law and have no basis in common law, monitoring prosecution and maintenance deadlines is critical to maintain the applicant or patent holders rights. For example, with respect to trademarks, where common law rights exist separate and apart from trademark registrations, the loss a trademark application or registration following a missed deadline may be unfortunate but can often be repaired by filing a new application and having the trademark owner rely on its common law rights that were unaffected by the loss of the application or registration. In contrast, if a patent application or an issued patent is lost due to a missed final deadline, the may sound the death knell for the application or patent in question as there is no underlying common law right.

4. The “Statutory Bar” Issue

If an inventor describes his or her invention in a printed publication, publicly uses the invention, or offers to sell the invention more than one year before a patent application is filed, the inventor will lose his or her U.S. patent rights. Although U.S. patent law gives a one year “grace period” before the patent application must be filed, under the laws of most foreign countries, a patent application must be filed before any first disclosure of an invention. Therefore, care must be exercised about any and all disclosures of an invention before a patent application is filed. Confidential disclosure agreements may be used as a tool to avoid starting the one year period running as a disclosure made in confidence is not a public disclosure.

D. After the Patent Issues: Proper Use of Patent Notices

Once the PTO issues a patent, the owner should mark articles covered by that patent, or where that is impossible, the packaging, with the word “Patent” or “Pat.” along with the patent number. Although such notice is not a legal prerequisite to patent protection, in the absence of any marking, a plaintiff must show that the defendant had notice of the patent in order to recover damages for infringement occurring before the suit is filed or before the accused had actual
notice of the patent. Therefore, the “Patent” notice along with the patent number should routinely be used on patented products to help ensure that an infringer cannot attempt to assert ignorance of the asserted patent right.

Patent rights begin when the patent is issued by the PTO and are not retroactive. Therefore, those competitors who make, use, sell, or offer for sale the invention during the patent application process but discontinue these practices once a patent is issued cannot be held liable to the patent owner for patent infringement. The notices “Pat. Applied for” or “Pat. Pending” do not provide patent protection. The use of those notices while an application is pending, however, may have some deterrent effect on potential infringers. It is unlawful to use the notices “Pat. Applied for” and “Pat. Pending” unless a patent application is actually filed and pending before the PTO.

E. Ownership and Assignment

Patents and patent applications have all of the attributes of personal property. Title ownership of the patent or patent application may be transferred in whole or in part by a written assignment to anyone. Patents and patent applications may also be licensed throughout the entire United States or in a specified geographic region.

Before a patent application is filed, ownership of the invention described in the patent application should be determined. Ownership originally resides in its inventor. When there is more than one inventor, each inventor holds an undivided interest in the entire invention. Each inventor therefore may enforce the invention without the consent of the other inventors and without paying royalties to the other inventors. An assignment or other contract between the inventors is required to alter this arrangement.

If the invention was made as part of the inventor’s job, the inventor may be obligated to assign the invention to his or her employer. For example, the inventor’s employment contract may require the inventor to assign all inventions made in the course of employment to the employer. Likewise, absent an agreement that sets out a different result, a franchisee that develops an improvement to a patent of the franchisor might own that improvement.

Even when not entitled to an outright assignment of the invention, the employer may be entitled to “shop rights” on the invention if the employee-inventor used the employer’s resources to conceive the invention or reduce the invention to practice. “Shop rights” are a nonexclusive, royalty-free, non-transferable right to practice the invention. The employer can assert “shop rights” to defeat a patent infringement suit brought by the inventor or the inventor’s successors.

An assignment of a patent should be recorded in the PTO within three months of the date of the assignment so as to give notice of the assignment. Failure to record within this period of time may result in an assignment being void as against any subsequent purchaser or mortgagee for value who did not have notice of the assignment.
F. Enforcement of Patent Rights

Generally, to enforce a U.S. patent, the patent holder must commence a civil suit against the infringer by filing a complaint in federal district court to obtain an injunction and/or damages for patent infringement. In instances where the accused product is being imported into the U.S. from abroad, a patentee may alternatively file a complaint with the U.S. International Trade Commission ("ITC"). District court and ITC decisions are appealable to the U.S. Court of Appeals for the Federal Circuit, rather than the respective regional circuit court, which in 1982 became the exclusive federal court of appeals for patent litigation. Having a central appeals court for patent litigation has resulted in more consistent and coherent treatment of patents.

By statute, damages can generally be recovered for infringing acts occurring up to 6 years prior to the filing of the complaint. If the patentee waits more than 6 years to commence a suit after learning of the infringement, however, then the equitable doctrine of laches may prevent any recovery of past damages, unless the patent owner can provide an adequate explanation for the delay in commencing an infringement action.

The infringement inquiry is a two-step process in which the asserted patent claims are first interpreted to analyze their proper scope and meaning and are then compared to the accused product or process to determine infringement. The plaintiff/patent holder bears the burden of proving infringement and must show the presence of each and every element or at least one claim in the accused product or process, either literally or by equivalence.

Literal or direct infringement is the simplest case of infringement because every element in a patent claim is found exactly as claimed in the accused product. Even if each claimed element is not found exactly as claimed in the accused device, the patent holder may yet prove infringement by showing that the accused device contains corresponding elements that are substantially equivalent to those claimed. An accused structure is considered a "substantial equivalent" if it represents only an "insubstantial change" from the literally claimed structure. One method of determining whether an accused structure embodies an insubstantial change is if it performs substantially the same function as the claimed device in substantially the same way to achieve substantially the same result.

Accused infringers often allege patent invalidity as a defense to a charge of infringement. Patents are presumed valid, however, and can only be proved invalid by clear and convincing evidence. Patents may be held invalid on several grounds, but the most successful challenges are often based on the presence of prior art (e.g., publications or patents dated prior to the inventor's date of invention), which show the claimed invention or an obvious variant thereof.

Accused infringers may also allege patent unenforceability as a defense to an infringement charge. In order to prevail on an unenforceability defense, the defendant must prove that the PTO was intentionally misled with respect to a material issue during prosecution of the patent. Various remedies are available to a successful patent holder, including monetary damages. Activities occurring prior to such notice are considered innocent infringement for
which there is no liability. This notice requirement does not apply to "paper patent," i.e., patents that are not being practiced by the patent owner or his licensee, or patents covering processes. As discussed above, patent owners can provide constructive notice to the public of their patent rights by marking products covered by their patents with the appropriate patent number. This constructive notice also exempts the patent holder from the notice requirement.

There are two main methods of assessing damages in patent infringement suits: (1) lost profits and (2) reasonable royalty. The most lucrative awards for patent owners usually result from a lost profits analysis. In lost profits analysis, a successful plaintiff/patent holder will recover profits lost to the infringer that would have been earned but for the infringing activities. Such awards usually include profits on sales lost by the patent owner due to the acts of the infringer, but can also include other damage theories, such as price erosion. Courts will generally award lost profits if the patentee can establish the existence of sufficient demand for the patented product, an absence of acceptable noninfringing substitutes, and the patentee’s own capacity to have met that demand.121 Moreover, patentees may recover monetary damages for sales of nonpatented items if they were a foreseeable consequence of the defendant's infringing activities.122

If lost profits cannot be established, the patentee will be entitled to no less than a "reasonable royalty". To determine a reasonable royalty, courts will attempt to estimate the royalty rate that the parties would have agreed upon if they had been willing to enter into a license agreement. In so doing, courts will consider many factors including: (1) the royalties received in the past by the patentee for licensing the patent in suit; (2) the royalties received in the past by the patentee for licensing other patents comparable to the patent in suit; (3) the commercial relationship between the patentee and infringer, such as whether they are competitors in the same territory in the same line of business, or whether they have an inventor-promoter relationship; and (4) the duration of the patent. Courts will generally award higher royalty amounts to holders of pioneer or core patents.123

Courts are permitted to award attorneys’ fees in exceptional cases, which have been found where there has been willful or deliberate infringement or bad faith continuation of litigation.124 A trial court is also permitted to increase damages up to three times the amount

122 Rite Hite Corp. v. Kelley Co., 56 F.3d 1538 (Fed. Cir. 1995) (en banc).
123 See, e.g., Rite-Hite at 1554 (Federal Circuit affirmed District Court’s awarding reasonable royalty of no less than one-half of the per unit profits that it was foregoing. In so determining, the court considered that the patent was a "pioneer" patent with manifest commercial success).
found or assessed where there has been willful and wanton infringement or bad faith litigation.  

The most common basis for increased damages is where the defendant has been found guilty of willful infringement. Willfulness is often found where the infringer failed to obtain the advice of competent counsel after receiving notice of another’s patent rights.

Equitable relief is also available to a successful plaintiff. United States patent statutes allow courts to grant injunctions in accordance with the principles of equity to prevent the violation of any right secured by patent, on such terms as the court deems reasonable.

Preliminary injunctions to prevent alleged infringing activity during the course of the litigation may be granted upon a strong showing of probable success on the merits and irreparable injury to the patent owner should the infringement be allowed to continue, provided there will not be a strong adverse impact on the public. The court also balances the hardships between the parties in deciding whether to grant preliminary relief. In a patent context, irreparable harm will be assumed when a clear showing has been made that a patent is valid and infringed.

As previously mentioned, where infringing products are being imported into the U.S., a patent owner may turn to the ITC for assistance. If successful before the ITC, a patent holder may obtain a limited exclusion order preventing the importation into the U.S. of the subject articles by the defendant/infringer. If a widespread violation of the patent owner’s rights is shown with respect to a particular article, the patent owner may request a general exclusion order directing the U.S. Customs Service to prohibit the entry of all goods of a specified type into the U.S., regardless of the source.

125 Roberts v. Sears, Roebuck & Co., 723 F.2d 1324 (7th Cir. 1983).
126 State Indus. v. Mor-Flo Indus., Inc., 883 F.2d 1573, 1577 (Fed. Cir. 1989).
128 We Care, Inc. v. Ultra Mark, Int. Corp., 930 F.2d 1567, 1570 (Fed. Cir. 1991).
G. Patents in Franchise Systems

Though patents are typically not key elements of a franchise system, they can play a strong supporting role. Products and systems (e.g., reservation systems) may be protected by utility patents, ornamentation by design patents, and a franchisor’s actual business methods perhaps by utility patents. An inventory of a franchisor’s intellectual property may serve as a useful tool to identify new developments that could qualify for patent protection. Because of the timing concerns presented by the statutory bar issue discussed above, a franchisor should also consider putting policies in place to attempt to identify new developments and consider possible patent options without waiting to conduct an intellectual property audit (which may be far less frequent that annually).

In at least one situation known to the authors, rather than playing a mere supporting role, a patent is critical to the success of a franchise system and the products it sells. In the Eggland’s Best franchise system, patented chicken feed (along with stringent quality control) yields the signature high quality eggs that sold under the EGGLAND’S BEST eggs. “Eggland’s Best eggs and feed program are so special and unique that the United States Patent Office has granted the company a patent titled U.S. Patent #5,246,717: ‘Eggs compatible with Cholesterol Reducing Diet and Method of Producing the Same.’”

H. Design Patents

Design patents may be an overlooked protection vehicle in a franchisor’s intellectual property rights arsenal can provide effective protection for a wide variety of products. A design patent can be obtained only if the design is for an article of manufacture. The design must also be definite and reproducible. Typically, the design is based on the appearance created by the surface ornamentation of the article, its configuration, or a combination thereof. Thus, virtually anything constructed from raw materials with a definite and reproducible design can be the proper subject of design patent protection. To be patentable, a design must also be “ornamental,” which generally involves a minimal level of artistic skill.

On the other hand, a design which is primarily utilitarian cannot qualify for a design patent because no ornamental creativity is present. In particular, where the design is primarily dictated by the function, or where the differences over the prior designs are due to functional considerations, the design is considered to be functional and without ornamentality. The mere fact that the individual elements of a design are functional is not fatal as long as the design as a whole is not dictated by its utilitarian purpose.


135 Oddzon Prods., Inc. v. Just Toys, Inc., 122 F.3d 1396, 1405 (Fed. Cir. 1997) (“Where a design contains both functional and non-functional elements, the scope of the claim must be construed in order to identify the non-functional aspects of the design as shown in the patent.”)
In addition to meeting the ornamentality requirement, as with an invention covered by a utility patent, a design must also be new (i.e., novel) and nonobvious to be patentable. The general test applied when determining novelty is to look at the claimed design as a whole and the prior art in question; if an ordinary observer would consider the new design to be different, and not substantially identical to the existing design, the claim is considered novel. Nonobviousness is determined by evaluating whether the design would have been obvious to a “designer of ordinary skill” who designs articles of the type involved in view of the prior art. Four analytical steps are taken when making an obviousness determination: (1) the claimed design as a whole is examined; (2) all of the relevant prior art is identified; (3) the level of skill in the relevant designing field is evaluated; and (4) an obviousness determination is made through the hypothetical eyes of a person of such skill.  

A design patent application, unlike that for a utility patent, relies almost exclusively on the drawings to disclose the invention. Only one claim is permitted per design patent, and the claim is limited to the design as shown in the drawings. The drawings themselves must disclose the complete appearance of the article and, therefore, usually include seven views; all sides plus a perspective view of the front, side and top of the article. The drawings cannot contain color, and cannot show hidden surfaces or features. Thus, the observable portions of the article must be drawn with such precision so as not to leave anything to conjecture. In addition to the drawings, the application must include a title for the design, a brief written description of the design, a filing fee, and an oath (or declaration) executed by the designer(s).  

Once filed, the patent application is examined for compliance with the statutory requirements and certain formalities. The patent examiner performs a search in the records of the U.S. Patent and Trademark Office to uncover the prior art, and typically makes an initial rejection of the application. The applicant is then afforded an opportunity to overcome the rejection, either by distinguishing the claimed design from the prior art, amending the application, or complying with any of several possible formality objections.  

Once the design patent issues, the owner has the right to exclude others from making, using, offering to sell, or selling articles of manufacture which fall within the scope of the patent. The design patent remains in force for 14 years from the date of issuance. To support a finding of infringement, the accused design must “embody the patent design or any colorable limitation thereof.”  

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Substantial similarity is evaluated from the perspective of the ordinary observer. In particular, if an ordinary observer, giving such attention as a purchaser usually gives to an item, would determine that the two designs are substantially similar such that the resemblance of the two items would induce him to mistakenly purchase one item while wanting to buy the other, then the substantial similarity requirement is met. 139

I. Business Method Patents

In addition to seeking a patent on a new device or design, franchisors and franchisees can try to patent a new method of doing business to attempt to gain an advantage over competitors. As discussed above, a patent may be granted only to one who "invents or discovers" a new and useful process, machine, or composition. 140 Courts, patent applicants, litigants, and patent examiners have long struggled with the distinction between an "invention" or "discovery," which is patentable, and an abstract idea or principle, which is not. That line has proven particularly difficult to draw in the area of so-called "business method" patents.

Prior to 1998, there was a great deal of uncertainty about the patentability of claims that focused on business methods. In State Street Bank & Trust Co. v. Signature Financial Group, Inc., 141 the Federal Circuit seemed to put to rest much of that uncertainty. The court rejected the so-called "business method exception" to patentability and held that the applicable test for patentability was whether the claimed subject matter produced "a useful, concrete and tangible result." 142 The broad holding of State Street was widely credited with ushering in a new era in which business methods—and even claims directed only to computer software—were generally accepted as potentially patentable.

Ten years later, the law in this area dramatically shifted once again when the Federal Circuit addressed the patentability of a method of risk hedging for commodities trading, invented by Bernard Bilski and Rand Warsaw. After the PTO rejected the claims as unpatentable under Section 101, Bilski and Warsaw appealed that decision to the Federal Circuit. On October 30, 2008, the Federal Circuit issued a 9-3 en banc opinion 143 that established a two-part test: "A claimed process is surely patent-eligible under Section 101 if: (1) it is tied to a particular machine or apparatus; or (2) it transforms a particular article into a different state or thing."

The federal circuit went on to affirm the PTO’s rejection of the method claimed by Bilski and Warsaw because the method did “not involve the transformation of any physical object or substance, or an electronic signal representative of any physical object or substance." 144 The court expressly declined to address how this new machine-or-transformation test would apply to

139 See, e.g., Gorham Co. v. White, 81 U.S. 511, 527 (1871).
142 Id. at 1373.
143 In re Bilski, 545 F.3d 943 (Fed. Cir. 2008 en banc).
144 Id. at 964.
claims relating to software or other computer-implemented business methods. Last summer, the Supreme Court granted certiorari in the case of In re Bilski and, on June 28, 2010, issued its long-awaited decision in the case.145

The majority opinion, written by Justice Kennedy, began by noting that the Patent Act broadly allows a patent to be issued on a “process.” The only exceptions to patentability that exist in Supreme Court precedent are for “laws of nature, physical phenomena, and abstract ideas.” Thus, the Court rejected the federal circuit’s holding that the “machine-or-transformation test” is the only test for patentability of a method claim. Instead, the Court held that this test is “a useful and important clue, an investigative tool, for determining whether some claimed inventions are processes under § 101.” This sentiment was reminiscent of the Court’s recent holding in KSR v. Teleflex, where it held that the federal circuit’s teaching-suggestion motivation test was one useful tool to analyze obviousness, but could not be applied as a rigid “all-or-nothing” test.146

The Court also rejected attempts by some amici curiae to revive the so-called “business method exception” from the period before State Street was decided. The majority opinion concluded that “a business method is simply one kind of ‘method’ that is, at least in some circumstances, eligible for patenting under § 101.” A separate section of Justice Kennedy’s opinion suggests that “a narrower category or class of patent applications that claim to instruct how business should be conducted” might well be broadly unpatentable. That section of the opinion, however, was joined by only four Justices and, thus, was not part of the holding in the case. In his concurrence,147 Justice Stevens urged the Court to conclude that: “[B]usiness methods are not patentable. More precisely, although a process is not patent-ineligible simply because it is useful for conducting business, a claim that merely describes a method of doing business does not qualify as a ‘process’ under § 101.” Because the pertinent section of Justice Kennedy’s opinion was supported by five votes, however, it appears that business methods are still potentially patentable and thus eligible for consideration by franchisors.

Perhaps paralleling a Hollywood blockbuster’s ending that hints at a sequel, the Court also noted that “[T]imes change. Technology and other innovations progress in unexpected ways. . . . [T]his fact does not mean that unforeseen innovations such as computer programs are always unpatentable.”148 The significance of that last sentence, however, was perhaps diminished by the later clarification that “the Court today is not . . . holding that any of the above-mentioned technologies from the Information Age should or should not receive patent protection.”149 It is perhaps to be expected that Court has expressed no opinion on the patentability of computer software, since that issue was not presented in the particular case under consideration.

147 Justice Stevens’ concurrence was joined by Justices Ginsburg, Breyer, and Sotomayor.
148 2010 U.S. Lexis 5521 at *19.
149 2010 U.S. Lexis 5521 at *21
With respect to the particular patent claims at issue in the case, the Court affirmed the judgment of the Federal Circuit, because the applicants were trying to patent the "abstract idea" of risk hedging with only "token post solution components." The Court held this type of method claim unpatentable under existing Supreme Court precedent.\textsuperscript{150}

In the end, it appears that the law in this area has essentially returned to where it was prior to the Federal Circuit’s 1998 decision in \textit{State Street}. A method claim may potentially be patentable, as long as it does not fall within one of the exceptions for "laws of nature, physical phenomena, and abstract ideas." For those attempting to discern the common ground among the different opinions, Justice Breyer’s separate concurrence may be particularly useful as it sets forth a summary of four key points that "are consistent with both the opinion of the Court and Justice Stevens’ opinion concurring in the judgment:"

\begin{itemize}
  \item "'[P]henomena of nature, . . . mental processes, and abstract intellectual concepts are not patentable.'"
  \item The machine-or-transformation test has "repeatedly helped the Court to determine what is ‘a patentable process.’"
  \item The machine-or-transformation test is not the "exclusive test."
  \item The Court did not express approval of the Federal Circuit’s "useful, concrete, and tangible result" test (from \textit{State Street}) which preceded Bilski (and, indeed, seemed to go out of its way to make that point clear).
\end{itemize}

\section*{J. FDD Disclosure and Other Issues}

\subsection*{1. \textbf{Item 14: Patents, Copyrights and Proprietary Information}}

Item 14 of franchise disclosure documents ("Patents, Copyrights and Proprietary Information") requires disclosure of information relating to patents that are material to the franchise.\textsuperscript{151} The authors have seen very few Item 14 FDD disclosures\textsuperscript{152} in which the franchisor identifies any patent rights. Interestingly, at least some patent practitioners would be wary of the requirements of Item 14(1)(iii) as they would argue that in some cases that the very existence of a patent application before it is published is itself confidential and perhaps even a trade secret and would be reluctant to disclose the required information.

\subsection*{2. \textbf{Use an “Innovations Clause”}}

As with copyrights, some franchisors include assignment provisions (sometimes subsumed within an “innovations” clause) in their franchise agreements to ensure that the any patentable inventions or processes in materials that franchisees that relate to the franchise system are transferred to the franchisor automatically. Unlike copyrights, where the application for registration may be submitted at the outset in the assignee’s name, recall that patent

\begin{footnotes}
\footnote{150} Including most notably \textit{Parker v. Flook}, 437 U.S. 584 (1978).
\footnote{151} 16 C.F.R. §436.5.
\footnote{152} See Appendix A for excerpts from Item 14 as relates to patents.
\end{footnotes}
inventions must be filed in the name of the inventor. Consequently, an assignment—whether separate or embedded in an innovations clause—should include a duty of cooperation (often referred to as a “further assurances” undertaking) upon the party that may be viewed as the inventor. Alternatively, a franchisor could include a provision giving it a non-terminable, transferable license to use such inventions and processes. In the absence of any pertinent provision, upon termination or expiration of the franchise agreement there may be uncertainty as to whether and how either the franchisor or franchisee may use the work in question. Shop rights might not be applicable as the franchisee is not an employee of the franchisor while use by the franchisee of the invention may violate other post-termination obligations of the franchisee.

3. **Actions at Time of Termination/Nonrenewal of Franchises**

The typical franchise agreement provisions covering the obligations of a franchisee upon termination or expiration of the franchise agreement may—at least indirectly—cover many of the steps that franchisors should consider imposing with respect to patent issues. If not, franchisors may want to consider adding provisions specific to patent, including but not limited to:

- refrain from using, reproducing, or otherwise exploiting any items or processes covered by the franchisor’s patent(s)
- assign to franchisor all rights in any innovations created by franchisee as a result of the franchise relationship
- refrain from seeking to patent any innovations developed by the franchisee
- indemnify franchisor from liability for any continued use of third party patent-protected material

To limit liability for patent violations, beyond the requirements of typical end of relationship provisions regarding de-identification and restrictive covenants, franchisees exiting a system may want to ensure that they have deleted patented software from their computers, ceased sale of patented items not covered by inventory phase-out clauses, and taken other steps to ensure that they do not improperly use patented materials licensed or sublicensed by the franchisor.

V. **CONCLUSION**

Franchise lawyers often handle issues arising from trademarks associated with a franchise system. Most franchise systems also have other intellectual property rights, which may often have equal or greater importance. Franchise counsel will be more effective in representing franchise clients, particularly franchisors, by being able to assist in identifying, acquiring, licensing, protecting and enforcing a franchisor’s trade secrets, copyrights and patents.
Appendix A

Excerpt from FDD Item 14 (As Relates to Copyrights)

Item 14: Patents, Copyrights, and Proprietary Information.

(1) Disclose whether the franchisor owns rights in, or licenses to, ... copyrights that are material to the franchise. (emphasis added)... If so, state: ....

(iv) For each copyright:

(A) The duration of the copyright.

(B) The registration number and date.

(C) Whether the franchisor can and intends to renew the copyright.

(2) Describe any current material determination of ... the United States Copyright Office, or a court regarding the patent or copyright. Include the forum and matter number. Describe how the determination affects the franchised business.

(3) State the forum, case number, claims asserted, issues involved, and effective determinations for any material proceeding pending in any court.

(4) If an agreement limits the use of the ... copyright, state the parties to and duration of the agreement, the extent to which the agreement may affect the franchisee, and other material terms of the agreement.

(5) Disclose the franchisor’s obligation to protect the ...copyright; and to defend the franchisee against claims arising from the franchisee’s use of ... copyrighted items, including:

(i) Whether the franchisor’s obligation is contingent upon the franchisee notifying the franchisor of any infringement claims or whether the franchisee’s notification is discretionary.

(ii) Whether the franchise agreement requires the franchisor to take affirmative action when notified of infringement.

(iii) Who has the right to control any litigation.

(iv) Whether the franchisor must participate in the defense of a franchisee or indemnify the franchisee for expenses or damages in a proceeding involving a ... copyright licensed to the franchisee.

(v) Whether the franchisor’s obligation is contingent upon the franchisee modifying or discontinuing the use of the subject matter covered by the ... copyright.

(vi) The franchisee’s rights under the franchise agreement if the franchisor requires the franchisee to modify or discontinue using the subject matter covered by the ...copyright.
(6) If the franchisor knows of any ... copyright infringement that could materially affect the franchisee, disclose:

(i) The nature of the infringement.

(ii) The locations where the infringement is occurring.

(iii) The length of time of the infringement (to the extent known).

(iv) Any action taken or anticipated by the franchisor.

Excerpt from FDD Item 14 (As Relates to Patents)

(1) Disclose whether the franchisor owns rights in, or licenses to, ... patents... that are material to the franchise. (Emphasis added)... If so, state:

(i) The nature of the patent, patent application, ... and its relationship to the franchise.

(ii) For each patent:

(A) The duration of the patent.

(B) The type of patent (for example, mechanical, process, or design).

(C) The patent number, issuance date, and title.

(iii) For each patent application:

(A) The type of patent application (for example, mechanical, process, or design).

(B) The serial number, filing date, and title.

(2) Describe any current material determination of ... the United States Patent and Trademark Office, or a court regarding the patent .... Include the forum and matter number. Describe how the determination affects the franchised business.

(3) State the forum, case number, claims asserted, issues involved, and effective determinations for any material proceeding pending in any court.

(4) If an agreement limits the use of the patent, patent application, or ... , state the parties to and duration of the agreement, the extent to which the agreement may affect the franchisee, and other material terms of the agreement.
(5) Disclose the franchisor's obligation to protect the patent, patent application ..., and to defend the franchisee against claims arising from the franchisee's use of patented ..., items, including:

(i) Whether the franchisor's obligation is contingent upon the franchisee notifying the franchisor of any infringement claims or whether the franchisee's notification is discretionary.

(ii) Whether the franchise agreement requires the franchisor to take affirmative action when notified of infringement.

(iii) Who has the right to control any litigation.

(iv) Whether the franchisor must participate in the defense of a franchisee or indemnify the franchisee for expenses or damages in a proceeding involving a ... copyright licensed to the franchisee.

(v) Whether the franchisor's obligation is contingent upon the franchisee modifying or discontinuing the use of the subject matter covered by the patent....

(vi) The franchisee's rights under the franchise agreement if the franchisor requires the franchisee to modify or discontinue using the subject matter covered by the patent....

(6) If the franchisor knows of any patent ... infringement that could materially affect the franchisee, disclose:

(i) The nature of the infringement.

(ii) The locations where the infringement is occurring.

(iii) The length of time of the infringement (to the extent known).

(iv) Any action taken or anticipated by the franchisor.
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David Gurnick is an attorney with the Lewitt Hackman firm in Los Angeles, California, emphasizing franchising and distribution law and litigation. David’s practice includes litigation and transactional matters for franchising companies, product and services distributors and intellectual property companies. David chairs the Litigation Section of the San Fernando Valley Bar Association, of which he is a Past President and past chair of its Business Law Section. David has taught semester courses in Franchising Law as an adjunct professor at the University of LaVerne College of Law and is a past trustee of the University of West Los Angeles College of Law, and Los Angeles County Bar Association. David is admitted to practice in the U.S. Supreme Court, Ninth Circuit and Federal Circuit Courts of Appeals, U.S. District Court for the Central District of California, the District of Columbia and all courts of the State of California, and is certified by the State Bar of California Board of Legal Specialization as a specialist in Franchising and Distribution Law. David is the author of Franchising Depositions, a treatise on taking and defending depositions in franchise law cases, published by Juris Publishing Co., and numerous other articles on a range of franchise-related subjects, and is completing work on Distribution Law of the United States to be published by Juris Publishing Co. David has been a speaker at the American Bar Association Forum on Franchising, International Franchise Association Legal Symposium, programs of the State Bar of California, California Continuing Education of the Bar, San Fernando Valley Bar Association and other organizations. David earned his Law Degree at UC Berkeley (Boalt Hall) and his Bachelor’s degree at UCLA where he graduated summa cum laude and Phi Beta Kappa.
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James Sims is a partner in Morgan, Lewis and Bockius LLP, resident in Washington, DC. His practice focuses on substantive trademark and copyright issues, licensing, and franchising issues. Jim counsels clients in the financial services, pharmaceutical, high-technology, food, education, publishing, and luxury resort lodging industries on how to protect and exploit their intellectual property rights both domestically and abroad. He has represented clients in administrative litigation before the Patent and Trademark Office as well as in federal district court. He frequently handles diligence and negotiations in M&A transactions involving franchise systems. Jim served as acting Chief Trademark Counsel for a Fortune 250 consumer products company for several months, counseling while there on a wide range of intellectual property matters.

Jim has written articles on intellectual property and franchising topics for numerous publications and speaks often on intellectual property and franchise issues. A former Articles and Topics Editor of the Franchise Law Journal, he also served as co-editor of the American Bar Association’s comprehensive IP publication, The Intellectual Property Handbook: A Practical Guide for Franchise, Business and IP Counsel.

A graduate of George Washington University’s National Law Center, Jim is a member of the ABA’s Intellectual Property Law (IPL) Section, co-chaired and vice-chaired the IPL Section’s annual CLE program for several years, and is an active member of the ABA’s Forum on Franchising. He has served as chair of the IPL Section’s Trademarks and Unfair Competition Division as well as its Copyright Division, and also of its Copyright Office Affairs and Franchising Committees. Jim is a member of the International Trademark Association, a Lifetime Fellow of the American Bar Foundation, and serves on the Intellectual Property Advisory Board of The George Washington University School of Law. Jim is admitted to practice in the District of Columbia and Pennsylvania.